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September 10, 2008

Damaris Cristiano, Esquire
United States Environmental Protection Agency
Office of Regional Counsel - Region II
290 Broadway - 17th Floor,
New Jersey Superfund Branch
New York, New York 10007-1866

RE: Scientific Chemical Processing Superfund Site
Carlstadt, Bergen County, New Jersey

Dear Damaris:

Pursuant to Paragraph 44.f of the September 30, 2004 Consent Decree, please find a copy of Annual 10-K reports for the preceding fiscal year for the following companies that are Settling Defendants:

3M Company
Air Products & Chemicals Inc.
Bristol-Myers Squibb Company
E. I. Du Pont de Nemours & Company
General Electric Corporation
Honeywell International Inc.
Merck & Co. Inc.
Pfizer Inc

Please confirm that this submission demonstrates to EPA's satisfaction that one or more of the Settling Defendants meets the requirements of 40 C.F.R. §264-143(f)(1)(i) or (ii), with respect to a $3.5 million financial obligation.

Thank you for your kind assistance in this matter.

Yours very truly,

William L. Warren

WLW/ndp
Enclosures

cc: SCP Site Remedial Project Manager – w/o enclosures

Jonathan I. Epstein, Partner responsible for Princeton Office

Established 1849

PR01/ 442373.4

265568

3M CO (MMM)

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10-K

10-K
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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10–K

☒ ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the fiscal year ended December 31, 2007

Commission file number 1–3285

3M COMPANY

State of Incorporation: **Delaware** I.R.S. Employer Identification No. **41–0417775**

Principal executive offices: **3M Center, St. Paul, Minnesota 55144**
Telephone number: **(651) 733–1110**

SECURITIES REGISTERED PURSUANT TO SECTION 12(b) OF THE ACT:

Title of each class	Name of each exchange on which registered
Common Stock, Par Value $.01 Per Share	New York Stock Exchange, Inc. Chicago Stock Exchange, Inc.

Note: The common stock of the Registrant is also traded on the SWX Swiss Exchange.
Securities registered pursuant to section 12(g) of the Act: None

Indicate by check mark if the Registrant is a well–known seasoned issuer, as defined in Rule 405 of the Securities Act. Yes ☒ . No ☐ .

Indicate by check mark if the Registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act. Yes ☐ . No ☒ .

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

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S–K is not contained herein, and will not be contained, to the best of Registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10–K or any amendment to this Form 10–K. ☐

Indicate by check mark whether the Registrant is a large accelerated filer, an accelerated filer, or a non–accelerated filer. See definition of "accelerated filer and large accelerated filer" in Rule 12b–2 of the Exchange Act. Large accelerated filer ☒ Accelerated filer ☐ Non–accelerated filer ☐

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

The aggregate market value of voting stock held by nonaffiliates of the Registrant, computed by reference to the closing price and shares outstanding, was approximately $56.4 billion as of January 31, 2008 (approximately $62.1 billion as of June 30, 2007, the last business day of the Registrant's most recently completed second quarter).

Shares of common stock outstanding at January 31, 2008: 707,662,632.

DOCUMENTS INCORPORATED BY REFERENCE

Parts of the Company's definitive proxy statement (to be filed pursuant to Regulation 14A within 120 days after Registrant's fiscal year–end of December 31, 2007) for its annual meeting to be held on May 13, 2008, are incorporated by reference in this Form 10–K in response to Part III, Items 10, 11, 12, 13 and 14.

This document (excluding exhibits) contains 92 pages.
The table of contents is set forth on page 2. The exhibit index begins on page 90.

3M COMPANY
FORM 10-K

For the Year Ended December 31, 2007
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3M COMPANY
ANNUAL REPORT ON FORM 10–K

For the Year Ended December 31, 2007

PART I

Item 1. Business.

3M Company, formerly known as Minnesota Mining and Manufacturing Company, was incorporated in 1929 under the laws of the State of Delaware to continue operations begun in 1902. The Company's ticker symbol is MMM. As used herein, the term "3M" or "Company" includes 3M Company and its subsidiaries unless the context indicates otherwise. In addition, for any references to Note 1 through Note 18, refer to the Notes to Consolidated Financial Statements in Item 8 of this document.

Available Information

The SEC maintains a website that contains reports, proxy and information statements, and other information regarding issuers, including the Company, that file electronically with the SEC. The public can obtain any documents that the Company files with the SEC at http://www.sec.gov. The Company files annual reports, quarterly reports, proxy statements and other documents with the Securities and Exchange Commission (SEC) under the Securities Exchange Act of 1934 (Exchange Act). The public may read and copy any materials that the Company files with the SEC at the SEC's Public Reference Room at 100 F Street, N.E., Room 1580, Washington, D.C. 20549. The public may obtain information on the operation of the Public Reference Room by calling the SEC at 1–800–SEC–0330.

3M also makes available free of charge through its website (http://investor.3M.com) the Company's Annual Report on Form 10–K, Quarterly Reports on Form 10–Q, Current Reports on Form 8–K, and, if applicable, amendments to those reports filed or furnished pursuant to the Exchange Act as soon as reasonably practicable after the Company electronically files such material with, or furnishes it to, the SEC.

General

3M is a diversified technology company with a global presence in the following businesses: industrial and transportation; health care; display and graphics; consumer and office; safety, security and protection services; and electro and communications. 3M is among the leading manufacturers of products for many of the markets it serves. Most 3M products involve expertise in product development, manufacturing and marketing, and are subject to competition from products manufactured and sold by other technologically oriented companies.

At December 31, 2007, the Company employed 76,239 people, with 34,138 employed in the United States and 42,101 employed internationally.

Business Segments

As discussed in Note 16 to the Consolidated Financial Statements, effective in the first quarter of 2007, 3M made certain product moves between its business segments in its continuing effort to drive growth by aligning businesses around markets and customers. Segment information presented herein reflects the impact of these changes for all periods presented.

3M continues to manage its operations in six operating business segments: Industrial and Transportation; Health Care; Display and Graphics; Consumer and Office; Safety, Security and Protection Services; and Electro and Communications. 3M's six business segments bring together common or related 3M technologies, enhancing the development of innovative products and services and providing for efficient sharing of business resources. These segments have worldwide responsibility for virtually all 3M product lines. Certain small businesses and lab–sponsored products, as well as various corporate assets and expenses, are not allocated to the business segments. Financial information and other disclosures relating to 3M's business segments and operations in major geographic areas are provided in the Notes to Consolidated Financial Statements.

Industrial and Transportation Business: The Industrial and Transportation Business segment serves a broad range of markets, such as appliance, paper and packaging, food and beverage, and automotive. Industrial and Transportation products include tapes, a wide variety of coated and nonwoven abrasives, adhesives, specialty materials, closures for disposable diapers, and components and products that are used in the manufacture, repair, and maintenance of automotive, marine, aircraft and specialty vehicles. The August 2005 acquisition of CUNO, Incorporated ("CUNO") added a comprehensive line of filtration products for the separation, clarification and purification of fluids and gases.

Major industrial products include vinyl, polyester, foil and specialty industrial tapes and adhesives; Scotch® Masking Tape, Scotch® Filament Tape and Scotch® Packaging Tape; packaging equipment; 3M™ VHB™ Bonding Tapes; conductive, low surface energy, hot melt, spray and structural adhesives; reclosable fasteners; label materials for durable

goods; and coated, nonwoven and microstructured surface finishing and grinding abrasives for the industrial market. Other products include a comprehensive line of filtration products for the separation, clarification and purification of fluids and gases; fluoroelastomers for seals, tubes and gaskets in engines; engineering fluids; and closures for disposable diapers.

Major transportation products include insulation components, including components for catalytic converters; functional and decorative graphics; abrasion-resistant films; masking tapes; fasteners and tapes for attaching nameplates, trim, moldings, interior panels and carpeting; coated, nonwoven and microstructured finishing and grinding abrasives; structural adhesives; and other specialty materials. In addition, 3M provides paint finishing and detailing products, including a complete system of cleaners, dressings, polishes, waxes and other products.

Health Care Business: The Health Care segment serves markets that include medical, clinics and hospitals, pharmaceuticals, dental and orthodontic practitioners, and health information systems. Products and services provided to these and other markets include medical and surgical supplies, skin health and infection prevention products, drug delivery systems, dental and orthodontic products, health information systems and microbiology products. As discussed in Note 2, the global branded pharmaceuticals business was sold in December 2006 and January 2007.

In the medical and surgical areas, 3M is a supplier of medical tapes, dressings, wound closure products, orthopedic casting materials, electrodes and stethoscopes. In infection prevention, 3M markets a variety of surgical drapes, masks and preps, as well as sterilization assurance equipment. Other products include drug delivery systems, such as metered-dose inhalers, transdermal skin patches and related components. Dental and orthodontic products include restoratives, adhesives, finishing and polishing products, crowns, impression materials, preventive sealants, professional tooth whiteners, prophylaxis and orthodontic appliances. In health information systems, 3M develops and markets computer software for hospital coding and data classification, as well as providing related consulting services. 3M provides microbiology products that make it faster and easier for food processors to test the microbiological quality of food.

Display and Graphics Business: The Display and Graphics segment serves markets that include electronic display, touch screen, traffic safety and commercial graphics. This segment includes optical film and lens solutions for electronic displays; touch screens and touch monitors; computer screen filters; reflective sheeting for transportation safety; and commercial graphics systems.

The optical film business provides films that serve numerous market segments of the electronic display industry. 3M provides distinct products for five market segments, including products for: 1) LCD computer monitors, 2) LCD televisions, 3) hand-held devices such as cellular phones, 4) notebook PCs and 5) automotive displays. Other optical products include lens systems for projection televisions, in addition to desktop and notebook computer screen filters that address needs for light control, privacy viewing and glare reduction. The touch systems business includes touch screens and touch monitors. In traffic safety systems, 3M provides reflective sheetings used on highway signs, vehicle license plates, construction work-zone devices, trucks and other vehicles, and also provides pavement marking systems. Major commercial graphics products include films, inks, digital signage systems and related products used to produce graphics for vehicles and signs.

Consumer and Office Business: The Consumer and Office segment serves markets that include consumer retail, office retail, home improvement, building maintenance and other markets. Products in this segment include office supply products, stationery products, construction and home improvement products, home care products, protective material products and consumer health care products.

Major consumer and office products include Scotch® brand products, such as Scotch® Magic™ Tape, Scotch® Glue Stick and Scotch® Cushioned Mailer; Post-it® Products, such as Post-it® Flags, Post-it® Note Pads, Post-it® Labeling & Cover-up Tape, and Post-it® Pop-up Notes and Dispensers; construction and home improvement products, including surface-preparation and wood-finishing materials, Command™ Adhesive Products and Filtrete™ Filters for furnaces and air conditioners; home care products, including Scotch-Brite® Scour Pads, Scotch-Brite® Scrub Sponges, Scotch-Brite™ Microfiber Cloth products, O-Cel-O™ Sponges and Scotchgard™ Fabric Protectors; protective material products, certain maintenance-free respirators, and Nexcare™ Adhesive Bandages.

Safety, Security and Protection Services Business: The Safety, Security and Protection Services segment serves a broad range of markets that increase the safety, security and productivity of workers, facilities and systems. Major product offerings include personal protection products, safety and security products, energy control products, cleaning and protection products for commercial establishments, roofing granules for asphalt shingles, and supply chain execution software solutions. In August 2006, 3M completed the acquisition of Security Printing and Systems Limited, a producer of finished, personalized passports and secure cards, which expanded the 3M product line related to border and civil security solutions. 3M's new emerging business opportunity in its Track and Trace initiative within 3M's Safety, Security and Protection Services segment resulted in the merging of a number of formerly separate efforts into one concerted effort for

future growth. Track and Trace has a growing array of applications — from tracking packages to managing medical and legal records.

This segment's products include certain maintenance–free and reusable respirators, personal protective equipment, electronic surveillance products, films that protect against counterfeiting, and reflective materials that are widely used on apparel, footwear and accessories, enhancing visibility in low–light situations. Other products include theft protection systems for libraries and library patron self–checkout systems; spill–control sorbents; Thinsulate™ Insulation and Thinsulate™ Lite Loft™ Insulation; 3M™ Scotchtint™ Window Film for buildings; 3M™ Ultra Safety and Security Window Film for property and personal protection during destructive weather conditions; nonwoven abrasive materials for floor maintenance and commercial cleaning; floor matting; natural and color–coated mineral granules for asphalt shingles; and supply chain execution software solutions.

Electro and Communications Business: The Electro and Communications segment serves the electrical, electronics and communications industries, including electrical utilities; electrical construction, maintenance and repair; original equipment manufacturer (OEM) electrical and electronics; computers and peripherals; consumer electronics; telecommunications central office, outside plant and enterprise; as well as aerospace, military, automotive and medical markets; with products that enable the efficient transmission of electrical power and speed the delivery of information and ideas. Products include electronic and interconnect solutions, microinterconnect systems, high–performance fluids, high–temperature and display tapes, telecommunications products, electrical products, and visual systems products.

Major electronic and electrical products include packaging and interconnection devices; high–performance fluids used in the manufacture of computer chips, and for cooling electronics and lubricating computer hard disk drives; high– temperature and display tapes; insulating materials, including pressure–sensitive tapes and resins; and related items. 3M™ Flexible Circuits use electronic packaging and interconnection technology, providing more connections in less space, and are used in ink–jet print cartridges, cell phones and electronic devices. This segment serves the world's telecommunications companies with a wide array of products for fiber–optic and copper–based telecommunications systems for rapid deployment in fixed and wireless networks. The 3M™ Aluminum Conductor Composite Reinforced (ACCR) electrical power cable, with an aluminum–based metal matrix at its core, increases transmission capacity for existing power lines. Visual communication products serve the world's office and education markets with overhead projectors and transparency films, as well as equipment and materials for electronic and multimedia presentations.

Distribution

3M products are sold through numerous distribution channels, including directly to users and through numerous wholesalers, retailers, jobbers, distributors and dealers in a wide variety of trades in many countries around the world. Management believes the confidence of wholesalers, retailers, jobbers, distributors and dealers in 3M and its products — a confidence developed through long association with skilled marketing and sales representatives — has contributed significantly to 3M's position in the marketplace and to its growth. 3M has 157 sales offices worldwide, with nine in the United States and 148 internationally.

Research and Patents

Research and product development constitutes an important part of 3M's activities and has been a major driver of 3M's sales growth. Research, development and related expenses totaled $1.368 billion in 2007, $1.522 billion in 2006 and $1.274 billion in 2005. The global branded pharmaceuticals business, which was divested in December 2006 and January 2007, incurred research, development and related expenses of approximately $120 million in 2006 and $142 million in 2005. The 2006 amount also included a $95 million in–process research and development charge (discussed in Note 2) and $75 million in restructuring actions (Note 4). Research and development, covering basic scientific research and the application of scientific advances in the development of new and improved products and their uses, totaled $788 million in 2007, compared to $943 million in 2006, decreasing due to the $95 million for purchased in–process research and development discussed above and also due to the pharmaceuticals business divestiture. Research and development expenses totaled $818 million in 2005. Related expenses primarily include technical support provided by 3M to existing customers who are using 3M products, and the costs of internally developed patents.

The Company's products are sold around the world under various trademarks that are important to the Company. The Company also owns, or holds licenses to use, numerous U.S. and foreign patents. The Company's research and development activities generate a steady stream of inventions that are covered by new patents. Patents applicable to specific products extend for varying periods according to the date of patent application filing or patent grant and the legal term of patents in the various countries where patent protection is obtained. The actual protection afforded by a patent, which can vary from country to country, depends upon the type of patent, the scope of its coverage and the availability of legal remedies in the country.

The Company believes that its patents provide an important competitive advantage in many of its businesses. In general, no single patent or group of related patents is in itself essential to the Company as a whole or to any of the Company's

business segments. The importance of patents in the Display and Graphics segments is described in "Performance by Business Segment" — "Display and Graphics Business" in Part II, Item 7.

Raw Materials

In 2007, the Company experienced cost increases affecting metals, wood pulp and oil–derived raw materials. Costs for these materials have remained high throughout the year, and 3M would expect this level to carry over into early 2008, with some moderation occurring later in the year. To date, the Company is receiving sufficient quantities of all raw materials to meet its reasonably foreseeable production requirements. It is impossible to predict future shortages of raw materials or the impact any such shortages would have. 3M has avoided disruption to its manufacturing operations through careful management of existing raw material inventories and development and qualification of additional supply sources. 3M manages commodity price risks through negotiated supply contracts, price protection agreements and forward physical contracts.

Environmental Law Compliance

3M's manufacturing operations are affected by national, state and local environmental laws around the world. 3M has made, and plans to continue making, necessary expenditures for compliance with applicable laws. 3M is also involved in remediation actions relating to environmental matters from past operations at certain sites (refer to "Environmental and Other Liabilities and Insurance Receivables" in Note 13, Commitments and Contingencies).

Environmental expenditures relating to existing conditions caused by past operations that do not contribute to current or future revenues are expensed. Reserves for liabilities for anticipated remediation costs are recorded on an undiscounted basis when they are probable and reasonably estimable, generally no later than the completion of feasibility studies or the Company's commitment to a plan of action. Environmental expenditures for capital projects that contribute to current or future operations generally are capitalized and depreciated over their estimated useful lives.

In 2007, 3M expended about $21 million for capital projects related to protecting the environment. This amount excludes expenditures for remediation actions relating to existing matters caused by past operations. Capital expenditures for environmental purposes have included pollution control devices — such as wastewater treatment plant improvements, scrubbers, containment structures, solvent recovery units and thermal oxidizers — at new and existing facilities constructed or upgraded in the normal course of business. Consistent with the Company's policies stressing environmental responsibility, capital expenditures (other than for remediation projects) for known projects are presently expected to be about $47 million over the next two years for new or expanded programs to build facilities or modify manufacturing processes to minimize waste and reduce emissions.

While the Company cannot predict with certainty the future costs of such cleanup activities, capital expenditures or operating costs for environmental compliance, the Company does not believe they will have a material effect on its capital expenditures, earnings or competitive position.

Executive Officers

Following is a list of the executive officers of 3M, and their age, present position, the year elected to their present position and other positions they have held during the past five years. No family relationships exist among any of the executive officers named, nor is there any undisclosed arrangement or understanding pursuant to which any person was selected as an officer. This information is presented as of the date of the 10–K filing (February 15, 2008).

Name	Age	Present Position	Year Elected to Present Position	Other Positions Held During 2003–2007
George W. Buckley	60	Chairman of the Board, President and Chief Executive Officer	2005	Chairman and Chief Executive Officer, Brunswick Corporation, 2000–2005
Patrick D. Campbell	55	Senior Vice President and Chief Financial Officer	2002	
Joe E. Harlan	48	Executive Vice President, Electro and Communications Business	2004	President and Chairman of the Board, Sumitomo 3M Limited, 2003–2004 Executive Vice President, Sumitomo 3M Limited, 2002–2003

Executive Officers
(continued)

Name	Age	Present Position	Year Elected to Present Position	Other Positions Held During 2003–2007
Michael A. Kelly	51	Executive Vice President, Display and Graphics Business	2006	Division Vice President, Occupational Health and Environmental Safety Division, 2003–2006 General Manager, Performance Materials Division, 2003 Managing Director, 3M Korea, 2001–2003
Angela S. Lalor	42	Senior Vice President, Human Resources	2006	Staff Vice President, Human Resources Operations, 2005 Executive Director, Human Resources Operations, 2004–2005 Director, Compensation and Employee Administration, 2002–2004
Jean Lobey	55	Executive Vice President, Safety, Security and Protection Services Business	2005	Managing Director, 3M Brazil, 2003–2004 Executive Director, Six Sigma, Europe and Middle East, 2001–2003
Robert D. MacDonald	57	Senior Vice President, Marketing and Sales	2004	Division Vice President, Automotive Aftermarket Division, 2002–2004
Moe S. Nozari	65	Executive Vice President, Consumer and Office Business	2002	
Frederick J. Palensky	58	Executive Vice President, Research and Development and Chief Technology Officer	2006	Executive Vice President, Enterprise Services, 2005–2006 Executive Vice President, Safety, Security and Protection Services Business, 2002–2005
Brad T. Sauer	48	Executive Vice President, Health Care Business	2004	Executive Vice President, Electro and Communications Business, 2002–2004
Hak Cheol Shin	50	Executive Vice President, Industrial and Transportation Business	2006	Executive Vice President, Industrial Business, 2005 Division Vice President, Industrial Adhesives and Tapes Division, 2003–2005 Division Vice President, Electronics Markets Materials Division, 2002–2003
Marschall I. Smith	63	Senior Vice President, Legal Affairs and General Counsel	2007	Vice President and General Counsel, Brunswick Corporation, 2001–2007
Inge G. Thulin	54	Executive Vice President, International Operations	2004	Vice President, Asia Pacific; and Executive Vice President, International Operations, 2003–2004 Vice President, Europe and Middle East, 2002–2003
John K. Woodworth	56	Senior Vice President, Corporate Supply Chain Operations	2006	Vice President, Asia Pacific, 2004–2006 Division Vice President, Electronic Solutions Division, 2003–2004 Division Vice President, Electronic and Interconnect Solutions Division, 2002–2003

Item 1A. Risk Factors.

The most significant risk factors applicable to the Company are as follows:

* *Results are impacted by the effects of, and changes in, worldwide economic conditions.* The Company operates in more than 60 countries and derives approximately 63% of its revenues from outside the United States. The Company's business may be affected by factors in the United States and other countries that are beyond its control, such as downturns in economic activity in a specific country or region, or in the various industries in which the Company operates; social, political or labor conditions in a specific country or region; or adverse changes in interest rates, tax, or regulations in the jurisdictions in which the company operates.

* *The Company's results are affected by competitive conditions and customer preferences.* Demand for the Company's products, which impacts revenue and profit margins, is affected by (i) the development and timing of the introduction of competitive products; (ii) the Company's response to downward pricing to stay competitive; (iii) changes in customer order patterns, such as changes in the levels of inventory maintained by customers and the timing of customer purchases which may be affected by announced price changes, changes in the Company's incentive programs, or the customer's ability to achieve incentive goals; and (iv) changes in customers' preferences for our products, including the success of products offered by our competitors, and changes in customer designs for their products that can affect the demand for some of the Company's products.

* *Foreign currency exchange rates and fluctuations in those rates may affect the Company's ability to realize projected growth rates in its sales and earnings.* Because the Company derives approximately 63% of its revenues from outside the United States, its ability to realize projected growth rates in sales and earnings could be adversely affected if the U.S. dollar strengthens significantly against foreign currencies.

* *The Company's growth objectives are largely dependent on the timing and market acceptance of its new product offerings, including its ability to continually renew its pipeline of new products and to bring those products to market.* This ability may be adversely affected by difficulties or delays in product development, such as the inability to identify viable new products, obtain adequate intellectual property protection, or gain market acceptance of new products. There are no guarantees that new products will prove to be commercially successful.

* *The Company's future results are subject to fluctuations in the costs and availability of purchased components, compounds, raw materials and energy, including oil and natural gas and their derivatives, due to shortages, increased demand, supply interruptions, currency exchange risks, natural disasters and other factors.* The Company depends on various components, compounds, raw materials, and energy (including oil and natural gas and their derivatives) supplied by others for the manufacturing of its products. It is possible that any of its supplier relationships could be interrupted due to natural and other disasters and other events, or be terminated in the future. Any sustained interruption in the Company's receipt of adequate supplies could have a material adverse effect on the Company. In addition, while the Company has a process to minimize volatility in component and material pricing, no assurance can be given that the Company will be able to successfully manage price fluctuations or that future price fluctuations or shortages will not have a material adverse effect on the Company.

* *Acquisitions, strategic alliances, divestitures, and other unusual events resulting from portfolio management actions and other evolving business strategies, and possible organizational restructuring could affect future results.* The Company monitors its business portfolio and organizational structure and has made and may continue to make acquisitions, strategic alliances, divestitures and changes to its organizational structure. With respect to acquisitions, future results will be affected by the Company's ability to integrate acquired businesses quickly and obtain the anticipated synergies.

* *The Company's future results may be affected if the Company generates fewer productivity improvements than estimated.* The Company utilizes various tools, such as Lean Six Sigma, to improve operational efficiency and productivity. There can be no assurance that all of the projected productivity improvements will be realized.

* *The Company's future results may be affected by various legal and regulatory proceedings, including those involving product liability, antitrust, environmental or other matters.* The outcome of these legal proceedings may differ from the Company's expectations because the outcomes of litigation, including regulatory matters, are often difficult to reliably predict. Various factors or developments can lead the Company to change current estimates of liabilities and related insurance receivables where applicable, or make such estimates for matters previously not susceptible of reasonable estimates, such as a significant judicial ruling or judgment, a significant settlement, significant regulatory developments or changes in applicable law. A future adverse ruling, settlement or unfavorable development could result in future charges that could have a material adverse effect on the Company's results of operations or cash flows in any particular period. For a more detailed discussion of the legal proceedings involving the Company and the associated accounting estimates, see the discussion in Note 13.

Item 1B. Unresolved Staff Comments.

None.

Item 2. Properties.

3M's general offices, corporate research laboratories, and certain division laboratories are located in St. Paul, Minnesota. In the United States, 3M has nine sales offices in eight states and operates 74 manufacturing facilities in 27 states. Internationally, 3M has 148 sales offices. The Company operates 93 manufacturing and converting facilities in 32 countries outside the United States.

3M owns substantially all of its physical properties. 3M's physical facilities are highly suitable for the purposes for which they were designed. Because 3M is a global enterprise characterized by substantial intersegment cooperation, properties are often used by multiple business segments.

Item 3. Legal Proceedings.

Discussion of legal matters is incorporated by reference from Part II, Item 8, Note 13, "Commitments and Contingencies," of this document, and should be considered an integral part of Part I, Item 3, "Legal Proceedings."

Item 4. Submission of Matters to a Vote of Security Holders.

None in the quarter ended December 31, 2007.

PART II

Item 5. Market for Registrant's Common Equity, Related Stockholder Matters and Issuer Purchases of Equity Securities.

Equity compensation plans' information is incorporated by reference from Part III, Item 12, "Security Ownership of Certain Beneficial Owners and Management and Related Stockholder Matters," of this document, and should be considered an integral part of Item 5. At January 31, 2008, there were approximately 121,302 shareholders of record. 3M's stock is listed on the New York Stock Exchange, Inc. (NYSE), the Chicago Stock Exchange, Inc., and the SWX Swiss Exchange. Cash dividends declared and paid totaled $.48 per share for each quarter of 2007, and $.46 per share for each quarter of 2006. Stock price comparisons follow:

Stock price comparisons (NYSE composite transactions)

(Per share amounts)	First Quarter	Second Quarter	Third Quarter	Fourth Quarter	Year
2007 High	**$ 79.88**	**$ 89.03**	**$ 93.98**	**$ 97.00**	**$ 97.00**
2007 Low	**72.90**	**75.91**	**83.21**	**78.98**	**72.90**
2006 High	$ 79.83	$ 88.35	$ 81.60	$ 81.95	$ 88.35
2006 Low	70.30	75.76	67.05	73.00	67.05

Issuer Purchases of Equity Securities

Repurchases of common stock are made to support the Company's stock-based employee compensation plans and for other corporate purposes. On February 13, 2006, the Board of Directors authorized the purchase of $2.0 billion of the Company's common stock between February 13, 2006 and February 28, 2007. In August 2006, 3M's Board of Directors authorized the repurchase of an additional $1.0 billion in share repurchases, raising the total authorization to $3.0 billion for the period from February 13, 2006 to February 28, 2007. In February 2007, 3M's Board of Directors authorized a two-year share repurchase of up to $7.0 billion for the period from February 12, 2007 to February 28, 2009.

Issuer Purchases of Equity Securities (registered pursuant to Section 12 of the Exchange Act)

Period	Total Number of Shares Purchased (1)	Average Price Paid per Share	Total Number of Shares Purchased as Part of Publicly Announced Plans or Programs	Maximum Approximate Dollar Value of Shares that May Yet Be Purchased under the Plans or Programs (Millions)
January 1–31, 2007	1,311,268	$ 76.33	1,277,200	$ 651
February 1–28, 2007	6,542,591	$ 75.12	6,522,500	$ 6,731
March 1–31, 2007	8,187,472	$ 75.59	8,151,700	$ 6,115
Total January 1 — March 31, 2007	16,041,331	$ 75.46	15,951,400	$ 6,115
April 1–30, 2007	3,548,221	$ 77.55	3,476,700	$ 5,846
May 1–31, 2007	4,428,219	$ 85.84	4,202,800	$ 5,485
June 1–30, 2007	3,885,033	$ 86.58	3,810,800	$ 5,155
Total April 1 — June 30, 2007	11,861,473	$ 83.60	11,490,300	$ 5,155
July 1–31, 2007	1,646,251	$ 89.01	1,510,300	$ 5,021
August 1–31, 2007	2,329,478	$ 87.05	2,247,300	$ 4,825
September 1–30, 2007	2,086,564	$ 90.24	2,029,600	$ 4,642
Total July 1 — September 30, 2007	6,062,293	$ 88.68	5,787,200	$ 4,642
October 1–31, 2007	2,192,302	$ 88.89	2,178,500	$ 4,448
November 1–30, 2007	1,702,375	$ 82.35	1,692,000	$ 4,309
December 1–31, 2007	1,896,612	$ 85.41	1,873,500	$ 4,149
Total October 1 — Dec. 31, 2007	5,791,289	$ 85.83	5,744,000	$ 4,149
Total January 1 — December 31, 2007	39,756,386	$ 81.42	38,972,900	$ 4,149

(1) The total number of shares purchased includes: (i) shares purchased under the Board's authorizations described above, and (ii) shares purchased in connection with the exercise of stock options (which totaled 34,068 shares in January 2007, 20,091 shares in February 2007, 35,772 shares in March 2007, 71,521 shares in April 2007, 225,419 shares in May 2007, 74,233 shares in June 2007, 135,951 shares in July 2007, 82,178 shares in August 2007, 56,964 shares in September 2007, 13,802 shares in October 2007, 10,375 shares in November 2007, and 23,112 shares in December 2007).

Item 6. Selected Financial Data.

(Dollars in millions, except per share amounts)	2007	2006	2005	2004	2003
Years ended December 31:					
Net sales	$ 24,462	$ 22,923	$ 21,167	$ 20,011	$ 18,232
Income before cumulative effect of accounting change	4,096	3,851	3,146	2,841	2,286
Per share of common stock:					
Income before cumulative effect of accounting change — basic	5.70	5.15	4.11	3.64	2.92
Income before cumulative effect of accounting change — diluted	5.60	5.06	4.03	3.56	2.88
Cash dividends declared and paid	1.92	1.84	1.68	1.44	1.32
At December 31:					
Total assets	$ 24,694	$ 21,294	$ 20,541	$ 20,723	$ 17,612
Long-term debt (excluding portion due within one year) and long-term capital lease obligations	4,088	1,112	1,368	798	1,805

The above income and earnings per share information exclude a cumulative effect of accounting change in 2005 ($35 million, or 5 cents per diluted share). Refer to Note 1 for more detail.

2007 results included net gains that increased operating income by $681 million and net income by $448 million. 2007 included gains related to the sale of businesses ($849 million pre-tax, $550 million after-tax) and a gain on sale of real estate ($52 million pre-tax, $37 million after-tax), which were partially offset by increases in environmental liabilities ($134 million pre-tax, $83 million after-tax), restructuring actions ($41 million pre-tax, $27 million after-tax), and other exit activities ($45 million pre-tax, $29 million after-tax). 2006 results included net gains that increased operating income by $523 million and net income by $438 million. 2006 included net benefits from gains related to the sale of certain portions of 3M's branded pharmaceuticals business ($1.074 billion pre-tax, $674 million after-tax) and favorable income tax adjustments ($149 million), which were partially offset by restructuring actions ($403 million pre-tax, $257 million after-tax), acquired in-process research and development expenses ($95 million pre-tax and after-tax), settlement costs of a previously disclosed antitrust class action ($40 million pre-tax, $25 million after-tax), and environmental obligations related to the pharmaceuticals business ($13 million pre-tax, $8 million after-tax). 2005 results included charges that reduced net income by $75 million. This related to a tax liability resulting from 3M's reinvestment of approximately $1.7 billion of foreign earnings in the United States pursuant to the repatriation provisions of the American Jobs Creation Act of 2004. 2003 results included charges related to an adverse ruling in a lawsuit filed against 3M in 1997 by LePage's Inc. that reduced operating income by $93 million ($58 million after tax).

Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations.

Management's Discussion and Analysis of Financial Condition and Results of Operations (MD&A) is designed to provide a reader of 3M's financial statements with a narrative from the perspective of management. 3M's MD&A is presented in nine sections:

	Reference (pages)
• Overview	12
• Results of Operations	15
• Performance by Business Segment	18
• Performance by Geographic Segment	27
• Critical Accounting Estimates	28
• New Accounting Pronouncements	30
• Financial Condition and Liquidity	30
• Financial Instruments	35
• Forward–Looking Statements	35

OVERVIEW

3M is a diversified global manufacturer, technology innovator and marketer of a wide variety of products. 3M manages its operations in six operating business segments: Industrial and Transportation; Health Care; Display and Graphics; Consumer and Office; Safety, Security and Protection Services; and Electro and Communications.

3M's strategy continues to emphasize a commitment to grow at a faster pace, using a four–pronged approach, which includes reinvesting in its core businesses, developing adjacent emerging business opportunities, expanding on the Company's already world–class capabilities internationally, and acquiring companies in complementary faster–growing industries. The Company will continue to invest in research and development and plant start–ups in 2008, including investments in emerging markets around the world. Research, development and related expenses totaled $1.368 billion in 2007. Capital expenditures totaled $1.422 billion in 2007, up $254 million compared with 2006. The Company expects capital expenditures to total approximately $1.3 billion to $1.4 billion in 2008, providing the capacity to meet expected growth.

In December 2006 and January 2007, 3M completed the sale of its branded pharmaceuticals business, resulting in gains in the fourth quarter of 2006 and first quarter of 2007. In addition, 3M recorded a gain related to the sale of its Opticom Priority Control Systems and Canoga Traffic Detection businesses in the second quarter of 2007. In both 2007 and 2006, these gains on sale of businesses and a gain on sale of real estate were partially offset by restructuring and other items. Refer to Note A at the end of this overview section for additional details. Including these items, in 2007, 3M reported record net sales of $24.462 billion and record net income of $4.096 billion, or $5.60 per diluted share, compared with net sales of $22.923 billion and net income of $3.851 billion, or $5.06 per diluted share, in 2006. Excluding the items in Note A in both years, the Company still achieved strong underlying operating performance, helped by a 6.7% increase in net sales, which included the divestiture impacts discussed above that reduced sales growth by 3.8%.

The following table contains sales and operating income results by business segment for the years ended December 31, 2007 and 2006. Refer to the Performance by Business Segment section for discussion of the gain on sale of businesses, restructuring and other items that impacted reported operating income results.

	2007			2006			2007 vs. 2006 % change	
(Dollars in millions)	Net Sales	% of Total	Oper. Income	Net Sales	% of Total	Oper. Income	Net Sales	Oper. Income
Business Segments								
Industrial and Transportation	$ 7,274	29.7%	$ 1,501	$ 6,640	29.0%	$ 1,342	9.6%	11.8%
Health Care	3,968	16.2%	1,882	4,011	17.5%	1,845	(1.1)%	2.0%
Display and Graphics	3,892	15.9%	1,174	3,770	16.4%	1,044	3.2%	12.4%
Consumer and Office	3,403	13.9%	688	3,164	13.8%	629	7.6%	9.3%
Safety, Security and Protection Services	3,070	12.6%	611	2,663	11.6%	549	15.3%	11.3%
Electro and Communications	2,775	11.3%	481	2,631	11.5%	411	5.5%	17.0%
Corporate and Unallocated	80	0.4%	(144)	44	0.2%	(124)		
Total Company	$ 24,462	100%	$ 6,193	$ 22,923	100%	$ 5,696	6.7%	8.7%

In 2007, worldwide total sales increased 6.7%. Local–currency sales growth (which includes volume, selling price and acquisition impacts, but excludes divestiture and translation impacts) was 7.3%, with organic local–currency growth of 4.9% (including 0.7% benefit from pharmaceuticals supply agreements) and acquisitions adding 2.4%. Divestitures, primarily the sale of the global branded pharmaceuticals business (Health Care segment), decreased worldwide sales growth by 3.8%. The sale of the pharmaceuticals business is not presented as a discontinued operation due to the extent of the projected continuing cash flows from 3M's contractual supply relationship with the buyers in relation to those of the business that was sold.

The breadth of 3M's product lines was evident during 2007 as the Company experienced solid sales growth across the portfolio. Health Care led all segments with local–currency sales growth of 18.3% (excluding divestitures). This includes a 4.4% benefit from acquisitions and 4.5% benefit due to the pharmaceuticals supply agreements. The sale of 3M's global branded pharmaceuticals business reduced Health Care sales growth by 23.7%. Local–currency sales increased 10.8% in Safety, Security and Protection Services, including 7.4% from numerous acquisitions. Local–currency sales increased 5.8% in Industrial and Transportation, 5.0% in Consumer and Office, 2.3% in Electro and Communications, and 1.8% (excluding the impact of the Opticom/Canoga divestiture) in Display and Graphics. While 3M experienced broad–based sales growth, there was softness in certain markets in 2007. Within Display and Graphics, optical film sales increased slightly year–on–year, but 3M experienced an attachment rate loss in LCD desktop monitors and LCD TV segments, particularly in the second half of 2007, as competition continued to intensify in this market. 3M also experienced weakness in its roofing granules business for residential asphalt shingles and in its electronic solutions business due to softness in certain segments of the consumer electronics market. Refer to the section entitled Performance by Business Segment for a more detailed discussion of the results of the respective segments.

Geographically, the European region (which includes Europe, Middle East and Africa) led local–currency sales growth in 2007, with an increase of 11.7%, 7.4% of which was organic (excluding acquisitions, divestiture and translation impacts). Sales growth in Europe was led by Safety, Security and Protection Services and Health Care (without Pharmaceuticals). The combined Latin America and Canada area local–currency sales increased 10.6%, of which 9.6% was organic, with growth led by Industrial and Transportation, Safety, Security and Protection Services and Health Care (without Pharmaceuticals). Asia Pacific local–currency sales increased 4.9%, of which 4.5% was organic, with all six business segments contributing to this increase. United States local–currency sales increased 5.7%, of which 2.6% was organic. Organic volume growth in the U.S. was led by Health Care (without Pharmaceuticals) and Industrial and Transportation, which was partially offset by softness in the electronic solutions business and weakness in a few businesses that are impacted by the slowdown in the U.S. housing, road construction and mass retail markets, primarily the roofing granules, protective materials, traffic safety and office supply businesses. Divestitures, primarily the sale of the global branded pharmaceuticals business, reduced sales in Europe by 6.6%, in the United States by 4.2%, in the combined Latin America and Canada area by 2.8%, and in Asia Pacific by 1.3%. Currency effects increased total international sales by 5.2%, with Europe positively impacted by 8.5%, the combined Latin America and Canada area by 5.9%, and Asia Pacific by 2.0%, as the U.S. dollar weakened in aggregate against the multitude of currencies in these geographic areas.

Operating income for 2007 increased 8.7% year–on–year, including a net 2.2 percentage point benefit from the impact of items discussed in Note A below. Operating income margins were approximately 25% in both 2007 and 2006, with items in Note A positively impacting these margins in both years by approximately 2.5 percentage points.

3M generated $4.275 billion of operating cash flows in 2007, an increase of $436 million compared to 2006. In 2007, the Company utilized $4.619 billion of cash to repurchase 3M common stock and pay dividends, compared to $3.727 billion in 2006. In February 2007, 3M's Board of Directors authorized a two–year share repurchase of up to $7.0 billion for the period from February 12, 2007 to February 28, 2009. As of December 31, 2007, approximately $4.1 billion remained available for repurchase. In February 2008, 3M's Board authorized a dividend increase of 4.2% for 2008, marking the 50 th consecutive year of dividend increases for 3M. 3M's debt to total capital ratio (total capital defined as debt plus equity) as of December 31, 2007 was 30%. 3M has an AA credit rating from Standard & Poor's, with a stable outlook, and an Aa1 credit rating from Moody's Investors Service, with a negative outlook. The Company has sufficient access to capital markets to meet currently anticipated growth and acquisition investment funding needs.

In 2007, the Company experienced cost increases affecting metals, wood pulp and oil–derived raw materials. Costs for these materials have remained high throughout the year, and 3M would expect this level to carry over into early 2008, with some moderation occurring later in the year. To date the Company is receiving sufficient quantities of all raw materials to meet its reasonably foreseeable production requirements. It is impossible to predict future shortages of raw materials or the impact any such shortages would have. 3M has avoided disruption to its manufacturing operations through careful management of existing raw material inventories and development and qualification of additional supply sources. 3M manages commodity price risks through negotiated supply contracts, price protection agreements and forward physical contracts.

In 2007, the Company modified elements of its long-term incentive compensation programs. With the May 2007 Management Stock Ownership Program (MSOP) Annual Grant, the Company reduced the number of traditional stock options granted by reducing the number of employees eligible to receive annual grants and by shifting a portion of the annual grant away from traditional stock options primarily to restricted stock units. These changes will reduce the annual dilution impact from approximately 1.5% of total outstanding common stock to approximately 1%. However, associated with the reduction in the number of eligible employees, the Company provided a one-time "buyout" grant of restricted stock units to the impacted employees, which resulted in increased stock-based compensation expense in 2007. Stock-based compensation expense totaled $0.18 per diluted share in 2007, compared with $0.17 per diluted share in 2006. The Company's MSOP, including restricted stock units, is discussed further in Note 15.

The preceding forward-looking statements involve risks and uncertainties that could cause results to differ materially from those projected (refer to the forward-looking statements section in Item 7 and the risk factors provided in Item 1A for discussion of these risks and uncertainties).

(Note A). In 2007, gains on sale of businesses and real estate, net of restructuring and other items, increased operating income by $681 million and net income by $448 million, or $0.62 per diluted share. 2007 included net benefits from gains related to the sale of businesses ($849 million pre-tax, $550 million after-tax) and a gain on sale of real estate ($52 million pre-tax, $37 million after-tax), which were partially offset by increases in environmental liabilities ($134 million pre-tax, $83 million after-tax), restructuring actions ($41 million pre-tax, $27 million after-tax), and other exit activities ($45 million pre-tax, $29 million after-tax). These items, except the gain on sale of real estate, are discussed in more detail in Note 2 (Acquisitions and Divestitures), Note 4 (Restructuring Actions and Other Exit Activities) and Note 13 (Commitments and Contingencies). Gains on sale of businesses include the second-quarter 2007 sale of 3M's Opticom Priority Control Systems and Canoga Traffic Detection businesses, and the first-quarter 2007 sale of the global branded pharmaceuticals business in Europe. Concerning the real estate sale, 3M sold its current lab facility located in Suwon, Korea and is currently building a new state-of-the-art customer-oriented R&D facility closer to Seoul and many of 3M's major customers.

In 2006, gains of sale of businesses, net of restructuring and other items, increased operating income by $523 million and net income by $438 million, or $0.57 per diluted share. 2006 included net benefits from gains related to the sale of certain portions of 3M's branded pharmaceuticals business ($1.074 billion pre-tax, $674 million after-tax) and favorable income tax adjustments ($149 million), which were partially offset by restructuring actions ($403 million pre-tax, $257 million after-tax), acquired in-process research and development expenses ($95 million pre-tax and after-tax), settlement costs of a previously disclosed antitrust class action ($40 million pre-tax, $25 million after-tax), and environmental obligations related to the pharmaceuticals business ($13 million pre-tax, $8 million after-tax). These items, except the settlement costs and environmental obligations, are discussed in more detail in Note 2 (Acquisitions and Divestitures), Note 4 (Restructuring Actions and Other Exit Activities), Note 8 (Income Taxes) and Note 13 (Commitments and Contingencies). Concerning settlement costs, the Company recorded $40 million in 2006 with respect to a settlement in principle related to the antitrust class action brought on behalf of direct purchasers who did not purchase private label tape. Concerning environmental obligations, the Company increased its reserves by $13 million during 2006 for estimated environmental remediation costs at a European pharmaceutical plant.

RESULTS OF OPERATIONS

Net Sales:

	2007			2006		
	U.S.	Intl.	Worldwide	U.S.	Intl.	Worldwide
Net sales (millions)	$ 8,987	$ 15,475	$ 24,462	$ 8,853	$ 14,070	$ 22,923
% of worldwide sales	36.7%	63.3%		38.6%	61.4%	
Components of net sales change:						
Volume — organic	1.6%	7.4%	5.1%	3.1%	8.0%	6.1%
Volume — acquisitions	3.1	2.1	2.4	2.6	1.9	2.1
Price	1.0	(1.1)	(0.2)	1.4	(1.8)	(0.5)
Local–currency sales (including acquisitions)	5.7	8.4	7.3	7.1	8.1	7.7
Divestitures	(4.2)	(3.6)	(3.8)	—	—	—
Translation	—	5.2	3.2	—	1.0	0.6
Total sales change	1.5%	10.0%	6.7%	7.1%	9.1%	8.3%

In 2007, local–currency sales growth of 7.3% (which includes acquisitions, but excludes divestiture and translation impacts) was led by the Health Care; Safety, Security and Protection Services; Industrial and Transportation and Consumer and Office segments. All business segments have contributed positive local–currency sales growth for four consecutive years. Acquisitions increased 2007 sales by 2.4%, led by the August 2006 acquisition of Security Printing and Systems Limited and the late 2006 acquisitions of Softmed Systems Inc. and Biotrace International PLC.

In 2006, local–currency sales growth of 7.7% was broad–based, as all business segments made positive contributions to local–currency sales growth. Acquisitions increased 2006 sales by 2.1%, driven by the August 2005 acquisition of CUNO and the August 2006 acquisition of Security Printing and Systems Limited.

Refer to both the "Performance by Business Segment" and "Performance by Geographic Area" sections for additional discussion of sales change.

Operating Expenses:

(Percent of net sales)	2007	2006	2005	2007 Versus 2006	2006 Versus 2005
Cost of sales	52.1%	51.1%	49.2%	1.0%	1.9%
Selling, general and administrative expenses	20.5	22.1	21.9	(1.6)	0.2
Research, development and related expenses	5.6	6.6	6.0	(1.0)	0.6
Gain on sale of businesses	(3.5)	(4.6)	—	1.1	(4.6)
Operating income	25.3%	24.8%	22.9%	0.5%	1.9%

As discussed in the preceding overview section, the 2007 gain on sale of businesses and real estate, net of environmental liability charges, restructuring and other exit activities, benefited 2007 operating income by $681 million, or 2.8% of net sales. In addition, the 2006 gain on sale, net of restructuring and other items, benefited 2006 operating income by $523 million, or 2.2% of net sales. The following tables summarize these items by operating expense category. Items included in the "Other" category of the table for 2006 are acquired in–process research and development expenses ($95 million), settlement costs of a previously disclosed antitrust class action ($40 million), and environmental obligations related to the pharmaceuticals business ($13 million).

(Millions)	2007 Gain on Sale, Restructuring and Other Summary				
	Gain on Sale of businesses	Environ-mental liabilities	Restructuring and other exit activities	Gain on sale of real estate	Total
Cost of sales	$ —	$ —	$ 64	$ —	$ 64
Selling, general and administrative expenses	—	134	26	(52)	108
Research, development and related expenses	—	—	(4)	—	(4)
Gain on sale of businesses	(849)	—	—		(849)
Total operating income penalty (benefit)	$ (849)	$ 134	$ 86	$ (52)	$ (681)

(Millions)	2006 Gain on Sale, Restructuring and Other Summary						
	Gain on sale of pharma-ceuticals business	Pharma-ceuticals restructuring actions	Overhead reduction actions	Business specific actions	Total restruc-turing actions	Other	Total
Cost of sales	$ —	$ 32	$ 24	$ 74	$ 130	$ 13	$ 143
Selling, general and administrative expenses	—	66	81	51	198	40	238
Research, development and related expenses	—	68	7	—	75	95	170
Gain on sale of businesses	(1,074)	—	—	—	—	—	(1,074)
Total operating income penalty (benefit)	$ (1,074)	$ 166	$ 112	$ 125	$ 403	$ 148	$ (523)

Cost of Sales:

Cost of sales includes manufacturing, engineering and freight costs. Cost of sales as a percent of net sales increased 1.0 percentage point in 2007 compared to 2006, with this increase primarily due to the sale of the branded pharmaceuticals business, which had lower than average cost of sales. Raw material costs increased approximately 1% in 2007, compared with 2006. In 2007, restructuring and other exit costs increased cost of sales by $64 million, or 0.3 percentage points. These charges primarily related to the consolidation of certain flexible circuit manufacturing operations, the phase-out of operations at the Company's New Jersey roofing granule facility and charges related to the Company's decision to close an Electro and Communications facility in Wisconsin. In 2006, restructuring and other items increased cost of sales by $143 million, or 0.7 percentage points.

Cost of sales increased 1.9 percentage points in 2006. Approximately 1.2 percentage points of this increase related to numerous items, such as higher raw material costs, slightly lower selling prices, and higher costs associated with scaling up additional manufacturing capacity. In addition, there were supply chain inefficiencies caused by capacity-constraints. Finally, 3M accelerated the pace of acquisitions in 2006, which increased cost of sales slightly for the year. Broad-based sales volume growth and productivity gains helped offset some of this impact. Raw material costs increased approximately 3% for 2006, compared with 2005.

Selling, General and Administrative Expenses:

Selling, general and administrative (SG&A) expenses as a percent of net sales decreased 1.6 percentage points in 2007 when compared to 2006, as expenses incurred in 2006 in the Company's now-divested global branded Pharmaceuticals business did not repeat in 2007. Non-pharmaceutical ongoing SG&A expenses, after adjusting for the following items, were up approximately 7% in dollars, reflecting the Company's continued investment in sales and marketing to support growth markets. In 2007, SG&A includes increases in environmental liabilities, restructuring charges and other exit activities, net of the gain on sale of real estate ($108 million combined net expense), which increased SG&A as a percent of sales by 0.4 percentage points. 2006 included restructuring actions and settlement costs of a previously disclosed antitrust class action ($238 million combined expense), which increased 2006 SG&A as a percent of sales by 1.0 percentage points. In dollars, SG&A decreased $51 million when comparing 2007 to 2006, with the change in restructuring and other items year-on-year decreasing SG&A by $130 million, pharmaceutical SG&A spending decreasing $241 million and other SG&A spending increasing $320 million, or approximately 7% in dollars. The Company continues to constrain administrative costs.

SG&A expenses as a percentage of net sales increased 0.2 of a percentage point in 2006 when compared to 2005. In dollars, SG&A increased $435 million, with restructuring and other items increasing SG&A by $238 million and other spending increasing SG&A by $197 million. 3M continues to invest in growth-oriented SG&A as sales and marketing costs increased faster than sales, while administrative expenses remained relatively flat in dollars, attributable to ongoing cost-control efforts.

Research, Development and Related Expenses:

Research, development and related expenses (R&D) as a percent of net sales decreased 1.0 percentage point in 2007 when compared to 2006, as expenses incurred in 2006 in the Company's now-divested R&D-intensive Pharmaceuticals business did not repeat in 2007. Non-pharmaceutical ongoing R&D expenses, after adjusting for the following items, were up approximately 11% in dollars, as the Company continued to aggressively invest in future technologies and growth opportunities. 2006 spending included a $95 million in-process research and development charge (discussed in Note 2) and $75 million in restructuring actions (Note 4), which increased 2006 R&D as a percent of sales by 0.7 percentage points. In dollars, R&D spending decreased $154 million when comparing 2007 to 2006, with the change in restructuring and other items year-on-year decreasing R&D by $174 million, 2006 pharmaceutical SG&A spending decreasing $120 million and other R&D spending increasing $140 million, or approximately 11% in dollars, reflecting 3M's continuing commitment to fund future growth for the Company.

R&D increased as a percent of sales by 0.6 of a percentage point, or $248 million, when comparing 2006 to 2005. The 2006 spending included a $95 million in-process research and development charge (discussed in Note 2) and $75 million in restructuring actions (Note 4). Other spending increased approximately $78 million, representing an increase of approximately 6% compared with 2005.

Gain on Sale of Businesses:

In January 2007, 3M completed the sale of its global branded pharmaceuticals business in Europe to Meda AB. 3M received proceeds of $817 million for this transaction and recognized, net of assets sold, a pre-tax gain of $781 million in 2007 (recorded in the Health Care segment). In June 2007, 3M completed the sale of its Opticom Priority Control Systems and Canoga Traffic Detection businesses to TorQuest Partners Inc., a Toronto-based investment firm. 3M received proceeds of $80 million for this transaction and recognized, net of assets sold, transaction and other costs, a pre-tax gain of $68 million (recorded in the Display and Graphics segment) in 2007.

In December 2006, 3M completed the sale of its global branded pharmaceuticals businesses in the United States, Canada, and Latin America region and the Asia Pacific region, including Australia and South Africa. 3M received proceeds of $1.209 billion for these transactions and recognized a pre-tax gain on sale of $1.074 billion in 2006 (recorded in the Health Care segment). For more detail, refer to Note 2.

Operating Income:

3M uses operating income as one of its primary business segment performance measurement tools. Operating income margins over the past several years have been in excess of 22%, helped by solid sales growth and an ongoing strong commitment to maintaining operational discipline throughout 3M's global operations. Operating income margins of 25.3% in 2007 were positively impacted by 2.8 percentage points ($681 million) from the gain on sale of businesses and real estate, net of environmental liabilities, restructuring and other exit activities. Operating income margins of 24.8% for 2006 were positively impacted by 2.2 percentage points ($523 million) from the gain on sale of portions of the pharmaceuticals business, net of restructuring and other actions. Adjusting for the preceding items, operating income margins in 2007 were similar to 2006.

Interest Expense and Income:

(Millions)	2007	2006	2005
Interest expense	$ 210	$ 122	$ 82
Interest income	(132)	(51)	(56)
Total	$ 78	$ 71	$ 26

Interest Expense: Interest expense increased year-on-year in both 2007 and 2006, primarily due to higher average debt balances and higher interest rates.

Interest Income: Interest income increased in 2007 due to higher average cash, cash equivalent and marketable securities balances and higher interest rates. Interest income was lower in 2006, with lower average cash, cash equivalent and marketable securities balances partially offset by higher interest rates.

Provision for Income Taxes:

(Percent of pre-tax income)	2007	2006	2005
Effective tax rate	32.1%	30.6%	33.7%

The effective tax rate for 2007 was 32.1%, compared with 30.6% in 2006. The Company's 2007 tax rate benefited from reduced international tax rates and an increased benefit for the domestic manufacturer's deduction, but was penalized by the elimination of the foreign export sales benefit. The Company's 2006 tax rate included benefits from adjustments to its reserves for tax contingencies following the settlement of income tax audits. Refer to Note 8 for additional information.

The tax rate for 2006 was 30.6%, compared with 33.7% in 2005. As discussed above, the Company's 2006 tax rate included benefits from adjustments to its reserves for tax contingencies. In 2005, the Company repatriated approximately $1.7 billion of foreign earnings under the American Jobs Creation Act of 2004 (Jobs Act). The Jobs Act provided 3M the opportunity to tax-effectively repatriate foreign earnings for U.S. qualifying investments specified by 3M's domestic reinvestment plan. As a consequence, in the second quarter of 2005, 3M recorded a tax expense of $75 million, net of available foreign tax credits, which negatively impacted the 2005 effective worldwide tax rate by 1.6%. No similar repatriation occurred in 2006 since this Jobs Act provision only applied to 2005.

Minority Interest:

(Millions)	2007	2006	2005
Minority interest	$ 55	$ 51	$ 55

Minority interest expense eliminates the income or loss attributable to non-3M ownership interests in 3M consolidated entities. 3M's most significant consolidated entity with non-3M ownership interests is Sumitomo 3M Limited in Japan (3M owns 75% of Sumitomo 3M Limited).

Cumulative Effect of Accounting Change:

As of December 31, 2005, the Company adopted FASB Interpretation No. 47, "Accounting for Conditional Asset Retirement Obligations" (FIN 47). This accounting standard applies to the fair value of a liability for an asset retirement obligation associated with the retirement of tangible long-lived assets and where the liability can be reasonably estimated. Conditional asset retirement obligations exist for certain of the Company's long-term assets. The fair value of these obligations is recorded as liabilities on a discounted basis. Over time the liabilities are accreted for the change in the present value and the initial capitalized costs are depreciated over the useful lives of the related assets. The adoption of FIN 47 resulted in the recognition of an asset retirement obligation liability of $59 million at December 31, 2005 and an after-tax charge of $35 million for 2005, which was reflected as a cumulative change in accounting principle in the Consolidated Statement of Income. At December 31, 2007, the asset retirement obligation liability was $59 million.

Currency Effects:

3M estimates that year-on-year currency effects, including hedging impacts, increased net income by approximately $150 million in 2007, $20 million in 2006 and $115 million in 2005. This estimate includes the effect of translating profits from local currencies into U.S. dollars; the impact of currency fluctuations on the transfer of goods between 3M operations in the United States and abroad; and transaction gains and losses, including derivative instruments designed to reduce foreign currency exchange rate risks. 3M estimates that year-on-year derivative and other transaction gains and losses increased net income by approximately $10 million in 2007, had an immaterial impact on net income in 2006, and increased net income by approximately $50 million in 2005.

PERFORMANCE BY BUSINESS SEGMENT

Disclosures relating to 3M's business segments are provided in Item 1, Business Segments. Financial information and other disclosures are provided in the Notes to the Consolidated Financial Statements. As discussed in Note 16 to the Consolidated Financial Statements, effective in the first quarter of 2007, 3M made certain product moves between its business segments in its continuing effort to drive growth by aligning businesses around markets and customers. Segment information presented herein reflects the impact of these changes for all periods presented. The reportable segments are the Health Care segment, Industrial and Transportation segment, Display and Graphics segment, Consumer and Office segment, Safety, Security and Protection Services segment, and Electro and Communications segment. Information related to 3M's business segments is presented in the tables that follow. Local-currency sales (which include both core and acquisition volume impacts, plus price impacts) are provided for each segment. The divestiture impact, translation impact and total sales change are also provided for each segment.

As discussed in Note 1, effective January 1, 2006, 3M adopted Statement of Financial Accounting Standards No. 123 (revised 2004), "Share-Based Payment" (SFAS No. 123R), which required 3M to expense stock-based compensation. The Company adopted SFAS No. 123R using the modified retrospective method. Effective January 1, 2006, all prior periods were revised to give effect to the fair-value-based method of accounting for awards granted in fiscal years beginning on or after January 1, 1995. For additional discussion, refer to Note 15. Stock-based compensation expense for the years ended December 31, 2007, 2006 and 2005 is summarized by business segment in the table that follows.

Stock-based compensation expense

	Years ended December 31		
(Millions)	2007	2006	2005
Industrial and Transportation	$ 58	$ 50	$ 46
Health Care	40	42	35
Display and Graphics	33	27	19
Consumer and Office	24	24	21
Safety, Security and Protection Services	23	21	16
Electro and Communications	21	21	18
Corporate and Unallocated	29	15	—
Total Company	$ 228	$ 200	$ 155

As discussed in the preceding overview section, the combination of the 2007 gain on sale of businesses and real estate, net of environmental liability charges, restructuring and other exit activities benefited 2007 operating income by $681 million, or 2.8% of net sales. The 2006 gain on sale of businesses, net of restructuring and other items benefited 2006 operating income by $523 million, or 2.2% of net sales. The following tables summarize these items by business segment. In 2006, items included in the "Other" category of the table are acquired in-process research and development expenses ($95 million), settlement costs of a previously disclosed antitrust class action ($40 million), and environmental obligations related to the pharmaceuticals business ($13 million).

	2007 Gain on Sale, Restructuring and Other Summary				
(Millions)	Gain on sale of businesses	Environ-mental liabilities	Restructuring and other exit activities	Gain on sale of real estate	Total
Industrial and Transportation	$ —	$ —	$ 9	$ —	$ 9
Health Care:					
Gain on sale of pharmaceuticals business	(781)	—	—	—	(781)
Restructuring actions and other	—	—	(10)	—	(10)
Display and Graphics	(68)	—	17	—	(51)
Consumer and Office	—	—	—	—	—
Safety, Security and Protection Services	—	—	29	—	29
Electro and Communications	—	—	41	—	41
Corporate and Unallocated	—	134	—	(52)	82
Total operating income penalty (benefit)	$ (849)	$ 134	$ 86	$ (52)	$ (681)

(Millions)	Gain on sale of pharma-ceuticals business	Pharma-ceuticals restructuring actions	Over-head reduction actions	Busi-ness specific actions	Total restruc-turing actions	Other	Total
	2006 Gain on Sale, Restructuring and Other Summary						
Industrial and Transportation	$ —	$ —	$ —	$ 15	$ 15	$ —	$ 15
Health Care:							
Gain on sale of pharmaceuticals business	(1,074)	—	—	—	—	—	(1,074)
Restructuring actions and other	—	166	112	15	293	108	401
Display and Graphics	—	—	—	39	39	—	39
Consumer and Office	—	—	—	—	—	—	—
Safety, Security and Protection Services	—	—	—	10	10	—	10
Electro and Communications	—	—	—	46	46	—	46
Corporate and Unallocated	—	—	—	—	—	40	40
Total operating income penalty (benefit)	$ (1,074)	$ 166	$ 112	$ 125	$ 403	$ 148	$ (523)

Industrial and Transportation Business (29.7% of consolidated sales):

	2007	2006	2005
Sales (millions)	$ 7,274	$ 6,640	$ 6,047
Sales change analysis:			
Local currency (volume and price)	5.8%	9.0%	6.4%
Translation	3.8	0.8	1.2
Total sales change	9.6%	9.8%	7.6%
Operating income (millions)	$ 1,501	$ 1,342	$ 1,210
Percent change	11.8%	11.0%	16.7%
Percent of sales	20.6%	20.2%	20.0%

The Industrial and Transportation segment serves a broad range of markets, such as appliance, paper and packaging, food and beverage, and automotive. Industrial and Transportation products include tapes, a wide variety of coated and non-woven abrasives, adhesives, specialty materials, filtration products, closures for disposable diapers, and components and products that are used in the manufacture, repair and maintenance of automotive, marine, aircraft and specialty vehicles. The August 2005 acquisition of CUNO added a comprehensive line of filtration products for the separation, clarification and purification of fluids and gases.

In 2007, local-currency sales increased 5.8%, including 1.8% growth from acquisitions. During the fourth quarter of 2007, this segment added four complementary gap-filling acquisitions, bringing total completed acquisitions for the year to seven. In combination with focused investments in research and development, these acquisitions will help strengthen the core tapes, adhesives and abrasives platforms for many years to come. Sales growth was broad-based, led by industrial adhesives and tapes, automotive aftermarket, abrasives and automotive OEM businesses. All geographic areas contributed positively to growth. Significant manufacturing investments were made in emerging economies such as India, China and Poland to simplify the supply chain and get closer to local customers. Good operational discipline helped deliver operating income growth of 11.8%, with operating income margins of 20.6%. Operating income included $9 million in restructuring and other exit activity expenses, primarily comprised of severance and related benefits.

In 2006, local-currency sales grew 9.0%, including 4.6% growth from acquisitions, primarily related to the August 2005 acquisition of CUNO. Since CUNO was acquired in early August 2005 and is thus considered part of organic growth effective in August 2006, the acquisition benefit reflected in 2006 only reflects the months from January 2006 through July 2006. The industrial adhesives and tapes business, along with the automotive aftermarket business, which sells products to body shops for vehicle repairs, led organic sales growth in 2006. 3M also posted good sales growth in its abrasives business and its energy and advanced materials business. Growth in the automotive OEM business was impacted by softness in the U.S. domestic automotive industry. Geographically, local-currency sales growth in dollars was strongest in the Asia Pacific and Europe areas. Operating income increased 11.0% to $1.342 billion in 2006.

Operating income included $15 million in restructuring expenses, primarily comprised of asset impairments and severance and related benefits, which negatively impacted operating income growth by 1.2%.

In March 2005, 3M's automotive business completed the purchase of 19% of TI&M Beteiligungsgesellschaft mbH (TI&M) for approximately $55 million. TI&M is the parent company of I&T Innovation Technology Entwicklungs- und Holding Aktiengesellschaft (I&T), an Austrian maker of flat flexible cable and circuitry. Pursuant to a Shareholders Agreement, 3M marketed the firm's flat flexible wiring systems for automotive interior applications to the global automotive market. I&T filed a petition for bankruptcy protection in August 2006. As part of its agreement to purchase the shares of TI&M, the Company was granted a put option, which gave the Company the right to sell back its entire ownership interest in TI&M to the other investors from whom 3M acquired its 19% interest. The put option became exercisable January 1, 2007. The Company exercised the put option and recovered approximately $25 million of its investment from one of the investors based in Belgium in February 2007. The other two TI&M investors have filed a bankruptcy petition in Austria. The Company is pursuing recovery of the balance of its investment both through the Austrian bankruptcy proceedings and pursuant to the terms of the Share Purchase Agreement. The Company believes collection of its remaining investment is probable and, as a result, no impairment reserve has been recorded.

Health Care Business (16.2% of consolidated sales):

	2007	2006	2005
Sales (millions)	$ 3,968	$ 4,011	$ 3,760
Sales change analysis:			
Local currency (volume and price)	18.3%	6.0%	4.2%
Divestitures	(23.7)	—	—
Translation	4.3	0.7	0.4
Total sales change	(1.1)%	6.7%	4.6%
Operating income (millions)	$ 1,882	$ 1,845	$ 1,114
Percent change	2.0%	65.6%	14.6%
Percent of sales	47.4%	46.0%	29.6%

The Health Care segment serves markets that include medical, clinics and hospitals, pharmaceuticals, dental and orthodontic practitioners, and health information systems. Products and services provided to these and other markets include medical and surgical supplies, skin health and infection prevention products, drug delivery systems, dental and orthodontic products, health information systems and microbiology solutions. As discussed in Note 2, the global branded pharmaceuticals business was sold in December 2006 and January 2007.

In 2007, Health Care sales were $3.968 billion. Local-currency growth was 18.3% (excluding divestitures), including 4.4 percentage points of growth from acquisitions and 4.5 percentage points of growth from supply agreements related to the sale of the global branded pharmaceuticals business. The sale of the pharmaceuticals business reduced Health Care sales growth by 23.7%. 3M provides disaggregated information on sales growth for Health Care's remaining businesses (without pharmaceuticals) further below.

The combination of the following items positively impacted total year 2007 Health Care operating income by $791 million. As discussed in Note 2, in January 2007 the Company sold its branded pharmaceuticals business in the Europe region. The operating income gain related to this sale, which is included in Health Care, totaled $781 million. In addition, as discussed in Note 4, a net operating income gain of $10 million was recorded in 2007, which primarily related to adjustments to restructuring costs incurred in the fourth quarter of 2006.

In 2006, Health Care sales were $4.011 billion. Organic local-currency growth was 5.3%, with acquisitions adding an additional 0.7% of growth. Local-currency growth was led by the medical supplies and dental businesses. 3M's pharmaceutical business was approximately 19% of Health Care sales in 2006. Pharmaceutical local-currency sales declined 3.5% in 2006, while the remaining businesses' 2006 local-currency sales growth increased 8.5%. Geographically, Health Care's local-currency sales growth was strongest in the United States, Europe and Asia Pacific areas. Operating income for 2006 was up 65.6%, impacted by the gain on sale of 3M's branded pharmaceuticals business, restructuring impacts and other items as discussed in the following paragraph, which positively impacted operating income growth by 60.4%.

The combination of the following items positively impacted total year 2006 Health Care operating income by $673 million, primarily in the fourth quarter of 2006. As discussed in Note 2, in early December 2006, the Company sold its branded pharmaceuticals business in the Asia Pacific region, including Australia and South Africa. The Company also sold its branded pharmaceuticals business in the United States, Canada and Latin America in late December 2006. The

operating income gain related to this sale, which is included in Health Care, totaled $1.074 billion. In addition, as discussed in Note 4, the Health Care segment for the year 2006 included $293 million in restructuring costs, primarily employee–related severance and benefit costs. Of the $293 million, $166 million was related to the pharmaceuticals business and $15 million related to Health Care severance and other costs. In addition, $112 million of severance and benefit costs were recorded in the fourth quarter of 2006 related to worldwide staff overhead reduction actions taken to streamline the Company's cost structure in response to the sale of 3M's branded pharmaceuticals business. Health Care also included $95 million of expensed in–process research and development costs related to the Brontes acquisition and $13 million in environmental reserves related to the pharmaceuticals business.

3M believes the following disaggregated information for 3M Health Care's remaining businesses (without pharmaceuticals) and for pharmaceuticals on a stand–alone basis provides useful information.

Health Care Business without Pharmaceuticals:

	2007	2006	2005
Sales (millions)	$ 3,968	$ 3,237	$ 2,963
Sales change analysis:			
Local currency (volume and price)	18.3%	8.5%	5.3%
Translation	4.3	0.7	0.4
Total sales change	22.6%	9.2%	5.7%
Operating income (millions)	$ 1,086	$ 806	$ 888
Percent change	34.6%	(9.1)%	14.0%
Percent of sales	27.4%	24.9%	30.0%

The following discussion provides information on 3M Health Care's remaining businesses (without pharmaceuticals).

In 2007, sales growth was broad–based across all platforms, led by infection prevention solutions and skin and wound care therapy products in medical, HFA–based components (non–CFC) for drug inhalers in drug delivery, and healthcare funding and performance management solutions for the hospital market in health information systems. Geographically, Health Care (without pharmaceuticals) achieved strong growth rates in all major regions, led by Europe, the United States, and the combined Latin America and Canada area. Local–currency sales increased 18.3%, with acquisitions contributing 4.4 percentage points of this growth. Much of the acquisition growth came from two deals that closed in late 2006 — Biotrace International, PLC, a U.K.–based provider of microbiology products, and SoftMed, a Maryland–based provider of health information software solutions. Health Care also closed five complementary acquisitions in 2007 to strengthen the portfolio and accelerate growth into the future in the medical, oral care and health information systems businesses. Sales growth also included 4.5 percentage points of growth due to supply agreements related to the sale of the global branded pharmaceuticals business. Operating income increased 34.6%, with an operating income margin of 27.4%. Operating income for 2007 included $5 million in restructuring expenses, primarily severance and related benefits.

In 2006, sales were $3.237 billion. Organic local–currency growth was 7.4%, with acquisitions adding an additional 1.1% of growth. Local–currency growth was led by the medical supplies and dental businesses. Geographically, local–currency sales growth was strongest in the United States, Europe and Asia Pacific areas. Operating income for 2006 included $95 million of expensed in–process research and development costs related to the Brontes acquisition and also included business–specific restructuring actions that totaled $15 million, primarily comprised of severance and related benefits plus asset impairments. Including this combined operating income penalty of $110 million, or 12.4 percentage point negative impact on operating income growth, 2006 operating income decreased 9.1%.

Pharmaceuticals Business:

	2007	2006	2005
Sales (millions)	$ —	$ 774	$ 797
Sales change analysis:			
Local currency (volume and price)	N/A	(3.5)%	0.3%
Translation	N/A	0.6	0.3
Total sales change	N/A	(2.9)%	0.6%
Operating income (millions)	$ 796	$ 1,039	$ 226
Percent change	N/A	N/A	16.6%
Percent of sales	N/A	N/A	28.4%

The combination of the following items positively impacted total year 2007 pharmaceuticals operating income by $796 million. As discussed in Note 2, in January 2007 the Company sold its branded pharmaceuticals business in the Europe region. The operating income gain related to this sale totaled $781 million. In addition, as discussed in Note 4, a net operating income gain of $15 million was recorded in 2007, which primarily related to adjustments to restructuring costs incurred in the fourth quarter of 2006. Drug Delivery Systems Division (part of Health Care without Pharmaceuticals) is a source of supply to the acquiring companies and records sales and operating income related to the pharmaceuticals supply agreements.

In total, the combination of the following items positively impacted total year 2006 pharmaceuticals operating income by $783 million, primarily in the fourth quarter of 2006. As discussed in Note 2, in early December 2006, the Company sold its branded pharmaceuticals business in the Asia Pacific region, including Australia and South Africa. The Company also sold its branded pharmaceuticals business in the United States, Canada and Latin America in late December 2006. The operating income gain related to these transactions totaled $1.074 billion. As discussed in Note 4, $112 million of severance and benefit costs were recorded in the fourth quarter of 2006 related to worldwide staff overhead reduction actions taken to streamline the Company's cost structure in response to the sale of 3M's branded pharmaceuticals business. As also discussed in Note 4, the pharmaceuticals business for total year 2006 included $97 million in employee–related severance and benefits and $69 million of asset impairments and other expenses. In addition, an environmental reserve of $13 million was recognized related to the pharmaceuticals business.

Display and Graphics Business (15.9% of consolidated sales):

	2007	2006	2005
Sales (millions)	$ 3,892	$ 3,770	$ 3,547
Sales change analysis:			
Local currency (volume and price)	1.8%	6.0%	4.6%
Divestitures	(0.4)	—	—
Translation	1.8	0.3	0.2
Total sales change	3.2%	6.3%	4.8%
Operating income (millions)	$ 1,174	$ 1,044	$ 1,148
Percent change	12.4%	(9.0)%	2.9%
Percent of sales	30.2%	27.7%	32.4%

The Display and Graphics segment serves markets that include electronic display, touch screen, traffic safety and commercial graphics. This segment includes optical film and lens solutions for electronic displays; touch screens and touch monitors; computer screen filters; reflective sheeting for transportation safety; and commercial graphics systems. The optical film business provides films that serve numerous market segments of the electronic display industry. 3M provides distinct products for five market segments, including products for: 1) LCD computer monitors 2) LCD televisions 3) handheld devices such as cellular phones 4) notebook PCs and 5) automotive displays. The optical business includes a number of different products that are protected by various patents and groups of patents. The remaining lifetimes of such patents, as well as patents protecting future products, range from less than a few years to more than 10 years. These patents provide varying measures of exclusivity to 3M for a number of such products. 3M's proprietary manufacturing technology and know–how also provide a competitive advantage to 3M with respect to some of these products.

In 2007, Display and Graphics local-currency sales increased 1.8%, excluding the impact of the Opticom/Canoga business sale. The Company recorded positive sales growth in all major businesses — commercial graphics, traffic safety systems and optical systems. Throughout the year, commercial graphics saw strong performance in the vehicle wrapping market where 3M provides films, inks and other products for this "rolling billboard" industry. The traffic safety systems business also experienced growth for the year, with faster growth internationally as the 3M reflective solutions for highway construction projects are a perfect match in developing economies that are adding infrastructure. In June 2007, 3M completed the sale of its Opticom Priority Control Systems and Canoga Traffic Detection businesses. 3M received proceeds of $80 million from this transaction and recognized an operating income gain of $68 million in the Display and Graphics segment in the second quarter of 2007. In addition, Display and Graphics recorded restructuring and other exit activity expenses of $17 million in 2007. Operating income in 2007 was $1.174 billion, including this aggregate net operating income benefit of $51 million, which contributed 1.3 percentage points of the 30.2% operating income margin. Operating income in 2006 (as discussed below) included $39 million in restructuring expenses. These year-on-year impacts contributed 8.7 percentage points of the reported 12.4% operating income growth.

Optical systems continues to focus on market segmentation, with strong penetration in handhelds, computer displays and LCD televisions. 3M continues to experience attachment rate pressure in LCD desktop monitors and LCD TV segments, although in the fourth quarter of 2007 3M saw a mix-shift back to 1080p LCD TV's from 720p, which impacts 3M business as 3M films are used more heavily in the 1080p sets. 3M believes over the long term that 1080p LCD TV's will gain an increasing share of the overall LCD TV market. While 3M remains optimistic about the longer-term prospects for the optical film business, continuing price and attachment rate pressure is expected in 2008. Due to this pressure, 3M expects Display and Graphics operating income margins in 2008 to decline a few percentage points when compared to 2007 (excluding the net operating income benefit of 1.3 percentage points in 2007 discussed in the preceding paragraph). 3M's continued investment in this business has led to a solid stream of new products. 3M's brightness enhancement films provide an environmental solution through reduced energy consumption — an increasingly important requirement from both retail customers and government units. 3M has made significant sustainable factory improvements by relentlessly reducing costs and by adding needed capacity to secure future growth.

In 2006, the Display and Graphics business posted local-currency sales growth of 6.0%. Optical film sales volumes increased at double-digit rates in 2006. 3M saw an acceleration in the LCD industry due to strong consumer demand for LCD TV's, which drove record sales of 3M's proprietary optical films, despite ongoing downward pricing pressure in these consumer electronic applications. Commercial Graphics, a supplier of large-format graphics solutions that cut across a range of industries, delivered strong double-digit local-currency growth in 2006. Traffic Safety Systems also posted solid local-currency growth. Operating income declined by 9.0%. Operating income included $39 million in restructuring expenses, primarily comprised of asset impairments and severance and related benefits, which negatively impacted operating income growth by 3.4%. These asset impairments relate to decisions the Company made in the fourth quarter of 2006 to exit certain marginal product lines in the Touch Systems and Optical Systems businesses. In optical film, selling price declines, the sales mix shift towards larger LCD displays, and operational challenges related to the Company's new optical film manufacturing production line penalized operating income in 2006.

Consumer and Office Business (13.9% of consolidated sales):

	2007	2006	2005
Sales (millions)	$ 3,403	$ 3,164	$ 2,926
Sales change analysis:			
Local currency (volume and price)	5.0%	7.4%	6.1%
Translation	2.6	0.7	1.0
Total sales change	7.6%	8.1%	7.1%
Operating income (millions)	$ 688	$ 629	$ 609
Percent change	9.3%	3.4%	9.4%
Percent of sales	20.2%	19.9%	20.8%

The Consumer and Office segment serves markets that include consumer retail, office retail, home improvement, building maintenance and other markets. Products in this segment include office supply products, stationery products, construction and home improvement products, home care products, protective material products and consumer health care products.

In 2007, Consumer and Office experienced broad-based local-currency sales growth of 5.0%, led by the construction and home improvement and home cleaning businesses. In construction and home improvement, products such as Scotch™ Blue Painter's Tape, Filtrete™ home furnace filters and Command™ mounting and fastening products, helped drive results. Geographically, international growth is gaining traction, while a slowdown in the United States was driven by soft

overall U.S. retail sales and a soft residential housing environment. Approximately 60% of global sales for this segment are in the United States. Operating income increased 9.3% and now exceeds 20% of sales.

In 2006, Consumer and Office local-currency sales growth of 7.4% was broad-based across the portfolio, led by the construction and home improvement division, which serves the do-it-yourself retail channel. 3M also posted very good sales growth in the mass retail channel and continued to penetrate large key accounts, primarily in the United States, with an array of unique, highly functional products featuring customer-inspired designs. Operating income was $629 million, up 3.4% year on year. 3M experienced slower sales growth in the construction and home improvement market in the fourth quarter of 2006, impacted by a housing slowdown in the United States.

Safety, Security and Protection Services Business (12.6% of consolidated sales):

	2007	2006	2005
Sales (millions)	$ 3,070	$ 2,663	$ 2,320
Sales change analysis:			
Local currency (volume and price)	10.8%	13.7%	6.8%
Translation	4.5	1.1	1.0
Total sales change	15.3%	14.8%	7.8%
Operating income (millions)	$ 611	$ 549	$ 513
Percent change	11.3%	7.1%	14.3%
Percent of sales	19.9%	20.6%	22.1%

The Safety, Security and Protection Services segment serves a broad range of markets that increase the safety, security and productivity of workers, facilities and systems. Major product offerings include personal protection products, safety and security products, energy control products, cleaning and protection products for commercial establishments, roofing granules for asphalt shingles, and supply chain execution software solutions. In August 2006, 3M completed the acquisition of Security Printing and Systems Limited, a producer of finished, personalized passports and secure cards, which expands the 3M product line related to border and civil security solutions. 3M's new emerging business opportunity in its Track and Trace initiative within 3M's Safety, Security and Protection Services segment resulted in the merging of a number of formerly separate efforts into one concerted effort for future growth. Track and Trace has a growing array of applications — from tracking packages to managing medical and legal records.

In 2007, local-currency sales in the Safety, Security and Protection Services segment were up 10.8%. Acquisitions contributed 7.4 percentage points of this growth, including a carry-over benefit from the August 2006 acquisition of Security Printing and Systems Limited. In addition, during 2007 3M closed two small, but strategic, gap-filling acquisitions. These included E. Wood, a U.K.-based provider of corrosion protection products and Rochford Thompson, a manufacturer of optical character recognition passport readers used by airlines and immigration authorities. Sales growth was led by the respiratory protection business, followed by the security systems, corrosion protection and building and commercial services businesses. 2007 sales growth was held back by market softness in the U.S. residential construction market, which negatively impacted the roofing granules business. The decline in the roofing granules business reduced Safety, Security and Protection Services 2007 sales growth by approximately 1.5%. Geographically, sales growth was led by Europe and the combined Latin America and Canada area. This segment recorded a restructuring charge of $29 million in the second quarter of 2007 related to the phase-out of operations at its New Jersey roofing granule facility. This included fixed asset impairments and employee-related restructuring liabilities. Including this charge, operating income margins were approximately 20% for total year 2007.

In 2006, local-currency sales in the Safety, Security and Protection Services business were up 13.7%. Growth in the business was driven by strong global demand for personal safety products, especially respiratory protection. Acquisitions contributed 4.1% of growth, primarily due to the Security Printing and Systems Limited acquisition in August 2006. 3M continued to invest in additional respirator capacity, such as a new respirator manufacturing facility in Korea, which will serve the Asia Pacific region. 3M also posted outstanding growth in corrosion protection, a smaller but growing business, which supplies coatings for all types of commercial and industrial applications in a variety of industries. 3M's roofing granules business experienced a challenging fourth quarter, with a sales decline of nearly 50%, resulting in sales in this business declining nearly 10% when comparing total year 2006 with 2005. Geographically, local-currency growth was positive across all regions of the world, led by Europe and the United States. Operating income increased 7.1% to $549 million in 2006. Operating income includes $10 million in restructuring expenses, primarily severance and related benefits, which negatively impacted operating income growth by 1.9%.

Electro and Communications Business (11.3% of consolidated sales):

	2007	2006	2005
Sales (millions)	$ 2,775	$ 2,631	$ 2,509
Sales change analysis:			
Local currency (volume and price)	2.3%	4.0%	1.5%
Translation	3.2	0.8	0.7
Total sales change	5.5%	4.8%	2.2%
Operating income (millions)	$ 481	$ 411	$ 422
Percent change	17.0%	(2.6)%	40.7%
Percent of sales	17.3%	15.6%	16.8%

The Electro and Communications segment serves the electrical, electronics and communications industries, including electrical utilities; electrical construction, maintenance and repair; OEM electrical and electronics; computers and peripherals; consumer electronics; telecommunications central office, outside plant and enterprise; as well as aerospace, military, automotive and medical markets; with products that enable the efficient transmission of electrical power and speed the delivery of information and ideas. Products include electronic and interconnect solutions, micro interconnect systems, high–performance fluids, high–temperature and display tapes, telecommunications products, electrical products, and visual systems products.

In 2007, the Electro and Communications segment local–currency sales increased 2.3%, including 1.5 percentage points from acquisitions. Strong sales growth in the communications and electrical markets businesses was partially offset by the flexible circuits business, which supplies components primarily to the ink jet printer market. This business continues to penalize segment results as the ink jet market has become commoditized and as a number of applications go end–of–life. Softness in this business held back overall Electro and Communications sales and operating income growth by 2.5 percent and 9.3 percent, respectively. Operating income increased 17% as this segment has driven productivity improvements and taken actions to improve its competitiveness. Operating income in 2007 was penalized by a $23 million charge related to consolidating its global flexible circuits manufacturing operations and $18 million in restructuring expenses, primarily for asset impairment charges related to the Company's decision to close a facility in Wisconsin. Combined, these two items negatively impacted 2007 operating income by $41 million and operating income margins by 1.5 percentage points.

In 2006, the Electro and Communications business organic local–currency growth of 2.7% was attributable to the electrical and electronics markets. Acquisitions contributed 1.3 percentage points to sales growth. 3M generated good top–line growth in its electrical markets division, which sells a number of insulating, testing and connecting products and solutions to both power utilities and manufacturing OEMs. 3M saw good growth from its electronics markets business, driven by double–digit growth in its semi–conductor and assemblies business. Partially offsetting this was some sales softness in 3M's U.S. communications markets business due to higher copper costs and a decline in 3M's visual systems business, which traditionally offered analog overhead and electronic projectors and film. Operating income declined by 2.6% to $411 million. Operating income included $46 million in restructuring expenses, primarily comprised of asset impairments and severance and related benefits, which negatively impacted operating income growth by 10.9%. Operating margins were impacted by rising raw material costs, specifically copper costs, in 3M's electrical and telecommunications markets businesses.

PERFORMANCE BY GEOGRAPHIC AREA

Financial information related to 3M operations in various geographic areas is provided in Note 17. Operating income results by geographic area were significantly impacted by the gain on sale businesses and other items as discussed in Note A at the end of the preceding overview section. A summary of key information and discussion related to 3M's geographic areas follow:

Geographic Area Net Sales and Operating Income (Dollars in millions)	2007			2007 vs. 2006 % Change				
	Sales	% of Total	Oper. Income	Local Currency	Divesti-tures	Trans-lation	Total Sales Change	Oper. Income
United States	$ 8,987	36.7%	$ 1,692	5.7%	(4.2)%	—	1.5%	(11.3)%
Asia Pacific	6,601	27.0%	2,136	4.9%	(1.3)%	2.0%	5.6%	1.8%
Europe, Middle East and Africa	6,503	26.6%	1,705	11.7%	(6.6)%	8.5%	13.6%	56.1%
Latin America and Canada	2,365	9.7%	665	10.6%	(2.8)%	5.9%	13.7%	5.8%
Other Unallocated	6	—	(5)					
Total Company	$ 24,462	100%	$ 6,193	7.3%	(3.8)%	3.2%	6.7%	8.7%

While 3M manages its businesses globally and believes its business segment results are the most relevant measure of performance, the Company also utilizes geographic area data as a secondary performance measure. Export sales are reported within the geographic area where the final sales to 3M customers are made. A portion of the products or components sold by 3M's operations to its customers are exported by these customers to different geographic areas. As customers move their operations from one geographic area to another, 3M's results will follow. Thus, net sales in a particular geographic area are not indicative of end–user consumption in that geographic area.

U.S. local–currency sales increased 5.7%, with acquisitions contributing 3.1 percentage points. U.S. local–currency sales growth was led by Health Care (without Pharmaceuticals) and Industrial and Transportation, which was partially offset by softness in the electronic solutions business and weakness in a few businesses that are impacted by the slowdown in the U.S. housing, road construction and mass retail markets, primarily roofing granules, protective materials, traffic safety and office supply businesses. Asia Pacific local–currency sales increased 4.9%, with all six business segments contributing to this increase. Sales in Japan totaled approximately $2 billion, with local–currency sales up 2% from 2006. European local–currency sales increased 11.7%, with good growth across all segments, especially Safety, Security and Protection Services and Health Care (without Pharmaceuticals). In the combined Latin America and Canada area, local–currency sales increases of 10.6% were led by Industrial and Transportation; Safety, Security and Protection Services; and Health Care (without Pharmaceuticals). Foreign currency translation positively impacted European area sales by 8.5%, the combined Latin America and Canada area sales by 5.9%, and the Asia Pacific area by 2%, as the U.S. dollar weakened against these currencies. For 2007, international operations represented approximately 63% of 3M's sales.

Since 3M sold its global branded pharmaceuticals business in December 2006 and January 2007, both sales growth and operating income were negatively impacted when comparing 2007 to 2006. Sales in 2006 for pharmaceuticals totaled $332 million in the United States, $315 million in the Europe, Middle East and Africa area, $77 million in the Asia Pacific area, and $50 million in the Latin America and Canada area. In 2007, the gain on sale of businesses and a gain on sale of real estate, net of restructuring and other items, increased worldwide operating income by $681 million, with the largest impact in the Europe, Middle East and Africa area. In 2006, the gain on sale, restructuring and other items increased worldwide operating income by $523 million, with the largest impact in the United States. These items are discussed in more detail in the preceding overview section.

Geographic Area Supplemental Information

(Millions, except Employees)	Employees as of December 31,			Capital Spending			Property, Plant and Equipment — net		
	2007	2006	2005	2007	2006	2005	2007	2006	2005
United States	34,138	34,553	33,033	$ 841	$ 692	$ 532	$ 3,668	$ 3,382	$ 3,291
Asia Pacific	12,970	12,487	11,574	299	252	228	1,116	959	865
Europe, Middle East and Africa	17,675	17,416	16,722	203	134	120	1,308	1,162	1,076
Latin America and Canada	11,456	10,877	9,898	79	90	63	490	404	361
Total Company	76,239	75,333	71,227	$ 1,422	$ 1,168	$ 943	$ 6,582	$ 5,907	$ 5,593

Employment:
Employment increased by approximately 900 people since year–end 2006, with acquisitions adding approximately 2,500 employees, while restructuring and the pharmaceuticals divestiture reduced employment. Employment increased by approximately 4,100 people in 2006 compared with 2005, partially due to acquisitions, with more than 750 people added by 3M's three largest 2006 acquisitions alone. In addition, 3M has increased employees in faster–growing areas of the world, such as Brazil, India, Russia, China and Poland, where on a local–currency basis sales increased more than 15% in both 2007 and 2006.

Capital Spending/Net Property, Plant and Equipment:
The bulk of 3M capital spending historically has been in the United States, resulting in higher net property, plant and equipment balances in the United States. The Company is striving to more closely align its manufacturing and sourcing with geographic market sales, and because approximately 63% of sales are outside the United States, this would increase production outside the United States, helping to improve customer service and reduce working capital requirements. Capital expenditures were $1.422 billion in 2007 and are expected to total $1.3 billion to $1.4 billion in 2008.

CRITICAL ACCOUNTING ESTIMATES

Information regarding significant accounting policies is included in Note 1. As stated in Note 1, the preparation of financial statements requires management to make estimates and assumptions that affect the reported amounts of assets, liabilities, revenue and expenses, and related disclosure of contingent assets and liabilities. Management bases its estimates on historical experience and on various assumptions that are believed to be reasonable under the circumstances, the results of which form the basis for making judgments about the carrying values of assets and liabilities that are not readily apparent from other sources. Actual results may differ from these estimates.

The Company believes its most critical accounting estimates relate to legal proceedings, the Company's pension and postretirement obligations, asset impairments and income taxes. Senior management has discussed the development, selection and disclosure of its critical accounting estimates with the Audit Committee of 3M's Board of Directors.

Legal Proceedings:
The categories of claims for which the Company has estimated its probable liability, the amount of its liability accruals, and the estimates of its related insurance receivables are critical accounting estimates related to legal proceedings. Please refer to the section entitled "Accrued Liabilities and Insurance Receivables Related to Legal Proceedings" (contained in "Legal Proceedings" in Note 13) for additional information about such estimates.

Pension and Postretirement Obligations:
3M has various company–sponsored retirement plans covering substantially all U.S. employees and many employees outside the United States. The Company accounts for its defined benefit pension and postretirement health care and life insurance benefit plans in accordance with Statement of Financial Accounting Standards (SFAS) No. 87, "Employers' Accounting for Pensions," SFAS No. 106, "Employer's Accounting for Postretirement Benefits Other than Pensions," in measuring plan assets and benefit obligations and in determining the amount of net periodic benefit cost, and SFAS No. 158, "Employer's Accounting for Defined Benefit Pension and Other Postretirement Benefit Plans an amendment of FASB Statements No. 87, 88, 106 and 132(R)," which was issued in September 2006 and effective as of December 31, 2006. SFAS No. 158 requires employers to recognize the underfunded or overfunded status of a defined benefit postretirement plan as an asset or liability in its statement of financial position and recognize changes in the funded status in the year in which the changes occur through accumulated other comprehensive income, which is a component of stockholders' equity.

Pension benefits associated with these plans are generally based primarily on each participant's years of service, compensation, and age at retirement or termination. Two critical assumptions, the discount rate and the expected return on plan assets, are important elements of expense and liability measurement. The assumed health care trend rate is the most significant postretirement health care assumption. See Note 11 for additional discussion of actuarial assumptions used in determining pension and postretirement health care liabilities and expenses.

The Company determines the discount rate used to measure plan liabilities as of the December 31 measurement date for the U.S. pension and postretirement benefit plans. The discount rate reflects the current rate at which the associated liabilities could be effectively settled at the end of the year. In estimating this rate, the Company looks at rates of return on fixed-income investments of similar duration to the liabilities in the plan that receive high, investment grade ratings by recognized ratings agencies. Using this methodology, the Company determined a discount rate of 6.00% to be appropriate as of December 31, 2007, which is an increase of 0.25 of a percentage point from the rate used as of December 31, 2006.

A significant element in determining the Company's pension expense in accordance with SFAS No. 87 is the expected return on plan assets, which is based on historical results for similar allocations among asset classes. For the U.S. pension plan, the Company's assumption for the expected return on plan assets was 8.75% for 2007 and will be reduced to 8.50% for 2008. Refer to Note 11 for information on how this rate is determined.

For the year ended December 31, 2007, the Company recognized total consolidated pre-tax pension expense (after settlements, curtailments and special termination benefits) of $190 million, down from $347 million in 2006. Pension expense (before settlements, curtailments and special termination benefits) is anticipated to decrease to approximately $90 million in 2008. For the pension plans, holding all other factors constant, an increase/decrease in the expected long-term rate of return on plan assets of 0.25 of a percentage point would decrease/increase 2008 pension expense by approximately $26 million for U.S. pension plans and approximately $11 million for international pension plans. Also, holding all other factors constant, an increase/decrease in the discount rate used to measure plan liabilities of 0.25 of a percentage point would decrease/increase 2008 pension expense by approximately $32 million for U.S. pension plans and approximately $21 million for international pension plans. See Note 11 for details of the impact of a one percentage point change in assumed health care trend rates on the postretirement health care benefit expense and obligation.

Asset Impairments:
3M net property, plant and equipment totaled $6.6 billion as of December 31, 2007. Management makes estimates and assumptions in preparing the consolidated financial statements for which actual results will emerge over long periods of time. This includes the recoverability of long-lived assets employed in the business, including assets of acquired businesses. These estimates and assumptions are closely monitored by management and periodically adjusted as circumstances warrant. For instance, expected asset lives may be shortened or an impairment recorded based on a change in the expected use of the asset or performance of the related business reporting unit. Impairments recorded in 2007 and 2006 related to restructuring actions and other exit activities are discussed in Note 4.

3M goodwill totaled approximately $4.6 billion as of December 31, 2007, which, based on impairment testing, is not impaired. Impairment testing for goodwill is done at a reporting unit level. Reporting units are one level below the business segment level, but can be combined when reporting units within the same segment have similar economic characteristics. The majority of goodwill relates to and is assigned directly to a specific reporting unit. An impairment loss generally would be recognized when the carrying amount of the reporting unit's net assets exceeds the estimated fair value of the reporting unit. The estimated fair value of a reporting unit is determined using earnings for the reporting unit multiplied by a price/earnings ratio for comparable industry groups, or by using a discounted cash flow analysis.

Income Taxes:
The extent of 3M's operations involves dealing with uncertainties and judgments in the application of complex tax regulations in a multitude of jurisdictions. The final taxes paid are dependent upon many factors, including negotiations with taxing authorities in various jurisdictions and resolution of disputes arising from federal, state, and international tax audits. The Company recognizes potential liabilities and records tax liabilities for anticipated tax audit issues in the U.S. and other tax jurisdictions based on its estimate of whether, and the extent to which, additional taxes will be due. As of January 1, 2007, the Company follows FIN 48 guidance to record these liabilities (refer to Note 8 for additional information). The Company adjusts these reserves in light of changing facts and circumstances; however, due to the complexity of some of these uncertainties, the ultimate resolution may result in a payment that is materially different from the Company's current estimate of the tax liabilities. If the Company's estimate of tax liabilities proves to be less than the ultimate assessment, an additional charge to expense would result. If payment of these amounts ultimately proves to be less than the recorded amounts, the reversal of the liabilities would result in tax benefits being recognized in the period when the Company determines the liabilities are no longer necessary.

NEW ACCOUNTING PRONOUNCEMENTS

Information regarding new accounting pronouncements is included in Note 1 to the Consolidated Financial Statements.

FINANCIAL CONDITION AND LIQUIDITY

The Company generates significant ongoing cash flow. Increases in long-term debt have been used, in part, to fund share repurchase activities and acquisitions. On November 15, 2007, 3M (Safety, Security and Protection Services Business) announced that it had entered into a definitive agreement for 3M's acquisition of 100 percent of the outstanding shares of Aearo Holding Corp. : a global leader in the personal protection industry that manufactures and markets personal protection and energy absorbing products : for approximately $1.2 billion. The sale is expected to close towards the end of the first quarter of 2008.

At December 31 (Millions)	2007	2006	2005
Total Debt	$ 4,920	$ 3,553	$ 2,381
Less: Cash, cash equivalents and marketable securities	2,955	2,084	1,072
Net Debt	$ 1,965	$ 1,469	$ 1,309

Cash, cash equivalents and marketable securities at December 31, 2007 totaled approximately $3 billion, helped by strong cash flow generation and by the timing of debt issuances. At December 31, 2006, cash balances were higher due to the significant pharmaceuticals sales proceeds received in December 2006. 3M believes its ongoing cash flows provide ample cash to fund expected investments and capital expenditures. The Company has sufficient access to capital markets to meet currently anticipated growth and acquisition investment funding needs. The Company does not utilize derivative instruments linked to the Company's stock. However, the Company does have contingently convertible debt that, if conditions for conversion are met, is convertible into shares of 3M common stock (refer to Note 10 in this document).

The Company's financial condition and liquidity are strong. Various assets and liabilities, including cash and short-term debt, can fluctuate significantly from month to month depending on short-term liquidity needs. Working capital (defined as current assets minus current liabilities) totaled $4.476 billion at December 31, 2007, compared with $1.623 billion at December 31, 2006. Working capital was higher primarily due to increases in cash and cash equivalents, short-term marketable securities, receivables and inventories and decreases in short-term debt and accrued income taxes.

The Company's liquidity remains strong, with cash, cash equivalents and marketable securities at December 31, 2007 totaling approximately $3 billion. Primary short-term liquidity needs are provided through U.S. commercial paper and euro commercial paper issuances. As of December 31, 2007, outstanding total commercial paper issued totaled $349 million and averaged $1.249 billion during 2007. The Company believes it unlikely that its access to the commercial paper market will be restricted. In June 2007, the Company established a medium-term notes program through which up to $3 billion of medium-term notes may be offered, with remaining shelf borrowing capacity of $2.5 billion as of December 31, 2007. On April 30, 2007, the Company replaced its $565-million credit facility with a new $1.5-billion five-year credit facility, which has provisions for the Company to request an increase of the facility up to $2 billion (at the lenders' discretion), and providing for up to $150 million in letters of credit. As of December 31, 2007, there are $110 million in letters of credit drawn against the facility. At December 31, 2007, available short-term committed lines of credit internationally totaled approximately $67 million, of which $13 million was utilized. Debt covenants do not restrict the payment of dividends. The Company has a "well-known seasoned issuer" shelf registration statement, effective February 24, 2006, to register an indeterminate amount of debt or equity securities for future sales. The Company intends to use the proceeds from future securities sales off this shelf for general corporate purposes.

At December 31, 2007, certain debt agreements ($350 million of dealer remarketable securities and $87 million of ESOP debt) had ratings triggers (BBB-/Baa3 or lower) that would require repayment of debt. The Company has an AA credit rating, with a stable outlook, from Standard & Poor's and an Aa1 credit rating, with a negative outlook, from Moody's Investors Service. In addition, under the $1.5-billion five-year credit facility agreement, 3M is required to maintain its EBITDA to Interest Ratio as of the end of each fiscal quarter at not less than 3.0 to 1. This is calculated (as defined in the agreement) as the ratio of consolidated total EBITDA for the four consecutive quarters then ended to total interest expense on all funded debt for the same period. At December 31, 2007, this ratio was approximately 35 to 1.

3M's cash and cash equivalents balance at December 31, 2007 totaled $1.896 billion, with an additional $1.059 billion in current and long-term marketable securities. 3M's strong balance sheet and liquidity provide the Company with significant flexibility to take advantage of numerous opportunities going forward. The Company will continue to invest in its operations to drive growth, including continual review of acquisition opportunities. As previously discussed, 3M expects to complete

the acquisition of Aearo Holding Corp. for approximately $1.2 billion in 2008. 3M paid dividends of $1.380 billion in 2007, and has a long history of dividend increases. In February 2008, the Board of Directors increased the quarterly dividend on 3M common stock by 4.2% to 50 cents per share, equivalent to an annual dividend of $2.00 per share. In February 2007, 3M's Board of Directors authorized a two-year share repurchase of up to $7.0 billion for the period from February 12, 2007 to February 28, 2009. At December 31, 2007, the Company has $4.1 billion remaining under this authorization, which the Company does not currently expect to fully utilize by February 28, 2009.

In 2008, the Company expects to contribute an amount in the range of $100 million to $400 million to its U.S. and international pension plans. The Company does not have a required minimum pension contribution obligation for its U.S. plans in 2008. Therefore, the amount of the anticipated discretionary contribution could vary significantly depending on the U.S.-plans funding status as of the 2008 measurement date and the anticipated tax deductibility of the contribution. Future contributions will also depend on market conditions, interest rates and other factors. 3M believes its strong cash flow and balance sheet will allow it to fund future pension needs without compromising growth opportunities.

The Company uses various working capital measures that place emphasis and focus on certain working capital assets and liabilities. These measures are not defined under U.S. generally accepted accounting principles and may not be computed the same as similarly titled measures used by other companies. One of the primary working capital measures 3M uses is a combined index, which includes accounts receivable, inventory and accounts payable. This combined index (defined as quarterly net sales — fourth quarter at year-end — multiplied by four, divided by ending net accounts receivable plus inventory less accounts payable) was 5.3 at December 31, 2007, down from 5.4 at December 31, 2006. Receivables increased $260 million, or 8.4%, compared with December 31, 2006. Currency translation increased accounts receivable by $159 million year-on-year, as the U.S. dollar weakened in aggregate against a multitude of currencies. Inventories increased $251 million, or 9.7%, compared with December 31, 2006. Currency translation increased inventories by $132 million year-on-year. Accounts payable increased $103 million compared with December 31, 2006, with $65 million of this year-on-year increase related to currency translation.

Cash flows from operating, investing and financing activities are provided in the tables that follow. Individual amounts in the Consolidated Statement of Cash Flows exclude the effects of acquisitions, divestitures and exchange rate impacts, which are presented separately in the cash flows. Thus, the amounts presented in the following operating, investing and financing activities tables reflect changes in balances from period to period adjusted for these effects.

Cash Flows from Operating Activities:

Years ended December 31 (Millions)	2007	2006	2005
Net income	$ 4,096	$ 3,851	$ 3,111
Depreciation and amortization	1,072	1,079	986
Company pension contributions	(376)	(348)	(654)
Company postretirement contributions	(3)	(37)	(134)
Company pension expense	190	347	331
Company postretirement expense	65	93	106
Stock-based compensation expense	228	200	155
Gain from sale of businesses	(849)	(1,074)	—
Income taxes (deferred and accrued income taxes)	(34)	(178)	402
Excess tax benefits from stock-based compensation	(74)	(60)	(54)
Accounts receivable	(35)	(103)	(184)
Inventories	(54)	(309)	(294)
Accounts payable	(4)	68	113
Product and other insurance receivables and claims	158	58	122
Other — net	(105)	252	198
Net cash provided by operating activities	$ 4,275	$ 3,839	$ 4,204

Cash flows from operating activities can fluctuate significantly from period to period, as pension funding decisions, tax timing differences and other items can significantly impact cash flows. In both 2007 and 2006, the Company made discretionary contributions of $200 million to its U.S. qualified pension plan, and in 2005 made discretionary contributions totaling $500 million.

In 2007, cash flows provided by operating activities increased $436 million, including an increase in net income of $245 million. Since the gain from sale of businesses is included in and increases net income, the pre-tax gain from the sale of the businesses must be subtracted, as shown above, to properly reflect operating cash flows. The cash proceeds from the sale of the pharmaceuticals business are shown as part of cash from investing activities; however, when the related taxes are paid they are required to be shown as part of cash provided by operating activities. Thus, operating cash flows for 2007 were penalized due to cash income tax payments of approximately $630 million in 2007 that related to the sale of the global branded pharmaceuticals business. Non-pharmaceutical related cash income tax payments were approximately $475 million lower than 2006 due to normal timing differences in tax payments, which benefited cash flows. Accounts receivable and inventory increases reduced cash flows in 2007, but decreased cash flow less than in 2006, resulting in a year-on-year benefit to cash flows of $323 million. The category "Other-net" in the preceding table reflects changes in other asset and liability accounts, including the impact of cash payments made in connection with 3M's restructuring actions (Note 4).

In 2006, cash flows provided by operating activities decreased $365 million. This decrease was due in large part to an increase of approximately $600 million in tax payments in 2006 compared with 2005. The higher tax payments in 2006 primarily related to the Company's repatriation of $1.7 billion of foreign earnings in the United States pursuant to the provisions of the American Jobs Creation Act of 2004. The category "Other-net" in the preceding table reflects changes in other asset and liability accounts, including outstanding liabilities at December 31, 2006, related to 3M's restructuring actions (Note 4).

Cash Flows from Investing Activities:

Years ended December 31 (Millions)	2007	2006	2005
Purchases of property, plant and equipment (PP&E)	$ (1,422)	$ (1,168)	$ (943)
Proceeds from sale of PP&E and other assets	103	49	41
Acquisitions, net of cash acquired	(539)	(888)	(1,293)
Proceeds from sale of businesses	897	1,209	—
Purchases and proceeds from sale or maturities of marketable securities and investments — net	(406)	(662)	(46)
Net cash used in investing activities	$ (1,367)	$ (1,460)	$ (2,241)

Investments in property, plant and equipment enable growth in diverse markets, helping to meet product demand and increasing manufacturing efficiency. In 2007, numerous plants were opened or expanded internationally. This included two facilities in Korea (respirator manufacturing facility and optical plant), an optical plant in Poland, industrial adhesives/tapes facilities in both Brazil and the Philippines, a plant in Russia (corrosion protection, industrial adhesive and tapes, and respirators), a plant in China (optical systems, industrial adhesives and tapes, and personal care), an expansion in Canada (construction and home improvement business), in addition to investments in India, Mexico and other countries. In addition, 3M expanded manufacturing capabilities in the U.S., including investments in industrial adhesives/tapes and optical. 3M also exited several high-cost underutilized manufacturing facilities and streamlined several supply chains by relocating equipment from one facility to another. The streamlining work has primarily occurred inside the U.S. and is in addition to the streamlining achieved through plant construction. As a result of this increased activity, capital expenditures were $1.422 billion in 2007, an increase of $254 million when compared to 2006. The Company expects capital expenditures to total approximately $1.3 billion to $1.4 billion in 2008. Refer to the preceding "Capital Spending/Net Property, Plant and Equipment" section for more detail.

Refer to Note 2 for information on 2007, 2006 and 2005 acquisitions. Note 2 also provides information on the proceeds from the sale of businesses. The Company is actively considering additional acquisitions, investments and strategic alliances, and from time to time may also divest certain businesses.

Purchases of marketable securities and investments and proceeds from sale (or maturities) of marketable securities and investments are primarily attributable to asset-backed securities, agency securities, corporate medium-term note securities, auction rate securities and other securities, which are classified as available-for-sale. Refer to Note 9 for more details about 3M's diversified marketable securities portfolio, which totaled $1.059 billion as of December 31, 2007. Purchases of marketable securities, net of sales and maturities, totaled $429 million for 2007 and $637 million for 2006. Purchases of investments in 2005 include the purchase of 19% of TI&M Beteiligungsgesellschaft mbH for approximately $55 million, which is reported as "Investments" in the Consolidated Balance Sheet and as "Purchases of marketable securities and investments" in the Consolidated Statement of Cash Flows. The recovery of approximately $25 million of this investment in 2007 reduced "Investments" and is shown in cash flows within "Proceeds from sale of marketable securities and investments." This investment is discussed in more detail under the preceding section

entitled Industrial and Transportation Business. Additional purchases of investments include additional survivor benefit insurance and equity investments.

Cash Flows from Financing Activities:

Years ended December 31 (Millions)	2007	2006	2005
Change in short-term debt — net	$ (1,222)	$ 882	$ (258)
Repayment of debt (maturities greater than 90 days)	(1,580)	(440)	(656)
Proceeds from debt (maturities greater than 90 days)	4,024	693	429
Total cash change in debt	$ 1,222	$ 1,135	$ (485)
Purchases of treasury stock	(3,239)	(2,351)	(2,377)
Reissuances of treasury stock	796	523	545
Dividends paid to stockholders	(1,380)	(1,376)	(1,286)
Excess tax benefits from stock-based compensation	74	60	54
Distributions to minority interests and other — net	(20)	(52)	(76)
Net cash used in financing activities	$ (2,547)	$ (2,061)	$ (3,625)

Total debt at December 31, 2007, was $4.920 billion, up from $3.553 billion at year-end 2006. The net change in short-term debt is primarily due to commercial paper activity. In 2007, the repayment of debt for maturities greater than 90 days is primarily comprised of commercial paper repayments of approximately $1.15 billion and the November 2007 redemption of approximately $322 million in Convertible Notes. In 2007, proceeds from debt included long-term debt and commercial paper issuances totaling approximately $4 billion. This was comprised of Eurobond issuances in December 2007 and July 2007 totaling approximately $1.5 billion in U.S. dollars, a March 2007 long-term debt issuance of $750 million and a December 2007 fixed rate note issuance of $500 million, plus commercial paper issuances (maturities greater than 90 days) of approximately $1.25 billion. Increases in long-term debt have been used, in part, to fund share repurchase activities. The Company accelerated purchases of treasury stock when compared to prior years, buying back $3.2 billion in shares in 2007. Total debt was 30% of total capital (total capital is defined as debt plus equity), compared with 26% at year-end 2006.

Debt securities, including 2007 debt issuances, the Company's shelf registration, dealer remarketable securities and Convertible Notes, are all discussed in more detail in Note 10. The Company has a "well-known seasoned issuer" shelf registration statement, effective February 24, 2006, to register an indeterminate amount of debt or equity securities for future sales. On June 15, 2007, the Company registered 150,718 shares of the Company's common stock under this shelf on behalf of and for the sole benefit of the selling stockholders in connection with the Company's acquisition of assets of Diamond Productions, Inc. The Company intends to use the proceeds from future securities sales off this shelf for general corporate purposes. In connection with this shelf registration, in June 2007 the Company established a medium-term notes program through which up to $3 billion of medium-term notes may be offered. In December 2007, 3M issued a five-year, $500 million, fixed rate note with a coupon rate of 4.65% under this medium-term notes program. This program has a remaining capacity of $2.5 billion as of December 31, 2007.

The Company's $350 million of dealer remarketable securities (classified as current portion of long-term debt) were remarketed for one year in December 2007. At December 31, 2007, $350 million of dealer remarketable securities (final maturity 2010) and $62 million of floating rate notes (final maturity 2044) are classified as current portion of long-term debt as the result of put provisions associated with these debt instruments. The Company has Convertible Notes with a book value of $222 million at December 31, 2007. The next put option date for these Convertible Notes is November 2012. In November 2007, 364,598 outstanding bonds were redeemed resulting in a payout from 3M of approximately $322 million.

Repurchases of common stock are made to support the Company's stock-based employee compensation plans and for other corporate purposes. In February 2007, 3M's Board of Directors authorized a two-year share repurchase of up to $7.0 billion for the period from February 12, 2007 to February 28, 2009. As of December 31, 2007, approximately $4.1 billion remained available for repurchase. Refer to the table titled "Issuer Purchases of Equity Securities" in Part II, Item 5, for more information.

Cash dividends paid to stockholders totaled $1.380 billion ($1.92 per share) in 2007, $1.376 billion ($1.84 per share) in 2006 and $1.286 billion ($1.68 per share) in 2005. 3M has paid dividends since 1916. In February 2008, the Board of Directors increased the quarterly dividend on 3M common stock by 4.2% to 50 cents per share, equivalent to an annual dividend of $2.00 per share. This marked the 50th consecutive year of dividend increases. Other cash flows from

financing activities primarily include distributions to minority interests, excess tax benefits from stock–based compensation, changes in cash overdraft balances, and principal payments for capital leases.

Off–Balance Sheet Arrangements and Contractual Obligations:
As of December 31, 2007, the Company has not utilized special purpose entities to facilitate off–balance sheet financing arrangements. 3M's accrued product warranty liabilities, recorded on the Consolidated Balance Sheet as part of current and long–term liabilities, are estimated at approximately $21 million. 3M does not consider this amount to be material. The fair value of 3M guarantees of loans with third parties and other guarantee arrangements are not material.

In addition to guarantees, 3M, in the normal course of business, periodically enters into agreements that require the Company to indemnify either major customers or suppliers for specific risks, such as claims for injury or property damage arising out of the use of 3M products or the negligence of 3M personnel, or claims alleging that 3M products infringe third–party patents or other intellectual property. While 3M's maximum exposure under these indemnification provisions cannot be estimated, these indemnifications are not expected to have a material impact on the Company's consolidated results of operations or financial condition.

A summary of the Company's significant contractual obligations as of December 31, 2007, follows:

Contractual Obligations

		Payments due by year					
(Millions)	Total	2008	2009	2010	2011	2012	After 2012
Long–term debt, including current portion (Note 10)	$ 4,559	$ 540	$ 477	$ 24	$ —	$ 500	$ 3,018
Interest on long–term debt	2,671	211	185	170	169	169	1,767
Operating leases (Note 13)	441	98	79	58	35	30	141
Capital leases (Note 13)	84	7	6	6	6	5	54
Unconditional purchase obligations and other	787	626	120	33	5	2	1
Total contractual cash obligations	$ 8,542	$ 1,482	$ 867	$ 291	$ 215	$ 706	$ 4,981

Long–term debt payments due in 2008 include $350 million of dealer remarketable securities (final maturity 2010) and $62 million of floating rate notes (final maturity 2044). These securities are classified as the current portion of long–term debt as the result of put provisions associated with these debt instruments.

Unconditional purchase obligations are defined as an agreement to purchase goods or services that is enforceable and legally binding on the Company. Included in the unconditional purchase obligations category above are certain obligations related to take or pay contracts, capital commitments, service agreements and utilities. These estimates include both unconditional purchase obligations with terms in excess of one year and normal ongoing purchase obligations with terms of less than one year. Many of these commitments relate to take or pay contracts, in which 3M guarantees payment to ensure availability of products or services that are sold to customers. The Company expects to receive consideration (products or services) for these unconditional purchase obligations. Contractual capital commitments are included in the preceding table, but these commitments represent a small part of the Company's expected capital spending in 2008 and beyond. The purchase obligation amounts do not represent the entire anticipated purchases in the future, but represent only those items for which the Company is contractually obligated. The majority of 3M's products and services are purchased as needed, with no unconditional commitment. For this reason, these amounts will not provide a reliable indicator of the Company's expected future cash outflows on a stand–alone basis.

Other obligations, included in the preceding table within the caption entitled "Unconditional purchase obligations and other," include the current portion of the liability for uncertain tax positions under FIN 48. The Company is not able to reasonably estimate the timing of the long–term payments or the amount by which the liability will increase or decrease over time; therefore, the long–term portion of the liability of $304 million is excluded from the preceding table. Refer to Note 8 for further details.

As discussed in Note 11, the Company does not have a required minimum pension contribution obligation for its U.S. plans in 2008 and Company contributions to its U.S. and international pension plans are expected to be largely discretionary in 2008 and future years; therefore, amounts related to these plans are not included in the preceding table.

FINANCIAL INSTRUMENTS

The Company enters into contractual derivative arrangements in the ordinary course of business to manage foreign currency exposure, interest rate risks and commodity price risks. A financial risk management committee, composed of senior management, provides oversight for risk management and derivative activities. This committee determines the Company's financial risk policies and objectives, and provides guidelines for derivative instrument utilization. This committee also establishes procedures for control and valuation, risk analysis, counterparty credit approval, and ongoing monitoring and reporting.

The Company enters into foreign exchange forward contracts, options and swaps to hedge against the effect of exchange rate fluctuations on cash flows denominated in foreign currencies and certain intercompany financing transactions. The Company manages interest rate risks using a mix of fixed and floating rate debt. To help manage borrowing costs, the Company may enter into interest rate swaps. Under these arrangements, the Company agrees to exchange, at specified intervals, the difference between fixed and floating interest amounts calculated by reference to an agreed-upon notional principal amount. The Company manages commodity price risks through negotiated supply contracts, price protection agreements and forward physical contracts.

A Monte Carlo simulation technique was used to test the Company's exposure to changes in currency and interest rates and assess the risk of loss or benefit in after-tax earnings of financial instruments, derivatives and underlying exposures outstanding at December 31, 2007. The model (third-party bank dataset) used a 95% confidence level over a 12-month time horizon. The model used analyzed 17 currencies, interest rates related to three currencies, and five commodities, but does not purport to represent what actually will be experienced by the Company. This model does not include certain hedge transactions, because the Company believes their inclusion would not materially impact the results. The following table summarizes the possible adverse and positive impacts to after-tax earnings related to these exposures.

(Millions)	Adverse impact on after-tax earnings		Positive impact on after-tax earnings	
	2007	2006	2007	2006
Foreign exchange rates	$ (54)	$ (56)	$ 57	$ 61
Interest rates	(13)	(15)	15	17
Commodity rates	(3)	(6)	2	5

The global exposures related to purchased components and materials are such that a 1% price change would result in a pre-tax cost or savings of approximately $60 million per year. The global energy exposure is such that a 10% price change would result in a pre-tax cost or savings of approximately $38 million per year. Derivative instruments are used to hedge approximately 1% of the purchased components and materials exposure and are used to hedge approximately 10% of this energy exposure.

FORWARD-LOOKING STATEMENTS

This Annual Report on Form 10-K, including "Management's Discussion and Analysis of Financial Condition and Results of Operations" in Item 7, contains forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995. The Company may also make forward-looking statements in other reports filed with the Securities and Exchange Commission, in materials delivered to stockholders and in press releases. In addition, the Company's representatives may from time to time make oral forward-looking statements.

Forward-looking statements relate to future events and typically address the Company's expected future business and financial performance. Words such as "plan," "expect," "aim," "believe," "project," "target," "anticipate," "intend," "estimate," "will," "should," "could" and other words and terms of similar meaning, typically identify such forward-looking statements. In particular, these include statements about the Company's strategy for growth, product development, market position, future performance or results of current or anticipated products, interest rates, foreign exchange rates, financial results, and the outcome of contingencies, such as legal proceedings. The Company assumes no obligation to update or revise any forward-looking statements.

Forward-looking statements are based on certain assumptions and expectations of future events and trends that are subject to risks and uncertainties. Actual future results and trends may differ materially from historical results or those reflected in any such forward-looking statements depending on a variety of factors. Discussion of these factors is incorporated by reference from Part I, Item 1A, "Risk Factors," of this document, and should be considered an integral part of Part II, Item 7, "Management's Discussion and Analysis of Financial Condition and Results of Operations."

Item 7A. Quantitative and Qualitative Disclosures About Market Risk.

In the context of Item 7A, market risk refers to the risk of loss arising from adverse changes in financial and derivative instrument market rates and prices, such as fluctuations in interest rates and foreign currency exchange rates. The Company discusses risk management in various places throughout this document, including discussions in Item 7 concerning Financial Condition and Liquidity, and Financial Instruments, and in the Notes to Consolidated Financial Statements (Long-Term Debt and Short-Term Borrowings, Derivatives and Other Financial Instruments, and the Derivatives and Hedging Activities accounting policy). All derivative activity is governed by written policies, and a value-at-risk analysis is provided for these derivatives. The Company does not have leveraged derivative positions. However, the Company does have contingently convertible debt that, if conditions for conversion are met, is convertible into shares of 3M common stock (refer to Note 10 in this document).

Item 8. Financial Statements and Supplementary Data.

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Management's Responsibility for Financial Reporting

Management is responsible for the integrity and objectivity of the financial information included in this report. The financial statements have been prepared in accordance with accounting principles generally accepted in the United States of America. Where necessary, the financial statements reflect estimates based on management's judgment.

Management has established and maintains a system of internal accounting and other controls for the Company and its subsidiaries. This system and its established accounting procedures and related controls are designed to provide reasonable assurance that assets are safeguarded, that the books and records properly reflect all transactions, that policies and procedures are implemented by qualified personnel, and that published financial statements are properly prepared and fairly presented. The Company's system of internal control is supported by widely communicated written policies, including business conduct policies, which are designed to require all employees to maintain high ethical standards in the conduct of Company affairs. Internal auditors continually review the accounting and control system.

3M Company

Management's Report on Internal Control Over Financial Reporting

Management is responsible for establishing and maintaining an adequate system of internal control over financial reporting. Management conducted an assessment of the Company's internal control over financial reporting based on the framework established by the Committee of Sponsoring Organizations of the Treadway Commission in *Internal Control — Integrated Framework*. Based on the assessment, management concluded that, as of December 31, 2007, the Company's internal control over financial reporting is effective.

The Company's internal control over financial reporting as of December 31, 2007 has been audited by PricewaterhouseCoopers LLP, an independent registered public accounting firm, as stated in their report which is included herein, which expresses an unqualified opinion on the effectiveness of the Company's internal control over financial reporting as of December 31, 2007.

3M Company

Report of Independent Registered Public Accounting Firm

To the Stockholders and Board of Directors of 3M Company:

In our opinion, the consolidated financial statements listed in the accompanying index present fairly, in all material respects, the financial position of 3M Company and its subsidiaries (the "Company") at December 31, 2007 and 2006, and the results of their operations and their cash flows for each of the three years in the period ended December 31, 2007 in conformity with accounting principles generally accepted in the United States of America. Also in our opinion, the Company maintained, in all material respects, effective internal control over financial reporting as of December 31, 2007, based on criteria established in *Internal Control — Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO). The Company's management is responsible for these financial statements, for maintaining effective internal control over financial reporting and for its assessment of the effectiveness of internal control over financial reporting, included in "Management's Report on Internal Control Over Financial Reporting" in the accompanying index. Our responsibility is to express opinions on these financial statements and on the Company's internal control over financial reporting based on our integrated audits. We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audits to obtain reasonable assurance about whether the financial statements are free of material misstatement and whether effective internal control over financial reporting was maintained in all material respects. Our audits of the financial statements included 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. Our audit of internal control over financial reporting included obtaining an understanding of internal control over financial reporting, assessing the risk that a material weakness exists, and testing and evaluating the design and operating effectiveness of internal control based on the assessed risk. Our audits also included performing such other procedures as we considered necessary in the circumstances. We believe that our audits provide a reasonable basis for our opinions.

As discussed in Note 1 to the consolidated financial statements, the Company changed the manner in which it accounts for conditional asset retirement obligations in 2005, the manner in which it accounts for defined benefit pension and other post–retirement plans in 2006, and the manner in which it accounts for uncertain tax positions in 2007.

A company's internal control over financial reporting is a process designed 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 (i) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the company; (ii) 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 (iii) 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 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.

/s/ PricewaterhouseCoopers LLP
PricewaterhouseCoopers LLP
Minneapolis, Minnesota
February 11, 2008

Consolidated Statement of Income

3M Company and Subsidiaries
Years ended December 31
(Millions, except per share amounts)

	2007	2006	2005
Net sales	$ 24,462	$ 22,923	$ 21,167
Operating expenses			
Cost of sales	12,735	11,713	10,408
Selling, general and administrative expenses	5,015	5,066	4,631
Research, development and related expenses	1,368	1,522	1,274
Gain on sale of businesses	(849)	(1,074)	—
Total	18,269	17,227	16,313
Operating income	6,193	5,696	4,854
Interest expense and income			
Interest expense	210	122	82
Interest income	(132)	(51)	(56)
Total	78	71	26
Income before income taxes, minority interest and cumulative effect of accounting change	6,115	5,625	4,828
Provision for income taxes	1,964	1,723	1,627
Minority interest	55	51	55
Income before cumulative effect of accounting change	4,096	3,851	3,146
Cumulative effect of accounting change	—	—	(35)
Net income	$ 4,096	$ 3,851	$ 3,111
Weighted average common shares outstanding — basic	718.3	747.5	764.9
Earnings per share — basic			
Income before cumulative effect of accounting change	$ 5.70	$ 5.15	$ 4.11
Cumulative effect of accounting change	—	—	(0.04)
Net income	$ 5.70	$ 5.15	$ 4.07
Weighted average common shares outstanding — diluted	732.0	761.0	781.3
Earnings per share — diluted			
Income before cumulative effect of accounting change	$ 5.60	$ 5.06	$ 4.03
Cumulative effect of accounting change	—	—	(0.05)
Net income	$ 5.60	$ 5.06	$ 3.98

The accompanying Notes to Consolidated Financial Statements are an integral part of this statement.

Consolidated Balance Sheet

3M Company and Subsidiaries
At December 31
(Dollars in millions, except per share amount)

	2007	2006
Assets		
Current assets		
Cash and cash equivalents	$ 1,896	$ 1,447
Marketable securities — current	579	471
Accounts receivable — net of allowances of $75 and $71	3,362	3,102
Inventories		
Finished goods	1,349	1,235
Work in process	880	795
Raw materials and supplies	623	571
Total inventories	2,852	2,601
Other current assets	1,149	1,325
Total current assets	9,838	8,946
Marketable securities — non-current	480	166
Investments	298	314
Property, plant and equipment	18,390	17,017
Less: Accumulated depreciation	(11,808)	(11,110)
Property, plant and equipment — net	6,582	5,907
Goodwill	4,589	4,082
Intangible assets — net	801	708
Prepaid pension and postretirement benefits	1,378	395
Other assets	728	776
Total assets	$ 24,694	$ 21,294
Liabilities and Stockholders' Equity		
Current liabilities		
Short-term borrowings and current portion of long-term debt	$ 901	$ 2,506
Accounts payable	1,505	1,402
Accrued payroll	580	520
Accrued income taxes	543	1,134
Other current liabilities	1,833	1,761
Total current liabilities	5,362	7,323
Long-term debt	4,019	1,047
Other liabilities	3,566	2,965
Total liabilities	$ 12,947	$ 11,335
Commitments and contingencies (Note 13)		
Stockholders' equity		
Common stock, par value $.01 per share	9	9
Shares outstanding — 2007: 709,156,031		
Shares outstanding — 2006: 734,362,802		
Additional paid-in capital	2,785	2,484
Retained earnings	20,316	17,933
Treasury stock	(10,520)	(8,456)
Unearned compensation	(96)	(138)
Accumulated other comprehensive income (loss)	(747)	(1,873)
Stockholders' equity — net	11,747	9,959
Total liabilities and stockholders' equity	$ 24,694	$ 21,294

The accompanying Notes to Consolidated Financial Statements are an integral part of this statement.

Consolidated Statement of Changes in Stockholders' Equity and Comprehensive Income

3M Company and Subsidiaries
Years Ended December 31
(Millions)

	2007	2006	2005
Common Stock, par value	$ 9	$ 9	$ 9
Additional Paid-in Capital			
Beginning balance	2,484	2,225	2,018
Stock-based compensation expense (excluding tax benefit)	228	200	155
Stock-based compensation tax benefit	73	59	52
Ending balance	2,785	2,484	2,225
Retained Earnings			
Beginning balance	17,933	15,715	14,198
Adjustment to beginning balance to initially apply FIN 48	(1)	—	—
Net income	4,096	3,851	3,111
Dividends paid	(1,380)	(1,376)	(1,286)
Issuances pursuant to stock option and benefit plans	(332)	(257)	(308)
Ending balance	20,316	17,933	15,715
Treasury Stock			
Beginning balance	(8,456)	(6,965)	(5,503)
Reacquired stock	(3,237)	(2,332)	(2,377)
Issuances pursuant to stock option and benefit plans	1,160	841	915
Issuances pursuant to acquisitions	13	—	—
Ending balance	(10,520)	(8,456)	(6,965)
Unearned Compensation			
Beginning balance	(138)	(178)	(196)
Amortization of unearned compensation	42	40	18
Ending balance	(96)	(138)	(178)
Accumulated Other Comprehensive Income (Loss)			
Beginning balance	(1,873)	(411)	132
Cumulative translation adjustment	532	506	(578)
Defined benefit pension plans adjustment	614	7	(46)
Adjustment to initially apply SFAS No. 158	—	(1,918)	—
Debt and equity securities — unrealized gain (loss)	(10)	(1)	1
Cash flow hedging instruments — unrealized gain (loss)	(10)	(56)	80
Ending balance	(747)	(1,873)	(411)
Total Stockholder's Equity	$ 11,747	$ 9,959	$ 10,395
Comprehensive Income			
Net income	4,096	3,851	3,111
Cumulative translation adjustment	532	506	(578)
Defined benefit pension plans adjustment	614	7	(46)
Debt and equity securities — unrealized gain (loss)	(10)	(1)	1
Cash flow hedging instruments — unrealized gain (loss)	(10)	(56)	80
Total Comprehensive Income	$ 5,222	$ 4,307	$ 2,568
Supplemental share information:	**2007**	**2006**	**2005**
Treasury stock			
Beginning balance	209.7	189.5	170.5
Reacquired stock	39.7	31.2	30.7
Issuances pursuant to stock options and benefit plans	(14.3)	(11.0)	(11.7)
Issuances pursuant to acquisitions	(0.2)	—	—
Ending balance	234.9	209.7	189.5

The accompanying Notes to Consolidated Financial Statements are an integral part of this statement.

Consolidated Statement of Cash Flows

3M Company and Subsidiaries
Years ended December 31
(Millions)

	2007	2006	2005
Cash Flows from Operating Activities			
Net income	$ 4,096	$ 3,851	$ 3,111
Adjustments to reconcile net income to net cash provided by operating activities			
Depreciation and amortization	1,072	1,079	986
Company pension and postretirement contributions	(379)	(385)	(788)
Company pension and postretirement expense	255	440	437
Stock-based compensation expense	228	200	155
Gain from sale of businesses	(849)	(1,074)	—
Deferred income taxes	11	(316)	132
Excess tax benefits from stock-based compensation	(74)	(60)	(54)
Changes in assets and liabilities			
Accounts receivable	(35)	(103)	(184)
Inventories	(54)	(309)	(294)
Accounts payable	(4)	68	113
Accrued income taxes	(45)	138	270
Product and other insurance receivables and claims	158	58	122
Other — net	(105)	252	198
Net cash provided by operating activities	4,275	3,839	4,204
Cash Flows from Investing Activities			
Purchases of property, plant and equipment (PP&E)	(1,422)	(1,168)	(943)
Proceeds from sale of PP&E and other assets	103	49	41
Acquisitions, net of cash acquired	(539)	(888)	(1,293)
Purchases of marketable securities and investments	(8,194)	(3,253)	(1,627)
Proceeds from sale of marketable securities and investments	6,902	2,287	1,573
Proceeds from maturities of marketable securities	886	304	8
Proceeds from sale of businesses	897	1,209	—
Net cash used in investing activities	(1,367)	(1,460)	(2,241)
Cash Flows from Financing Activities			
Change in short-term debt — net	(1,222)	882	(258)
Repayment of debt (maturities greater than 90 days)	(1,580)	(440)	(656)
Proceeds from debt (maturities greater than 90 days)	4,024	693	429
Purchases of treasury stock	(3,239)	(2,351)	(2,377)
Reissuances of treasury stock	796	523	545
Dividends paid to stockholders	(1,380)	(1,376)	(1,286)
Distributions to minority interests	(20)	(38)	(56)
Excess tax benefits from stock-based compensation	74	60	54
Other — net	—	(14)	(20)
Net cash used in financing activities	(2,547)	(2,061)	(3,625)
Effect of exchange rate changes on cash and cash equivalents	88	57	(23)
Net increase/(decrease) in cash and cash equivalents	449	375	(1,685)
Cash and cash equivalents at beginning of year	1,447	1,072	2,757
Cash and cash equivalents at end of year	$ 1,896	$ 1,447	$ 1,072

The accompanying Notes to Consolidated Financial Statements are an integral part of this statement.

Notes to Consolidated Financial Statements

NOTE 1. Significant Accounting Policies

Consolidation: 3M is a diversified global manufacturer, technology innovator and marketer of a wide variety of products. All significant subsidiaries are consolidated. All significant intercompany transactions are eliminated. As used herein, the term "3M" or "Company" refers to 3M Company and subsidiaries unless the context indicates otherwise.

Foreign currency translation: Local currencies generally are considered the functional currencies outside the United States. Assets and liabilities for operations in local-currency environments are translated at year-end exchange rates. Income and expense items are translated at average rates of exchange prevailing during the year. Cumulative translation adjustments are recorded as a component of accumulated other comprehensive income (loss) in stockholders' equity.

Reclassifications: Certain amounts in the prior years' consolidated financial statements have been reclassified to conform to the current year presentation.

Use of estimates: The preparation of financial statements in conformity with U.S. generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and the disclosure of contingent assets and liabilities at the date of the financial statements, and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from these estimates.

Cash and cash equivalents: Cash and cash equivalents consist of cash and temporary investments with maturities of three months or less when purchased.

Investments: Investments primarily include the cash surrender value of life insurance policies, real estate not used in the business, venture capital and equity-method investments. Unrealized gains and losses relating to investments classified as available-for-sale are recorded as a component of accumulated other comprehensive income (loss) in stockholders' equity.

Inventories: Inventories are stated at the lower of cost or market, with cost generally determined on a first-in, first-out basis.

Property, plant and equipment: Property, plant and equipment, including capitalized interest and internal engineering costs, are recorded at cost. Depreciation of property, plant and equipment generally is computed using the straight-line method based on the estimated useful lives of the assets. The estimated useful lives of buildings and improvements primarily range from 10 to 40 years, with the majority in the range of 20 to 40 years. The estimated useful lives of machinery and equipment primarily range from three to 15 years, with the majority in the range of five to 10 years. Fully depreciated assets are retained in property and accumulated depreciation accounts until disposal. Upon disposal, assets and related accumulated depreciation are removed from the accounts and the net amount, less proceeds from disposal, is charged or credited to operations. Property, plant and equipment amounts are reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount of an asset (asset group) may not be recoverable. An impairment loss would be recognized when the carrying amount of an asset exceeds the estimated undiscounted future cash flows expected to result from the use of the asset and its eventual disposition. The amount of the impairment loss to be recorded is calculated by the excess of the asset's carrying value over its fair value. Fair value is generally determined using a discounted cash flow analysis.

Goodwill: Goodwill is the excess of cost of an acquired entity over the amounts assigned to assets acquired and liabilities assumed in a business combination. Goodwill is not amortized. Goodwill is tested for impairment annually, and will be tested for impairment between annual tests if an event occurs or circumstances change that would indicate the carrying amount may be impaired. Impairment testing for goodwill is done at a reporting unit level. Reporting units are one level below the business segment level, but can be combined when reporting units within the same segment have similar economic characteristics. The majority of goodwill relates to and is assigned directly to specific reporting units. An impairment loss generally would be recognized when the carrying amount of the reporting unit's net assets exceeds the estimated fair value of the reporting unit. The estimated fair value of a reporting unit is determined using earnings for the reporting unit multiplied by a price/earnings ratio for comparable industry groups, or by using a discounted cash flow analysis. The Company completed its annual goodwill impairment test in the fourth quarter of 2007 and determined that no goodwill was impaired.

Intangible assets: Intangible assets include patents, tradenames and other intangible assets acquired from an independent party. Intangible assets with an indefinite life, namely certain tradenames, are not amortized. Intangible assets with a definite life are amortized on a straight-line basis, with estimated useful lives ranging from one to 20 years. Indefinite-lived intangible assets are tested for impairment annually, and will be tested for impairment between annual tests if an event occurs or circumstances change that would indicate that the carrying amount may be impaired. Intangible assets with a definite life are tested for impairment whenever events or circumstances indicate that the

carrying amount of an asset (asset group) may not be recoverable. An impairment loss is recognized when the carrying amount of an asset exceeds the estimated undiscounted cash flows used in determining the fair value of the asset. The amount of the impairment loss to be recorded is calculated by the excess of the asset's carrying value over its fair value. Fair value is generally determined using a discounted cash flow analysis. Costs related to internally developed intangible assets, such as patents, are expensed as incurred, primarily in "Research, development and related expenses."

Revenue (sales) recognition: The Company sells a wide range of products to a diversified base of customers around the world and has no material concentration of credit risk. Revenue is recognized when the risks and rewards of ownership have substantively transferred to customers. This condition normally is met when the product has been delivered or upon performance of services. The Company records estimated reductions to revenue for customer and distributor incentives, such as rebates, at the time of the initial sale. The estimated reductions are based on the sales terms, historical experience, trend analysis and projected market conditions in the various markets served. Sales, use, value-added and other excise taxes are not recognized in revenue.

The majority of 3M's sales agreements are for standard products and services with customer acceptance occurring upon delivery of the product or performance of the service. 3M also enters into agreements that contain multiple elements (such as equipment, installation and service) or non-standard terms and conditions. For multiple-element arrangements, 3M recognizes revenue for delivered elements when it has stand-alone value to the customer, the fair values of undelivered elements are known, customer acceptance of the delivered elements has occurred, and there are only customary refund or return rights related to the delivered elements. In addition to the preceding conditions, equipment revenue is not recorded until the installation has been completed if equipment acceptance is dependent upon installation, or if installation is essential to the functionality of the equipment. Installation revenues are not recorded until installation has been completed. For prepaid service contracts, sales revenue is recognized on a straight-line basis over the term of the contract, unless historical evidence indicates the costs are incurred on other than a straight-line basis. License fee revenue is recognized as earned, and no revenue is recognized until the inception of the license term. On occasion, agreements will contain milestones, or 3M will recognize revenue based on proportional performance. For these agreements, and depending on the specifics, 3M may recognize revenue upon completion of a substantive milestone, or in proportion to costs incurred to date compared with the estimate of total costs to be incurred.

Accounts Receivable and Allowances: Trade accounts receivable are recorded at the invoiced amount and do not bear interest. The Company maintains allowances for bad debts, cash discounts, product returns and various other items. The allowance for doubtful accounts and product returns is based on the best estimate of the amount of probable credit losses in existing accounts receivable and anticipated sales returns. The Company determines the allowances based on historical write-off experience by industry and regional economic data and historical sales returns. The Company reviews the allowance for doubtful accounts monthly. The Company does not have any significant off-balance-sheet credit exposure related to its customers.

Advertising and merchandising: These costs are charged to operations in the year incurred, and totaled $469 million in 2007, $471 million in 2006 and $457 million in 2005.

Research, development and related expenses: These costs are charged to operations in the year incurred and are shown on a separate line of the Consolidated Statement of Income. Research, development and related expenses totaled $1.368 billion in 2007, $1.522 billion in 2006 and $1.274 billion in 2005. In 2006, this included a $95 million in-process research and development charge (discussed in Note 2) and $75 million in restructuring actions (Note 4). Research and development expenses, covering basic scientific research and the application of scientific advances in the development of new and improved products and their uses, totaled $788 million in 2007 compared to $943 million in 2006, decreasing due to the $95 million for purchased in-process research and development discussed above and also due to the pharmaceuticals business divestiture (Note 2). Research and development expenses totaled $818 million in 2005. Related expenses primarily include technical support provided by 3M to customers who are using existing 3M products, and internally developed patent costs, which include costs and fees incurred to prepare, file, secure and maintain patents.

Internal-use software: The Company capitalizes direct costs of materials and services used in the development of internal-use software. Amounts capitalized are amortized on a straight-line basis over a period of three to five years and are reported as a component of machinery and equipment within property, plant and equipment.

Environmental: Environmental expenditures relating to existing conditions caused by past operations that do not contribute to current or future revenues are expensed. Reserves for liabilities for anticipated remediation costs are recorded on an undiscounted basis when they are probable and reasonably estimable, generally no later than the completion of feasibility studies or the Company's commitment to a plan of action. Environmental expenditures for capital projects that contribute to current or future operations generally are capitalized and depreciated over their estimated useful lives.

Income taxes: The provision for income taxes is determined using the asset and liability approach. Under this approach, deferred income taxes represent the expected future tax consequences of temporary differences between the carrying amounts and tax basis of assets and liabilities. The Company records a valuation allowance to reduce its deferred tax assets when uncertainty regarding their reliability exists. As of December 31, 2007, no significant valuation allowances were recorded.

Earnings per share: The difference in the weighted average shares outstanding for calculating basic and diluted earnings per share is attributable to the dilution associated with the Company's stock–based compensation plans. Certain Management Stock Ownership Program average options outstanding during the years 2007, 2006 and 2005 were not included in the computation of diluted earnings per share because they would not have had a dilutive effect (21.6 million average options for 2007, 31.5 million average options for 2006, and 15.4 million average options for 2005). As discussed in Note 10, the conditions for conversion related to the Company's Convertible Notes have never been met. If the conditions for conversion are met, 3M may choose to pay in cash and/or common stock; however, if this occurs, the Company has the intent and ability to settle this debt security in cash. Accordingly, there was no impact on 3M's diluted earnings per share. The computations for basic and diluted earnings per share for the years ended December 31 follow:

Earnings Per Share Computations (Amounts in millions, except per share amounts)	2007	2006	2005
Numerator:			
Net income	$ 4,096	$ 3,851	$ 3,111
Denominator:			
Denominator for weighted average commonshares outstanding — basic	718.3	747.5	764.9
Dilution associated with the Company's stock–based compensation plans	13.7	13.5	16.4
Denominator for weighted average common shares outstanding — diluted	732.0	761.0	781.3
Earnings per share — basic	$ 5.70	$ 5.15	$ 4.07
Earnings per share — diluted	$ 5.60	$ 5.06	$ 3.98

Stock–based compensation: In December 2004, the Financial Accounting Standards Board (FASB) issued SFAS No. 123 (revised 2004). SFAS No. 123R supersedes APB Opinion No. 25. Under APB Opinion No. 25, no compensation expense is recognized for employee stock option grants if the exercise price of the Company's stock option grants is at or above the fair market value of the underlying stock on the date of grant. Under SFAS No. 123R, compensation expense is recognized for both the General Employees' Stock Purchase Plan (GESPP) and the Management Stock Ownership Plan (MSOP). SFAS No. 123R requires the determination of the fair value of the share–based compensation at the grant date and the recognition of the related expense over the period in which the share–based compensation vests. The Company adopted SFAS No. 123R effective January 1, 2006. The Company adopted SFAS No. 123R using the modified retrospective method. All prior periods have been restated to give effect to the fair–value–based method of accounting for awards granted in fiscal years beginning on or after January 1, 1995. The Company believes that the modified retrospective application of this standard achieves the highest level of clarity and comparability among the presented periods. On November 10, 2005, the FASB issued FASB Staff Position No. FAS 123(R)–3, Transition Election Related to Accounting for the Tax Effects of Share–Based Payment Awards (the FSP). The FSP provides that companies may elect to use a specified "short–cut" method to calculate the historical pool of windfall tax benefits upon adoption of SFAS No. 123R. The Company elected to use the "short–cut" method when it adopted SFAS No. 123R on January 1, 2006. Refer to Note 15 for additional information.

Comprehensive income: Total comprehensive income and the components of accumulated other comprehensive income (loss) are presented in the Consolidated Statement of Changes in Stockholders' Equity and Comprehensive Income. Accumulated other comprehensive income (loss) is composed of foreign currency translation effects (including hedges of net investments in international companies), defined benefit pension plan adjustments, unrealized gains and losses on available–for–sale debt and equity securities, and unrealized gains and losses on cash flow hedging instruments.

Derivatives and hedging activities: All derivative instruments are recorded on the balance sheet at fair value. The Company uses interest rate swaps, currency swaps, and forward and option contracts to manage risks generally

associated with foreign exchange rate, interest rate and commodity market volatility. All hedging instruments that qualify for hedge accounting are designated and effective as hedges, in accordance with U.S. generally accepted accounting principles. If the underlying hedged transaction ceases to exist, all changes in fair value of the related derivatives that have not been settled are recognized in current earnings. Instruments that do not qualify for hedge accounting are marked to market with changes recognized in current earnings. The Company does not hold or issue derivative financial instruments for trading purposes and is not a party to leveraged derivatives. However, the Company does have contingently convertible debt that, if conditions for conversion are met, is convertible into shares of 3M common stock (refer to Note 10 in this document).

New Accounting Pronouncements

As of December 31, 2005, the Company adopted FASB Interpretation No. 47, "Accounting for Conditional Asset Retirement Obligations" (FIN 47). This accounting standard applies to the fair value of a liability for an asset retirement obligation associated with the retirement of tangible long–lived assets and where the liability can be reasonably estimated. Conditional asset retirement obligations exist for certain of the Company's long–term assets. The fair value of these obligations is recorded as liabilities on a discounted basis. Over time the liabilities are accreted for the change in the present value and the initial capitalized costs are depreciated over the useful lives of the related assets. The adoption of FIN 47 effective December 31, 2005, resulted in the recognition of an asset retirement obligation liability of $59 million at December 31, 2005, and an after–tax charge of $35 million for 2005, which is reflected as a cumulative effect of change in accounting principle in the Consolidated Statement of Income. At December 31, 2007, the asset retirement obligation liability was $59 million.

In February 2006, the FASB issued Statement of Financial Accounting Standards (SFAS) No. 155, "Hybrid Instruments." SFAS No. 155 amends SFAS No. 133 and SFAS No. 140, "Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities." SFAS No. 155 also resolves issues addressed in Statement 133 Implementation Issue No. D1, "Application of Statement 133 to Beneficial Interests in Securitized Financial Assets." SFAS No. 155: a) permits fair value remeasurement for any hybrid financial instrument that contains an embedded derivative that otherwise would require bifurcation, b) clarifies which interest–only strips and principal–only strips are not subject to the requirements of SFAS No. 133, c) establishes a requirement to evaluate interests in securitized financial assets to identify interests that are freestanding derivatives or that are hybrid financial instruments that contain an embedded derivative requiring bifurcation, d) clarifies that concentrations of credit risk in the form of subordination are not embedded derivatives, and e) amends SFAS No. 140 to eliminate the prohibition on a qualifying special purpose entity from holding a derivative financial instrument that pertains to a beneficial interest other than another derivative financial instrument. The Company adopted SFAS No. 155 effective January 1, 2007; however, there was no material impact.

In June 2006, the FASB issued Interpretation No. 48 (FIN 48), "Accounting for Uncertainty in Income Taxes, an interpretation of FASB Statement No. 109." This interpretation was effective as of January 1, 2007. Refer to Note 8 for additional information concerning this standard.

In September 2006, the FASB issued SFAS No. 157, "Fair Value Measurements." SFAS No. 157 establishes a single definition of fair value and a framework for measuring fair value, sets out a fair value hierarchy to be used to classify the source of information used in fair value measurements, and requires new disclosures of assets and liabilities measured at fair value based on their level in the hierarchy. SFAS No. 157 is effective for all fiscal years beginning after November 15, 2007 (January 1, 2008 for 3M) and is to be applied prospectively. In February 2008, the FASB issued Staff Positions No. 157–1 and No. 157–2 which partially defer the effective date of SFAS No. 157 for one year for certain nonfinancial assets and liabilities and remove certain leasing transactions from its scope. The Company is currently evaluating the impacts and disclosures of this standard, but would not expect SFAS No. 157 to have a material impact on 3M's consolidated results of operations or financial condition.

In September 2006, the Financial Accounting Standards Board (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)." Refer to Note 11 for additional information concerning this standard.

In February 2007, the FASB issued SFAS No. 159, "The Fair Value Option for Financial Assets and Financial Liabilities". SFAS No. 159 permits an entity to choose, at specified election dates, to measure eligible financial instruments and certain other items at fair value that are not currently required to be measured at fair value. An entity shall report unrealized gains and losses on items for which the fair value option has been elected in earnings at each subsequent reporting date. Upfront costs and fees related to items for which the fair value option is elected shall be recognized in earnings as incurred and not deferred. SFAS No. 159 also establishes presentation and disclosure requirements designed to facilitate comparisons between entities that choose different measurement attributes for similar types of assets and liabilities. SFAS No. 159 is effective for financial statements issued for fiscal years beginning after November 15, 2007 (January 1, 2008 for 3M) and interim periods within those fiscal years. At the

effective date, an entity may elect the fair value option for eligible items that exist at that date. The entity shall report the effect of the first remeasurement to fair value as a cumulative-effect adjustment to the opening balance of retained earnings. The Company has not elected the fair value option for eligible items that existed as of January 1, 2008.

In June 2007, the FASB's Emerging Issues Task Force reached a consensus on EITF Issue No. 07-3, "Accounting for Nonrefundable Advance Payments for Goods or Services to Be Used in Future Research and Development Activities" that would require nonrefundable advance payments made by the Company for future R&D activities to be capitalized and recognized as an expense as the goods or services are received by the Company. EITF Issue No. 07-3 is effective for 3M with respect to new arrangements entered into beginning January 1, 2008. The Company is currently evaluating the impacts and disclosures of this standard, but would not expect EITF Issue No. 07-3 to have a material impact on 3M's consolidated results of operations or financial condition.

In December 2007, the FASB issued SFAS No. 141R, "Business Combinations," which changes how business acquisitions are accounted. SFAS No. 141R requires the acquiring entity in a business combination to recognize all (and only) the assets acquired and liabilities assumed in the transaction and establishes the acquisition-date fair value as the measurement objective for all assets acquired and liabilities assumed in a business combination. Certain provisions of this standard will, among other things, impact the determination of acquisition-date fair value of consideration paid in a business combination (including contingent consideration); exclude transaction costs from acquisition accounting; and change accounting practices for acquired contingencies, acquisition-related restructuring costs, in-process research and development, indemnification assets, and tax benefits. For 3M, SFAS No. 141R is effective for business combinations and adjustments to an acquired entity's deferred tax asset and liability balances occurring after December 31, 2008. The Company is currently evaluating the future impacts and disclosures of this standard.

In December 2007, the FASB issued SFAS No. 160, "Noncontrolling Interests in Consolidated Financial Statements, an amendment of ARB No. 51," which establishes new standards governing the accounting for and reporting of noncontrolling interests (NCIs) in partially owned consolidated subsidiaries and the loss of control of subsidiaries. Certain provisions of this standard indicate, among other things, that NCIs (previously referred to as minority interests) be treated as a separate component of equity, not as a liability; that increases and decrease in the parent's ownership interest that leave control intact be treated as equity transactions, rather than as step acquisitions or dilution gains or losses; and that losses of a partially owned consolidated subsidiary be allocated to the NCI even when such allocation might result in a deficit balance. This standard also requires changes to certain presentation and disclosure requirements. For 3M, SFAS No. 160 is effective beginning January 1, 2009. The provisions of the standard are to be applied to all NCIs prospectively, except for the presentation and disclosure requirements, which are to be to applied retrospectively to all periods presented. The Company is currently evaluating the future impacts and disclosures of this standard.

In December 2007, the FASB ratified the Emerging Issues Task Force consensus on EITF Issue No. 07-1, "Accounting for Collaborative Arrangements" that discusses how parties to a collaborative arrangement (which does not establish a legal entity within such arrangement) should account for various activities. The consensus indicates that costs incurred and revenues generated from transactions with third parties (i.e. parties outside of the collaborative arrangement) should be reported by the collaborators on the respective line items in their income statements pursuant to EITF Issue No. 99-19, "Reporting Revenue Gross as a Principal Versus Net as an Agent." Additionally, the consensus provides that income statement characterization of payments between the participants in a collaborative arrangement should be based upon existing authoritative pronouncements; analogy to such pronouncements if not within their scope; or a reasonable, rational, and consistently applied accounting policy election. EITF Issue No. 07-1 is effective for 3M beginning January 1, 2009 and is to be applied retrospectively to all periods presented for collaborative arrangements existing as of the date of adoption. The Company is currently evaluating the impacts and disclosures of this standard, but would not expect EITF Issue No. 07-1 to have a material impact on 3M's consolidated results of operations or financial condition.

NOTE 2. Acquisitions and Divestitures

Divestitures:

In January 2007, 3M completed the sale of its global branded pharmaceuticals business in Europe to Meda AB. 3M received proceeds of $817 million for this transaction and recognized, net of assets sold, a pre-tax gain of $781 million (recorded in the Health Care segment) in 2007.

In December 2006, 3M completed the sale of its global branded pharmaceuticals business in the United States, Canada, and Latin America region and the Asia Pacific region, including Australia and South Africa. 3M received proceeds of $1.209 billion for this transaction and recognized, net of assets sold, a pre-tax gain of $1.074 billion (recorded in Health Care Business) in 2006.

Buyer and sale price information by region is as follows:

- Meda AB acquired 3M's pharmaceuticals business in Europe for $817 million in 2007.
- Graceway Pharmaceuticals Inc. acquired 3M's pharmaceutical operations in the United States, Canada, and Latin America for $860 million in 2006.
- Ironbridge Capital and Archer Capital acquired 3M's pharmaceuticals business in the Asia Pacific region, including Australia and South Africa for $349 million in 2006.

The agreements are the result of a review of strategic options for the branded pharmaceuticals business and its immune response modifier (IRM) platform that 3M announced in April 2006. Under the agreements, the purchasers acquired regional marketing and intellectual property rights for 3M's well-known branded pharmaceuticals, including Aldara, Difflam, Duromine, Tambocor, Maxair, Metrogel-Vaginal and Minitran. As part of the transaction, Graceway Pharmaceuticals also acquired the rights to certain IRM molecules.

In connection with these transactions, 3M entered into agreements whereby its Drug Delivery Systems Division became a source of supply to the acquiring companies. Because of the extent of 3M cash flows from these agreements in relation to those of the disposed-of businesses, the operations of the branded pharmaceuticals business are not classified as discontinued operations. See Note 4 for further discussion of restructuring actions that resulted from the divesture of the Company's global branded pharmaceuticals business.

In June 2007, 3M completed the sale of its Opticom Priority Control Systems and Canoga Traffic Detection businesses to TorQuest Partners Inc., a Toronto-based investment firm. 3M received proceeds of $80 million for this transaction and recognized, net of assets sold, transaction and other costs, a pre-tax gain of $68 million (recorded in the Display and Graphics segment) in 2007.

Acquisitions:

During 2007, the purchase price paid for business combinations totaled $539 million, net of cash acquired, plus approximately 150 thousand shares of 3M common stock, which had a market value of approximately $13 million.

The 16 business combinations completed during 2007 are summarized as follows:

1) In February 2007, 3M (Industrial and Transportation Business) purchased certain assets of Accuspray Application Technologies Inc., a manufacturer of spray paint equipment with a wide array of spray guns for architectural, automotive refinishing, industrial and woodworking applications.

2) In February 2007, 3M (Industrial and Transportation Business) purchased Sealed Air Corporation's 50 percent interest in PolyMask Corporation, a joint venture between 3M and Sealed Air that produces protective films. The acquisition of Sealed Air's interest results in 100 percent ownership by 3M.

3) In February 2007, 3M (Health Care Business) purchased 100 percent of the outstanding shares of Acolyte Biomedica Ltd., a Salisbury, U.K.-based provider of an automated microbial detection platform that aids in the rapid detection, diagnosis, and treatment of infectious diseases.

4) In May 2007, 3M (Safety, Security and Protection Services Business) purchased 100 percent of the outstanding shares of E Wood Holdings PLC, a North Yorkshire, UK-based manufacturer of high performance protective coatings for oil, gas, water, rail and automotive industries.

5) In May 2007, 3M (Electro and Communications Business) purchased certain assets of Innovative Paper Technologies LLC, a manufacturer of inorganic-based technical papers, boards and laminates for a wide variety of high temperature applications and Powell LLC, a supplier of non-woven polyester mats for the electrical industry.

6) In May 2007, 3M (Health Care Business) purchased certain assets of Articulos de Papel DMS Chile, a Santiago, Chile-based manufacturer of disposable surgical packs, drapes, gowns and kits.

7) In June 2007, 3M (Industrial and Transportation Business) purchased certain assets of Diamond Productions Inc., a manufacturer of superabrasive diamond and cubic boron nitride wheels and tools for dimensioning and finishing hard-to-grind materials in metalworking, woodworking and stone fabrication markets in exchange for approximately 150 thousand shares of 3M common stock, which had a market value of $13 million at the acquisition measurement date and was previously held as 3M treasury stock.

8) In July 2007, 3M (Safety, Security and Protection Services Business) purchased 100 percent of the outstanding shares of Rochford Thompson Equipment Ltd., a manufacturer of optical character recognition passport readers used by airlines and immigration authorities, headquartered in Newbury, U.K.

9) In August 2007, 3M (Health Care Business) purchased certain assets of Neoplast Co. Ltd., a manufacturer/distributor of surgical tapes and dressings and first aid bandages for both the professional and consumer markets across the Asia Pacific region.

10) In October 2007, 3M (Health Care Business) purchased 100 percent of the outstanding shares of Abzil Industria e Comercio Ltda., a manufacturer of orthodontic products based in Sao Jose do Rio Preto, Sao Paulo, Brazil.

11) In October 2007, 3M (Industrial and Transportation Business) purchased 100 percent of the outstanding shares of Venture Tape Corp. and certain related entities, a global provider of pressure sensitive adhesive tapes based in Rockland, Mass.

12) In October 2007, 3M (Display and Graphics Business) purchased certain assets of Macroworx Media Pvt Ltd., a software company that specializes in the design and development of digital signage solutions based in Bangalore, India.

13) In October 2007, 3M (Health Care Business) purchased 100 percent of the outstanding shares of Lingualcare Inc., a Dallas-based orthodontic technology and services company offering the iBraces system, a customized, lingual orthodontic solution.

14) In November 2007, 3M (Industrial and Transportation Business) purchased certain assets of Standard Abrasives, a manufacturer of coated abrasive specialties and non-woven abrasive products for the metalworking industry headquartered in Simi Valley, Ca.

15) In November 2007, 3M (Industrial and Transportation Business) purchased 100 percent of the outstanding shares of Unifam Sp. z o.o., a manufacturer of cut-off wheels, depressed center grinding wheels and flap discs based in Poland.

16) In November 2007, 3M (Industrial and Transportation Business) purchased certain assets of Bondo Corp., a manufacturer of auto body repair products for the automotive aftermarket and various other professional and consumer applications based in Atlanta, Ga.

In addition to the business combinations above, 3M periodically acquires certain tangible and/or intangible assets and purchases interests in certain enterprises that do not otherwise qualify for accounting as business combinations. These transactions are largely reflected as additional asset purchase and investment activity.

Purchased identifiable intangible assets for the 16 business combinations closed during the twelve months ended December 31, 2007 totaled $124 million and will be amortized on a straight-line basis over lives ranging from 2 to 10 years (weighted-average life of six years).

In 2007 and 2006, pro forma information related to acquisitions was not included because the impact on the Company's consolidated results of operations was not considered to be material. There were no material in-process research and development charges associated with 2007, while 2006 included $95 million in charges for the Brontes Technologies Inc. acquisition. The purchase price allocation of certain 2007 business combinations is considered preliminary. The impact on the Consolidated Balance Sheet of the purchase price allocations related to acquisitions and adjustments relative to other acquisitions within the allocation period follow:

Asset (Liability) (Millions)	2007 Impact	2006 Impact
Accounts receivable	$ 69	$ 76
Inventory	79	55
Other current assets	5	8
Property, plant, and equipment — net	68	65
Purchased intangible assets	131	282
Purchased goodwill	326	536
In-process R&D	1	95
Accounts payable and other current liabilities, net of other assets	(115)	(152)
Deferred tax liability	(12)	(77)
Net assets acquired	$ 552	$ 888
Supplemental information:		
Cash paid	$ 546	$ 962
Less: Cash acquired	7	74
Cash paid, net of cash acquired	$ 539	$ 888
Non-cash (3M shares at fair value)	13	—
Net assets acquired	$ 552	$ 888

Year 2006 acquisitions:

During the 12 months ended December 31, 2006, 3M completed 19 business combinations for a total purchase price of $888 million, net of cash acquired. Purchased identifiable intangible assets of $282 million for these acquisitions will be amortized on a straight-line basis over lives ranging from 1 to 17 years (weighted-average life of 9 years). The purchase price of several of these acquisitions is subject to increases, which could be triggered by the achievement of certain milestones.

The largest of these acquisitions was the August 2006 purchase of 100 percent of the outstanding shares of Security Printing and Systems Limited (Safety, Security and Protection Services Business) from authentos GmbH, Germany. The acquired company is a producer of finished, personalized passports and secure cards.

In October 2006, 3M (Health Care Business) purchased 100 percent of the outstanding shares of Brontes Technologies Inc. (Brontes), a Lexington, Massachusetts–based developer of proprietary 3–D imaging technology for dental and orthodontic applications, for $95 million in cash. Brontes was a "development stage enterprise" that did not yet have revenues from its principal operations and the technology acquired did not have any alternative future use. This transaction resulted in a 2006 charge of $95 million, or $0.13 per diluted share, reflecting the write–off of acquired in–process research and development costs, which are recognized as research, development and related expenses in the Consolidated Statement of Income.

The 17 additional business combinations are summarized as follows:

1) In January 2006, 3M (Consumer and Office Business) purchased 100 percent of the outstanding common shares of Interchemall Dom., a provider of household cleaning products based in Poland.

2) In March 2006, 3M (Industrial and Transportation Business) purchased certain assets of General Industrial Diamond Company Inc., a U.S. operation. The acquired company is a manufacturer of superabrasive grinding wheels, dressing tools and machines used to dimension and finish hard–to–grind materials in the industrial and commercial markets.

3) In April 2006, 3M (Health Care Business) purchased 100 percent of the outstanding shares of OMNII Oral Pharmaceuticals, a provider of differentiated preventive dental products, solutions and support for dental professionals.

4) In April 2006, 3M (Health Care Business) purchased certain assets of ClozeX Medical LLC, a provider of unique skin closure devices to treat lacerations and close surgical incisions. The agreement gives 3M exclusive worldwide rights for the manufacturing and distribution of ClozeX Wound Closures.

5) In June 2006, 3M (Health Care Business) purchased 100 percent of the outstanding shares of SBG (Software und Beratung im Gesundheitswesen) GmbH, a Berlin–based developer of software for managing diagnosis–related information in hospitals.

6) In June 2006, 3M (Safety, Security and Protection Services Business) purchased certain assets of POMP Medical and Occupational Health Products LLC, a Porto Alegre, Brazil–based provider of earplugs, eyewear and hand cream.

7) In July 2006, 3M (Industrial and Transportation Business) purchased certain assets of Pinnacle Distribution Concepts Inc., a leading transportation management system (TMS) provider specializing in the delivery of Web–based, "on–demand" solutions.

8) In July 2006, 3M (Electro and Communications Business) purchased certain assets of SCC Products Inc. and JJ Converting LLC, both based in Sanford, N.C. SCC Products Inc. is a provider of flexible static control packaging and workstation products for electronic devices. JJ Converting LLC is a producer of films used to make static control bags.

9) In August 2006, 3M (Display and Graphics Business) purchased 100 percent of the outstanding shares of Archon Technologies Inc., a Denver, Colorado–based provider of enterprise software solutions for motor vehicle agencies.

10) In August 2006, 3M (Safety, Security and Protection Services Business) purchased 100 percent of the outstanding shares of Aerion Technologies, a Denver, Colorado–based maker of safety products, including heat stress monitors, thermal cameras and carbon monoxide detectors.

11) In September 2006, 3M (Electro and Communications Business) purchased 100 percent of the outstanding shares of Credence Technologies Inc., a Soquel, California–based provider of instruments and high–end monitoring equipment for electrostatic discharge control and electromagnetic compliance.

12) In October 2006, 3M (Consumer and Office Business) purchased certain assets of Nylonge Corp., a global provider of household cleaning products, including cellulose sponges, scrub sponges and household wipes.

13) In October 2006, 3M (Industrial and Transportation Business) purchased 100 percent of the outstanding shares of NorthStar Chemicals, Inc., a Cartersville, Georgia–based adhesive manufacturer.

14) In November 2006, 3M (Industrial and Transportation Business) purchased 100 percent of the outstanding shares of Global Beverage Group Inc., a Canadian–based provider of delivery management software solutions for the direct–store–delivery of consumer packaged goods.

15) In November 2006, 3M (Health Care Business) purchased 100 percent of the outstanding shares of Biotrace International PLC, a Bridgend, UK–based manufacturer and supplier of industrial microbiology products used in food processing safety, health care, industrial hygiene and defense applications.

16) In December 2006, 3M (Electro and Communications Business) purchased certain assets of Mahindra Engineering and Chemical Products LTD, an India–based manufacturer of cable jointing kits and accessories.

17) In December 2006, 3M (Health Care Business) purchased 100 percent of the outstanding shares of SoftMed Systems Inc., a Maryland–based provider of health information management software and services that improve the workflow and efficiency of health care organizations.

The 2006 impact on the Consolidated Balance Sheet of the purchase price allocations related to the 2006 acquisitions and adjustments relative to other acquisitions within the allocation period were provided in the preceding table.

Year 2005 acquisitions:

The Company acquired CUNO on August 2, 2005. The operating results of CUNO are included in the Industrial and Transportation Business segment. CUNO is engaged in the design, manufacture and marketing of a comprehensive line of filtration products for the separation, clarification and purification of fluids and gases. 3M and CUNO have complementary sets of filtration technologies, creating an opportunity to bring an even wider range of filtration solutions to customers around the world. 3M acquired CUNO for approximately $1.36 billion, comprised of $1.27 billion of cash paid (net of cash acquired) and the acquisition of $80 million of debt, most of which has been repaid.

Purchased identifiable intangible assets of $268 million for the CUNO acquisition will be amortized on a straight-line basis over lives ranging from 5 to 20 years (weighted-average life of 15 years). In-process research and development charges from the CUNO acquisition were not material. Pro forma information related to this acquisition is not included because its impact on the Company's consolidated results of operations is not considered to be material. The allocation of the purchase price is presented in the table that follows.

2005 CUNO ACQUISITION Asset (Liability) (Millions)	
Accounts receivable	$ 96
Inventory	61
Property, plant, and equipment — net	121
Purchased intangible assets	268
Purchased goodwill	992
Other assets	30
Deferred tax liability	(102)
Accounts payable and other current liabilities	(104)
Interest bearing debt	(80)
Other long-term liabilities	(16)
Net assets acquired	$ 1,266
Supplemental information:	
Cash paid	$ 1,294
Less: Cash acquired	28
Cash paid, net of cash acquired	$ 1,266

During the year ended December 31, 2005, 3M entered into two immaterial additional business combinations for a total purchase price of $27 million, net of cash acquired.

1) 3M (Electro and Communications Business) purchased certain assets of Siemens Ultrasound division's flexible circuit manufacturing line, a U.S. operation. The acquired operation produces flexible interconnect circuits that provide electrical connections between components in electronics systems used primarily in the transducers of ultrasound machines.

2) 3M (Display and Graphics Business) purchased certain assets of Mercury Online Solutions Inc., a U.S. operation. The acquired operation provides hardware and software technologies and network management services for digital signage and interactive kiosk networks.

NOTE 3. Goodwill and Intangible Assets

As discussed in Note 16 to the Consolidated Financial Statements, effective in the first quarter of 2007, 3M made certain product moves between its business segments, which resulted in changes in the goodwill balances by business segment as presented below. For those changes that resulted in reporting unit changes, the Company applied the relative fair value method to determine the impact to reporting units. SFAS No. 142, "Goodwill and Other Intangible Assets," requires that goodwill be tested for impairment at least annually and when reporting units are changed.

Purchased goodwill from acquisitions totaled $326 million in 2007, $55 million of which is deductible for tax purposes. Purchased goodwill from acquisitions totaled $536 million in 2006, $41 million of which is deductible for tax purposes. The sale of 3M's global branded pharmaceuticals business (Health Care) resulted in the write-off of $54 million in goodwill, which is reflected in the 2006 translation and other column below. Changes in foreign currency exchange rates impacted both 2007 and 2006 goodwill balances. The goodwill balance by business segment follows:

Goodwill

(Millions)	Dec. 31, 2005 Balance	2006 acquisition activity	2006 translation and other	Dec. 31, 2006 Balance	2007 acquisition activity	2007 translation and other	Dec. 31, 2007 Balance
Industrial and Transportation	$ 1,283	$ 26	$ (7)	$ 1,302	$ 155	$ 67	$ 1,524
Health Care	559	191	(37)	713	73	53	839
Display and Graphics	871	12	3	886	—	8	894
Consumer and Office	71	11	7	89	—	5	94
Safety, Security and Protection Services	234	264	27	525	70	16	611
Electro and Communications	512	32	23	567	28	32	627
Total Company	$ 3,530	$ 536	$ 16	$ 4,082	$ 326	$ 181	$ 4,589

Acquired Intangible Assets

The carrying amount and accumulated amortization of acquired intangible assets as of December 31 follow:

(Millions)	2007	2006
Patents	$ 446	$ 419
Other amortizable intangible assets (primarily tradenames and customer–related intangibles)	801	641
Non–amortizable intangible assets (tradenames)	75	68
Total gross carrying amount	$ 1,322	$ 1,128
Accumulated amortization — patents	(305)	(266)
Accumulated amortization — other	(216)	(154)
Total accumulated amortization	(521)	(420)
Total intangible assets — net	$ 801	$ 708

Amortization expense for acquired intangible assets for the years ended December 31 follows:

(Millions)	2007	2006	2005
Amortization expense	$ 87	$ 89	$ 48

Expected amortization expense for acquired intangible assets recorded as of December 31, 2007 follows:

(Millions)	2008	2009	2010	2011	2012	After 2012
Amortization expense	$ 100	$ 98	$ 89	$ 81	$ 72	$ 286

The preceding expected amortization expense is an estimate. Actual amounts of amortization expense may differ from estimated amounts due to additional intangible asset acquisitions, changes in foreign currency exchange rates, impairment of intangible assets, accelerated amortization of intangible assets and other events.

NOTE 4. Restructuring Actions and Other Exit Activities

Restructuring Actions:

During the fourth quarter of 2006 and the first six months of 2007, management approved and committed to undertake the following restructuring actions:

- Pharmaceuticals business actions – employee–related, asset impairment and other costs pertaining to the Company's exit of its branded pharmaceuticals operations. These costs included severance and benefits for pharmaceuticals business employees who are not obtaining employment with the buyers as well as impairment charges associated with certain assets not transferred to the buyers.
- Overhead reduction actions – employee–related costs for severance and benefits, costs associated with actions to reduce the Company's cost structure.
- Business–specific actions – employee–related costs for severance and benefits, fixed and intangible asset impairments, certain contractual obligations, and expenses from the exit of certain product lines.

Components of these restructuring actions include:

Restructuring Actions

(Millions)	Employee-Related Items And Benefits	Contract Terminations and Other	Asset Impairments	Total
Expense incurred in 2006:				
Pharmaceuticals business actions	$ 97	$ 8	$ 61	$ 166
Overhead reduction actions	112	—	—	112
Business-specific actions	34	8	83	125
Total 2006 expense	$ 243	$ 16	$ 144	$ 403
Non-cash changes in 2006:				
Pharmaceuticals business actions	$ (19)	$ —	$ (61)	$ (80)
Overhead reduction actions	(12)	—	—	(12)
Business-specific actions	(4)	—	(83)	(87)
Total 2006 non-cash	$ (35)	$ —	$ (144)	$ (179)
Cash payments in 2006:				
Pharmaceuticals business actions	$ —	$ (2)	$ —	$ (2)
Overhead reduction actions	—	—	—	—
Business-specific actions	—	—	—	—
Total 2006 cash payments	$ —	$ (2)	$ —	$ (2)
Accrued liability balances as of Dec. 31, 2006:				
Pharmaceuticals business actions	$ 78	$ 6	$ —	$ 84
Overhead reduction actions	100	—	—	100
Business-specific actions	30	8	—	38
Total accrued balance	$ 208	$ 14	$ —	$ 222
Expenses (credits) incurred in 2007:				
Pharmaceuticals business actions	$ (12)	$ (4)	$ —	$ (16)
Overhead reduction actions	2	—	—	2
Business-specific actions	13	4	35	52
2007 expense	$ 3	$ —	$ 35	$ 38
Non-cash changes in 2007:				
Pharmaceuticals business actions	$ (21)	$ 4	$ —	$ (17)
Overhead reduction actions	(5)	—	—	(5)
Business-specific actions	(12)	(4)	(35)	(51)
2007 non-cash	$ (38)	$ —	$ (35)	$ (73)
Cash payments in 2007:				
Pharmaceuticals business actions	$ (40)	$ (6)	$ —	$ (46)
Overhead reduction actions	(87)	—	—	(87)
Business-specific actions	(26)	(8)	—	(34)
2007 cash payments	$ (153)	$ (14)	$ —	$ (167)
Accrued liability balances as of Dec. 31, 2007:				
Pharmaceuticals business actions	$ 5	$ —	$ —	$ 5
Overhead reduction actions	10	—	—	10
Business-specific actions	5	—	—	5
Total accrued liability balance	$ 20	$ —	$ —	$ 20

Income statement line in which the preceding 2007 and 2006 expenses (credits) are reflected:

(Millions)	2007	2006
Cost of sales	$ 40	$ 130
Selling, general and administrative expenses	5	198
Research, development and related expenses	(7)	75
Total	$ 38	$ 403

The amount of expenses (credits) incurred in 2007 and 2006 associated with the preceding are reflected in the Company's business segments as follows:

(Millions)	2007	2006
Industrial and Transportation	$ 2	$ 15
Health Care	(11)	293
Display and Graphics	3	39
Safety, Security and Protection Services	28	10
Electro and Communications	18	46
Corporate and Unallocated	(2)	—
Total	$ 38	$ 403

Actions with respect to the above activities were substantially completed in 2007 and additional charges and adjustments are not expected to be material.

In connection with this targeted restructuring plan, the Company eliminated a total of approximately 1,900 positions from various functions within the Company. Approximately 390 positions were pharmaceuticals business employees, approximately 960 positions related primarily to corporate staff overhead reductions, and approximately 550 positions were business-specific reduction actions. Of the 1,900 employment reductions, about 58% are in the United States, 21% in Europe, 12% in Latin America and Canada, and 9% in the Asia Pacific area. As a result of the second-quarter 2007 phase-out of operations at a New Jersey roofing granule facility and the sale of the Company's Opticom Priority Control Systems and Canoga Traffic Detection businesses, the Company eliminated approximately 100 additional positions.

Employee-related severance charges are largely based upon distributed employment policies and substantive severance plans and were reflected in the quarter in which management approved the restructuring actions. Severance amounts for which affected employees were required to render service in order to receive benefits at their termination dates were measured at the date such benefits were communicated to the applicable employees and recognized as expense over the employees' remaining service periods.

Non-cash employee-related changes in 2007 and 2006 primarily relate to special termination pension and medical benefits granted to certain U.S. eligible employees. These pension and medical benefits were reflected as a component of the benefit obligation of the Company's pension and medical plans as of December 31, 2007 and 2006. In addition, these changes also reflect non-cash stock option expense due to the reclassification of certain employees age 50 and older to retiree status, resulting in a modification of their original stock option awards for accounting purposes.

Contract termination and other charges primarily reflect costs to terminate a contract before the end of its term (measured at fair value at the time the Company provided notice to the counterparty) or costs that will continue to be incurred under the contract for its remaining term without economic benefit to the Company.

Business-specific asset impairment charges for 2007 totaled $35 million. This included charges of $24 million related to property, plant and equipment associated with the Company's decision to phase-out operations at a New Jersey roofing granule facility (Safety, Security and Protection Services segment) and charges of $11 million ($10 million related to property, plant and equipment and $1 million related to intangible assets) related to the Company's decision to close an Electro and Communications facility in Wisconsin. Asset impairment charges related to intangible assets and property, plant and equipment reflect the excess of the assets' carrying values over their fair values.

Asset impairment charges in 2006 associated with the pharmaceuticals business and business-specific actions include $109 million relative to property, plant and equipment; $30 million relative to intangible assets; and $5 million relative to other assets. Impairment charges relative to intangible assets and property, plant and equipment reflect the excess of the assets' carrying values over their fair values as discussed in Note 1. The pharmaceuticals business asset impairment charges are for certain assets not transferred to the buyers and primarily relate to the write-down of the assets to salvage value. The business-specific asset impairment charges primarily relate to decisions the Company made in the fourth quarter of 2006 to exit certain marginal product lines in the Display and Graphics segment and Electro and Communications segment.

Other Exit Activities:

During the second half of 2007, the Company recorded net pre–tax charges of $45 million related to exit activities. These charges related to employee reductions and fixed asset impairments, including the consolidation of certain flexible circuit manufacturing operations ($23 million recorded in the Electro and Communications segment) and other actions, primarily in the Display and Graphics segment and Industrial and Transportation segment. These charges were recorded in cost of sales and selling, general and administrative expenses and research, development and related expenses.

NOTE 5. Supplemental Balance Sheet Information

(Millions)	2007	2006
Other current assets		
Product and other insurance receivables	$ 220	$ 255
Deferred income taxes	428	412
Prepaid expenses and other	501	658
Total other current assets	$ 1,149	$ 1,325
Investments		
Available–for–sale (fair value)	$ 16	$ 14
Equity–method	64	86
Cash surrender value of life insurance policies, real estate and other (cost, which approximates fair value)	218	214
Total investments	$ 298	$ 314
Property, plant and equipment — at cost		
Land	$ 303	$ 281
Buildings and leasehold improvements	5,496	5,002
Machinery and equipment	11,801	11,130
Construction in progress	684	505
Capital leases	106	99
Gross property, plant and equipment	18,390	17,017
Accumulated depreciation*	(11,808)	(11,110)
Property, plant and equipment — net	$ 6,582	$ 5,907

*Includes accumulated depreciation for capital leases of $42 million for 2007 and $37 million for 2006.

Other assets		
Product and other insurance receivables	$ 318	$ 373
Deferred income taxes	176	253
Other	234	150
Total other assets	$ 728	$ 776
Other current liabilities		
Accrued trade payables	$ 458	$ 556
Employee benefits and withholdings	228	168
Deferred income	323	299
Property and other taxes	169	176
Product and other claims	120	115
Non–funded pension benefits	35	31
Deferred income taxes	22	7
Other	478	409
Total other current liabilities	$ 1,833	$ 1,761

Accounts payable (included as a separate line item in the Consolidated Balance Sheet) includes drafts payable on demand of $44 million and $65 million as of December 31, 2007, and 2006, respectively.

Supplemental Balance Sheet Information (continued)

(Millions)	2007	2006
Other liabilities		
Non-funded pension and postretirement benefits	$ 1,348	$ 1,437
Employee benefits	576	602
Product and other claims	372	311
Deferred income taxes	355	84
Long term taxes payable	310	—
Minority interest in subsidiaries	325	278
Deferred income	36	50
Capital lease obligations	69	65
Other	175	138
Total other liabilities	$ 3,566	$ 2,965

NOTE 6. Supplemental Stockholders' Equity and Accumulated Other Comprehensive Income Information

Common stock ($.01 par value per share) of 3.0 billion shares is authorized, with 944,033,056 shares issued. Treasury stock is reported at cost, with 234,877,025 shares at December 31, 2007, 209,670,254 shares at December 31, 2006, and 189,494,669 shares at December 31, 2005. Preferred stock, without par value, of 10 million shares is authorized but unissued.

The components of the ending balances of accumulated other comprehensive income (loss) as of December 31 follow:

Accumulated Other Comprehensive Income (Loss)

(Millions)	2007	2006	2005
Cumulative translation adjustment			
Balance at January 1	$ 210	$ (296)	$ 282
Pre-tax amount	456	503	(597)
Tax effect	76	3	19
Net of tax amount	532	506	(578)
Balance at December 31	742	210	(296)
Defined benefit pension plans adjustment			
Balance at January 1	(2,067)	(156)	(110)
Pre-tax amount	941	(3,208)	(28)
Tax effect	(327)	1,297	(18)
Net of tax amount	614	(1,911)	(46)
Balance at December 31	(1,453)	(2,067)	(156)
Unrealized gain (loss) on debt and equity securities			
Balance at January 1	2	3	2
Pre-tax amount	(16)	(1)	2
Tax effect	6	—	(1)
Net of tax amount	(10)	(1)	1
Balance at December 31	(8)	2	3
Unrealized gain (loss) on cash flow hedging instruments			
Balance at January 1	(18)	38	(42)
Pre-tax amount	(24)	(85)	126
Tax effect	14	29	(46)
Net of tax amount	(10)	(56)	80
Balance at December 31	(28)	(18)	38
Total accumulated other comprehensive income (loss)			
Balance at January 1	(1,873)	(411)	132
Pre-tax amount	1,374	(2,791)	(497)
Tax effect	(248)	1,329	(46)
Net of tax amount	1,126	(1,462)	(543)
Balance at December 31	$ (747)	$ (1,873)	$ (411)

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 standard eliminated the requirement for a "minimum pension liability adjustment" that was previously required under SFAS No. 87 and required employers to recognize the underfunded or overfunded status of a defined benefit plan as an asset or liability in its statement of financial position. In 2006, as a result of the implementation of SFAS No. 158, the Company recognized an after-tax decrease in accumulated other comprehensive income of $1.187 billion and $513 million for the U.S. and International pension benefit plans, respectively, and $218 million for the postretirement health care and life insurance benefit plan. See Note 11 for additional detail.

Reclassification adjustments are made to avoid double counting in comprehensive income items that are also recorded as part of net income. In 2007, as disclosed in the net periodic benefit cost table in Note 11, $198 million pre-tax ($123 million after-tax) were reclassified to earnings from accumulated other comprehensive income to pension and postretirement expense in the income statement. These pension and postretirement expense amounts are shown in the table in Note 11 as amortization of transition (asset) obligation, amortization of prior service cost (benefit) and amortization of net actuarial (gain) loss. Other reclassification adjustments (except for cash flow hedging instruments adjustments provided in Note 12) were not material. No tax provision has been made for the translation of foreign currency financial statements into U.S. dollars.

NOTE 7. Supplemental Cash Flow Information

(Millions)	2007	2006	2005
Cash income tax payments	$ 1,999	$ 1,842	$ 1,277
Cash interest payments	162	119	79
Capitalized interest	25	16	12

Individual amounts in the Consolidated Statement of Cash Flows exclude the impacts of acquisitions, divestitures and exchange rate impacts, which are presented separately. "Other — net" in the Consolidated Statement of Cash Flows within operating activities in 2007 and 2006 includes changes in liabilities related to 3M's restructuring actions (Note 4) and in 2005 includes the non-cash impact of adopting FIN 47 ($35 million cumulative effect of accounting change).

Transactions related to investing and financing activities with significant non-cash components are as follows: In 2007, 3M purchased certain assets of Diamond Productions, Inc. for approximately 150 thousand shares of 3M common stock, which has a market value of approximately $13 million at the acquisition's measurement date. Liabilities assumed from acquisitions are provided in the tables in Note 2.

NOTE 8. Income Taxes

Income Before Income Taxes, Minority Interest and Cumulative Effect of Accounting Change (Millions)	2007	2006	2005
United States	$ 2,820	$ 3,191	$ 2,604
International	3,295	2,434	2,224
Total	$ 6,115	$ 5,625	$ 4,828

Provision for Income Taxes (Millions)	2007	2006	2005
Currently payable			
Federal	$ 1,116	$ 1,087	$ 709
State	58	128	82
International	779	824	704
Deferred			
Federal	(105)	(261)	127
State	1	(24)	11
International	115	(31)	(6)
Total	$ 1,964	$ 1,723	$ 1,627

Components of Deferred Tax Assets and Liabilities (Millions)	2007	2006
Accruals not currently deductible		
Employee benefit costs	$ 240	$ 206
Product and other claims	258	190
Pension costs	(99)	478
Restructuring costs	2	66
Stock-based compensation	377	335
Product and other insurance receivables	(154)	(156)
Accelerated depreciation	(403)	(541)
Other	6	(4)
Net deferred tax asset (liability)	$ 227	$ 574

Reconciliation of Effective Income Tax Rate	2007	2006	2005
Statutory U.S. tax rate	35.0%	35.0%	35.0%
State income taxes — net of federal benefit	0.9	1.0	1.3
International income taxes — net	(2.8)	(1.5)	(2.2)
Jobs Act repatriation	—	—	1.6
Foreign export sales benefit	—	(0.9)	(1.0)
U.S. business credits	(0.3)	(0.3)	(0.4)
Reserves for tax contingencies/return to provision	0.4	(2.7)	—
Gain on sale of pharmaceuticals business	—	0.4	—
Restructuring actions	0.1	(0.3)	—
In-process research and development write-off	—	0.6	—
Medicare Modernization Act	(0.4)	(0.4)	(0.3)
Domestic Manufacturer's deduction	(0.8)	(0.3)	(0.2)
All other — net	—	—	(0.1)
Effective worldwide tax rate	32.1%	30.6%	33.7%

The Company files income tax returns in the U.S. federal jurisdiction, and various states and foreign jurisdictions. With few exceptions, the Company is no longer subject to U.S. federal, state and local, or non–U.S. income tax examinations by tax authorities for years before 1999. It is anticipated that its examination for the Company's U.S. income tax returns for the years 2002 through 2004 will be completed by the end of first quarter 2008. As of December 31, 2007, the IRS has proposed adjustments to the Company's tax positions for which the Company is fully reserved. Payments relating to any proposed assessments arising from the 2002 through 2004 audit may not be made until a final agreement is reached between the Company and the IRS on such assessments or upon a final resolution resulting from the administrative appeals process or judicial action. In addition to the U.S. federal examination, there is also limited audit activity in several U.S. state and foreign jurisdictions. Currently, the Company expects the liability for unrecognized tax benefits to change by an insignificant amount during the next 12 months.

The Company adopted the provisions of FASB Interpretation No. 48, "Accounting for Uncertainty in Income Taxes," on January 1, 2007. As a result of the implementation of Interpretation 48, the Company recognized an immaterial increase in the liability for unrecognized tax benefits, which was accounted for as a reduction to the January 1, 2007, balance of retained earnings. A reconciliation of the beginning and ending amount of gross unrecognized tax benefits ("UTB") is as follows:

(Millions)	Federal, State, and Foreign Tax
Gross UTB Balance at January 1, 2007	$ 691
Additions based on tax positions related to the current year	79
Additions for tax positions of prior years	143
Reductions for tax positions of prior years	(189)
Settlements	(24)
Reductions due to lapse of applicable statute of limitations	(20)
Gross UTB Balance at December 31, 2007	$ 680
Net UTB impacting the effective tax rate at December 31, 2007	$ 334

The total amount of unrecognized tax benefits that, if recognized, would affect the effective tax rate as of January 1, 2007 and December 31, 2007, respectively, are $261 million and $334 million. The ending net UTB results from adjusting the gross balance at December 31, 2007 for items such as Federal, State, and non–U.S. deferred items, interest and penalties, and deductible taxes. The net UTB is included as components of Accrued Income Taxes and Other Liabilities within the Consolidated Balance Sheet.

The Company recognizes interest and penalties accrued related to unrecognized tax benefits in tax expense. At January 1, 2007 and December 31, 2007, accrued interest and penalties on a gross basis were $65 million and $69 million, respectively. Included in these interest and penalty amounts is interest and penalties related to tax positions for which the ultimate deductibility is highly certain but for which there is uncertainty about the timing of such deductibility. Because of the impact of deferred tax accounting, other than interest and penalties, the disallowance of the shorter deductibility period would not affect the annual effective tax rate but would accelerate the payment of cash to the taxing authority to an earlier period.

In 2007, the Company completed the preparation and filing of its 2006 U.S. federal and state income tax returns, which did not result in any material changes to the Company's financial position. In 2006, an audit of the Company's U.S. tax returns for years through 2001 was completed. The Company and the Internal Revenue Service reached a final settlement for these years, including an agreement on the amount of a refund claim to be filed by the Company. The Company also substantially resolved audits in certain European countries. In addition, the Company completed the preparation and filing of its 2005 U.S. federal income tax return and the corresponding 2005 state income tax returns. The adjustments from amounts previously estimated in the U.S. federal and state income tax returns (both positive and negative) included lower U.S. taxes on dividends received from the Company's foreign subsidiaries. The Company also made quarterly adjustments (both positive and negative) to its reserves for tax contingencies. Considering the developments noted above and other factors, including the impact on open audit years of the recent resolution of issues in various audits, these reassessments resulted in a reduction of the reserves in 2006 by $149 million, inclusive of the expected amount of certain refund claims.

In 2005, the Company announced its intent to reinvest $1.7 billion of foreign earnings in the United States pursuant to the provisions of the American Jobs Creation Act of 2004. This Act provided the Company the opportunity to tax–

efficiently repatriate foreign earnings for U.S. qualifying investments specified in its domestic reinvestment plan. As a consequence, in 2005, 3M recorded a charge of $75 million.

The Company made discretionary contributions to its U.S. qualified pension plan of $200 million in 2007, $200 million in 2006, and $500 million in 2005. The current income tax provision includes a benefit for the pension contributions; the deferred tax provision includes a cost for the related temporary difference.

As a result of certain employment commitments and capital investments made by 3M, income from manufacturing activities in certain countries is subject to reduced tax rates or, in some cases, is exempt from tax for years through 2014. The income tax benefits attributable to the tax status of these subsidiaries are estimated to be $47 million (6 cents per diluted share) in 2007, $20 million (3 cents per diluted share) in 2006, and $23 million (3 cents per diluted share) in 2005.

The Company has not provided deferred taxes on unremitted earnings attributable to international companies that have been considered to be reinvested indefinitely. These earnings relate to ongoing operations and were approximately $5.7 billion as of December 31, 2007. Because of the availability of U.S. foreign tax credits, it is not practicable to determine the income tax liability that would be payable if such earnings were not indefinitely reinvested.

NOTE 9. Marketable Securities

The Company invests in asset-backed securities, agency securities, corporate medium-term note securities, auction rate securities and other securities. The following is a summary of amounts recorded on the Consolidated Balance Sheet for marketable securities (current and non-current) at December 31, 2007.

(Millions)	Dec. 31, 2007
Agency securities	$ 260
Asset-backed securities	186
Other securities	133
Current marketable securities	579
Asset-backed securities	267
Corporate medium-term notes securities	112
Agency securities	56
Auction rate securities	16
Other securities	29
Non-current marketable securities	480
Total marketable securities	$ 1,059

Classification of marketable securities as current or non-current is dependent upon management's intended holding period, the security's maturity date and liquidity considerations based on market conditions. If management intends to hold the securities for longer than one year as of the balance sheet date, they are classified as non-current. The fair value of marketable securities approximates cost, except for certain auction rate securities discussed in the next paragraph. Gross unrealized gains and losses for marketable securities were not material as of December 31, 2007 and 2006; however, in 2007 the Company did have both realized and unrealized losses associated with auction rate securities as discussed below. Gross realized gains and losses on sales of marketable securities were not material for 2007, 2006 or 2005, but in 2007 pre-tax gains totaled approximately $7 million. Cost of securities sold or reclassified use the first in, first out (FIFO) method. Since these marketable securities are classified as available-for-sale securities, changes in fair value will flow through other comprehensive income, with amounts reclassified out of other comprehensive income into earnings upon sale or "other-than-temporary" impairment (as discussed below).

3M has a diversified marketable securities portfolio of $1.059 billion as of December 31, 2007. Within this portfolio, current and long-term asset-backed securities (estimated fair value of $453 million) are primarily comprised of interests in automobile loans and credit cards, with only $27 million invested in interests in mortgage-backed securities or home equity loans. 3M's marketable securities portfolio also includes auction rate securities (estimated fair value of $16 million) that represent interests in collateralized debt obligations, which are collateralized by pools of residential and commercial mortgages, and interests in investment grade credit default swaps. During the second half of 2007, these auction rate securities failed to auction due to sell orders exceeding buy orders. Liquidity for these auction-rate securities is typically provided by an auction process that resets the applicable interest rate at pre-determined intervals,

usually every 7, 28, 35, or 90 days. The funds associated with failed auctions will not be accessible until a successful auction occurs or a buyer is found outside of the auction process. Based on broker–dealer valuation models and an analysis of other–than–temporary impairment factors, auction rate securities with an original par value of approximately $34 million were written–down to an estimated fair value of $16 million as of December 31, 2007. This write–down resulted in an "other–than–temporary" impairment charge of approximately $8 million (pre–tax) included in net income and a temporary impairment charge of $10 million (pre–tax) reflected as an unrealized loss within other comprehensive income for 2007. As of December 31, 2007, these investments in auction rate securities have been in a loss position for less than six months. These auction rate securities are classified as non–current marketable securities as of December 31, 2007 as indicated in the preceding table.

3M reviews impairments associated with the above in accordance with Emerging Issues Task Force (EITF) 03–1 and FSP SFAS 115–1 and 124–1, "The Meaning of Other–Than–Temporary–Impairment and Its Application to Certain Investments," to determine the classification of the impairment as "temporary" or "other–than–temporary." A temporary impairment charge results in an unrealized loss being recorded in the other comprehensive income component of stockholders' equity. Such an unrealized loss does not reduce net income for the applicable accounting period because the loss is not viewed as other–than–temporary. The company believes that a portion of the impairment of its auction rate securities investments is temporary and a portion is other–than–temporary. The factors evaluated to differentiate between temporary and other–than–temporary include the projected future cash flows, credit ratings actions, and assessment of the credit quality of the underlying collateral.

The balance at December 31, 2007 for marketable securities and short–term investments by contractual maturity are shown below. Actual maturities may differ from contractual maturities because the issuers of the securities may have the right to prepay obligations without prepayment penalties.

(Millions)	Dec. 31, 2007
Due in one year or less	$ 231
Due after one year through three years	545
Due after three years through five years	221
Due after five years	62
Total marketable securities	$ 1,059

NOTE 10. Long–Term Debt and Short–Term Borrowings

Long–term debt and short–term borrowings as of December 31 consisted of the following (with interest rates as of December 31, 2007):

Long–Term Debt (Millions) Description / Principal Amount	Currency/ Fixed vs. Floating*	Effective Interest Rate*	Maturity Date	2007	2006
Eurobond (625 million Euros)	Euro Fixed	4.98%	2014	919	—
30–year bond ($750 million)	USD Fixed	5.73%	2037	747	—
Eurobond (400 million Euros)	Euro Floating	4.45%	2014	591	—
Medium–term note ($500 million)	USD Fixed	4.67%	2012	500	—
Medium–term note ($400 million)	USD Floating	4.84%	2009	408	400
Dealer remarketable securities ($350 million)	USD Fixed	5.83%	2010	350	350
30–year debenture ($330 million)	USD Fixed	5.75%	2028	350	354
Convertible notes ($252 million)	USD Fixed	0.50%	2032	222	542
Floating rate note ($100 million)	USD Floating	4.56%	2041	100	100
ESOP debt guarantee ($87 million)	USD Fixed	5.62%	2008–2009	87	127
Floating rate note ($62 million)	USD Floating	4.64%	2044	62	62
Other borrowings	Various	4.27%	2008–2040	223	226
Total long–term debt				$ 4,559	$ 2,161
Less: current portion of long–term debt				540	1,114
Long–term debt (excluding current portion)				$ 4,019	$ 1,047

Short–Term Borrowings and Current Portion of Long–Term Debt (Millions)	Effective Interest Rate*	2007	2006
Current portion of long–term debt	5.37%	$ 540	$ 1,114
Non–U.S. dollar commercial paper	4.60%	349	314
U.S. dollar commercial paper		—	1,035
Other borrowings	7.57%	12	43
Total short–term borrowings and current portion of long–term debt		$ 901	$ 2,506

Weighted–Average Effective Interest Rate*

	Total		Excluding ESOP Debt	
At December 31	2007	2006	2007	2006
Short–term	5.10%	4.65%	5.07%	4.63%
Long–term	4.48%	3.67%	4.47%	3.49%

* Debt tables reflect the effects of interest rate swaps at December 31; weighted–average effective interest rate table reflects the combined effects of interest rate and currency swaps at December 31.

Maturities of long–term debt for the five years subsequent to December 31, 2007 are as follows (in millions):

2008	2009	2010	2011	2012	Thereafter	Total
$ 540	$ 477	$ 24	$ —	$ 500	$ 3,018	$ 4,559

Long–term debt payments due in 2008 include $350 million of dealer remarketable securities (final maturity 2010) and $62 million of floating rate notes (final maturity 2044). These securities are classified as current portion of long–term debt as the result of put provisions associated with these debt instruments.

The ESOP debt is serviced by dividends on stock held by the ESOP and by Company contributions. These contributions are not reported as interest expense, but are reported as an employee benefit expense in the Consolidated Statement of Income. Other borrowings includes debt held by 3M's international companies and floating

rate notes in the United States, with the long-term portion of this debt primarily composed of U.S. dollar floating rate debt.

At December 31, 2007, certain debt agreements ($350 million of dealer remarketable securities and $87 million of ESOP debt) had ratings triggers (BBB-/Baa3 or lower) that would require repayment of debt. The Company has an AA credit rating from Standard & Poor's, with a stable outlook, and an Aa1 credit rating from Moody's Investors Service, with a negative outlook. On April 30, 2007, the Company replaced its $565 million credit facility with a new $1.5 billion five-year credit facility, which has provisions for the Company to request an increase of the facility up to $2 billion (at the lenders' discretion), and providing for up to $150 million in letters of credit. As of December 31, 2007, there are $110 million in letters of credit drawn against the facility. Under the new credit agreement, 3M is required to maintain its EBITDA to Interest Ratio as of the end of each fiscal quarter at not less than 3.0 to 1. This is calculated (as defined in the agreement) as the ratio of consolidated total EBITDA for the four consecutive quarters then ended to total interest expense on all funded debt for the same period. At December 31, 2007, this ratio was approximately 35 to 1. At December 31, 2007, available short-term committed lines of credit internationally totaled approximately $67 million, of which approximately $13 million was utilized. Debt covenants do not restrict the payment of dividends.

The Company has a "well-known seasoned issuer" shelf registration statement, effective February 24, 2006, to register an indeterminate amount of debt or equity securities for future sales. On June 15, 2007, the Company registered 150,718 shares of the Company's common stock under this shelf on behalf of and for the sole benefit of the selling stockholders in connection with the Company's acquisition of assets of Diamond Productions, Inc. The Company intends to use the proceeds from future securities sales off this shelf for general corporate purposes. In connection with this shelf registration, in June 2007 the Company established a medium-term notes program through which up to $3 billion of medium-term notes may be offered. In December 2007, 3M issued a five-year, $500 million, fixed rate note with a coupon rate of 4.65% under this medium-term notes program. This program has a remaining capacity of $2.5 billion as of December 31, 2007.

In September 2003, the Company filed a shelf registration statement with the Securities and Exchange Commission relating to the potential offering of debt securities of up to $1.5 billion. This shelf registration became effective in October 2003. In December 2003, the Company established under the shelf a medium-term notes program through which up to $1.5 billion of medium-term notes may be offered. In March 2007, the Company issued a 30-year, $750 million, fixed rate note with a coupon rate of 5.70%. In November 2006, 3M issued a three-year, $400 million, fixed rate note. The Company entered into an interest rate swap to convert this to a rate based on a floating LIBOR index. In December 2004, 3M issued a 40-year, $62 million, floating rate note, with the rate based on a floating LIBOR index. This $1.5 billion medium term notes program was replaced by the $3 billion program established in June 2007.

In July 2007, 3M issued a seven year 5.0% fixed rate Eurobond for an amount of 750 million Euros (approximately $1.102 billion in U.S. Dollars at December 31, 2007). Upon debt issuance in July 2007, 3M completed a fixed-to-floating interest rate swap on a notional amount of 400 million Euros as a fair value hedge of a portion of the fixed interest rate Eurobond obligation. In December 2007, 3M reopened the existing seven year 5.0% fixed rate Eurobond for an additional amount of 275 million Euros (approximately $404 million in U.S. Dollars at December 31, 2007). This security was issued at a premium and was subsequently consolidated with the original security on January 15, 2008.

3M may redeem its 30-year zero-coupon senior notes (the "Convertible Notes") at any time in whole or in part, beginning November 21, 2007, at the accreted conversion price; however, bondholders may convert upon notification of redemption each of the notes into 9.4602 shares of 3M common stock. Holders of the 30-year zero-coupon senior notes have the option to require 3M to purchase their notes at accreted value on November 21 in the years 2005, 2007, 2012, 2017, 2022 and 2027. In November 2005, 22,506 of the 639,000 in outstanding bonds were redeemed, resulting in a payout from 3M of approximately $20 million. In November 2007, an additional 364,598 outstanding bonds were redeemed resulting in a payout from 3M of approximately $322 million. These payouts reduced the Convertible Notes' face value at maturity to $252 million, which equates to a book value of approximately $222 million at December 31, 2007. As disclosed in a Form 8-K in November 2005, 3M amended the terms of these securities to pay cash at a rate of 2.40% per annum of the principal amount at maturity of the Company's Convertible Notes, which equates to 2.75% per annum of the notes' accreted value on November 21, 2005. The cash interest payments were made semiannually in arrears on May 22, 2006, November 22, 2006, May 22, 2007 and November 22, 2007 to holders of record on the 15th calendar day preceding each such interest payment date. Effective November 22, 2007, the effective interest rate reverted back to the original yield of 0.50%.

3M originally sold $639 million in aggregate face amount of these "Convertible Notes" on November 15, 2002, which are convertible into shares of 3M common stock. The gross proceeds from the offering, to be used for general corporate purposes, were $550 million ($540 million net of issuance costs). Debt issuance costs were amortized on a straight-line basis over a three-year period beginning in November 2002. On February 14, 2003, 3M registered these Convertible Notes in a registration statement filed with the Securities and Exchange Commission. The terms of the

Convertible Notes include a yield to maturity of .50% and an initial conversion premium of 40% over the $65.00 (split–adjusted) closing price of 3M common stock on November 14, 2002. If certain conditions for conversion (relating to the closing common stock prices of 3M exceeding the conversion trigger price for specified periods) are met, holders may convert each of the 30–year zero–coupon senior notes into 9.4602 shares of 3M common stock in any calendar quarter commencing after March 31, 2003. The conversion trigger price for the fourth quarter of 2007 was $121.21 per share. If the conditions for conversion are met, and 3M elects not to settle in cash, the 30–year zero–coupon senior notes will be convertible in the aggregate into approximately 2.4 million shares of 3M common stock. The conditions for conversion related to the Company's Convertible Notes have never been met. If the conditions for conversion are met, 3M may choose to pay in cash and/or common stock; however, if this occurs, the Company has the intent and ability to settle this debt security in cash. Accordingly, there was no impact on 3M's diluted earnings per share.

In December 2007, the Company's $350 million of dealer remarketable securities were remarketed for one year. They were reissued with a fixed coupon rate of 5.83%. These securities, which are classified as current portion of long–term debt, were issued in December 2000. The remarketable securities can be remarketed annually, at the option of the dealer, for a year each time, with a final maturity date of December 2010. In the second quarter of 2007, 3M repurchased $42 million in floating rate notes due in 2037 at par as the bondholder exercised put provisions associated with this debt instrument.

NOTE 11. Pension and Postretirement Benefit Plans

3M has various company–sponsored retirement plans covering substantially all U.S. employees and many employees outside the United States. Pension benefits associated with these plans generally are based on each participant's years of service, compensation, and age at retirement or termination. In addition to providing pension benefits, the Company provides certain postretirement health care and life insurance benefits for substantially all of its U.S. employees who reach retirement age while employed by the Company. Most international employees and retirees are covered by government health care programs. The cost of company–provided postretirement health care plans for international employees is not material and is combined with U.S. amounts.

The Company's pension funding policy is to deposit with independent trustees amounts allowable by law. Trust funds and deposits with insurance companies are maintained to provide pension benefits to plan participants and their beneficiaries. There are no plan assets in the non–qualified plan due to its nature. For its U.S. postretirement health care and life insurance benefit plans, the Company has set aside amounts at least equal to annual benefit payments with an independent trustee.

In August 2006, the Pension Protection Act (PPA) was signed into law in the U.S. The PPA increases the funding target for defined benefit pension plans to 100% of the target liability. The PPA transition rules require a funding liability target of 92% in 2008, reaching 100% by 2011. 3M's U.S. qualified defined benefit plans are funded in excess of the applicable transition funding liability target for 2008; therefore, the Company expects that the plans will not be subject to the minimum required contribution of the PPA and its transition rules will not have a material impact on expected future contributions.

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 standard requires employers to recognize the underfunded or overfunded status of defined benefit pension and postretirement plans as an asset or liability in its statement of financial position, and recognize changes in the funded status in the year in which the changes occur through accumulated other comprehensive income, which is a component of stockholders' equity. This standard also eliminates the requirement for Additional Minimum Pension Liability (AML) required under SFAS No. 87. As a result of the application of SFAS No. 158 as of December 31, 2006, 3M reversed assets of $2.515 billion and increased liabilities by $703 million. These liabilities were offset to accumulated other comprehensive income and deferred taxes. In 2006, as a result of the implementation of SFAS No. 158, the Company recognized an after–tax decrease in accumulated other comprehensive income of $1.187 billion and $513 million for the U.S. and International pension benefit plans, respectively, and $218 million for the postretirement health care and life insurance benefit plan.

The following illustrates the adjustments to the Balance Sheet to record the initial adoption of the SFAS No. 158 funded status as of December 31, 2006:

(Millions)	With AML from 2005	AML adjustment	Pre-SFAS No. 158 with AML adjustments	SFAS No.158 adoption adjustments	Post SFAS No. 158
Prepaid Pension/(accrued pension liability)	$ 2,111	$ 15	$ 2,126	$ (3,199)	$ (1,073)
Intangible asset	24	(5)	19	(19)	—
Deferred tax asset	98	(3)	95	1,300	1,395
Accumulated other comprehensive income, net of tax	156	(7)	149	1,918	2,067
Accumulated other comprehensive income, pre-tax	254	(10)	244	3,218	3,462

Following is a reconciliation of the beginning and ending balances of the benefit obligation and the fair value of plan assets as of December 31:

	Qualified and Non-qualified Pension Benefits				Postretirement Benefits	
	United States		International			
(Millions)	2007	2006	2007	2006	2007	2006
Change in benefit obligation						
Benefit obligation at beginning of year	10,149	$ 10,052	$ 4,450	$ 3,884	$ 1,841	$ 1,918
Acquisitions	—	—	3	22	—	—
Service cost	192	196	125	124	57	58
Interest cost	568	539	228	183	104	104
Participant contributions	—	—	4	4	47	41
Foreign exchange rate changes	—	—	337	365	14	—
Plan amendments	18	2	17	(1)	(98)	(157)
Actuarial (gain) loss	(154)	(142)	(114)	26	(16)	35
Medicare Part D Reimbursement	—	—	—	—	10	10
Benefit payments	(565)	(530)	(175)	(146)	(159)	(168)
Settlements, curtailments, special termination benefits and other	7	32	(19)	(11)	9	—
Benefit obligation at end of year	$ 10,215	$ 10,149	$ 4,856	$ 4,450	$ 1,809	$ 1,841
Change in plan assets						
Fair value of plan assets at beginning of year	10,060	9,285	$ 3,970	3,340	$ 1,337	1,239
Acquisitions	—	—	1	21	—	—
Actual return on plan assets	1,376	1,072	188	325	127	188
Company contributions	225	233	151	115	3	37
Participant contributions	—	—	4	4	47	41
Foreign exchange rate changes	—	—	300	316	—	—
Benefit payments	(565)	(530)	(175)	(146)	(159)	(168)
Settlements, curtailments, special termination benefits and other	—	—	(15)	(5)	—	—
Fair value of plan assets at end of year	$ 11,096	$ 10,060	$ 4,424	$ 3,970	$ 1,355	$ 1,337
Funded status at end of year	$ 881	$ (89)	$ (432)	$ (480)	$ (454)	$ (504)

(Millions)	Qualified and Non-qualified Pension Benefits				Postretirement Benefits	
	United States		International			
	2007	2006	2007	2006	2007	2006
Amounts recognized in the Consolidated Balance Sheet as of Dec. 31,						
Non-current assets	$ 1,246	$ 269	$ 132	$ 126	$ —	$ —
Accrued benefit cost						
Current liabilities	(27)	(26)	(6)	(5)	(2)	—
Non-current liabilities	(338)	(332)	(558)	(601)	(452)	(504)
Ending balance	$ 881	$ (89)	$ (432)	$ (480)	$ (454)	$ (504)
Amounts recognized in accumulated other comprehensive income as of Dec. 31,						
Net transition obligation (asset)	$ —	$ —	$ 1	$ 3	$ —	$ —
Net actuarial loss (gain)	1,210	2,027	884	899	768	874
Prior service cost (credit)	68	64	(45)	(65)	(365)	(339)
Ending balance	$ 1,278	$ 2,091	$ 840	$ 837	$ 403	$ 535

The accumulated benefit obligation of the U.S. pension plans was $9.643 billion and $9.560 billion at December 31, 2007 and 2006, respectively. The accumulated benefit obligation of the international pension plans was $4.421 billion and $3.756 billion at December 2007 and 2006, respectively.

The U.S. nonqualified pension plan had a projected benefit obligation of $360 million and $354 million, respectively, as of December 31, 2007 and 2006, and has no plan assets due to the nature of the plan. The accumulated benefit obligation of the nonqualified pension plan is equal to the projected benefit obligation.

The following amounts relate to international pension plans with projected benefit obligations in excess of plan assets as of December 31:

(Millions)	2007	2006
Projected benefit obligation	$ 4,346	$ 3,680
Accumulated benefit obligation	3,989	3,049
Fair value of plan assets	3,782	3,073

The following amounts relate to international pension plans with accumulated benefit obligations in excess of plan assets as of December 31:

(Millions)	2007	2006
Projected benefit obligation	$ 3,497	$ 1,020
Accumulated benefit obligation	3,271	854
Fair value of plan assets	2,984	578

Components of net periodic benefit cost and other supplemental information for the years ended December 31 follow:

Components of net periodic benefit cost and other amounts recognizedin other comprehensive income (Millions)	Qualified and Non-qualified Pension Benefits						Postretirement Benefits		
	United States			International					
	2007	2006	2005	2007	2006	2005	2007	2006	2005
Net periodic benefit cost									
Service cost	$ 192	$ 196	$ 177	$ 125	$ 124	$ 102	$ 57	$ 58	$ 53
Interest cost	568	539	502	228	183	177	104	104	101
Expected return on plan assets	(840)	(764)	(665)	(290)	(245)	(217)	(107)	(103)	(93)
Amortization of transition (asset) obligation	—	—	—	3	3	4	—	—	—
Amortization of prior service cost (benefit)	14	13	13	(2)	(3)	(3)	(72)	(50)	(39)
Amortization of net actuarial (gain) loss	126	202	179	55	63	58	74	84	84
Net periodic benefit cost	$ 60	$ 186	$ 206	$ 119	$ 125	$ 121	$ 56	$ 93	$ 106
Settlements, curtailments, special termination benefits and other	7	32	6	4	4	(2)	9	—	—
Net periodic benefit cost after settlements, curtailments, special termination benefits and other	$ 67	$ 218	$ 212	$ 123	$ 129	$ 119	$ 65	$ 93	$ 106

The estimated amortization from accumulated other comprehensive income into net periodic benefit cost in 2008 follows:

Amounts expected to be amortized from accumulated other comprehensive income into net periodic benefit costs over next fiscal year (Millions)	Qualified and Non-qualified Pension Benefits		Postretirement Benefits
	United States	International	
Amortization of transition (asset) obligation	$ —	$ 3	$ —
Amortization of prior service cost (benefit)	15	(2)	(85)
Amortization of net actuarial (gain) loss	58	40	59
	$ 73	$ 41	$ (26)

Other supplemental information for the years ended December 31 follows:

Weighted-average assumptions used to determine benefit obligations	Qualified and Non-qualified Pension Benefits						Postretirement Benefits		
	United States			International					
	2007	2006	2005	2007	2006	2005	2007	2006	2005
Discount rate	6.00%	5.75%	5.50%	5.39%	4.88%	4.50%	6.00%	5.75%	5.50%
Compensation rate increase	4.30%	4.30%	4.30%	3.82%	3.67%	3.52%	N/A	N/A	N/A
Weighted-average assumptions used to determine net cost for years ended	2007	2006	2005	2007	2006	2005	2007	2006	2005
Discount rate	5.75%	5.50%	5.75%	4.88%	4.50%	4.88%	5.75%	5.50%	5.75%
Expected return on assets	8.75%	8.75%	8.75%	7.19%	7.20%	7.08%	8.60%	8.60%	8.60%
Compensation rate increase	4.30%	4.30%	4.30%	3.67%	3.52%	3.55%	N/A	N/A	N/A

As of December 31, 2005, the Company converted to the RP (Retirement Plans) 2000 Mortality Table for calculating the year-end 2005 U.S. pension and postretirement obligations and 2006 expense. The impact of this change increased the year-end 2005 U.S. Projected Benefit Obligations for pension by $385 million, the year-end 2005 U.S. Accumulated Benefit Obligations for pension by $349 million and the 2005 U.S. Accumulated Postretirement Benefit Obligation by $93 million. This change also increased pension expenses for 2006 by $64 million and postretirement expenses by $17 million.

The Company reviews external data and its own historical trends for health care costs to determine the health care trend rates for the postretirement medical plans. As of December 31, 2006, the Company modified its health care trend rates assumption by raising the rate and separating the trend rates used for plan participants less than 65 years of age and plan participants 65 years of age or older. The separation of the trend rates reflects the higher costs associated with prescription drugs in the 65 or older age group. The assumed health care trend rates as of December 31 are as follows:

	2007		2006	
Assumed health care trend rates	Pre-65	Post-65	Pre-65	Post-65
Health care cost trend rate used to determine benefit obligations	8.50%	9.75%	9.00%	10.25%
Rate that the cost trend rate is assumed to decline to (ultimate trend rate)	5.00%	5.00%	5.00%	5.00%
Years to Ultimate Trend Rate	8	8	9	9

The assumed health care trend rates shown above reflect 3M's expected medical and drug claims experience. The Company has developed certain long-term strategies to help offset trend rates through care management, strategic sourcing activities and plan design. A one percentage point change in assumed health cost trend rates would have the following effects:

Health Care Cost (Millions)	One Percentage Point Increase	One Percentage Point Decrease
Effect on total of service and interest cost	$ 23	$ (19)
Effect on postretirement benefit obligation	195	(165)

3M's investment strategy for its pension and postretirement plans is to manage the plans on a going-concern basis. The primary goal of the funds is to meet the obligations as required. The secondary goal is to earn the highest rate of return possible, without jeopardizing its primary goal, and without subjecting the Company to an undue amount of contribution rate volatility. Fund returns are used to help finance present and future obligations to the extent possible within actuarially determined funding limits and tax-determined asset limits, thus reducing the level of contributions 3M must make.

3M does not buy or sell any of its own stock as a direct investment for its pension and other postretirement benefit funds. However, due to external investment management of the funds, the plans may indirectly buy, sell or hold 3M stock. The aggregate amount of the shares would not be considered to be material relative to the aggregate fund percentages.

For the U.S. pension plan, the Company's assumption for the expected return on plan assets was 8.75% in 2007. The Company is lowering the 2008 expected return on plan assets for its U.S. pension plan by 0.25 percentage points to 8.50%. This will reduce 2008 expected pension income by approximately $26 million. Projected returns are based primarily on broad, publicly traded equity and fixed-income indices and forward-looking estimates of active portfolio and investment management. As of December 31, 2007, the Company's 2008 expected long-term rate of return on U.S. plan assets is based on an asset allocation assumption of 46% global equities, with an expected long-term rate of return of 7.75%, 13% private equities with an expected long-term rate of return of 12.75%; 24% fixed-income securities with an expected long-term rate of return of 5.0%; 12% absolute return investments independent of traditional performance benchmarks, with an expected long term return of 7%, 5% commodities with an expected long-term rate of return of 6.5%. The company expects additional positive return from active investment management. These assumptions result in an 8.50% expected rate of return on an annualized basis. The plan assets earned a rate of return in excess of 14%, 12% and 10% in 2007, 2006 and 2005, respectively. The average annual actual return on the plan assets over the past 10 and 25 years has been 9.1% and 12.2%, respectively.

During 2006, certain absolute return and commodity investments were included in equity and fixed income allocations. The 2006 presentation in the table that follows has been reclassified to conform to the 2007 presentation.

The U.S. plan's asset allocation by asset category as of plan measurement dates follows:

Asset Category	Target Allocation	Percentage of Plan Assets 2007	2006
U.S. qualified pension plan			
Global equity	46%	45%	57%
Fixed income	24	23	19
Private equity	13	16	12
Absolute return	12	11	9
Commodities	5	4	2
Cash	—	1	1
Total	100%	100%	100%
Postretirement benefits			
Global equity	69%	75%	79%
Fixed income	10	9	10
Private equity	18	13	10
Absolute return	2	2	—
Commodities	1	1	—
Cash	—	—	1
Total	100%	100%	100%

While the target asset allocations do not have a percentage allocated to cash, the plans will always have some cash due to cash flows. The postretirement allocation shown above represents a weighted–average allocation for U.S. plans.

The international plans' weighted–average asset allocation as of plan measurement dates follows:

Asset Category	Percentage of Plan Assets 2007	2006
International pension plans		
Global equity	46%	35%
Domestic equity	8	11
Foreign equity	4	11
Real estate	3	3
Domestic fixed income	19	19
Foreign fixed income	11	5
Insurance	9	15
Cash	—	1
Total	100%	100%

The preceding asset allocations for international plans represent the top six countries by projected benefit obligation. These countries represent approximately 90% of the total international plan assets. The other countries' asset allocations would not have a significant impact on the information presented.

In the third quarter of 2007, the Company made discretionary contributions totaling $200 million to its U.S. qualified pension plan. In 2008, the Company expects to contribute an amount in the range of $100 million to $400 million to its U.S. and international pension plans. The Company does not have a required minimum pension contribution obligation for its U.S. plans in 2008. Therefore, the amount of the anticipated discretionary contribution could vary significantly depending on the U.S. plans' funding status as of the 2008 measurement date and the anticipated tax deductibility of the contribution.

The following estimated benefit payments are payable from the plans to participants:

(Millions)	Qualified and Non-qualified Pension Benefits		Postretirement Benefits	Medicare Subsidy Receipts
	United States	International		
2008 Benefit Payments	$ 574	$ 188	$ 117	$ 13
2009 Benefit Payments	588	192	124	15
2010 Benefit Payments	607	197	130	17
2011 Benefit Payments	628	209	138	18
2012 Benefit Payments	665	222	143	20
Following five years	3,626	1,259	799	128

NOTE 12. Derivatives and Other Financial Instruments

The Company uses interest rate swaps, currency swaps, and forward and option contracts to manage risks generally associated with foreign exchange rate, interest rate and commodity price fluctuations. The information that follows explains the various types of derivatives and financial instruments, and includes a table that recaps cash flow hedging amounts.

Cash Flow Hedging — Foreign Currency Forward and Option Contracts: The Company enters into foreign exchange forward contracts, options and swaps to hedge against the effect of exchange rate fluctuations on cash flows denominated in foreign currencies and certain intercompany financing transactions. These transactions are designated as cash flow hedges. At December 31, 2007, the Company had various open foreign exchange forward and option contracts, the majority of which had maturities of one year or less. The settlement or extension of these derivatives will result in reclassifications to earnings in the period during which the hedged transactions affect earnings (from other comprehensive income). The maximum length of time over which 3M is hedging its exposure to the variability in future cash flows for a majority of the forecasted transactions is 12 months. Hedge ineffectiveness was not material for the years 2007, 2006 and 2005.

Cash Flow Hedging — Commodity Price Management: The Company manages commodity price risks through negotiated supply contracts, price protection agreements and forward physical contracts. The Company uses commodity price swaps as cash flow hedges of forecasted transactions to manage price volatility. The related mark-to-market gain or loss on qualifying hedges is included in other comprehensive income to the extent effective, and reclassified into cost of sales in the period during which the hedged transaction affects earnings. 3M has hedged its exposure to the variability of future cash flows for certain forecasted transactions through 2008. No significant commodity cash flow hedges were discontinued and hedge ineffectiveness was not material during the years 2007, 2006 and 2005.

Cash Flow Hedging — Forecasted Debt Issuance: In June 2007, the Company executed a pre-issuance cash flow hedge by entering into a floating-to-fixed interest rate swap on a notional amount of 350 million Euros related to the anticipated July 2007 Eurobond issuance of 750 million Euros. Upon debt issuance in July 2007, 3M terminated the floating-to-fixed swap. The termination of the swap resulted in an immaterial gain, which is being amortized over the seven year life of the Eurobond.

Amounts recorded in accumulated other comprehensive income (loss) related to cash flow hedging instruments follow.

Cash Flow Hedging Instruments Net of Tax (Millions)	Twelve months ended December 31		
	2007	2006	2005
Beginning balance	$ (18)	$ 38	$ (42)
Changes in fair value of derivatives	(17)	(53)	70
Reclassifications to earnings from equity	7	(3)	10
Total activity	(10)	(56)	80
Ending balance	$ (28)	$ (18)	$ 38

At December 31, 2007, the Company expects to reclassify to earnings over the next 12 months a majority of the cash flow hedging instruments after–tax loss of $28 million (with the impact offset by cash flows from underlying hedged items).

Fair Value Hedging — Interest Rate Swaps: The Company manages interest expense using a mix of fixed and floating rate debt. To help manage borrowing costs, the Company may enter into interest rate swaps. Under these arrangements, the Company agrees to exchange, at specified intervals, the difference between fixed and floating interest amounts calculated by reference to an agreed–upon notional principal amount.

At December 31, 2007, the Company had interest rate swaps designated as fair value hedges of underlying fixed rate obligations. In June 2006, the Company entered into a $330 million fixed–to–floating interest rate swap to hedge the 30–year bond due in 2028. The Company terminated the swap in March 2007 and the resulting gain will be recognized over the remaining life of the underlying debt. Accordingly, the termination of the swap did not have a material impact on 3M's consolidated results of operations or financial condition. As indicated in Note 10, in November 2006, the Company entered into a $400 million fixed–to–floating interest rate swap concurrent with the issuance of the three–year medium–term note due in 2009. Also as indicated in Note 10, in July 2007, in connection with the issuance of a seven–year Eurobond for an amount of 750 million Euros, the Company completed a fixed–to–floating interest rate swap on a notional amount of 400 million Euros as a fair value hedge of a portion of the fixed interest rate Eurobond obligation. The mark–to–market of these fair value hedges is recorded as gains or losses in interest expense and is offset by the gain or loss on the underlying debt instrument, which also is recorded in interest expense. The fair value of these interest rate swaps were $36 million and $26 million as of December 31, 2007 and 2006, respectively. These fair value hedges are 100% effective and, thus, there is no impact on earnings due to hedge ineffectiveness.

Net Investment Hedging: As circumstances warrant, the Company uses cross currency swaps, forwards and foreign currency denominated debt to hedge portions of the Company's net investments in foreign operations. For hedges that meet the effectiveness requirements, the net gains or losses attributable to changes in spot exchange rates are recorded in cumulative translation within other comprehensive income. The remainder of the change in value of such instruments is recorded in earnings.

In September 2006, the Company entered into a three–year floating–to–floating cross currency swap with a notional amount of $300 million. This transaction is a partial hedge of the Company's net investment in its Japanese subsidiaries. This swap converts U.S. dollar–based variable interest payments to yen–based variable interest payments associated with the notional amount.

In November 2006, the Company entered into a three–year floating–to–floating cross currency swap with a notional amount of $200 million. This transaction is a partial hedge of the Company's net investment in its European subsidiaries. This swap converts U.S. dollar–based variable interest payments to Euro–based variable interest payments associated with the notional amount.

In December 2006, the Company entered into foreign currency forward contracts with a notional amount of $556 million relative to the Company's net investment in its European subsidiaries and with a notional amount of $209 million relative to the Company's net investment in its Japanese subsidiaries. These forwards matured in December 2007.

In July and December 2007, as discussed in Note 10, the Company issued seven–year fixed rate Eurobond securities for amounts of 750 million Euros and 275 million Euros, respectively. 3M designated each of these Eurobond issuances as hedging instruments of the Company's net investment in its European subsidiaries.

In November and December 2007, the Company entered into foreign currency forward contracts with a notional amount of $200 million that were designated as a partial hedge of the Company's net investment in its Chinese subsidiaries. These forwards mature in December 2008.

The unrealized loss recorded in cumulative translation related to net investment hedging at December 31, 2007 was $28 million and the unrealized loss at December 31, 2006 was $18 million.

Currency Effects: 3M estimates that year–on–year currency effects, including hedging impacts, increased net income by approximately $150 million in 2007, $20 million in 2006, and $115 million in 2005. This estimate includes the effect of translating profits from local currencies into U.S. dollars; the impact of currency fluctuations on the transfer of goods between 3M operations in the United States and abroad; and transaction gains and losses, including derivative instruments designed to reduce foreign currency exchange rate risks. 3M estimates that year–on–year derivative and other transaction gains and losses increased net income by approximately $10 million in 2007, had an immaterial impact on net income in 2006, and increased net income by approximately $50 million in 2005.

Credit risk: The Company is exposed to credit loss in the event of nonperformance by counterparties in interest rate swaps, currency swaps, and option and foreign exchange contracts. However, the Company's risk is limited to the fair value of the instruments. The Company actively monitors its exposure to credit risk through the use of credit approvals and credit limits, and by selecting major international banks and financial institutions as counterparties. The Company does not anticipate nonperformance by any of these counterparties. During the second quarter of 2006, the Company entered into a credit support agreement with one of its primary derivatives counterparties. Under this agreement either party is required to post eligible collateral when the market value of transactions covered by the agreement exceeds specified thresholds, thus limiting credit exposure for both parties.

Fair value of financial instruments: At December 31, 2007 and 2006, the Company's financial instruments included cash and cash equivalents, marketable securities, accounts receivable, investments, accounts payable, borrowings, and derivative contracts. The fair values of cash and cash equivalents, accounts receivable, accounts payable, and short-term borrowings and current portion of long-term debt (except the $350 million dealer remarketable security) approximated carrying values because of the short-term nature of these instruments. Available-for-sale marketable securities, investments and derivative contracts are reported at fair values. Fair values for investments held at cost are not readily available, but are estimated to approximate fair value. The carrying amounts and estimated fair values of other financial instruments based on third-party quotes as of December 31 follow:

Financial Instruments' Carrying Amounts and Estimated Fair Values

	2007		2006	
(Millions)	Carrying Amount	Fair Value	Carrying Amount	Fair Value
Dealer remarketable securities	$ 350	$ 368	$ 350	$ 358
Convertible note (long-term in 2007 and short-term in 2006)	222	212	542	568
Long-term debt	3,797	3,796	1,047	1,054

NOTE 13. Commitments and Contingencies

Capital and Operating Leases:
Rental expense under operating leases was $226 million in 2007, $211 million in 2006, and $195 million in 2005. It is 3M's practice to secure renewal rights for leases, thereby giving 3M the right, but not the obligation, to maintain a presence in a leased facility. 3M's primary capital lease, which became effective in April 2003, involves a building in the United Kingdom (with a lease term of 22 years). During the second quarter of 2003, 3M recorded a capital lease asset and obligation of approximately 33.5 million United Kingdom pounds (approximately $67 million at December 31, 2007 exchange rates). Minimum lease payments under capital and operating leases with non-cancelable terms in excess of one year as of December 31, 2007, were as follows:

(Millions)	Capital Leases	Operating Leases
2008	$ 7	$ 98
2009	6	79
2010	6	58
2011	6	35
2012	5	30
After 2012	54	141
Total	84	$ 441
Less: Amounts representing interest	13	
Present value of future minimum lease payments	71	
Less: Current obligations under capital leases	2	
Long-term obligations under capital leases	$ 69	

Warranties/Guarantees:
3M's accrued product warranty liabilities, recorded on the Consolidated Balance Sheet as part of current and long-term liabilities, are estimated at approximately $21 million as of December 31, 2007. 3M does not consider this amount to be material. The fair value of 3M guarantees of loans with third parties and other guarantee arrangements are not material.

Related Party Activity:

Purchases from related parties (largely related to companies in which 3M has an equity interest) totaled approximately $144 million in 2007 ($160 million in 2006 and $141 million in 2005). Receivables due from related parties (largely related to receivables from employees for relocation and other ordinary business expense advances) totaled approximately $40 million in 2007 ($36 million in 2006, and $37 million in 2005). 3M sales to related parties totaled approximately $6 million in 2007 ($4 million in 2006, and $5 million in 2005). Indebtedness to 3M from related parties was not material in 2007, 2006 and 2005.

Legal Proceedings:

The Company and some of its subsidiaries are involved in numerous claims and lawsuits, principally in the United States, and regulatory proceedings worldwide. These include various products liability (involving products that the Company now or formerly manufactured and sold), intellectual property, and commercial claims and lawsuits, including those brought under the antitrust laws, and environmental proceedings. The following sections first describe the significant legal proceedings in which the Company is involved, and then describe the liabilities and associated insurance receivables the Company has accrued relating to its significant legal proceedings. Unless otherwise stated, the Company is vigorously defending all such litigation.

Shareholder Derivative Litigation

As previously reported, in July 2007, a shareholder derivative lawsuit was filed in the U.S. District Court for the District of Delaware against the Company as nominal defendant and against each then current member of the Board of Directors and the officers named in the Summary Compensation Table of the 2007 Proxy Statement. The suit alleges that the Company's 2007 Proxy Statement contained false and misleading statements concerning the tax deductibility of compensation payable under the Executive Annual Incentive Plan ("Plan") and the standards for determining the amounts payable under the Plan. The lawsuit seeks a declaration voiding shareholder approval of the Plan, termination of the Plan, voiding the elections of directors, equitable accounting, and awarding costs, including attorneys' fees. Plaintiff filed a motion for summary judgment, and the defendants filed a motion to dismiss all claims on the grounds that plaintiff had failed to make a demand on the Board and had otherwise failed to state a proper claim under the Private Securities Litigation Reform Act. The defendants also moved to transfer the case from the District of Delaware to the District of Minnesota. In February 2008, the Court denied without prejudice the plaintiff's motion for summary judgment.

Breast Implant Litigation

The Company and certain other companies were named as defendants in past years in numerous claims and lawsuits alleging damages for personal injuries of various types resulting from breast implants formerly manufactured by the Company or a related company. The vast majority of claims against the Company have been resolved. The Company does not consider its remaining probable liability to be material. Information concerning the associated insurance receivable and legal proceedings related to it follows in the paragraph entitled *Breast Implant Insurance Receivables*.

Respirator Mask/Asbestos Litigation

For more than 25 years the Company has defended and resolved the claims of hundreds of thousands of individual claimants alleging injuries from occupational dust exposures. As of December 31, 2007, the Company is a named defendant, with multiple co-defendants, in numerous lawsuits in various courts that purport to represent approximately 8,750 individual claimants, a decrease from the approximately 17,700 individual claimants with actions pending at December 31, 2006.

The vast majority of the lawsuits and claims resolved by and currently pending against the Company allege use of some of the Company's mask and respirator products and seek damages from the Company and other defendants for alleged personal injury from workplace exposures to asbestos, silica, coal or other occupational dusts found in products manufactured by other defendants or generally in the workplace. A minority of claimants generally allege personal injury from occupational exposure to asbestos from products previously manufactured by the Company, which are often unspecified, as well as products manufactured by other defendants, or occasionally at Company premises.

In many of these lawsuits and claims, the Company is named as a defendant with multiple co-defendants where no product the Company manufactured is identified or where the Company is ultimately determined not to have manufactured the products identified by the plaintiffs. The Company's vigorous defense of this litigation has resulted in dismissals of many claims without any payment by the Company, and jury verdicts for the Company in seven of the eight cases tried to verdict (such trials occurred in 1999, 2000, 2003, 2004 and 2007), and an appellate reversal in 2005 of the one jury verdict adverse to the Company.

As previously reported, the Company won a defense verdict in July 2007 from a jury in the federal court in Eastern District of Missouri. The jury found the Company had no liability whatever to a plaintiff who claimed he had silicosis and a related cancer and sought to recover damages from the Company arising from his alleged illness, which he claimed to have contracted from occupational exposure to silica despite his purported use of the Company's respirator mask equipment at various times. The jury rejected each of the plaintiff's theories of liability against the Company.

Many of the resolved lawsuits and claims involved unimpaired claimants who were recruited by plaintiffs' lawyers through mass chest x-ray screenings. The Company experienced a significant decline in the number of claims filed in 2007 from prior years by apparently unimpaired claimants. The Company attributes this decline to several factors, including certain changes enacted in several states in recent years of the law governing asbestos-related claims, and the highly-publicized decision in mid-2005 of the United States District Court for the Southern District of Texas that identified and criticized abuses by certain attorneys, doctors and x-ray screening companies on behalf of claimants. The Company expects the filing of claims by unimpaired claimants in the future to continue at much lower levels than in the past. The Company believes that due to this change in the type and volume of incoming claims, it is likely that the number of claims alleging more serious injuries, including mesothelioma and other malignancies, while remaining relatively constant, will represent a greater percentage of total claims than in the past. The Company has demonstrated in past trial proceedings that its respiratory protection products are effective as claimed when used in the intended manner and in the intended circumstances. Consequently the Company believes that claimants are unable to establish that their medical conditions, even if significant, are attributable to the Company's respiratory protection products. Nonetheless the Company's litigation experience indicates that such claims are costlier to resolve than the claims of unimpaired persons, and it therefore anticipates an increase in the average cost of resolving pending and future claims on a per-claim basis than it experienced in prior periods when the vast majority of claims were asserted by the unimpaired.

Plaintiffs have asserted specific dollar claims for damages in approximately 66% of the 3,979 lawsuits that were pending against the Company at the end of 2007 in all jurisdictions. A majority of states restrict or prohibit specifying damages in tort cases such as these, and most of the remaining jurisdictions do not require such specification. In those cases in which plaintiffs choose to assert specific dollar amounts in their complaints, brought in states that permit such pleading, the amounts claimed are typically not meaningful as an indicator of the Company's potential liability. This is because (a) the amounts claimed typically bear no relation to the extent of the plaintiff's injury, if any; (b) the complaints nearly always assert claims against multiple defendants with the typical complaint asserting claims against as few as a dozen different defendants to upwards of 275 different defendants, the damages alleged are not attributed to individual defendants, and a defendant's share of liability may turn on the law of joint and several liability, which can vary by state, and by the amount of fault a jury allocates to each defendant if a case is ultimately tried before a jury; (c) many cases are filed against the Company even though the plaintiffs did not use any of the Company's products and, ultimately, are withdrawn or dismissed without any payment; and (d) many cases are brought on behalf of plaintiffs who have not suffered any medical injury, and, ultimately, are resolved without any payment or a payment that is a small fraction of the damages initially claimed. Of the 2,629 pending cases in which purported damage amounts are specified in the complaints, 860 cases involve claims of $100,000 or less, (one (1) of them also alleges punitive damages of $15,000, nine (9) of them also allege punitive damages of $30,000, and three (3) of them also allege punitive damages of $1,000,000); 186 cases involve claims between $100,000 and $3 million (thirty-three (33) of them also allege punitive damages of $250,000, one (1) of them also alleges punitive damages of $1 million, forty-three (43) of them also allege punitive damages of $1.5 million, and 106 of them also allege punitive damages of $2 million); two (2) cases involve claims of $3 million to $7.5 million (one (1) also alleges punitive damages of $350,000 and one (1) of them also alleges punitive damages of $5 million); 21 cases involve claims of $7.5 million; four (4) cases involve claims of $7.5 million to $10 million (four (4) of them also allege damages of $21 million); 1,540 cases involve claims of $10 million (two (2) of them also allege punitive damages of $350,000, 1,531 of them also allege punitive damages of $10 million, and one (1) of them also alleges punitive damages of $15 million); 13 cases involve claims of $10 million to $50 million (one (1) of them also allege punitive damages of $15 million, five (5) of them also allege punitive damages of $15.5 million, and three (3) of them also allege punitive damages of $20 million); and three (3) cases involve claims of $50 million (two (2) of them also alleges punitive damages of $50 million). Some complaints allege that the compensatory and punitive damages are at least the amounts specified. As stated, the Company's experience and the other reasons cited indicate that the damage amounts specified in complaints are not a meaningful factor in any assessment of the Company's potential liability.

As previously reported, the State of West Virginia, through its Attorney General, filed a complaint in 2003 against the Company and two other manufacturers of respiratory protection products in the Circuit Court of Lincoln County, West Virginia and amended it in 2005. The amended complaint seeks substantial, but unspecified, compensatory damages primarily for reimbursement of the costs allegedly incurred by the State for worker's compensation and healthcare benefits provided to all workers with occupational pneumoconiosis and unspecified punitive damages.

Employment Litigation

As previously reported, one current and one former employee of the Company filed a purported class action in the District Court of Ramsey County, Minnesota, in December 2004, seeking to represent a class of all current and certain former salaried employees employed by 3M in Minnesota below a certain salary grade who were age 46 or older at any time during the applicable period to be determined by the Court. The complaint alleges the plaintiffs suffered various forms of employment discrimination on the basis of age in violation of the Minnesota Human Rights Act and seeks injunctive relief, unspecified compensatory damages (which they seek to treble under the statute), including back and front pay, punitive damages (limited by statute to $8,500 per claimant) and attorneys' fees. In January 2006, the plaintiffs filed a motion to join four additional named plaintiffs. This motion was unopposed by the Company and the four plaintiffs were joined in the

case, although one claim has been dismissed following an individual settlement. The class certification hearing was held in December 2007. The Company expects a ruling on the class certification in the first half of 2008.

A similar age discrimination purported class action was filed against the Company in November 2005 in the Superior Court of Essex County, New Jersey, on behalf of a class of New Jersey–based employees of the Company. The Company removed this case to the United States District Court for the District of New Jersey. On June 29, 2007, the attorneys for the plaintiff amended their complaint and dropped the class action allegations.

In addition, three former employees filed age discrimination charges against the Company with the U.S. Equal Employment Opportunity Commission and the pertinent state agencies in Minnesota and California during 2005; two of these charges were amended in 2006. Such filings include allegations that the release of claims signed by certain former employees in the purported class defined in the charges is invalid for various reasons and assert age discrimination claims on behalf of certain current and former salaried employees in states other than Minnesota and New Jersey. In 2006, one current employee filed an age discrimination charge against the Company with the U.S. Equal Employment Opportunity Commission and the pertinent state agency in Missouri, asserting claims on behalf of a class of all current and certain former salaried employees who worked in Missouri and other states other than Minnesota and New Jersey. The same law firm represents the plaintiffs and claimants in each of these proceedings.

Environmental Matters and Litigation

The Company's operations are subject to environmental laws and regulations including those pertaining to air emissions, wastewater discharges, toxic substances, and the handling and disposal of solid and hazardous wastes enforceable by national, state, and local authorities around the world, and private parties in the United States and abroad. These laws and regulations provide, under certain circumstances, a basis for the remediation of contamination and for personal injury and property damage claims. The Company has incurred, and will continue to incur, costs and capital expenditures in complying with these laws and regulations, defending personal injury and property damage claims, and modifying its business operations in light of its environmental responsibilities. In its effort to satisfy its environmental responsibilities and comply with environmental laws and regulations, the Company has established, and periodically updates, policies relating to environmental standards of performance for its operations worldwide.

Remediation: Under certain environmental laws, including the United States Comprehensive Environmental Response, Compensation and Liability Act of 1980 and similar state laws, the Company may be jointly and severally liable, typically with other companies, for the costs of environmental contamination at current or former facilities and at off–site locations. The Company has identified numerous locations, most of which are in the United States, at which it may have some liability. Please refer to the following section, "*Accrued Liabilities and Insurance Receivables Related to Legal Proceedings*" for more information on this subject.

Regulatory Activities: As previously reported, the Company has been voluntarily cooperating with ongoing reviews by local, state, national (primarily the U.S. Environmental Protection Agency (EPA)), and international agencies of possible environmental and health effects of perfluorooctanyl compounds (perfluorooctanoic acid or "PFOA" and perfluorooctane sulfonate or "PFOS") and related compounds. As a result of its phase–out decision in May 2000, the Company no longer manufactures perfluorooctanyl compounds, except that a subsidiary recovers and recycles PFOA in Gendorf, Germany, for internal use in production processes and has agreed to a product stewardship initiative with the EPA to work toward elimination of its use of PFOA by 2015.

Regulatory activities concerning PFOA and/or PFOS continue in Europe and elsewhere, and before certain international bodies. These activities include gathering of exposure and use information, risk assessment, and consideration of regulatory approaches.

As previously reported, the Company, in cooperation with state agencies, tested soil and groundwater beneath three former waste disposal sites in Washington County, Minnesota, used many years ago by the Company to dispose lawfully of waste containing perfluorinated compounds. In addition, subsequent testing of water from certain municipal wells in Oakdale, Minnesota and some private wells in Lake Elmo, Minnesota, indicated the presence of low levels of PFOS and PFOA that, in some cases, were slightly above guidelines established by the Minnesota Department of Health ("MDH"). As previously reported, the Company addressed the presence of these compounds in the water by treating certain municipal wells in Oakdale and by providing a grant to the City of Lake Elmo to extend city water to certain residents with these compounds in their private wells. In March 2007 the MDH lowered the Health–Based Values (HBVs) (i.e., the amount of a chemical in drinking water considered by the MDH staff to be safe for people to drink for a lifetime) for PFOA from 7 parts per billion (ppb) to 0.5 ppb and for PFOS from 1 ppb to 0.3 ppb. In August 2007 the MDH established these same levels as Health Risk Limits ("HRL") (i.e., the amount of a chemical in drinking water determined by the MDH to be safe for people to drink for a lifetime) through an expedited rule–making process. In a final report issued on January 15, 2008, the MDH proposed a draft value to lower the HRL for PFOA from 0.5 ppb to 0.3 ppb in anticipation of HRL rule–making in 2008.

As previously reported, the MDH has also detected low levels of a perfluorinated compound called perfluorobutanoic acid (PFBA) in municipal wells (and in private wells as announced by the MDH in June 2007) in six nearby communities (Woodbury, Cottage Grove, Newport, St. Paul Park, South St. Paul, and Hastings, all communities located southeast of

St. Paul), some of which slightly exceed the MDH's well guidance for PFBA, currently at 1 ppb. The Company is working with the MDH and the Minnesota Pollution Control Agency (MPCA) in assessing the source of PFBA in these wells and is supplying data that could be used in determining an appropriate drinking water guideline level. The MDH has not issued an HBV for PFBA, but the Company expects the MDH to issue further guidance in the first quarter of 2008. The Company has advised the affected communities that it will assist them in assuring their drinking water falls below the HBV for PFBA when such value is finally determined.

On May 22, 2007, the MPCA Citizen's Board approved the Settlement Agreement and Consent Order to address the presence of perfluorinated compounds in the soil and groundwater at former disposal sites in Washington County Minnesota and at the Company's manufacturing facility at Cottage Grove Minnesota. Under this agreement, the Company agreed to (i) evaluate releases of perfluorinated compounds from these sites and propose response actions; (ii) provide alternative drinking water if and when an HBV or HRL is exceeded for any perfluorinated compounds as a result of contamination from these sites; (iii) share information with the MPCA about perfluorinated compounds; (iv) reimburse the MPCA future costs of research that are connected to releases from the Company's operations in Minnesota (the Company agreed to reimburse the MPCA for past research costs and provided a grant up to $5 million over the next four years for the purpose of investigating and assessing the presence and effects of perflouronated compounds in the environment and biota); and (v) pay the MPCA up to $8 million towards the implementation of remedial actions at the Washington County Landfill. The Company is working with the MPCA under the terms of the Settlement Agreement and Consent Order to propose alternatives that the MPCA will consider to address the presence of perfluorinated compounds in the soil and groundwater at these sites.

The Company cannot predict what regulatory actions arising from the foregoing proceedings and activities, if any, may be taken regarding such compounds or the consequences of any such actions.

In February 2008, the EPA notified the Company that it is seeking $173,000 in penalties due to alleged past violations of certain monitoring and record keeping requirements under federal air pollution regulations at the Company's manufacturing facility in Cottage Grove, Minnesota. The Company had been operating under a monitoring and record keeping approach that had been approved by the MPCA. The EPA has now approved the Company's alternative monitoring and record keeping approach.

Litigation: As previously reported, a former employee filed a purported class action lawsuit in 2002 in the Circuit Court of Morgan County, Alabama, involving perfluorooctanyl chemistry, alleging that the plaintiffs suffered fear, increased risk, subclinical injuries, and property damage from exposure to perfluorooctanyl chemistry at or near the Company's Decatur, Alabama, manufacturing facility. The Circuit Court in 2005 granted the Company's motion to dismiss the named plaintiff's personal injury–related claims on the basis that such claims are barred by the exclusivity provisions of the state's Workers Compensation Act. The plaintiffs' counsel filed an amended complaint in November 2006, limiting the case to property damage claims on behalf of a purported class of residents and property owners in the vicinity of the Decatur plant. Also in 2005, the judge in a second purported class action lawsuit (filed by three residents of Morgan County, Alabama, seeking unstated compensatory and punitive damages involving alleged damage to their property from emissions of perfluorooctanyl compounds from the Company's Decatur, Alabama, manufacturing facility that formerly manufactured those compounds) granted the Company's motion to abate the case, effectively putting the case on hold pending the resolution of class certification issues in the action described above filed in the same court in 2002. Despite the stay, plaintiffs filed an amended complaint seeking damages for alleged personal injuries and property damage on behalf of the named plaintiffs and the members of a purported class. No further action in the case is expected unless and until the stay is lifted.

As previously reported, two residents of Washington County, Minnesota, filed in October 2004 a purported class action in the District Court of Washington County on behalf of Washington county residents who have allegedly suffered personal injuries and property damage from alleged emissions from the former perfluorooctanyl production facility at Cottage Grove, Minnesota, and from historic waste disposal sites in the vicinity of that facility. After the District Court granted the Company's motion to dismiss the claims for medical monitoring and public nuisance in April 2005, the plaintiffs filed an amended complaint adding additional allegations involving other perfluorinated compounds manufactured by the Company, alleging additional legal theories in support of their claims, adding four plaintiffs, and seeking relief based on alleged contamination of the City of Oakdale municipal water supply and certain private wells in the vicinity of Lake Elmo, Minnesota. In April 2006, the plaintiffs filed a second amended complaint adding two additional plaintiffs. The two original plaintiffs thereafter dismissed their claims against the Company. After a hearing on the plaintiffs' motion to certify the case as a class action at the end of March 2007, the Court on June 19, 2007 denied the plaintiffs' motion to certify the litigation as a class action. The trial of the individual cases is scheduled for January 2009.

Several hundred plaintiffs who claim to have lived in the vicinity of the ACME Barrel Company's storage drum reconditioning facility in Chicago, Illinois, filed a lawsuit in the third quarter of 2003 in the Circuit Court of Cook County, Illinois, against 3M and a number of other companies that allegedly were customers of ACME Barrel. Since the Court rejected plaintiffs' attempt to have this litigation proceed as a class action, 71 individuals have asserted claims against the Company and several other defendants for damages allegedly caused by emissions of hazardous materials from the ACME Barrel drum reconditioning facility.

In the second quarter of 2006, the New Jersey Department of Environmental Protection served a lawsuit that was filed in New Jersey state court against the Company and several other companies seeking cleanup and removal costs and damages to natural resources allegedly caused by the discharge of hazardous substances from two former waste disposal sites in New Jersey. During the fourth quarter, the Company negotiated a settlement of New Jersey's claims. Under the terms of the settlement, the company will transfer to the State of New Jersey 150 acres of undeveloped land with groundwater recharge potential, which the Company acquired for purposes of the settlement, and will pay the state's attorneys' fees. Notice of the settlement was published for public comment in December 2007, and no objections were received. As a result, the Company and the State of New Jersey have signed the formal settlement agreement pursuant to which the Company will transfer title to the property and will be dismissed from the lawsuit, which will continue against the codefendants.

Accrued Liabilities and Insurance Receivables Related to Legal Proceedings

The Company complies with the requirements of Statement of Financial Accounting Standards No. 5, "Accounting for Contingencies," and related guidance, and records liabilities for legal proceedings in those instances where it can reasonably estimate the amount of the loss and where liability is probable. Where the reasonable estimate of the probable loss is a range, the Company records the most likely estimate of the loss, or the low end of the range if there is no one best estimate. The Company either discloses the amount of a possible loss or range of loss in excess of established reserves if estimable, or states that such an estimate cannot be made. For those insured matters where the Company has taken a reserve, the Company also records receivables for the amount of insurance that it expects to recover under the Company's insurance program. For those insured matters where the Company has not taken a reserve because the liability is not probable or the amount of the liability is not estimable, or both, but where the Company has incurred an expense in defending itself, the Company records receivables for the amount of insurance that it expects to recover for the expense incurred. The Company discloses significant legal proceedings even where liability is not probable or the amount of the liability is not estimable, or both, if the Company believes there is at least a reasonable possibility that a loss may be incurred.

Because litigation is subject to inherent uncertainties, and unfavorable rulings or developments could occur, there can be no certainty that the Company may not ultimately incur charges in excess of presently recorded liabilities. A future adverse ruling, settlement, or unfavorable development could result in future charges that could have a material adverse effect on the Company's results of operations or cash flows in the period in which they are recorded. The Company currently believes that such future charges, if any, would not have a material adverse effect on the consolidated financial position of the Company, taking into account its significant available insurance coverage. Based on experience and developments, the Company periodically reexamines its estimates of probable liabilities and associated expenses and receivables, and whether it is able to estimate a liability previously determined to be not estimable and/or not probable. Where appropriate, the Company makes additions to or adjustments of its estimated liabilities. As a result, the current estimates of the potential impact on the Company's consolidated financial position, results of operations and cash flows for the legal proceedings and claims pending against the Company could change in the future.

The Company estimates insurance receivables based on an analysis of its numerous policies, including their exclusions, pertinent case law interpreting comparable policies, its experience with similar claims, and assessment of the nature of the claim, and records an amount it has concluded is likely to be recovered.

The following table shows the major categories of on-going litigation, environmental remediation and other environmental liabilities for which the Company has been able to estimate its probable liability and for which the Company has taken reserves and the related insurance receivables:

At December 31 (Millions)	2007	2006	2005
Breast implant liabilities	$ 1	$ 4	$ 7
Breast implant receivables	64	93	130
Respirator mask/asbestos liabilities	121	181	210
Respirator mask/asbestos receivables	332	380	447
Environmental remediation liabilities	37	44	30
Environmental remediation receivables	15	15	15
Other environmental liabilities	147	14	8

For those significant pending legal proceedings that do not appear in the table and that are not the subject of pending settlement agreements, the Company has determined that liability is not probable or the amount of the liability is not estimable, or both, and the Company is unable to estimate the possible loss or range of loss at this time. The amounts in the preceding table with respect to breast implant and environmental remediation represent the Company's best estimate of the respective liabilities. The Company does not believe that there is any single best estimate of the respirator/mask/asbestos liability or the other environmental liabilities shown above, nor that it can reliably estimate the amount or range of amounts by which those liabilities may exceed the reserves the Company has established.

Breast Implant Insurance Receivables: In the breast implant insurance coverage litigation, the District Court in Ramsey County Minnesota entered an order in September 2007 dismissing from the suit the last of the insurers that were still contesting the extent of their coverage for the Company's breast implant product liability claims. The dismissal was pursuant to a settlement the Company reached with those insurers during the third quarter of 2007. As of December 31, 2007, the Company had receivables for insurance recoveries related to the breast implant matter of $64 million. The Company received $29 million in 2007, reducing this receivable by that amount. The Company also received $48 million in January 2008 and expects to receive an additional $10 million by the end of 2008 pursuant to a settlement agreement with three insurers. The Company continues to pursue recovery against its remaining insurers and expects to collect the remaining receivable.

Respirator Mask/Asbestos Liabilities and Insurance Receivables: The Company estimates its respirator mask/asbestos liabilities, including the cost to resolve the claim and defense costs, by examining: (i) the Company's experience in resolving claims, (ii) apparent trends, (iii) the apparent quality of claims (*e.g.,* whether the claim has been asserted on behalf of asymptomatic claimants), (iv) changes in the nature and mix of claims (*e.g.,* the proportion of claims asserting usage of the Company's mask or respirator products and alleging exposure to each of asbestos, silica, coal or other occupational dusts, and claims pleading use of asbestos–containing products allegedly manufactured by the Company), (v) the number of current claims and a projection of the number of future asbestos and other claims that may be filed against the Company, (vi) the cost to resolve recently settled claims, and (vii) an estimate of the cost to resolve and defend against current and future claims. Because of the inherent difficulty in projecting the number of claims that have not yet been asserted, particularly with respect to the Company's respiratory products that themselves did not contain any harmful materials (which makes the various published studies that purport to project future asbestos claims substantially removed from the Company's principal experience and which themselves vary widely), the Company does not believe that there is any single best estimate of this liability, nor that it can reliably estimate the amount or range of amounts by which the liability may exceed the reserve the Company has established. No liability has been recorded regarding the pending action brought by the West Virginia Attorney General previously described.

Developments may occur that could affect the Company's estimate of its liabilities. These developments include, but are not limited to, significant changes in (i) the number of future claims, (ii) the average cost of resolving claims, (iii) the legal costs of defending these claims and in maintaining trial readiness, (iv) changes in the mix and nature of claims received, (v) trial and appellate outcomes, (vi) changes in the law and procedure applicable to these claims, and (vii) the financial viability of other co–defendants and insurers.

As of December 31, 2007, the Company's receivable for insurance recoveries related to the respirator mask/asbestos litigation was $332 million. Various factors could affect the timing and amount of recovery of this receivable, including (i) delays in or avoidance of payment by insurers; (ii) the extent to which insurers may become insolvent in the future, and (iii) the outcome of negotiations with insurers and legal proceedings with respect to respirator mask/asbestos liability insurance coverage. The difference between the accrued liability and insurance receivable represents in part the time delay between payment of claims on the one hand and receipt of insurance reimbursements on the other hand. Because of the lag time between settlement and payment of a claim, no meaningful conclusions may be drawn from quarterly changes in the amount of receivables for expected insurance recoveries and the quarterly changes in the number of claimants at the end of each quarter.

On January 5, 2007 the Company was served with a declaratory judgment action filed on behalf of two of its insurers (Continental Casualty and Continental Insurance Co.) disclaiming coverage for respirator/mask claims. The action was filed in Hennepin County, Minnesota and names, in addition to the Company, over 60 of the Company's insurers. This action is similar in nature to an action filed in 1994 with respect to breast implant coverage, which ultimately resulted in the Minnesota Supreme Court's ruling of 2003 that was largely in the Company's favor. At the company's request, the case was transferred to Ramsey County, over the objections of the insurers. The Minnesota Supreme Court agreed to hear the insurers' appeal of that decision. Oral argument on the appeal is scheduled for March 2008.

Environmental and Other Liabilities and Insurance Receivables: As of December 31, 2007, the Company had recorded liabilities of $37 million for estimated environmental remediation costs based upon an evaluation of currently available facts with respect to each individual site and also recorded related insurance receivables of $15 million. The Company records liabilities for remediation costs on an undiscounted basis when they are probable and reasonably estimable, generally no later than the completion of feasibility studies or the Company's commitment to a plan of action. Liabilities for estimated costs of environmental remediation, depending on the site, are based primarily upon internal or third–party environmental studies, and estimates as to the number, participation level and financial viability of any other potentially responsible parties, the extent of the contamination and the nature of required remedial actions. The Company adjusts recorded liabilities as further information develops or circumstances change. The Company expects that it will pay the amounts recorded over the periods of remediation for the applicable sites, currently ranging up to 30 years.

As of December 31, 2007, the Company had recorded liabilities of $147 million for estimated other environmental liabilities based upon an evaluation of currently available facts. As previously reported, the Company increased its other environmental liabilities by $121 million in the first quarter of 2007 as a result of regulatory developments in Minnesota and the completion of a comprehensive review with environmental consultants regarding its other environmental liabilities which include the estimated costs of addressing trace amounts of perfluorinated compounds in drinking water sources in the City of Oakdale and Lake Elmo, Minnesota, as well as presence in the soil and groundwater at the Company's manufacturing facilities in Decatur, Alabama, and Cottage Grove, Minnesota, and at two former disposal sites in Minnesota. The Company expects that most of the spending will occur over the next three to seven years. While the Company is not able to estimate the total costs of implementing the Settlement Agreement and Consent Order with the MPCA (*described above under Environmental Matters and Litigation – Regulatory Matters*), the Company increased its other environmental liabilities by an additional $13 million in the second quarter of 2007 to reflect its best estimate of the specific payment obligations under that agreement.

It is difficult to estimate the cost of environmental compliance and remediation given the uncertainties regarding the interpretation and enforcement of applicable environmental laws and regulations, the extent of environmental contamination and the existence of alternate cleanup methods. Developments may occur that could affect the Company's current assessment, including, but not limited to: (i) changes in the information available regarding the environmental impact of the Company's operations and products; (ii) changes in environmental regulations, changes in permissible levels of specific compounds in drinking water sources, or changes in enforcement theories and policies, including efforts to recover natural resource damages; (iii) new and evolving analytical and remediation techniques; (iv) success in allocating liability to other potentially responsible parties; and (v) the financial viability of other potentially responsible parties and third-party indemnitors.

NOTE 14. Employee Savings and Stock Ownership Plans

The Company sponsors employee savings plans under Section 401(k) of the Internal Revenue Code. These plans are offered to substantially all regular U.S. employees. Employee contributions of up to 6% of compensation are matched at rates ranging from 35% to 50%, with additional Company contributions depending upon Company performance. All Company contributions initially are invested in 3M common stock, with employee contributions invested in a number of investment funds pursuant to their elections. Vested employees may diversify their 3M shares into other investment options.

The Company maintains an Employee Stock Ownership Plan (ESOP). This plan was established in 1989 as a cost-effective way of funding the majority of the Company's contributions under 401(k) employee savings plans. Total ESOP shares are considered to be shares outstanding for earnings per share calculations.

Dividends on shares held by the ESOP are paid to the ESOP trust and, together with Company contributions, are used by the ESOP to repay principal and interest on the outstanding ESOP debt. The tax benefit related to dividends paid on unallocated shares was charged directly to equity and totaled approximately $3 million in 2007, $3 million in 2006, and $4 million in 2005. Over the life of the ESOP debt, shares are released for allocation to participants based on the ratio of the current year's debt service to the remaining debt service prior to the current payment.

The ESOP has been the primary funding source for the Company's employee savings plans. As permitted by AICPA Statement of Position 93-6, "Employers' Accounting for Employee Stock Ownership Plans," the Company has elected to continue its practices, which are based on Statement of Position 76-3, "Accounting Practices for Certain Employee Stock Ownership Plans" and subsequent consensus of the EITF of the FASB. Accordingly, the debt of the ESOP is recorded as debt, and shares pledged as collateral are reported as unearned compensation in the Consolidated Balance Sheet and Consolidated Statement of Changes in Stockholders' Equity and Comprehensive Income. Unearned compensation is reduced symmetrically as the ESOP makes principal payments on the debt. Expenses related to the ESOP include total debt service on the notes, less dividends. The Company contributes treasury shares, accounted for at fair value, to employee savings plans to cover obligations not funded by the ESOP (reported as an employee benefit expense).

Employee Savings and Stock Ownership Plans (Millions)	2007	2006	2005
Dividends on shares held by the ESOP	$ 37	$ 39	$ 36
Company contributions to the ESOP	10	9	12
Interest incurred on ESOP notes	5	8	10
Amounts reported as an employee benefit expense:			
Expenses related to ESOP debt service	5	4	7
Expenses related to treasury shares	34	36	27

ESOP Debt Shares	2007	2006	2005
Allocated	14,039,070	15,956,530	16,729,528
Committed to be released	278,125	286,620	366,969
Unreleased	2,457,641	3,831,425	5,145,039
Total ESOP debt shares	16,774,836	20,074,575	22,241,536

NOTE 15. Management Stock Ownership Program (MSOP) and General Employees' Stock Purchase Plan (GESPP)

The Company issues MSOP options to eligible employees annually in May using the closing stock price on the grant date, which is the date of the Annual Stockholders' Meeting. In May 2005, shareholders approved 36.75 million shares for issuance under the MSOP in the form of management stock options, restricted stock, restricted stock units and stock appreciation rights. Under the plan, the Company has principally issued stock options to management employees that are granted at market value on the date of grant. Prior to 2005, under previous plans, these options were generally exercisable one year after the date of grant, with expiration 10 years from the date of grant. Effective with the May 2005 grant, the Company changed its vesting period from one to three years with the expiration date remaining at 10 years from date of grant. In addition to grants to management employees, the Company makes other minor stock option grants to employees, for which vesting terms and option lives are not substantially different, and also makes minor grants of restricted stock units and other stock-based grants.

Outstanding shares under option include grants from previous plans. There were approximately 15,400 participants in the plan with either outstanding options or restricted stock units at December 31, 2007.

Management Stock Ownership Program

	2007		2006		2005	
	Number of Options	Exercise Price*	Number of Options	Exercise Price*	Number of Options	Exercise Price*
Under option —						
January 1	82,867,903	$ 67.41	80,157,713	$ 62.40	78,293,754	$ 58.70
Granted						
Annual	4,434,583	84.81	11,255,448	87.31	10,821,092	76.81
Progressive (Reload)	461,815	87.12	652,552	80.44	751,995	81.19
Other	51,730	82.93	84,400	76.45	570,631	78.07
Exercised	(12,498,051)	55.34	(8,693,946)	47.71	(9,027,646)	48.30
Canceled	(704,929)	77.36	(588,264)	74.72	(1,252,113)	75.65
December 31	74,613,051	$ 70.50	82,867,903	$ 67.41	80,157,713	$ 62.40
Options exercisable December 31	58,816,963	$ 66.83	64,218,738	$ 62.85	68,714,166	$ 60.03

*Weighted average

For options outstanding at December 31, 2007, the weighted-average remaining contractual life was 66 months and the aggregate intrinsic value was $1.070 billion. For options exercisable at December 31, 2007, the weighted-average remaining contractual life was 57 months and the aggregate intrinsic value was $1.042 billion. As of December 31, 2007, there was $118 million of compensation expense that has yet to be recognized related to non-vested stock option-based awards. This expense is expected to be recognized over the remaining vesting period with a weighted-average life of 18 months. The total intrinsic values of stock options exercised during 2007, 2006 and 2005, respectively, was $373 million, $289 million and $278 million. Cash received from options exercised during 2007, 2006 and 2005, respectively, was $692 million, $414 million and $437 million.

The Company's actual tax benefits realized for the tax deductions related to the exercise of employee stock options for 2007, 2006 and 2005, respectively, was $122 million, $93 million and $95 million. The Company does not have a specific policy to repurchase common shares to mitigate the dilutive impact of options; however, the Company has historically made adequate discretionary purchases, based on cash availability, market trends and other factors, to satisfy stock option exercise activity.

Beginning in 2007, the Company began reducing the number of traditional stock options granted under its long-term incentive compensation plan by reducing the number of employees eligible to receive annual grants and by shifting a

portion of the annual grant away from traditional stock options primarily to restricted stock units. These changes will reduce the annual dilution impact from 1.5% of total outstanding common stock to about 1%. However, associated with the reduction in the number of eligible employees, the Company provided a one–time "buyout" grant to the impacted employees, which resulted in increased stock–based compensation expense in 2007. The following table summarizes MSOP restricted stock and restricted stock unit activity during the twelve months ended December 31, 2007:

Restricted Stock and Restricted Stock Units

	Number of Awards	Grant Date Fair Value*
Nonvested balance — As of January 1, 2007	411,562	$ 78.11
Granted		
Annual	1,695,592	77.88
Other	22,465	50.88
Vested	(90,913)	77.38
Forfeited	(37,125)	79.04
As of December 31, 2007	2,001,581	$ 77.63

*Weighted average

As of December 31, 2007, there was $97 million of compensation expense that has yet to be recognized related to non–vested restricted stock and restricted stock units. This expense is expected to be recognized over the remaining vesting period with a weighted–average life of 39 months. The total fair value of restricted stock and restricted stock units that vested during the twelve–month periods ended December 31, 2007 and 2006 was $6 million and $5 million, respectively.

In addition, the Company issues cash settled Restricted Stock Units and Stock Appreciation Rights in certain countries. These grants do not result in the issuance of Common Stock and are considered immaterial by the Company.

The remaining total MSOP shares available for grant under the 2005 MSOP Program are 4,408,083, 13,074,202 and 24,937,892, respectively, as of December 31, 2007, 2006 and 2005. Restricted stock and restricted stock units, per the 2005 MSOP Program, shall be counted against the total shares available as 2.45 shares for every one share issued in connection with that award.

Effective with the May 2005 grant, the Company no longer issues options eligible for additional progressive (reload) options; however, when a progressive option is issued upon the exercise of a pre–May 2005 non–qualified stock option, the option is revalued and additional stock compensation expense is incurred.

For annual and progressive (reload) options, the weighted average fair value at the date of grant was calculated using the Black–Scholes option–pricing model and the assumptions that follow.

MSOP Assumptions

	Annual			Progressive (Reload)		
	2007	2006	2005	2007	2006	2005
Exercise price	$ 84.79	$ 87.23	$ 76.87	$ 87.12	$ 80.44	$ 81.19
Risk–free interest rate	4.6%	5.0%	4.0%	4.6%	4.5%	3.7%
Dividend yield	2.1%	2.0%	2.0%	2.1%	2.0%	2.0%
Volatility	20.0%	20.0%	23.5%	18.4%	20.1%	20.9%
Expected life (months)	69	69	69	25	39	40
Black–Scholes fair value	$ 18.12	$ 19.81	$ 18.28	$ 13.26	$ 12.53	$ 13.18

In connection with the adoption of SFAS No. 123R, in 2005 the Company reviewed and updated, among other things, its volatility and expected term assumptions. Expected volatility is a statistical measure of the amount by which a stock price is expected to fluctuate during a period. For the 2007, 2006 and 2005 annual grant date, the Company estimated the expected volatility based upon the average of the most recent one year volatility, the median of the term of the expected life rolling volatility, the median of the most recent term of the expected life volatility of 3M stock, and the implied volatility on the grant date. The expected term assumption is based on the weighted average of historical grants and assuming that options outstanding are exercised at the midpoint of the future remaining term.

As previously mentioned, the Company expanded its utilization of restricted stock units in conjunction with the May 2007 MSOP Annual Grant. The May 2007 annual restricted stock unit grant does not accrue dividends during the vesting period and vests over three years. The 2007 one–time "buyout" restricted stock unit grant vests over five years.

General Employees' Stock Purchase Plan (GESPP):

In May 1997, shareholders approved 30 million shares for issuance under the Company's GESPP. Substantially all employees are eligible to participate in the plan. Participants are granted options at 85% of market value at the date of grant. There are no GESPP shares under option at the beginning or end of each year because options are granted on the first business day and exercised on the last business day of the same month.

General Employees' Stock Purchase Plan

	2007		2006		2005	
	Shares	Exercise Price*	Shares	Exercise Price*	Shares	Exercise Price*
Options granted	1,507,335	$ 69.34	1,656,554	$ 65.25	1,646,521	$ 66.11
Options exercised	(1,507,335)	69.34	(1,656,554)	65.25	(1,646,521)	66.11
Shares available for grant — December 31	8,940,650		10,447,985		12,104,539	

*Weighted average

The weighted–average fair value per option granted during 2007, 2006 and 2005 was $12.24, $11.51 and $11.67, respectively. The fair value of GESPP options was based on the 15% purchase price discount. The Company recognized compensation expense for GESSP options of $18 million in 2007, $19 million in 2006, and $19 million in 2005.

MSOP / GESPP Stock–based Compensation Expense:

The impact of stock–based compensation on net income and earnings per share provided below for the year ended December 31, 2005, was recognized over the nominal vesting period, whereby if an employee retired before the end of the vesting period, the Company would recognize any remaining unrecognized compensation cost at the date of retirement. SFAS No. 123R requires recognition under a non–substantive vesting period approach, requiring compensation expense recognition when an employee is eligible to retire. 3M employees in the United States are eligible to retire beginning at age 55 and after having completed five years of service. Approximately 25% of the number of stock–based compensation awards are made to this population. The Company changed to the non–substantive vesting period approach for new stock compensation grants made after the Company's adoption of SFAS No. 123R on January 1, 2006. Therefore, primarily beginning in May 2006 with the annual MSOP grant, immediate expensing of those stock–based compensation awards granted to employees eligible to retire resulted in higher compensation expense than historically recognized in comparable prior periods. Capitalized stock–based compensation amounts were not material for 2007, 2006 and 2005. The income tax benefits can fluctuate by period due to the amount of Incentive Stock Options (ISO) exercised since the Company receives the ISO tax benefit upon exercise. The Company last granted ISO's in 2002. Amounts recognized in the financial statements with respect to both the MSOP and GESPP are as follows:

MSOP / GESPP STOCK–BASED COMPENSATION EXPENSE

	Years ended December 31		
(Millions, except per share amounts)	2007	2006	2005
Cost of sales	$ 47	$ 42	$ 27
Selling, general and administrative expenses	137	119	96
Research, development and related expenses	44	39	32
Operating Income (Loss)	$ (228)	$ (200)	$ (155)
Income tax benefits	$ 93	$ 72	$ 67
Net Income (Loss)	$ (135)	$ (128)	$ (88)
Earnings per share impact — diluted	$ (0.18)	$ (0.17)	$ (0.14)
Earnings per share — diluted	$ 5.60	$ 5.06	$ 3.98

The following table adjusts the revised diluted earnings per share for 2005 from the preceding table to reflect the approximate impact of using the non-substantive vesting period approach for these periods.

Stock-Based Compensation Pro Forma Earnings Per Share — Diluted	2005
Earnings per share — diluted	$ 3.98
Impact of retirement-eligible employees	$ (0.02)
Pro forma (adjusted to reflect non-substantive vesting period approach)	$ 3.96

NOTE 16. Business Segments

Effective in the first quarter of 2007, 3M made certain changes to its business segments in its continuing effort to drive growth by aligning businesses around markets and customers. The most significant of these changes are summarized as follows:

- 3M's new emerging business opportunity in its Track and Trace initiative resulted in the merging of a number of formerly separate efforts into one concerted effort for future growth. Track and Trace has a growing array of applications — from tracking packages to managing medical and legal records. The establishment of this new initiative within 3M's Safety, Security and Protection Services segment resulted in the transfer of certain businesses to this segment from other segments, including the transfer of HighJump Software Inc., a 3M U.S.-based subsidiary that provides supply chain execution software and solutions (Industrial and Transportation segment) and the transfer of certain Track and Trace products from the Electro and Communications segment.

- 3M's Visual Systems business (Consumer and Office segment), which offers analog overhead and electronic projectors and film, was transferred to the Electro and Communications segment. This transfer is intended to leverage common markets, customers, suppliers and technologies.

- 3M's Industrial and Transportation segment (Energy and Advanced Materials business) transferred the 3M™ Aluminum Conductor Composite Reinforced (ACCR) electrical power cable to the Electro and Communications segment (Electrical Markets business). With an aluminum-based metal matrix at its core, the ACCR product increases transmission capacity for existing power lines. The Electrical Markets business sells insulating, testing and connecting products to various markets, including the electric utility markets.

- Certain adhesives and tapes in the Industrial and Transportation segment (Industrial Adhesives and Tapes business) were transferred to the Consumer and Office segment (primarily related to the Construction and Home Improvement business and the Stationery Products business) and to the Electro and Communications segment (Electronics Markets Materials business). Certain maintenance-free respirator products for the consumer market in 3M's Safety, Security and Protection Services segment were transferred to the Consumer and Office segment (Construction and Home Improvement business).

- 3M transferred Film Manufacturing and Supply Chain Operations, a resource for the manufacturing and development of films and materials, to the Display and Graphics Business from Corporate and Unallocated.

The financial information presented herein reflects the impact of all of the preceding changes for all periods presented.

3M's businesses are organized, managed and internally grouped into segments based on differences in products, technologies and services. 3M continues to manage its operations in six operating business segments: Industrial and Transportation segment, Health Care segment, Display and Graphics segment, Consumer and Office segment, Safety, Security and Protection Services segment and Electro and Communications segment. 3M's six business segments bring together common or related 3M technologies, enhancing the development of innovative products and services and providing for efficient sharing of business resources. These segments have worldwide responsibility for virtually all 3M product lines. 3M is not dependent on any single product or market. Certain small businesses and lab-sponsored products, as well as various corporate assets and expenses, are not allocated to the business segments.

Transactions among reportable segments are recorded at cost. 3M is an integrated enterprise characterized by substantial intersegment cooperation, cost allocations and inventory transfers. Therefore, management does not represent that these segments, if operated independently, would report the operating income and other financial information shown. The allocations resulting from the shared utilization of assets are not necessarily indicative of the underlying activity for segment assets, depreciation and amortization, and capital expenditures.

Business Segment Products

Business Segment	Major Products
Industrial and Transportation	Tapes, coated and nonwoven abrasives, adhesives, specialty materials, filtration products, closures for disposable diapers, automotive components, abrasion-resistant films, structural adhesives and paint finishing and detailing products
Health Care	Medical and surgical supplies, skin health and infection prevention products, pharmaceuticals (sold in December 2006 and January 2007), drug delivery systems, dental and orthodontic products, health information systems and microbiology products
Display and Graphics	Optical films and lens solutions for electronic displays, touch screens and touch monitors, reflective sheeting for transportation safety, and commercial graphics systems
Consumer and Office	Sponges, scouring pads, high-performance cloths, consumer and office tapes, repositionable notes, carpet and fabric protectors, construction and home improvement products, home care products, protective material products and consumer health care products
Safety, Security and Protection Services	Personal protection products, safety and security products, energy control products, commercial cleaning and protection products, floor matting, roofing granules for asphalt shingles, and Track and Trace products, such as supply chain execution software solutions
Electro and Communications	Packaging and interconnection devices, insulating and splicing solutions for the electronics, telecommunications, electrical industries, and visual systems

Business Segment Information

	Net Sales			Operating Income		
(Millions)	2007	2006	2005	2007	2006	2005
Industrial and Transportation	$ 7,274	$ 6,640	$ 6,047	$ 1,501	$ 1,342	$ 1,210
Health Care	3,968	4,011	3,760	1,882	1,845	1,114
Display and Graphics	3,892	3,770	3,547	1,174	1,044	1,148
Consumer and Office	3,403	3,164	2,926	688	629	609
Safety, Security and Protection Services	3,070	2,663	2,320	611	549	513
Electro and Communications	2,775	2,631	2,509	481	411	422
Corporate and Unallocated	80	44	58	(144)	(124)	(162)
Total Company	$ 24,462	$ 22,923	$ 21,167	$ 6,193	$ 5,696	$ 4,854

	Assets			Depreciation & Amortization			Capital Expenditures		
(Millions)	2007	2006	2005	2007	2006	2005	2007	2006	2005
Industrial and Transportation	$ 5,872	$ 5,180	$ 5,013	$ 294	$ 287	$ 282	$ 396	$ 284	$ 263
Health Care	2,909	2,477	2,166	138	162	131	213	159	138
Display and Graphics	3,199	3,035	2,775	222	232	189	341	323	237
Consumer and Office	1,720	1,577	1,476	82	77	83	101	103	79
Safety, Security and Protection Services	2,344	2,061	1,429	161	120	121	205	151	100
Electro and Communications	2,063	2,003	1,877	146	173	155	136	117	113
Corporate and Unallocated	6,587	4,961	5,805	29	28	25	30	31	13
Total Company	$ 24,694	$ 21,294	$ 20,541	$ 1,072	$ 1,079	$ 986	$ 1,422	$ 1,168	$ 943

Segment assets for the operating business segments (excluding Corporate and Unallocated) primarily include accounts receivable; inventory; property, plant and equipment — net; goodwill and intangible assets; and other miscellaneous assets. Assets included in Corporate and Unallocated principally are cash, cash equivalents and marketable securities; insurance receivables; deferred income taxes; certain investments and other assets, including prepaid pension assets; and certain unallocated property, plant and equipment. Corporate and unallocated assets can change from year to year due to changes in cash, cash equivalents and marketable securities, changes in prepaid pension and postretirement benefits, and changes in other unallocated asset categories. For management reporting purposes, corporate goodwill (which at December 31, 2007, totaled approximately $400 million) is not allocated to the six operating business segments. In Note 3, corporate goodwill has been allocated to the respective market segments as required by SFAS No. 142 for impairment testing.

Corporate and Unallocated operating income principally includes corporate investment gains and losses, certain derivative gains and losses, insurance–related gains and losses, certain litigation expenses, corporate restructuring program charges and other miscellaneous items. Because this category includes a variety of miscellaneous items, it is subject to fluctuation on a quarterly and annual basis.

Refer to Note 2 and Note 4 for discussion of items that significantly impact business segment reported results. The most significant items impacting both 2007 and 2006 results are the net gain on sale of the pharmaceuticals business (within the Health Care segment) and restructuring and other actions.

NOTE 17. Geographic Areas

Geographic area information is used by the Company as a secondary performance measure to manage its businesses. Export sales and certain income and expense items are reported within the geographic area where the final sales to 3M customers are made.

	Net sales to customers			Operating Income			Property, plant and equipment, net		
(Millions)	2007	2006	2005	2007	2006	2005	2007	2006	2005
United States	$ 8,987	$ 8,853	$ 8,267	$ 1,692	$ 1,908	$ 1,200	$ 3,668	$ 3,382	$ 3,291
Asia Pacific	6,601	6,251	5,744	2,136	2,097	2,085	1,116	959	865
Europe, Middle East and Africa	6,503	5,726	5,219	1,705	1,092	1,057	1,308	1,162	1,076
Latin America and Canada	2,365	2,080	1,881	665	629	512	490	404	361
Other Unallocated	6	13	56	(5)	(30)	—	—	—	—
Total Company	$ 24,462	$ 22,923	$ 21,167	$ 6,193	$ 5,696	$ 4,854	$ 6,582	$ 5,907	$ 5,593

Both 2007 and 2006 operating income results by geographic area were significantly impacted by the sale of businesses and restructuring and other exit activities. Refer to Note 2 and Note 4 for discussion of these items.

Asia Pacific includes Japan net sales to customers of $2.063 billion in 2007, $2.048 billion in 2006, and $2.094 billion in 2005. Asia Pacific includes Japan net property, plant and equipment of $357 million in 2007, $345 million in 2006, and $350 million in 2005.

NOTE 18. Quarterly Data (Unaudited)

(Millions, except per-share amounts) 2007	First Quarter	Second Quarter	Third Quarter	Fourth Quarter	Year 2007
Net sales	$ 5,937	$ 6,142	$ 6,177	$ 6,206	$ 24,462
Cost of sales	3,022	3,175	3,240	3,298	12,735
Net income	1,368	917	960	851	4,096
Earnings per share — basic	1.88	1.28	1.34	1.20	5.70
Earnings per share — diluted	1.85	1.25	1.32	1.17	5.60

2006	First Quarter	Second Quarter	Third Quarter	Fourth Quarter	Year 2006
Net sales	$ 5,595	$ 5,688	$ 5,858	$ 5,782	$ 22,923
Cost of sales	2,721	2,840	2,990	3,162	11,713
Net income	899	882	894	1,176	3,851
Earnings per share — basic	1.19	1.17	1.20	1.60	5.15
Earnings per share — diluted	1.17	1.15	1.18	1.57	5.06

Gross profit is calculated as net sales minus cost of sales. In 2007, gains on sales of businesses and real estate, net of restructuring and other items, increased net income by $448 million, or $0.62 per diluted share, with $422 million, or $0.57 per diluted share recorded in the first quarter of 2007. 2007 included net benefits from gains related to the sale of businesses and a gain on sale of real estate, which were partially offset by increases in environmental liabilities, restructuring actions, and other exit activities. In 2006, a gain on sale, net of restructuring and other items, increased net income by $438 million, or $0.57 per diluted share, with $354 million, or $0.47 per diluted share, recorded in the fourth quarter of 2006. 2006 included net benefits from gains related to the sale of certain portions of 3M's branded pharmaceuticals business and favorable income tax adjustments, which were partially offset by restructuring actions, acquired in-process research and development expenses, settlement costs of a previously disclosed antitrust class action, and environmental obligations related to the pharmaceuticals business.

Item 9. Changes in and Disagreements With Accountants on Accounting and Financial Disclosure.
None.

Item 9A. Controls and Procedures.

a. The Company carried out an evaluation, under the supervision and with the participation of its management, including the Chief Executive Officer and Chief Financial Officer, of the effectiveness of the design and operation of the Company's "disclosure controls and procedures" (as defined in the Exchange Act Rule 13a-15(e)) as of the end of the period covered by this report. Based upon that evaluation, the Chief Executive Officer and Chief Financial Officer concluded that the Company's disclosure controls and procedures are effective.

b. The Company's management is responsible for establishing and maintaining an adequate system of internal control over financial reporting, as defined in the Exchange Act Rule 13a-15(f). The management conducted an assessment of the Company's internal control over financial reporting based on the framework established by the Committee of Sponsoring Organizations of the Treadway Commission in *Internal Control — Integrated Framework.* Based on the assessment, the management concluded that, as of December 31, 2007, the Company's internal control over financial reporting is effective. The Company's internal control over financial reporting as of December 31, 2007 has been audited by PricewaterhouseCoopers LLP, an independent registered public accounting firm, as stated in their report which is included herein, which expresses an unqualified opinion on the effectiveness of the Company's internal control over financial reporting as of December 31, 2007.

c. There was no change in the Company's internal control over financial reporting that occurred during the Company's most recently completed fiscal quarter that has materially affected, or is reasonably likely to materially affect, the Company's internal control over financial reporting.

Item 9B. Other Information.
Effective March 31, 2007, 3M voluntarily delisted from NYSE Arca Inc., formerly the Pacific Exchange, to eliminate duplicative administrative requirements and costs inherent with dual listings as a result of the NYSE Group's recent merger with Archipelago Holdings, the parent company of NYSE Arca. 3M does not believe that withdrawing its listing from NYSE Arca Inc. will have any impact on the liquidity of its stock. NYSE Arca will continue to trade 3M stock on an unlisted trading privilege basis. 3M's common stock will continue to be listed on the New York Stock Exchange, the company's principal listing exchange.

PART III

Documents Incorporated by Reference
In response to Part III, Items 10, 11, 12, 13 and 14, parts of the Company's definitive proxy statement (to be filed pursuant to Regulation 14A within 120 days after Registrant's fiscal year–end of December 31, 2007) for its annual meeting to be held on May 13, 2008, are incorporated by reference in this Form 10–K.

Item 10. Directors, Executive Officers and Corporate Governance. The information relating to directors and nominees of 3M is set forth under the caption "Proposal No. 1 — Election of Directors" in 3M's proxy statement for its 2007 annual meeting of stockholders ("3M Proxy Statement") and is incorporated by reference herein. Information about executive officers is included in Item 1 of this Annual Report on Form 10–K. The information required by Items 407(c)(3), (d)(4) and (d)(5) of Regulation S–K is contained under the captions "Governance of the Company — Director Nomination Process", "Board and Committee Membership — Audit Committee" of the 3M Proxy Statement and such information is incorporated by reference herein.

Code of Ethics. All of our employees, including our Chief Executive Officer and Chief Financial Officer are required to abide by 3M's long–standing business conduct policies to ensure that our business is conducted in a consistently legal and ethical manner. 3M has posted the text of such code of ethics on its website (http://www.3M.com/businessconduct). At the same website, any future amendments to the code of ethics will also be posted. Any person may request a copy of the code of ethics, at no cost, by writing to us at the following address:

3M Company
3M Center, Building 220–9E–02
St. Paul, MN 55144–1000
Attention: Director, Business Conduct and Compliance

Item 11. Executive Compensation. The information required by Item 402 of Regulation S-K is contained under the captions "Executive Compensation" (excluding the information under the caption "— Compensation Committee Report") and "Director Compensation and Stock Ownership Guidelines" of the 3M Proxy Statement. Such information is incorporated by reference.

The information required by Items 407(e)(4) and (e)(5) of Regulation S-K is contained under the captions "Compensation Committee Interlocks and Insider Participation" and "Executive Compensation — Compensation Committee Report" of the 3M Proxy Statement. Such information (other than the Compensation Committee Report, which shall not be deemed to be "filed") is incorporated by reference.

Item 12. Security Ownership of Certain Beneficial Owners and Management and Related Stockholder Matters. The information relating to security ownership of certain beneficial owners and management is set forth under the designation "Beneficial Ownership Table" and "Security Ownership of More Than 5 Percent Stockholders" in the 3M Proxy Statement and such information is incorporated by reference herein.

Equity compensation plans information follows:

Equity Compensation Plans Information (1)

Plan Category	A Number of securities to be issued upon exercise of outstanding options, warrants and rights	B Weighted-average exercise price of outstanding options, warrants and rights	C Number of securities remaining available for future issuance under equity compensation plans (excluding securities reflected in column (A)
Equity compensation plans approved by security holders			
MSOP — Options	74,613,051	$ 70.50	—
MSOP — RSU's	2,001,581	—	—
MSOP — Total	76,614,632	$ 70.50	4,408,083
GESPP	—	—	8,940,650
Non-employee directors	—	—	504,893
Subtotal	76,614,632	$ 70.50	13,853,626
Equity compensation plans not approved by security holders	—	—	—
Total	76,614,632	$ 70.50	13,853,626

(1) The weighted-average exercise price in column B is only applicable to options issued under the MSOP. The number of securities remaining available for future issuance in column C is approved for the MSOP program in total and not individually with respect to MSOP-Options and MSOP-RSU's.

Item 13. Certain Relationships and Related Transactions, and Director Independence.
With respect to certain relationships and related transactions as set forth in Item 404 of Regulation S-K, no matters require disclosure. The information required by Item 407(a) of Regulation S-K is contained under the caption "Governance of the Company — Director Independence" of the 3M Proxy Statement and such information is incorporated by reference herein.

Item 14. Principal Accounting Fees and Services. The information relating to principal accounting fees and services is set forth under the designation "Fees of the Independent Registered Public Accounting Firm" in the 3M Proxy Statement and such information is incorporated by reference herein.

PART IV

Item 15. Exhibits and Financial Statement Schedules.

(a) (1) Financial Statements. The consolidated financial statements filed as part of this report are listed in the index to financial statements on page 37 as follows:

	Page Number
Report of Independent Registered Public Accounting Firm	39
Consolidated Statement of Income for the years ended December 31, 2007, 2006 and 2005	40
Consolidated Balance Sheet at December 31, 2007 and 2006	41
Consolidated Statement of Changes in Stockholders' Equity and Comprehensive Income for the years ended December 31, 2007, 2006 and 2005	42
Consolidated Statement of Cash Flows for the years ended December 31, 2007, 2006 and 2005	43
Notes to Consolidated Financial Statements	44–87

(a) (2) Financial Statement Schedules. Financial statement schedules are omitted because of the absence of the conditions under which they are required or because the required information is included in the Consolidated Financial Statements or the notes thereto. The financial statements of unconsolidated subsidiaries are omitted because, considered in the aggregate, they would not constitute a significant subsidiary.

(a) (3) Exhibits. The exhibits are either filed with this report or incorporated by reference into this report. Exhibit numbers 10.1 through 10.24 are management contracts or compensatory plans or arrangements. See (b) Exhibits, which follow.

(b) Exhibits.

Index to Exhibits:

(3) Articles of Incorporation and bylaws

(3.1) Certificate of incorporation, as amended as of May 11, 2007, is incorporated by reference from our Form 8–K dated May 14, 2007.

(3.2) Bylaws, as amended as of February 11, 2008, is incorporated by reference from our Form 8–K dated February 11, 2008.

(4) Instruments defining the rights of security holders, including indentures:

(4.1) Indenture, dated as of November 17, 2000, between 3M and Citibank, N.A., with respect to 3M's senior debt securities, is incorporated by reference from our Form 8–K dated December 7, 2000.

(4.2) Indenture, dated as of November 21, 2002, between 3M and Citibank, N.A., with respect to Liquid Yield Option™ Notes zero coupon senior debt securities, is incorporated by reference from Registration No. 333–103234 on Form S–3 filed on February 14, 2003.

(4.3) First Supplemental Indenture, dated as of November 16, 2005, to Indenture between 3M and Citibank, N.A., with respect to Liquid Yield Option™ Notes zero coupon senior debt securities, is incorporated by reference from our 8–K dated November 17, 2005.

(4.4) Except as set forth in the preceding Exhibits 4.1, 4.2 and 4.3, the instruments defining the rights of holders of long–term debt securities of 3M have been omitted. We agree to furnish to the SEC, upon request, a copy of such instruments with respect to issuances of long–term debt of 3M.

(10) Material contracts and management compensation plans and arrangements:

(10.1) 3M 2005 Management Stock Ownership Program is incorporated by reference from our Proxy Statement for the 2005 Annual Meeting of Stockholders.

(10.2) 3M 2002 Management Stock Ownership Program is incorporated by reference from our Proxy Statement for the 2002 Annual Meeting of Stockholders.

(10.3) 3M 1997 Management Stock Ownership Program is incorporated by reference from our Proxy Statement for the 1997 Annual Meeting of Stockholders.

(10.4) 3M 1992 Management Stock Ownership Program is incorporated by reference from our Proxy Statement for the 1992 Annual Meeting of Stockholders.

(10.5) Form of award agreement for non-qualified stock options granted under the 2005 Management Stock Ownership Program, is incorporated by reference from our Form 8-K dated May 16, 2005.
(10.6) Form of award agreement for non-qualified stock options granted under the 2002 Management Stock Ownership Program, is incorporated by reference from our Form 10-K for the year ended December 31, 2004.
(10.7) 3M 1997 General Employees' Stock Purchase Plan, as amended through November 8, 2004, is incorporated by reference from our Form 10-K for the year ended December 31, 2004.
(10.8) 3M VIP (Voluntary Investment Plan) Plus is incorporated by reference from Registration Statement No. 333-73192 on Form S-8, filed on November 13, 2001.
(10.9) 3M Deferred Compensation Plan, as amended through February 2008, is incorporated by reference from our 8-K dated February 14, 2008.
(10.10) 3M Executive Annual Incentive Plan is incorporated by reference from our Form 8-K dated May 14, 2007.
(10.11) 3M Performance Unit Plan, as amended through February 11, 2007, is incorporated by reference from our Form 8-K dated May 14, 2007.
(10.12) Description of changes to Non-Employee Director Compensation and Stock Ownership Guidelines dated as of August 13, 2007 is incorporated by reference from our Form 10-Q for the quarter ended September 30, 2007.
(10.13) Description of changes to 3M Compensation Plan for Non-Employee Directors is incorporated by reference from our Form 8-K dated August 8, 2005.
(10.14) 3M Compensation Plan for Non-Employee Directors, as amended, through November 8, 2004, is incorporated by reference from our Form 10-K for the year ended December 31, 2004.
(10.15) 3M 1992 Directors Stock Ownership Program, as amended through November 8, 2004, is incorporated by reference from our Form 10-K for the year ended December 31, 2004.
(10.16) 3M Executive Life Insurance Plan, as amended, is incorporated by reference from our Form 10-K for the year ended December 31, 2003.
(10.17) Summary of Personal Financial Planning Services for 3M Executives is incorporated by reference from our Form 10-K for the year ended December 31, 2003.
(10.18) 3M policy on reimbursement of incentive payments is incorporated by reference from our Form 10-K for the year ended December 31, 2006.
(10.19) Employment agreement dated as of December 6, 2005, between 3M and George W. Buckley is incorporated by reference from our Form 8-K dated December 9, 2005.
(10.20) Amendment, dated August 14, 2006, to employment agreement between 3M and George W. Buckley is incorporated by reference from our Form 10-Q for the quarter ended September 30, 2006.
(10.21) Description of compensation plan for Robert S. Morrison is incorporated by reference from our Form 8-K dated August 8, 2005.
(10.22) Employment agreement dated as of January 23, 2002, between 3M and Patrick D. Campbell is incorporated by reference from our Form 10-K for the year ended December 31, 2001.
(10.23) Employment agreement dated as of November 19, 2002, between 3M and Richard F. Ziegler is incorporated by reference from our Form 10-K for the year ended December 31, 2002.
(10.24) Letter agreement dated as of March 14, 2007, between 3M and Richard F. Ziegler is incorporated by reference from our 8-K dated March 19, 2007.
(10.25) Five-year credit agreement as of April 30, 2007, is incorporated by reference from our Form 8-K dated May 3, 2007.

Filed electronically herewith:
(12) Calculation of ratio of earnings to fixed charges.
(21) Subsidiaries of the Registrant.
(23) Consent of Independent Registered Public Accounting Firm.
(24) Power of attorney.
(31.1) Certification of the Chief Executive Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002, 18 U.S.C. Section 1350.
(31.2) Certification of the Chief Financial Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002, 18 U.S.C. Section 1350.
(32.1) Certification of the Chief Executive Officer pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, 18 U.S.C. Section 1350.
(32.2) Certification of the Chief Financial Officer pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, 18 U.S.C. Section 1350.

SIGNATURES

Pursuant to the requirements of Section 13 or 15(d) of the Securities Exchange Act of 1934, the Registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

3M COMPANY

By /s/ Patrick D. Campbell
Patrick D. Campbell,
Senior Vice President and Chief Financial Officer
(Principal Financial and Accounting Officer)
February 15, 2008

Pursuant to the requirements of the Securities Exchange Act of 1934, this report has been signed below by the following persons on behalf of the Registrant and in the capacities indicated on February 15, 2008.

Signature	Title
George W. Buckley	Chairman of the Board, President and Chief Executive Officer (Principal Executive Officer and Director)
Linda G. Alvarado	Director
Vance D. Coffman	Director
Michael L. Eskew	Director
W. James Farrell	Director
Herbert L. Henkel	Director
Edward M. Liddy	Director
Robert S. Morrison	Director
Aulana L. Peters	Director
Rozanne L. Ridgway	Director

Patrick D. Campbell, by signing his name hereto, does hereby sign this document pursuant to powers of attorney duly executed by the other persons named, filed with the Securities and Exchange Commission on behalf of such other persons, all in the capacities and on the date stated, such persons constituting a majority of the directors of the Company.

By/s/ Patrick D. Campbell
Patrick D. Campbell, *Attorney-in-Fact*

AIR PRODUCTS & CHEMICALS INC /DE/ (APD)

7201 HAMILTON BLVD
ALLENTOWN, PA 18195-1501
610. 481.4911
http://www.airproducts.com/

10-K

FORM 10-K
Filed on 11/28/2007 - Period: 09/30/2007
File Number 001-04534

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800.669.1154
www.gsionline.com

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549

FORM 10–K

(Mark One)

☑ **ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**
For the fiscal year ended 30 September 2007

or

☐ **TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**
For the transition period from _____ to _____
Commission file number 1–4534

AIR PRODUCTS AND CHEMICALS, INC.
(Exact Name of Registrant as Specified in Its Charter)

Delaware (State or Other Jurisdiction of Incorporation or Organization)	**23–1274455** (IRS Employer Identification No.)
7201 Hamilton Boulevard, Allentown, Pennsylvania (Address of Principal Executive Offices)	**18195–1501** (Zip Code)
Registrant's telephone number, including area code	**(610) 481–4911**

Securities registered pursuant to Section 12(b) of the Act:

Title of Each Class	Name of Each Exchange on Which Registered
Common Stock, par value $1.00 per share	New York
Preferred Stock Purchase Rights	New York
$8\frac{3}{4}$% Debentures Due 2021	New York

Indicate by check mark if the registrant is a well–known seasoned issuer, as defined in Rule 405 of the Securities Act. YES ☑ NO ☐
Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act. YES ☐ NO ☑
Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. YES ☑ NO ☐
Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S–K (§ 229.405) is not contained herein, and will not be contained, to the best of registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10–K or any amendment to this Form 10–K. ☐
Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, or a non–accelerated filer. See definition of "accelerated filer and large accelerated filer" in Rule 12b–2 of the Exchange Act. (Check one):
Large Accelerated Filer ☑ Accelerated Filer ☐ Non–Accelerated Filer ☐
Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b–2 of the Act). YES ☐ NO ☑
The aggregate market value of the voting stock held by non–affiliates of the registrant on 31 March 2007 was approximately $16 billion. For purposes of the foregoing calculations all directors and/or executive officers have been deemed to be affiliates, but the registrant disclaims that any such director and/or executive officer is an affiliate.
The number of shares of common stock outstanding as of 19 November 2007 was 215,386,799.

DOCUMENTS INCORPORATED BY REFERENCE

Parts I, II and IV: Annual Report to Shareholders for the fiscal year ended 30 September 2007. With the exception of those portions that are incorporated by reference into Parts I, II and IV of this Form 10–K, the Annual Report is not deemed to be filed.
Part III: Proxy Statement for Annual Meeting of Shareholders to be held 24 January 2008.

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PART I

ITEM 1. BUSINESS.

GENERAL DESCRIPTION OF BUSINESS

Air Products and Chemicals, Inc. (the "Company"), a Delaware corporation originally founded in 1940, serves technology, energy, industrial and healthcare customers globally with a unique portfolio of products, services and solutions that include atmospheric gases, process and specialty gases, performance materials, equipment and services. The Company is the world's largest supplier of hydrogen and helium and has built leading positions in growth markets such as semiconductor materials, refinery hydrogen, natural gas liquefaction, and advanced coatings and adhesives. As used in this Report, unless the context indicates otherwise, the term "Company" includes subsidiaries and predecessors of the registrant and its subsidiaries.

The Company manages its operations, assesses performance and reports earnings under six business segments: Merchant Gases; Tonnage Gases; Electronics and Performance Materials; Equipment and Energy; Healthcare; and Chemicals. The Company previously managed its operations and reported results under three business segments: Gases, Chemicals and Equipment.

FINANCIAL INFORMATION ABOUT SEGMENTS

Financial information concerning the Company's six business segments appears in Note 21 to the Consolidated Financial Statements included under Item 8 herein, which information and all other specific references herein to information appearing in the 2007 Financial Review Section of the Annual Report are incorporated herein by reference.

NARRATIVE DESCRIPTION OF BUSINESS BY SEGMENTS

MERCHANT GASES

Merchant Gases sells industrial gases such as oxygen, nitrogen and argon (primarily recovered by the cryogenic distillation of air), hydrogen and helium (purchased or refined from crude helium), and certain medical and specialty gases throughout the world to customers in many industries, including those in metals, glass, chemical processing, food processing, medical gases, steel, general manufacturing and petroleum and natural gas industries.

Merchant Gases delivers its products by one of the following three methods:

(1) *"liquid bulk"* — under which product is delivered in bulk (in liquid or gaseous form) by tanker or tube trailer and stored, usually in its liquid state, in equipment designed and installed by the Company at the customer's site for vaporizing into a gaseous state as needed. Liquid bulk sales are typically governed by three–to–five year contracts;

(2) *"packaged gases"* — under which small quantities of product are delivered in either cylinders or dewars. The Company operates packaged gas businesses in Europe, Asia and Brazil; in the United States, its packaged gas business sells products only for the electronics and magnetic resonance imaging (principally helium) industries; and

(3) *"small on–site plants"* — under which customers receive product through small on–sites (cryogenic or non–cryogenic generators) either by a sale of gas contract or the sale of the equipment to the customer.

Electric power is the largest cost component in the production of atmospheric gases — oxygen, nitrogen and argon. Natural gas is also an energy source at a number of the Company's Merchant Gases facilities. The Company mitigates energy and natural gas prices through pricing formulas and surcharges. A shortage or interruption of electricity or natural gas supply, or a price increase that cannot be passed through to customers, possibly for competitive reasons, may adversely affect the operations or results of Merchant Gases. During fiscal year 2007, no significant difficulties were encountered in obtaining adequate supplies of energy or raw materials. Shortages of argon and helium did limit further growth in our Merchant Gases segment in fiscal year 2007.

Merchant Gases competes in the United States against three global industrial gas companies, L'Air Liquide S.A., Linde AG and Praxair, Inc., and several regional sellers (including Airgas, Inc.). Competition is based primarily on price, reliability of supply and the development of applications for use of industrial gases. Similar competitive situations exist in the European

and Asian industrial gas markets in which the Company competes against the three global companies as well as regional competitors.
Sales of atmospheric gases (oxygen, nitrogen and argon) constituted approximately 17 percent of the Company's consolidated sales in fiscal year 2007, 18 percent in fiscal year 2006 and 17 percent in fiscal year 2005.

TONNAGE GASES

Tonnage Gases provides hydrogen, carbon monoxide, nitrogen, oxygen and syngas principally to the petroleum refining, chemical and metallurgical industries worldwide. Gases are produced at large facilities located adjacent to customers' facilities or by pipeline systems from centrally–located production facilities and are generally governed by contracts with fifteen–to–twenty year terms. The Company is the world's largest provider of hydrogen, which is used by oil refiners to facilitate the conversion of heavy crude feedstock and lower the sulfur content of gasoline and diesel fuels to reduce smog and ozone depletion. The metallurgical industry utilizes nitrogen for inerting and oxygen for the manufacture of steel and certain non–ferrous metals, and the chemical industry uses hydrogen, oxygen, nitrogen, carbon monoxide and syngas (a hydrogen–carbon monoxide mixture) as feedstocks in the production of many basic chemicals. The Company delivers product through pipelines from centrally located facilities in or near the Texas Gulf Coast; Los Angeles, California; Baton Rouge and New Orleans, Louisiana; Alberta, Canada; Rotterdam, the Netherlands; Ulsan, Korea; Tangshan, China; Kuan Yin, Taiwan; Singapore; and Camaçari, Brazil. The Company owns less than controlling interests in pipelines located in Thailand, Singapore and South Africa.
Electric power is the largest cost component in the production of atmospheric gases. Natural gas is also an energy source at a number of Tonnage Gases facilities. The Company mitigates energy and natural gas prices through long–term cost pass–through contracts. Natural gas is the principal raw material for hydrogen, carbon monoxide and syngas production. During fiscal year 2007, no significant difficulties were encountered in obtaining adequate supplies of energy or raw materials.
Tonnage Gases competes in the United States against three global industrial gas companies, L'Air Liquide S.A., Linde AG and Praxair, Inc., and several regional sellers. Competition is based primarily on price, reliability of supply, the development of applications that use industrial gases and, in some cases, provision of other services or products such as power and steam generation. Similar competitive situations exist in the European and Asian industrial gas markets where the Company competes against the three global companies as well as regional competitors.
Tonnage Gases hydrogen sales constituted approximately 15 percent of the Company's consolidated sales in fiscal year 2007, 15 percent in fiscal year 2006 and 12 percent in fiscal year 2005.

ELECTRONICS AND PERFORMANCE MATERIALS

Electronics and Performance Materials employs applications technology to provide solutions to a broad range of global industries through chemical synthesis, analytical technology, process engineering and surface science. This segment provides the electronics industry with specialty gases (such as nitrogen trifluoride, silane, arsine, phosphine, white ammonia, silicon tetrafluoride, carbon tetrafluoride, hexafluoromethane, critical etch gases and tungsten hexafluoride), as well as tonnage gases (primarily nitrogen), specialty and bulk chemicals, services and equipment for the manufacture of silicon and compound semiconductors, thin film transistor liquid crystal displays and photovoltaic devices. These products are delivered through various supply chain methods, including bulk delivery systems or distribution by pipelines such as those located in California's Silicon Valley; Phoenix, Arizona; Tainon, Taiwan; Gumi and Giheung, Korea; and Tianjin and Shanghai, China. The Company has announced that the High Process Purity Chemicals business will be sold during fiscal year 2008.
Electronics and Performance Materials also provides performance materials for a wide range of products, including coatings, inks, adhesives, civil engineering, personal care, institutional and industrial cleaning, mining, oil refining and polyurethanes, and focuses on the development of new materials aimed at providing unique functionality to emerging markets. Principal performance materials include polyurethane catalysts and other additives for polyurethane foam, epoxy amine curing agents and auxiliary products for epoxy systems and specialty surfactants for formulated systems.
The Electronics and Performance Materials segment uses a wide variety of raw materials, including alcohols, ethyleneamines, cyclohexamine, acrylonitriles and glycols. During fiscal year 2007, no significant difficulties were encountered in obtaining adequate supplies of energy or raw materials.
The Electronics and Performance Materials segment faces competition on a product–by–product basis against competitors ranging from niche suppliers with a single product to larger and more vertically integrated companies. Competition is principally conducted on the basis of price, quality, product performance, reliability of product supply, technical innovation, service and global infrastructure.

Total sales from Electronics and Performance Materials constituted approximately 21 percent of the Company's consolidated sales in fiscal year 2007, 21 percent in fiscal year 2006 and 21 percent in fiscal year 2005.

EQUIPMENT AND ENERGY

Equipment and Energy designs and manufactures cryogenic and gas processing equipment for air separation (utilizing membrane technology and adsorption technology), hydrocarbon recovery and purification, natural gas liquefaction (known as "LNG") and helium distribution (cryogenic transportation containers), and serves energy markets in a variety of ways.

Equipment is sold globally to customers in the chemical and petrochemical manufacturing, oil and gas recovery and processing and steel and primary metals processing industries. The segment also provides a broad range of plant design, engineering, procurement and construction management services to its customers.

Energy markets are served through the Company's operation and partial ownership of cogeneration and flue gas desulphurization facilities and its development of hydrogen as an energy carrier and oxygen–based technologies to serve energy markets in the future. The Company owns and operates a cogeneration facility in Calvert City, Kentucky; operates and owns fifty percent interests in a 49–megawatt fluidized–bed coal–fired power generation facility in Stockton, California and a 24–megawatt gas–fired combined–cycle power generation facility near Rotterdam, the Netherlands; and operates and owns a 48.8 percent interest in a 112–megawatt gas–fueled power generation facility in Thailand. The Company also operates and owns a fifty percent interest in a flue gas desulphurization facility in Indiana.

Steel, aluminum and capital equipment subcomponents (compressors, etc.) are the principal raw materials in the equipment portion of this segment. Adequate raw materials for individual projects are acquired under firm purchase agreements. Coal, petroleum coke and natural gas are the largest cost components in the production of energy. The Company mitigates these cost components, in part, through long–term cost–pass–through contracts. During fiscal year 2007, no significant difficulties were encountered in obtaining adequate supplies of raw materials.

Equipment and Energy competes with a great number of firms for all of its offerings except LNG heat exchangers, for which there are fewer competitors due to the limited market size and proprietary technologies. Competition is based primarily on technological performance, service, technical know–how, price and performance guarantees.

The backlog of equipment orders (including letters of intent believed to be firm) from third party customers (including equity affiliates) was approximately $258 million on 30 September 2007, approximately 42 percent of which is for cryogenic air separation equipment and 27 percent of which is for LNG heat exchangers, as compared with a total backlog of approximately $446 million on 30 September 2006. The Company expects that approximately $225 million of the backlog on 30 September 2007 will be completed during fiscal year 2008.

HEALTHCARE

Healthcare provides respiratory therapies, home medical equipment and infusion services to over 500,000 patients in their homes. The Company operates in fifteen countries, including the United States, and is the market leader in Spain, Portugal, the United Kingdom and Mexico. Its serves patients whose conditions include chronic lung disease, asthma, emphysema, sleep apnea and diabetes by providing oxygen therapy, pharmacist–managed direct–shipped respiratory medications, home nebulizer therapy, sleep management therapy, anti–infection therapy, enteral nutrition, beds and wheelchairs.

Labor is the largest cost component in this segment. In addition, the Company purchases oxygen concentrators and cylinders, beds, wheelchairs, sleep apnea products and equipment for respiratory therapy from multiple vendors.

The home healthcare market is highly competitive. Competition in the Company's Healthcare segment involves regulatory compliance, price, quality, service and reliability of supply. Home healthcare in the United States is served by over 2,000 regional and local providers, including Apria Healthcare Group and Lincare Holdings Inc. Reimbursement levels are established by fee schedules regulated by Medicare and Medicaid or by the levels negotiated with insurance companies. Accordingly, in the United States, home healthcare companies compete primarily on the basis of service. The structure of home healthcare in Europe is different from that in the United States. In certain countries in Europe, competitive bidding leads to exclusive supply arrangements for fixed terms. In other European countries, a licensed home healthcare provider competes for customers in a manner similar to that in the U.S. Three large industrial gas companies, L'Air Liquide S.A., Linde AG, and Praxair, Inc., represent Healthcare's principal competitors in Europe. Maintaining competitiveness requires efficient logistics, reimbursement and accounts receivable systems.

CHEMICALS

The Chemicals segment consists of the Polymer Emulsions business and the Polyurethane Intermediates (PUI) business. The Company announced plans to divest its Polymer Emulsions business in 2006 and is currently in advanced discussions with its partner in the business, Wacker Chemie AG, over Wacker's purchase of the Company's interests in their two polymers joint ventures.

Polymers are water–based and water–soluble emulsion products derived primarily from vinyl acetate monomer. The Company's major emulsions products are AIRFLEX® vinyl acetate–ethylene copolymer emulsions and vinyl acetate homopolymer emulsions, which are used in adhesives, nonwoven fabric binders, paper coatings, paints, inks and carpet backing binder formulations.

The Company produces di–nitrotoluene ("DNT"), which is converted to toluene diamine ("TDA") and sold for use as an intermediate in the manufacture of a major precursor of flexible polyurethane foam used in furniture cushioning, carpet underlay, bedding and seating in automobiles. Most of the Company's TDA is sold under long–term contracts to a small number of customers.

The Company employs proprietary technology and scale of production to differentiate its polyurethane intermediates from those of its competitors. The Company also produces nitric acid as a raw material for its intermediates.

The Chemicals segment's principal raw material purchases are chemical intermediates produced by others from basic petrochemical feedstocks such as olefins and aromatic hydrocarbons, which are generally derived from various crude oil fractions or from liquids extracted from natural gas. The Company purchases its chemical intermediates, which are generally readily available, from many sources and normally is not dependent on one supplier. The Company uses such raw materials in the production of emulsions and polyurethane intermediates. In addition, the Company purchases finished and semi–finished materials and chemical intermediates from many suppliers. The Company also purchases ammonia under long–term contracts as a feedstock for its Pasadena, Texas facility. During fiscal year 2007, there was a shortage of a key polymers raw material, vinyl acetate monomer, however, the business was able to obtain adequate supplies. There were no other significant difficulties in supplying adequate supplies of energy or raw materials.

The Chemicals segment competes against a number of chemical companies, some of which are larger and more vertically integrated than the Company. While competition varies from product to product, the Company believes it has strong market positions in most of its chemical products. The possibility of back integration by large customers is a major competitive factor in the Company's polyurethane intermediates business. Competition is conducted principally on the basis of price, quality, product performance, reliability of product supply and technical service assistance.

Chemicals sales constituted 10 percent of the Company's consolidated sales in fiscal year 2007, 10 percent in fiscal year 2006 and 12 percent in fiscal year 2005.

NARRATIVE DESCRIPTION OF THE COMPANY'S BUSINESS GENERALLY

FOREIGN OPERATIONS

The Company, through subsidiaries, affiliates and minority–owned ventures, conducts business in over forty countries outside the United States. Its international businesses are subject to risks customarily encountered in foreign operations, including fluctuations in foreign currency exchange rates and controls, import and export controls and other economic, political and regulatory policies of local governments.

The Company has majority or wholly–owned foreign subsidiaries that operate in Canada, 17 European countries (including the United Kingdom and Spain), 11 Asian countries (including China, Korea, Singapore and Taiwan) and four Latin American countries (including Mexico and Brazil). The Company also owns less–than–controlling interests in entities operating in Europe, Asia, Africa and Latin America (including Italy, Germany, China, Korea, India, Singapore, Thailand, South Africa and Mexico).

Financial information about the Company's foreign operations and investments is included in Notes 8, 17 and 21 to the Consolidated Financial Statements included under Item 8 herein. Information about foreign currency translation is included under "Foreign Currency" in Note 1 and information on the Company's exposure to currency fluctuations is included under "Currency Risk Management" in Note 6 to the Consolidated Financial Statements included under Item 8 herein and in Management's Discussion and Analysis of Financial Condition and Results of Operations under "Foreign Currency Exchange Rate Risk" included under Item 7 herein. Export sales from operations in the United States to unconsolidated customers amounted to $715 million, $732 million and $714 million in fiscal years 2007, 2006 and 2005, respectively. Total export sales in fiscal year 2007 included $422 million in export sales to affiliated

customers. The sales to affiliated customers were primarily equipment sales within the Equipment and Energy segment and Electronic and Performance Materials sales.

TECHNOLOGY DEVELOPMENT

The Company pursues a market–oriented approach to technology development through research and development, engineering and commercial development processes. It conducts research and development principally in its laboratories located in the United States (Trexlertown, Pennsylvania; Carlsbad, California; Milton, Wisconsin; and Phoenix, Arizona), the United Kingdom (Basingstoke, London and Carrington); Germany (Burghausen and Hamburg); the Netherlands (Utrecht); Spain (Barcelona and Madrid) and Asia (Tokyo, Japan; Shanghai, China; Giheung, Korea; and Hsinchu, Taiwan). The Company also funds and cooperates in research and development programs conducted by a number of major universities and undertakes research work funded by others — principally the United States Government.

The Company's corporate research groups, which include materials, process and analytical centers, support the research efforts of various businesses throughout the Company. Technology development efforts for use within Merchant Gases, Tonnage Gases and Equipment and Energy focus primarily on new and improved processes and equipment for the production and delivery of industrial gases and new or improved applications for all such products. Research and technology development for Electronics and Performance Materials is primarily concerned with new products and applications to strengthen and extend the Company's present positions. Work is also performed in Electronics and Performance Materials to lower processing costs and develop new processes for the new products. In Healthcare, the Company employs new scientific developments, knowledge, clinical evidence or technology to develop new products and services that focus on both the clinical and home healthcare environment.

Research and development expenditures were $140 million during fiscal year 2007, $151 million in fiscal year 2006 and $132 million in fiscal year 2005, and the Company expended $19 million on customer–sponsored research activities during fiscal year 2007, $21 million during fiscal year 2006 and $17 million in fiscal year 2005.

As of 1 November 2007, the Company owned 1,031 United States patents and 2,912 foreign patents and is a licensee under certain patents owned by others. While the patents and licenses are considered important, the Company does not consider its business as a whole to be materially dependent upon any particular patent, patent license or group of patents or licenses.

ENVIRONMENTAL CONTROLS

The Company is subject to various environmental laws and regulations in the countries in which it has operations. Compliance with these laws and regulations results in higher capital expenditures and costs. From time to time the Company is involved in proceedings under the Comprehensive Environmental Response, Compensation, and Liability Act (the federal Superfund law), similar state laws and the Resource Conservation and Recovery Act (RCRA) relating to the designation of certain sites for investigation and possible cleanup. Additional information with respect to these proceedings is included under Item 3, Legal Proceedings, below. The Company's accounting policies on environmental expenditures are discussed in Note 1 and particulars on environmental loss contingencies are provided in Note 19 to the Consolidated Financial Statements included under Item 8 herein.

The amounts charged to income from continuing operations on an after–tax basis related to environmental matters totaled $25 million in fiscal 2007, $26 million in 2006 and $26 million in 2005. These amounts represent an estimate of expenses for compliance with environmental laws, remedial activities and activities undertaken to meet internal Company standards. Such costs are estimated to be $21 million in 2008 and $22 million in 2009.

Although precise amounts are difficult to define, the Company estimates that in fiscal year 2007 it spent approximately $11 million on capital projects to control pollution versus $14 million in 2006. Capital expenditures to control pollution in future years are estimated at approximately $10 million in 2008 and $6 million in 2009. The cost of any environmental compliance generally is contractually passed through to the customer.

The Company accrues environmental investigatory and remediation costs for identified sites when it is probable that a liability has been incurred and the amount of loss can be reasonably estimated. The potential exposure for such costs is estimated to range from $52 million to a reasonably possible upper exposure of $65 million. The accrual on the balance sheet for 30 September 2007 was $52.2 million and for 30 September 2006 was $52.4 million. Actual costs to be incurred in future periods may vary from the estimates, given inherent uncertainties in evaluating environmental exposures. Subject to the imprecision in estimating future environmental costs, the Company does not expect that any sum it may have to pay in connection with environmental matters in excess of the amounts recorded or disclosed above would have a materially adverse effect on its financial condition or results of operations in any one year.

INSURANCE

The Company's policy is to obtain public liability and property insurance coverage that is currently available at what management determines to be a fair and reasonable price. The Company maintains public liability and property insurance coverage at amounts that management believes are sufficient to meet the Company's anticipated needs in light of historical experience to cover future litigation and claims. There is no assurance, however, that the Company will not incur losses beyond the limits of, or outside the coverage of, its insurance.

EMPLOYEES

On 30 September 2007, the Company (including majority–owned subsidiaries) had approximately 22,100 employees, of whom approximately 21,500 were full–time employees and of whom approximately 11,200 were located outside the United States. The Company has collective bargaining agreements with unions at various locations that expire on various dates over the next four years. The Company considers relations with its employees to be satisfactory and does not believe that the impact of any expiring or expired collective bargaining agreements will result in a material adverse impact on the Company.

AVAILABLE INFORMATION

All periodic and current reports, registration statements and other filings that the Company is required to file with the Securities and Exchange Commission ("SEC"), including the Company's annual report on Form 10–K, quarterly reports on Form 10–Q, current reports on Form 8–K and amendments to those reports filed or furnished pursuant to Section 13(a) of the Exchange Act (the "1934 Act Reports"), are available free of charge through the Company's Internet website at www.airproducts.com. Such documents are available as soon as reasonably practicable after electronic filing of the material with the SEC. All 1934 Act Reports filed during the period covered by this Report were available on the Company's website on the same day as filing.

The public may also read and copy any materials filed by the Company with the SEC at the SEC's Public Reference Room at 100 F Street, N.E., Washington, DC 20549. The public may obtain information on the operation of the Public Reference Room by calling the SEC at 1–800–SEC–0330. The SEC maintains an Internet site that contains reports, proxy and information statements and other information regarding issuers that file electronically with the SEC; the address of that site is www.sec.gov.

SEASONALITY

Although none of the six business segments are subject to seasonal fluctuations to any material extent, the Chemicals segment is susceptible to the cyclical nature of the chemicals industry. The Electronics and Performance Materials segment is susceptible to the cyclical nature of the electronics industry and to seasonal fluctuations in underlying end–use Performance Materials markets.

WORKING CAPITAL

The Company's policy is to consistently maintain an adequate level of working capital to support its business needs at all times.

CUSTOMERS

There is no single or small number of customers upon which any business segment depends.

GOVERNMENTAL CONTRACTS

No segment's business is subject to a government entity's renegotiation of profits or termination of contracts that would be material to the Company's business as a whole.

EXECUTIVE OFFICERS OF THE COMPANY

The Company's executive officers and their respective positions and ages on 15 November 2007 follow. Except where indicated, each of the executive officers listed below has been employed by the Company in the position indicated during the past five fiscal years. Information with respect to offices held is stated in fiscal years.

Name	Age	Office
M. Scott Crocco	43	Vice President and Corporate Controller (became Vice President in 2008; Corporate Controller in 2006; and Director of Corporate Decision Support in 2003)
Robert D. Dixon (A)	48	Senior Vice President and General Manager—Merchant Gases (became Senior Vice President in 2008; Vice President and General Manager—Merchant Gases in 2007; President—Air Products Asia in 2003; and Vice President—Air Products Asia in 2003)
Michael F. Hilton (A)	53	Senior Vice President and General Manager—Electronics and Performance Materials (became Senior Vice President in 2008; Vice President and General Manager—Electronics and Performance Materials in 2007; and Vice President—Electronics Businesses in 2003)
Paul E. Huck (A)	57	Senior Vice President and Chief Financial Officer (became Senior Vice President in 2008; Vice President and Chief Financial Officer in 2004; and Vice President and Corporate Controller in 2002)
Stephen J. Jones (A)	46	Senior Vice President, General Counsel and Secretary (became Senior Vice President, General Counsel and Secretary in 2008; Vice President and Associate General Counsel in 2007; and Vice President and General Manager—Industrial Chemicals Division in 2003)
John W. Marsland (A)	41	Vice President and General Manager—Healthcare (became Vice President and General Manager—Healthcare in 2007; Vice President and General Manager, Global Healthcare in 2005; and Vice President—Corporate Development Office in 2003)
John E. McGlade (A)(B)(C)	53	President and Chief Executive Officer (became Chief Executive Officer in 2008; President and Chief Operating Officer in 2006; Group Vice President—Chemicals in 2003; and Vice President—Chemicals Group Business Divisions in 2003)
Lynn C. Minella (A)	49	Senior Vice President—Human Resources and Communications (became Senior Vice President—Human Resources and Communications in 2008; Vice President—Human Resources in 2004; and Vice President, Human Resources, Software Group, International Business Machines Corporation in 2002)
Scott A. Sherman (A)	56	Senior Vice President and General Manager—Tonnage Gases, Equipment and Energy (became Senior Vice President in 2008; Vice President and General Manager—Tonnage Gases, Equipment and Energy in 2007; and Vice President and General Manager—Energy and Process Industries in 2001)

(A) Member, Corporate Executive Committee
(B) Member, Board of Directors
(C) Member, Executive Committee of the Board of Directors

ITEM 1A. RISK FACTORS.

The Company operates in over 40 countries around the world and faces a variety of risks and uncertainties that could materially affect its future operations and financial performance. Many of these risks and uncertainties are not within the Company's control. Risks that may significantly impact the Company include the following:

Overall Economic Conditions and Demand for Products — General economic conditions in markets in which the Company does business can impact the demand for its goods and services. Decreased demand for its products and services can have a negative impact on the Company's financial performance and cash flow.

Demand for the Company's products and services in part depends on the general economic conditions affecting the countries and industries in which the Company does business. A downturn in economic conditions in a country or industry served by the Company may negatively impact demand for the Company's products and services, in turn negatively impacting the Company's operations and financial results. Further, changes in demand for its products and services can magnify the impact of economic cycles on the Company's businesses. Unanticipated contract terminations by current customers can negatively impact operations, financial results and cash flow. The Company's recent divestiture of certain of its chemicals businesses, along with the potential sale of its polymers business, should make the Company less susceptible to the cyclical nature of the chemicals industry.

Competition — The Company faces strong competition from several large, global competitors and many smaller regional ones in most of its business segments. Inability to compete effectively in a segment could adversely impact sales and financial performance.

The Merchant Gases segment competes with three global industrial gas companies, L'Air Liquide S.A., Linde AG and Praxair, Inc., as well as with several regional competitors in North America (including Airgas, Inc.) and in Europe and Asia. Competition is based primarily on price, product quality, reliability of supply and development of innovative applications.

The Tonnage Gases segment also competes with the three global industrial gas competitors noted above as well as with several regional competitors in North America, Europe and Asia. Competition is based primarily on price, product quality, reliability of supply, development of innovative applications and, in some instances, provision of additional items such as power and steam generation.

The Electronics and Performance Materials segment faces competition on a product–by–product basis against companies ranging from niche suppliers with a single product to larger and more vertically integrated companies. Competition is principally conducted on the basis of price, quality, product performance, reliability of product supply and technical service assistance.

Equipment and Energy competes against many firms based primarily on technological performance, service, technical know–how, price and performance guarantees.

Healthcare competes against many local and regional providers in the United States, including Apria Healthcare Group and Lincare Holdings Inc., and against three large industrial gas companies, L'Air Liquide, S.A., Linde AG and Praxair, Inc., as well as local and regional suppliers in Europe. Competition is based primarily on quality of service. Remaining competitive requires efficient logistic, reimbursement and accounts receivable systems.

The Chemicals segment competes against a large number of chemical companies, generally on a product–by–product basis, principally on the basis of price, quality, product performance, reliability of product supply and technical service assistance. Several of these competitors are larger than the Company and are more vertically integrated.

Raw Material and Energy Cost and Availability — Volatility in raw material and energy costs, interruption in ordinary sources of supply and an inability to recover unanticipated increases in energy and raw material costs from customers could result in lost sales or significantly increase the cost of doing business.

Electricity is the largest cost input for the production of atmospheric gases in Merchant Gases and Tonnage Gases. Because the Company's industrial gas facilities use substantial amounts of electricity, energy price fluctuations could materially impact the financial performance of these segments. While the Company has been successful in contracting for electricity under multi–year agreements and passing through the cost to its customers, there is no assurance that it will be able to do so in the future.

Hydrocarbons, including natural gas, are the primary feedstock for the production of hydrogen, carbon monoxide and synthesis gas within Merchant Gases and Tonnage Gases. Volatility in hydrocarbon prices can impact the Company's financial performance. While the Company generally passes this risk through to its customers under its take–or–pay contracts by matching feedstock prices to the purchase price of the product being produced, an inability to do so in the future could impact its financial results.

The Company's large delivery truck fleet requires a readily available supply of gasoline and diesel fuel. The Company attempts to pass through increases in the cost of these fuels to its customers whenever possible.

Steel, aluminum and capital equipment subcomponents (such as compressors) are the principal raw materials in the equipment portion of the Equipment and Energy segment. Firm purchase agreements that cover the term of the project provide for adequate raw materials. Coal, petroleum coke and natural gas are the largest cost components for the energy portion of this segment. These costs are mitigated, in part, through long–term cost–pass–through contracts.

The Electronics and Performance Materials segment uses a wide variety of raw materials, including alcohols, ethyleneamines, cyclohexamine, acrylonitriles and glycols. The Company purchases these materials from numerous suppliers. Though the Company attempts to pass through increases in the cost of these materials to its customers whenever possible, it is subject to competitive pressures.

The principal raw materials used in Chemicals are chemical intermediates such as olefins and aromatic hydrocarbons produced by outside suppliers from basic petrochemical feed–stocks like crude oil or natural gas. This segment also depends on adequate energy sources and natural gas as a feedstock for certain products. The Company does not depend on any one supplier for its chemical intermediates supply.

Despite the Company's contractual pass–through of the costs of energy, raw materials and delivery fuel, a shortage or interruption in their supply or an increase in any of their prices that cannot be passed on to customers for competitive or other reasons can negatively impact the Company's operations, financial results and cash flow.

Regulatory and Political Risks and Foreign Operations — The Company is subject to extensive government regulation in jurisdictions around the globe in which it does business. Regulations address, among other things, environmental compliance, import/export restrictions, healthcare services, taxes and financial reporting, and can significantly increase the cost of doing business, which in turn can negatively impact the Company's operations, financial results and cash flow.

The Company is subject to government regulation and intervention both in the United States and in all foreign jurisdictions in which it conducts its business. Compliance with applicable laws and regulations results in higher capital expenditures and operating costs and changes to current regulations with which the Company complies can necessitate further capital expenditures and increases in operating costs to enable continued compliance. Additionally, from time to time, the Company is involved in proceedings under certain of these laws and regulations. Foreign operations are subject to political instabilities, restrictions on funds transfers, import/export restrictions and currency fluctuation. Significant areas of regulation and intervention include the following:

Environmental and Health Compliance. The Company is committed to conducting its activities so that there is no or only minimal damage to the environment; there is no assurance, however, that its activities will not at times result in liability under environmental and health regulations. Costs and expenses resulting from such liability may materially negatively impact the Company's operations and financial condition. Overall, environmental and health laws and regulations will continue to affect the Company's businesses worldwide. For a more detailed description of these matters, see "Narrative Description of the Company's Business Generally — Environmental Controls" herein.

Import/Export Regulation. The Company is subject to significant regulatory oversight of its import and export operations due to the nature of its product offerings. The Company voluntarily participates in various government programs designed to enhance supply chain security and promote appropriate screening practices and internal controls regarding its purchases and sales to customers around the world. Penalties for non-compliance can be significant and violation can result in adverse publicity for the Company.

Nationalization and Expropriation. The Company's operations in certain foreign jurisdictions are subject to nationalization and expropriation risk and some of its contractual relationships within these jurisdictions are subject to cancellation without full compensation for loss. The occurrence of any of these risks could have a material, adverse impact on the Company's operations and financial condition. For a more detailed description of these matters, see "Narrative Description of the Company's Business Generally — Foreign Operations" herein.

Home Healthcare Regulation. The Company's Healthcare segment is subject to extensive government regulation, including laws directed at preventing fraud, abuse, kickbacks and false claims, laws regulating billing and reimbursement under various governmental healthcare programs and laws related to the privacy of patient data. Enforcement actions may be brought by the government or by qui tam relaters (private citizens bringing an action on behalf of the government), which could result in the imposition of fines or exclusion from participation in government healthcare programs. Also, the government contracts with regional carriers who administer claims processing for governmental healthcare programs. These carriers conduct both pre-payment and post-payment reviews and audits, which could result in demands for refunds or recoupments of amounts paid. The Company maintains a compliance program designed to minimize the likelihood that it would engage in conduct that violates these requirements or that could result in material refunds or recoupments. In addition, state and federal healthcare programs are subject to reform by legislative and administrative initiatives that could impact the relative cost of doing business and the amount of reimbursement for products and services provided by the Company. The Company closely monitors reform initiatives and participates actively in trade association and other activities designed to influence these reforms.

Taxes. The Company structures its operations to be tax efficient and to make use of tax credits and other incentives when it makes business sense to do so. Nevertheless, changes in tax laws, actual results of operations, final audit of tax returns by taxing authorities, and the timing and rate at which tax credits can be utilized can change the rate at which the Company is taxed, thereby affecting its financial results and cash flow.

Financial Accounting Standards. The Company's financial results can be impacted by new or modified financial accounting standards.

Financial Market Risks — The Company's earnings, cash flow and financial position are exposed to financial market risks worldwide, including interest rate and currency exchange rate fluctuations and exchange rate controls.

The Company operates in over 40 countries. It finances a portion of its operations through United States and foreign debt markets with various short-term and long-term public and private borrowings, and conducts its business in both U.S. dollars and many foreign currencies. Consequently, it is subject to both interest rate and currency exchange rate fluctuations. The Company actively manages the interest rate risk inherent in its debt portfolio in accordance with parameters set by management addressing the type of debt issued (fixed versus floating rate) and the use of derivative financial instruments. The Company strives to mitigate its currency exchange rate risks by minimizing cash flow exposure to adverse changes in exchange rates through the issuance of debt in currencies in which operating cash flows are generated and the use of derivative financials instruments. Derivative counterparty risk is mitigated by contracting with major financial institutions that have investment grade credit ratings. All derivative instruments are entered into for other than trading purposes. For a more detailed analysis of these matters see Note 6 to the Consolidated Financial Statements included under Item 8 herein.

Catastrophic Events — Catastrophic events such as natural disasters, pandemics, war and acts of terrorism, could disrupt the Company's business or the business of its suppliers or customers, any of which disruptions could have a negative impact on the Company's operations, financial results and cash flow.

The Company's operations are at all times subject to the occurrence of catastrophic events outside the Company's control, ranging from severe weather conditions such as hurricanes, floods, earthquakes and storms, to health epidemics and pandemics, to acts of war and terrorism. Any such event could cause a serious business disruption that could affect the Company's ability to produce and distribute its products and possibly expose it to third-party liability claims. Additionally,

such events could impact the Company's suppliers, in which event energy and raw materials may be unavailable to the Company, and its customers, who may be unable to purchase or accept the Company's products and services. Any such occurrence could have a negative impact on the Company's operations and financial condition.

Company Undertakings — The Company actively manages its business to protect and optimize its assets and businesses. There is no assurance, however, that the Company's undertakings will result in the intended protections and optimizations. In certain circumstances, the Company's undertakings could negatively impact its operations and financial results.

Operations. Inherent in the Company's operations of its facilities, pipelines and delivery systems are hazards that require continuous oversight and control. If operational risks materialize, they could result in loss of life, damage to the environment or loss of production, all of which could negatively impact the Company's on–going operations, financial results and cash flow. While the safety and security of the Company's operations have always been a priority, the Company has significantly expanded its efforts in this area since the terrorist attacks of September 11, 2001. It has been an active participant in the development and implementation of the American Chemistry Council's Responsible Care Security Code and has implemented this Code at all global facilities. Security vulnerability assessments ("SVA") were conducted and necessary security upgrades implemented at facilities in North American, Europe and Asia. There is one remaining project in Asia which will be completed by December 2007 and security upgrades in Brazil are scheduled for completion by the end of fiscal year 2008. The Company has also developed global security standards to address the safety and security of its global supply chain.

Portfolio Management. The Company continuously reviews and manages its portfolio of assets in an attempt to conduct its businesses in a manner to maximize value to its shareholders. Portfolio management involves many variables, including future acquisitions and divestitures, restructurings and re–segmentations and cost–cutting and productivity initiatives. The timing, impact and ability to complete such undertakings, the costs and financial charges associated with such activities and the ultimate financial impact of such undertakings is uncertain and can have a negative short or long–term impact on the Company's operations and financial results.

Insurance. The Company carries public liability and property insurance in amounts that management believes are sufficient to meet its anticipated needs in light of historical experience to cover future litigation and property damage claims. Nevertheless, the occurrence of an unforeseen event for which the Company does not have adequate insurance could result in a negative impact on its financial results and cash flow. There is no assurance that the Company will collect insurance proceeds to which it is entitled if an insurer's business fails or it refuses to pay in a timely manner. Further, there is no assurance that the Company will not incur losses beyond the limits of, or outside the coverage of, its insurance policies.

Security. Acts of terrorism that threaten the Company or its facilities, pipelines, transportation or computer systems could severely disrupt its business operations and adversely affect the results of operations.

IT Risk. The security of the Company's IT systems could be compromised, which could adversely affect its ability to operate. The Company utilizes a global enterprise resource planning (ERP) system and other technologies for the distribution of information both within the Company and to customers and suppliers. The ERP system and other technologies are potentially vulnerable to interruption from viruses, hackers or system breakdown. To mitigate these risks, the Company has implemented a variety of security measures, including virus protection, a state of the art data center, redundancy procedures and recovery processes. A significant system interruption, however, could seriously affect the Company's business operation and financial condition.

Litigation. The Company is involved from time to time in various legal proceedings, including competition, environmental, health, safety, product liability and insurance matters. There is a risk that a lawsuit may be settled or adjudicated for an amount that is not insured. Any such uninsured amount could have a significant impact on the Company's financial condition and cash flow.

Recruiting and Retaining. Continued business success depends on the recruitment, development and retention of qualified employees. The inability to attract, develop or retain quality employees could negatively impact the Company's business objectives which might adversely affect the Company's business operation and financial condition.

ITEM 1B. UNRESOLVED STAFF COMMENTS.

The Company has not received any written comments from the Commission staff that remain unresolved.

ITEM 2. PROPERTIES.

The Company owns its principal executive offices, which are located at its headquarters in Trexlertown, Pennsylvania, and also owns additional principal administrative offices in Hersham, near London, England and in Hattingen, Germany. Its principal Asian administrative offices, which are leased, are located in Hong Kong; Shanghai, China; Taipei, Taiwan; and Singapore. Additional administrative offices are leased near Philadelphia, Pennsylvania; Ontario, Canada; Tokyo, Japan; Seoul, South Korea; Kuala Lumpur, Malaysia; Brussels, Belgium; Paris, France; Barcelona, Spain; Utrecht, the Netherlands; and São Paulo, Brazil. Management believes the Company's manufacturing facilities, described in more detail below, are adequate to support its businesses.

Following is a description of the properties used by the Company's six business segments:

MERCHANT GASES

Merchant Gases currently operates over 150 facilities across the United States and in Canada (approximately 20 of which sites are owned), over 50 sites in Europe (approximately half of which sites are owned) and over 50 facilities in seven countries within Asia and in Brazil. Helium is recovered at sites in Kansas and Texas and distributed from several transfill sites in the U.S. and Asia. Sales support offices are located at its Trexlertown headquarters as well as in leased properties in three states, at several sites in Europe and at 15 sites in Asia.

TONNAGE GASES

Tonnage Gases operates 50 plants in the United States that produce over 300 standard tons–per–day of product. Over 30 of these facilities produce or recover hydrogen, many of which support the three major pipeline systems located along the Gulf Coast of Texas, on the Mississippi River corridor and in Los Angeles, California. The segment also operates approximately 20 tonnage plants in Europe and 16 tonnage plants within Asia, the majority of which are on leased properties. Sales support offices are located at the Company's headquarters in Trexlertown, Pennsylvania, as well as in leased offices in Texas, Louisiana, California and Calgary, Alberta.

ELECTRONICS AND PERFORMANCE MATERIALS

The electronics business within the Electronics and Performance Materials segment produces, packages and stores nitrogen, specialty gases and electronic chemicals at 50 sites in the United States (the majority of which are leased), nine facilities (including sales offices) in Europe and over 40 facilities in Asia (approximately half of which are located on customer sites).

The performance materials portion of this segment operates facilities in Los Angeles, California; Calvert City, Kentucky; Paulsboro, New Jersey; Wichita, Kansas; Milton, Wisconsin; Reserve, Louisiana; Clayton, U.K.; Singapore; Isehara, Japan; and Yisin and Changzhou, China. Substantially all of the performance materials properties are owned.

This segment has eight field sales offices in the United States as well as sales offices in Europe, Taiwan, Korea, Singapore and China, the majority of which are leased.

EQUIPMENT AND ENERGY

Equipment and Energy operates five plants and two sales offices in the U.S. The Company manufactures a significant portion of the world's supply of LNG equipment at its Wilkes–Barre, Pennsylvania site. When capacity is available, the site manufactures air separation columns and cold boxes for company–owned facilities and for sale to third parties. The Acrefair site in the United Kingdom and a new operation in Caojing, China also produce air separation columns. Cryogenic transportation containers for liquid helium are manufactured and reconstructed at facilities in eastern Pennsylvania and Liberal, Kansas. Additional facilities utilized by the segment include three plants and offices in Europe. Electric power is produced at various facilities including Stockton, California; Calvert City, Kentucky; and Rotterdam in the Netherlands.

Flue gas desulfurization operations are conducted at the Pure Air facility in Chesterton, Indiana. The Company or its affiliates own approximately 50 percent of the real estate in this segment and lease the remaining 50 percent.

HEALTHCARE

Healthcare has 177 facilities that are located in the United States, six countries in Europe (including the U.K., Spain and Portugal), Canada, Mexico, Argentina and Korea. The majority of Healthcare facilities are leased. Many of the U.S. facilities were consolidated or upgraded to newer facilities in 2007.

CHEMICALS

In Chemicals, polyurethane intermediates operations are located in Pasadena, Texas and its polymer emulsions operations are conducted at properties in Calvert City, Kentucky; South Brunswick, New Jersey; Piedmont, South Carolina; Elkton, Maryland; Cologne, Germany; and Ulsan, Korea. The Chemicals segment has sales offices and laboratories in the United States, Europe, Mexico, Korea and China, the majority of which are leased.

ITEM 3. LEGAL PROCEEDINGS.

In the normal course of business the Company and its subsidiaries are involved in various legal proceedings, including competition, environmental, health, safety, product liability and insurance matters. Certain proceedings involve governmental authorities under the Comprehensive Environmental Response, Compensation, and Liability Act (the federal Superfund law); the Resource Conservation and Recovery Act (RCRA); and similar state environmental laws relating to the designation of certain sites for investigation or remediation. Presently there are approximately 33 sites on which a final settlement has not been reached where the Company, along with others, has been designated a Potentially Responsible Party by the Environmental Protection Agency or is otherwise engaged in investigation or remediation. The Company does not expect that any sums it may have to pay in connection with these matters would have a materially adverse effect on its consolidated financial position. Additional information on the Company's environmental exposure is included under "Narrative Description of the Company's Business Generally — Environmental Controls."

ITEM 4. SUBMISSION OF MATTERS TO A VOTE OF SECURITY HOLDERS.

Not applicable.

PART II

ITEM 5. MARKET FOR REGISTRANT'S COMMON EQUITY, RELATED STOCKHOLDER MATTERS AND ISSUER PURCHASES OF EQUITY SECURITIES.

The Company's common stock (ticker symbol "APD") is listed on the New York Stock Exchange. Quarterly stock prices, as reported on the New York Stock Exchange composite tape of transactions, and dividend information for the last two fiscal years appear below. Cash dividends on the Company's common stock are paid quarterly. The Company's objective is to pay dividends consistent with the reinvestment of earnings necessary for long-term growth.

It is the Company's expectation that comparable cash dividends will continue to be paid in the future.

Quarterly Stock Information

2007	High	Low	Close	Dividend
First	$72.45	$66.19	$70.28	$ .34
Second	78.63	68.58	73.96	.38
Third	82.74	73.30	80.37	.38
Fourth	98.51	77.26	97.76	.38
				$1.48

2006	High	Low	Close	Dividend
First	$61.89	$53.00	$59.19	$ .32
Second	68.10	58.01	67.19	.34
Third	69.54	59.18	63.92	.34
Fourth	68.48	60.92	66.37	.34
				$1.34

The Company has authority to issue 25,000,000 shares of preferred stock in series. The Board of Directors is authorized to designate the series and to fix the relative voting, dividend, conversion, liquidation, redemption and other rights, preferences and limitations. When preferred stock is issued, holders of Common Stock are subject to the dividend and liquidation preferences and other prior rights of the preferred stock. There currently is no preferred stock outstanding. The Company's Transfer Agent and Registrar is American Stock Transfer and Trust Company, 59 Maiden Lane, Plaza Level, New York, New York 10038, telephone (800) 937-5449 (U.S. and Canada) or (718) 921-8200 (all other locations), Internet website www.amstock.com, and e-mail address info@amstock.com.

As of 19 November 2007, there were 9,253 record holders of the Company's Common Stock.

Purchases of Equity Securities by the Issuer

The Company continued a stock repurchase program as described in footnote 1 to the following table. As of 30 September 2007, the Company had purchased 15.0 million of its outstanding shares at a cost of $1,063.4 million. The Company expects to complete the $1.5 billion program by 30 September 2008.

On 20 September 2007 the Company's Board of Directors authorized the repurchase of an additional $1 billion of common stock. The program does not have a stated expiration date. This additional $1 billion program will be completed at the Company's discretion while maintaining sufficient funds for investing in its businesses and growth opportunities.

Purchases of equity securities by the issuer during the fourth quarter of fiscal 2007 are as follows:

Period	(a) Total Number of Shares (or Units) Purchased	(b) Average Price Paid per Share (or Unit)	(c) Total Number of Shares (or Units) Purchased as Part of Publicly Announced Plans or Programs	(d) Maximum Number (or Approximate Dollar Value) of Shares (or Units) that May Yet Be Purchased Under the Plans or Programs[1][2]
7/1/07-7/31/07	490,128	$ 85.46	490,128	$ 588,894,011.53
8/1/07-8/31/07	1,358,380	$ 84.39	1,358,380	$ 474,260,820.63
9/1/07-9/30/07	410,600	$ 91.69	410,600	$ 436,612,357.16
TOTAL	2,259,108	$ 85.95	2,259,108	$ 436,612,357.16

(1) On 22 March 2006, the Company announced plans to purchase up to $1.5 billion of Air Products and Chemicals, Inc. common stock under a share repurchase program approved by the Company's Board of Directors on 16 March 2006.

(2) For the quarter ending 30 September 2007, the Company expended $194.2 million in cash for the repurchase of shares, which was composed of $188.2 million for shares repurchased during the quarter and $6.0 million for shares repurchased in June 2007 and settling in July 2007. $5.9 million was reported as an accrued liability on the balance sheet for share repurchases executed in September 2007 and settling in October 2007.

ITEM 6. SELECTED FINANCIAL DATA.

The tabular information appearing under "Five–Year Summary of Selected Financial Data" on page 76 of the 2007 Financial Review Section of the Annual Report to Shareholders is incorporated herein by reference.

ITEM 7. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS.

The textual information appearing under "Management's Discussion and Analysis" on pages 14 through 36 of the 2007 Financial Review Section of the Annual Report to Shareholders is incorporated herein by reference.

ITEM 7A. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK.

The textual information appearing under "Market Risks and Sensitivity Analysis" on page 32 of the 2007 Financial Review Section of the Annual Report to Shareholders is incorporated herein by reference.

ITEM 8. FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA.

The consolidated financial statements and the related notes thereto, together with the reports thereon of KPMG LLP dated 27 November 2007, appearing on pages 38 through 76 of the 2007 Financial Review Section of the Annual Report to Shareholders, are incorporated herein by reference.

Management's Report on Internal Control Over Financial Reporting, appearing on page 37 of the 2007 Financial Review Section of the Annual Report to Shareholders, is incorporated herein by reference.

The Report of Independent Registered Public Accounting Firm on Internal Control over Financial Reporting, appearing on page 38 of the 2007 Financial Review Section of the Annual Report to Shareholders, is incorporated herein by reference.

The Report of Independent Registered Public Accounting Firm, KPMG LLP, appearing on page 39 of the 2007 Financial Review Section of the Annual Report to Shareholders, is incorporated herein by reference.

ITEM 9. CHANGES IN AND DISAGREEMENTS WITH ACCOUNTANTS ON ACCOUNTING AND FINANCIAL DISCLOSURE.

Not Applicable.

ITEM 9A. CONTROLS AND PROCEDURES.

Under the supervision of the Chief Executive Officer and Chief Financial Officer, the Company's management conducted an evaluation of the effectiveness of the design and operation of the Company's disclosure controls and procedures as of 30 September 2007. Based on that evaluation, the Chief Executive Officer and Chief Financial Officer concluded that the design and operation of its disclosure controls and procedures have been effective. There has been no change in the Company's internal controls over financial reporting (as that term is defined in Rules 13a–15(f) and 15d–15(f) under the Exchange Act) which have occurred during the quarter ended 30 September 2007 that has materially affected, or is reasonably likely to materially affect, the Company's internal controls over financial reporting.

Management's Report on Internal Control Over Financial Reporting is provided under Item 8. "Financial Statements and Supplementary Data," appearing above. The report of KPMG LLP, the Company's independent registered public accounting firm, regarding the Company's internal control over financial reporting, is also provided under Item 8. "Financial Statements and Supplementary Data," appearing above.

ITEM 9B. OTHER INFORMATION.
Not Applicable.

PART III

ITEM 10. DIRECTORS AND EXECUTIVE OFFICERS AND CORPORATE GOVERNANCE.
The biographical information relating to the Company's directors, appearing in the Proxy Statement relating to the Company's 2008 Annual Meeting of Shareholders (the "2008 Proxy Statement") under the section, "The Board of Directors," is incorporated herein by reference. Biographical information relating to the Company's executive officers is set forth in Item 1 of Part I of this Report.
Information on Section 16(a) Beneficial Ownership Reporting Compliance, appearing in the 2008 Proxy Statement under the section, "Air Products Stock Beneficially Owned by Officers and Directors," is incorporated herein by reference.
The Company's Code of Conduct was updated in 2003 to comply with the requirements of Sarbanes–Oxley and the New York Stock Exchange. The Code of Conduct was filed as Exhibit 14 to the 2003 Annual Report on Form 10–K. In 2005, the Code of Conduct was further updated to make it more reader friendly, cover additional areas of compliance and internal policies and expand its application to employees and businesses worldwide. The existing Code of Conduct was filed as Exhibit 14 to the 2005 Annual Report on Form 10–K. The Code of Conduct can also be found at the Company's Internet website at www.airproducts.com/Responsibility/Governance/Code_of_Conduct/EmployeeCodeofConduct/message.htm.
Information on the Company's procedures regarding its consideration of candidates recommended by shareholders and a procedure for submission of such candidates, appearing in the 2008 Proxy Statement under the section, "Selection of Directors" is incorporated by reference. Information on the Company's Audit Committee and its Audit Committee Financial Expert, appearing in the 2008 Proxy Statement under the section, "Audit Committee" is incorporated by reference.

ITEM 11. EXECUTIVE COMPENSATION.
The information under "Compensation of Executive Officers" which includes "Report of the Management Development and Compensation Committee," "Compensation Discussion and Analysis," "Executive Compensation Tables," "Potential Payments Upon Termination or Change in Control" and "Information About Stock Performance and Ownership," appearing in the 2008 Proxy Statement, is incorporated herein by reference.

ITEM 12. SECURITY OWNERSHIP OF CERTAIN BENEFICIAL OWNERS AND MANAGEMENT AND RELATED STOCKHOLDER MATTERS.

Securities Authorized for Issuance Under Equity Compensation Plans.

Equity Compensation Plan Information

The following table provides information as of September 30, 2007, about Company stock that may be issued upon the exercise of options, warrants, and rights granted to employees or members of the Board of Directors under the Company's existing equity compensation plans, including plans approved by shareholders and plans that have not been approved by shareholders in reliance on the New York Stock Exchange's former treasury stock exception or other applicable exception to the Exchange's listing requirements.

Plan Category	Number of securities to be issued upon exercise of outstanding options, warrants, and rights	Weighted–average exercise price of outstanding options, warrants, and rights	Number of securities remaining available for future issuance under equity compensation plans (excluding securities reflected in column (a))
Equity compensation plans approved by security holders	19,082,194(1)	$ 45.65	7,254,972(2)
Equity compensation plans not approved by security holders	1,591,073(3)	$ 36.58	0
Total	20,673,267	$ 44.95	7,254,972

(1) Represents Long–Term Incentive Plan outstanding stock options and deferred stock units that have been granted. Deferred stock units entitle the recipient to one share of Company common stock upon vesting, which is conditioned on continued employment during a deferral period and may also be conditioned on earn out against certain performance targets.

(2) Represents authorized shares that were available for future grants as of September 30, 2007. These shares may be used for options, deferred stock units, restricted stock, and other stock–based awards to officers, directors, and key employees. Full value awards such as restricted stock are limited to 20% of cumulative awards.

(3) Represents outstanding options under Global Employee Stock Awards (295,917), the Stock Incentive Plan (989,703), the Stock Option Plan for Directors (42,000), and the U.K. Savings–Related Share Option Schemes (117,195). This number also includes deferred stock units granted under the Deferred Compensation Plan for Directors prior to 23 January 2003 (52,399) and deferred stock units under the Deferred Compensation Plan (93,859). Deferred stock units issued under the Deferred Compensation Plan are purchased for the fair market value of the underlying shares of stock with eligible deferred compensation.

The following equity compensation plans or programs were not approved by shareholders. All of these plans have either been discontinued or do not require shareholder approval because participants forego current compensation equal to the full market value of any share units credited under the plans.
Global Employee Stock Option Awards and Stock Incentive Program — No further awards will be made under these programs. All stock options under these programs were granted at fair market value on the date of grant, first became exercisable three years after grant, and terminate ten years after the date of grant or upon the holder's earlier termination of employment for reasons other than retirement, disability, death, or involuntary termination due to Company action necessitated by business conditions.

Stock Option Plan for Directors — No further awards will be made under this plan. All stock options under this plan were granted at fair market value on the date of grant. The options became exercisable six months after grant and remain exercisable for nine and one–half years unless the director resigns from our Board after serving for less than six years (other than because of disability or death). This plan is no longer offered. Stock options may now be granted to directors under the Long–Term Incentive Plan; however, since September 2005, the compensation program for nonemployee directors has not provided stock options.

The Air Products PLC U.K. Savings–Related Share Option Scheme and the Air Products Group Limited U.K. Savings–Related Share Option Scheme (together, the "U.K. Plan") are employee benefit plans for employees of Air Products PLC (and certain of its U.K. subsidiaries) and Air Products Group Limited (and certain of its U.K. subsidiaries), respectively (together, the "U.K. Companies"). No further options will be offered under the U.K. Plan. Employees participate in the U.K. Plan by having elected to do so during a brief invitation period. An employee who elected to participate chose a five– or seven–year option period and has amounts of salary automatically withheld and contributed to a savings account at a bank not affiliated with the Company. At the end of the five–year savings period, a tax–free bonus is added to the employee's account. An employee who elected a seven–year option and retains his savings account for seven years receives a further bonus at the end of the seventh year. At the end of the option period, the participant may use his savings to purchase shares of Company stock at the fixed option price or receive in cash the amount of his savings and bonus(es). His election must be made within six months of the close of the option period. The option price is an amount determined by the directors of the U.K. Companies on the date the option is granted, which may not be less than 90 percent of Market Value (as defined in the U.K. Plan) on the date of grant.

Deferred Compensation Plan for Directors — This plan is no longer offered. Our compensation program for nonemployee directors provides that one–half of each director's quarterly retainer is paid in deferred stock units. Directors have the opportunity to purchase more deferred stock units with up to all of the rest of their retainers and meeting fees. New directors and directors continuing in office after our annual meetings are awarded an annual grant of deferred stock units. Each deferred stock unit entitles the director to one share of Company stock when paid out. Deferred stock units also accrue dividend equivalents which are equal to the dividends that would have been paid on a share of stock during the period the units are outstanding. Accumulated dividend equivalents are converted to deferred stock units on a quarterly basis. Deferred stock units are now provided to directors under the Long–Term Incentive Plan.

The Company's Deferred Compensation Plan is an unfunded employee retirement benefit plan available to certain of the Company's U.S.–based management and other highly compensated employees (and those of its subsidiaries) who receive awards under the Company's Annual Incentive Plan, which is the annual cash bonus plan for executives and key salaried employees of the Company and its subsidiaries. Because participants forego current compensation to "purchase" deferred stock units for full value under the Plan, it is not required to be approved by shareholders under the NYSE listing standards. Under the Plan, participants may defer a portion of base salary which cannot be contributed to the Company's Retirement Savings Plan, a 401(k) and profit–sharing plan offered to all salaried employees ("RSP"), because of tax limitations ("elective deferrals") and earn matching contributions from the Company that they would have received if their Elective Deferrals had been contributed to the RSP ("matching credits"). In addition, participants in the Plan may defer all or a portion of their bonus awards under the Annual Incentive Plan ("bonus deferrals") under the Deferred Compensation Plan. Finally, certain participants under the Plan who participate in the profit–sharing component of the RSP rather than the Company's salaried pension plans receive contribution credits under the Plan which are a percentage of their salary ranging from 4–6% based on their years of service ("contribution credits"). The dollar amount of elective deferrals, matching credits, bonus deferrals, and contribution credits is initially credited to an unfunded account, which earns interest credits. Participants are periodically permitted while employed by the Company to irrevocably convert all or a portion of their interest bearing account to deferred stock units in a Company stock account. Upon conversion, the Company stock account is credited with deferred stock units based on the fair market value of a share of Company stock on the date of crediting. Dividend equivalents corresponding to the number of units are credited quarterly to the interest–bearing account. Deferred stock units generally are paid after termination of employment in shares of Company stock.

The Deferred Compensation Plan was formerly known as the Supplementary Savings Plan. The name was changed in 2006 when the deferred bonus program, previously administered under the Annual Incentive Plan, was merged into this Plan.

The information set forth in the sections headed "Persons Owning More than 5% of Air Products Stock as of September 30, 2007," and "Air Products Stock Beneficially Owned by Officers and Directors," appearing in the Proxy Statement relating to the Company's 2008 Annual Meeting of Shareholders, is incorporated herein by reference.

ITEM 13. CERTAIN RELATIONSHIPS AND RELATED TRANSACTIONS, AND DIRECTOR INDEPENDENCE.
The information appearing in the 2008 Proxy Statement under the sections "Director Independence" and "Transactions with Related Parties" are incorporated by reference.

ITEM 14. PRINCIPAL ACCOUNTANT FEES AND SERVICES.
The information appearing in the 2008 Proxy Statement under the section "Fees of Independent Registered Public Accountant," is incorporated herein by reference.

PART IV

ITEM 15. EXHIBITS AND FINANCIAL STATEMENT SCHEDULES.
(a) The following documents are filed as a part of this Report to the extent below noted:
1. The 2007 Financial Review Section of the Company's 2007 Annual Report to Shareholders. Information contained therein is not deemed filed except as it is incorporated by reference into this Report. The following financial information is incorporated herein by reference:

(Page references to 2007 Financial Review Section of the Annual Report)

Management's Discussion and Analysis	14
Management's Report on Internal Control over Financial Reporting	37
Report of Independent Registered Public Accounting Firm on Internal Control over Financial Reporting	38
Report of Independent Registered Public Accounting Firm	39
Consolidated Income Statements for the years ended 30 September 2007, 2006 and 2005	40
Consolidated Balance Sheets at 30 September 2007 and 2006	41
Consolidated Statements of Cash Flows for the years ended 30 September 2007, 2006 and 2005	42
Consolidated Statements of Shareholders' Equity for the years ended 30 September 2007, 2006 and 2005	43
Notes to the Consolidated Financial Statements	44
Business Segment and Geographic Information	73
Five–Year Summary of Selected Financial Data	76

2. The following additional information should be read in conjunction with the consolidated financial statements in the Company's 2007 Financial Review Section of the Annual Report to Shareholders:

(Page references to this Report)

Report of Independent Registered Public Accounting Firm on Schedule II	22
Consolidated Schedule for the years ended 30 September 2007, 2006 and 2005 as follows:	
Schedule Number	
II Valuation and Qualifying Accounts	23

All other schedules are omitted because the required matter or conditions are not present or because the information required by the Schedules is submitted as part of the consolidated financial statements and notes thereto.
3. Exhibits.
Exhibits filed as a part of this Annual Report on Form 10–K are listed in the Index to Exhibits located on page 24 of this Report.

SIGNATURES

Pursuant to the requirements of Section 13 or 15(d) of the Securities Exchange Act of 1934, the registrant has duly caused this Report to be signed on its behalf by the undersigned, thereunto duly authorized.

AIR PRODUCTS AND CHEMICALS, INC.
(Registrant)

By: /s/ Paul E. Huck
Paul E. Huck
Senior Vice President and Chief Financial Officer
(Principal Financial Officer)

Date: 28 November 2007

Pursuant to the requirements of the Securities Exchange Act of 1934, this report has been signed below by the following persons on behalf of the registrant and in the capacities and on the dates indicated.

Signature and Title	Date
/s/ John E. McGlade (John E. McGlade) President, Chief Executive Officer and Director (Principal Executive Officer)	28 November 2007
/s/ M. Scott Crocco (M. Scott Crocco) Vice President and Corporate Controller (Principal Accounting Officer)	28 November 2007
* (Mario L. Baeza) Director	28 November 2007
* (William L. Davis, III) Director	28 November 2007
* (Michael J. Donahue) Director	28 November 2007
* (Ursula O. Fairbairn) Director	28 November 2007

Signature and Title	Date
*	28 November 2007
(W. Douglas Ford) Director	
*	28 November 2007
(Edward E. Hagenlocker) Director	
*	28 November 2007
(Evert Henkes) Director	
*	28 November 2007
(John P. Jones III) Director and Chairman	
*	28 November 2007
(Margaret G. McGlynn) Director	
*	28 November 2007
(Charles H. Noski) Director	
*	28 November 2007
(Lawrence S. Smith) Director	

* Stephen J. Jones, Senior Vice President, General Counsel and Secretary, by signing his name hereto, does sign this document on behalf of the above noted individuals, pursuant to a power of attorney duly executed by such individuals, which is filed with the Securities and Exchange Commission herewith.

/s/ Stephen J. Jones
Stephen J. Jones
Attorney-in-Fact

Date: 28 November 2007

REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM ON SCHEDULE II

The Shareholders and Board of Directors of Air Products and Chemicals, Inc.:

Under date of 27 November 2007, we reported on the consolidated balance sheets of Air Products and Chemicals, Inc. and subsidiaries as of 30 September 2007 and 2006, and the related consolidated income statements and consolidated statements of shareholders' equity and of cash flows for each of the years in the three–year period ended 30 September 2007, as contained in the Annual Report to Shareholders. Also, under the date of 27 November 2007, we reported on the effectiveness of Air Products and Chemicals, Inc.'s internal control over financial reporting as of 30 September 2007. In connection with our audits of the aforementioned consolidated financial statements, we also audited the related consolidated financial statement schedule referred to in Item 15 (a)(2) in this Form 10–K. This financial statement schedule is the responsibility of the Company's management. Our responsibility is to express an opinion on this financial statement schedule based on our audits.

As discussed in Note 2 to the consolidated financial statements, the Company adopted Statement of Financial Accounting Standards (SFAS) No. 158, "Employers' Accounting for Defined Benefit Pension and Other Postretirement Plans," as of 30 September 2007, Financial Accounting Standards Board Interpretation No. 47, "Accounting for Conditional Asset Retirement Obligations," effective 30 September 2006, and SFAS No. 123 (R), "Share–Based Payment," and related interpretations on 1 October 2005.

In our opinion, such financial statement schedule, when considered in relation to the basic consolidated financial statements taken as a whole, presents fairly, in all material respects, the information set forth therein.

KPMG LLP

Philadelphia, Pennsylvania
27 November 2007

SCHEDULE II
CONSOLIDATED

AIR PRODUCTS AND CHEMICALS, INC. AND SUBSIDIARIES
SCHEDULE II—VALUATION AND QUALIFYING ACCOUNTS
For the Years Ended 30 September 2007, 2006, and 2005

Description	Balance at Beginning of period	Additions: Charged to Expense	Additions: Charged to other Accounts	Other Changes Increase (Decrease): Cumulative Translation Adjustment	Other Changes Increase (Decrease): Other	Balance at End of Period
			(in millions of dollars)			
Year Ended 30 September 2007						
Allowance for doubtful accounts	$44	$23	$ —	$ 2	$(20)[b]	$49
Allowance for deferred tax assets	$37	$ (3)	$ —	$ (1)	$ —	$33
Year Ended 30 September 2006						
Allowance for doubtful accounts	$35	$27	$ —	$ 1	$(19)[b]	$44
Allowance for deferred tax assets	$18	$ 2	$ 17 [a]	$ —	$ —	$37
Year Ended 30 September 2005						
Allowance for doubtful accounts	$30	$11	$ —	$ —	$ (6) [b]	$35
Allowance for deferred tax assets	$16	$ 2	$ —	$ —	$ —	$18

Notes:

[a] Primarily adjustment associated with acquisition of deferred tax asset.

[b] Primarily write–offs of uncollectible accounts.

INDEX TO EXHIBITS

Exhibit No.	Description
(3)	Articles of Incorporation and By–Laws.
3.1	Amended and Restated By–Laws of the Company. (Filed as Exhibit 3 to the Company's Form 8–K Report dated 26 September 2006.)*
3.2	Restated Certificate of Incorporation of the Company. (Filed as Exhibit 3.2 to the Company's Form 10–K Report for the fiscal year ended 30 September 1987.)*
3.3	Amendment to the Restated Certificate of Incorporation of the Company dated 25 January 1996. (Filed as Exhibit 3.3 to the Company's Form 10–K Report for the fiscal year ended 30 September 1996.)*
(4)	Instruments defining the rights of security holders, including indentures. Upon request of the Securities and Exchange Commission, the Company hereby undertakes to furnish copies of the instruments with respect to its long–term debt.
4.1	Rights Agreement, dated as of 19 March 1998, between the Company and First Chicago Trust Company of New York. (Filed as Exhibit 1 to the Company's Form 8–A Registration Statement dated 19 March 1998, as amended by Form 8–A/A dated 16 July 1998.)*
4.2	Amended and Restated Credit Agreement dated as of 16 September 1999 among the Company, Additional Borrowers parties thereto, Lenders parties thereto, and The Chase Manhattan Bank (as amended). (Filed as Exhibit 4.2 to the Company's Form 10–K Report for the fiscal year ended 30 September 1999.)*
(10)	Material Contracts.
10.1	1990 Deferred Stock Plan of the Company, as amended and restated effective 1 October 1989. (Filed as Exhibit 10.1 to the Company's Form 10–K Report for the fiscal year ended 30 September 1989.)*
10.2	The Rules of the United Kingdom Savings–Related Share Option Scheme of the Company as adopted on 24 October 1997, as amended on 1 October 1999 and 5 November 1999. (Filed as Exhibit 10.2 to the Company's Form 10–K Report for the fiscal year ended 30 September 2002.)*
10.3	Stock Option Program for Directors of the Company, formerly known as the Stock Option Plan for Directors. Effective 23 January 2003, this Plan was combined with the Long–Term Incentive Plan and offered as a program thereunder. (Filed as Exhibit 10.5 to the Company's Form 10–K Report for the fiscal year ended 30 September 2004.)*
10.4	Letter dated 7 July 1997 concerning pension for an executive officer. (Filed as Exhibit 10.7(c) to the Company's Form 10–K Report for the fiscal year ended 30 September 1998.)*
10.5	Air Products and Chemicals, Inc. Severance Plan effective 15 March 1990. (Filed as Exhibit 10.8(a) to the Company's Form 10–K Report for the fiscal year ended 30 September 1992.)*
10.6	Air Products and Chemicals, Inc. Change of Control Severance Plan effective 15 March 1990. (Filed as Exhibit 10.8(b) to the Company's Form 10–K Report for the fiscal year ended 30 September 1992.)*
10.7	Amended and Restated Trust Agreement by and between the Company and PNC Bank, N.A. relating to the Defined Benefit Pension Plans dated as of 1 August 1999. (Filed as Exhibit 10.13 to the Company's Form 10–K Report for the fiscal year ended 30 September 1999.)*
10.7(a)	Amendment No. 1 to the Amended and Restated Trust Agreement by and between the Company and PNC Bank, N.A. relating to the Defined Benefit Pension Plan, adopted 1 January 2000. (Filed as Exhibit 10.13(a) to the Company's Form 10–K Report for the fiscal year ended 30 September 2000.)*

Exhibit No.	Description
10.7(b)	Amendment No. 2 to the Amended and Restated Trust Agreement by and between the Company and PNC Bank, N.A. relating to the Defined Benefit Plans, adopted 11 April 2007.
10.8	Amended and Restated Trust Agreement by and between the Company and PNC Bank, N.A. relating to the Supplementary Savings Plan dated as of 1 August 1999. (Filed as Exhibit 10.14 to the Company's Form 10–K Report for the fiscal year ended 30 September 1999.)*
10.8(a)	Amendment No. 1 to the Amended and Restated Trust Agreement by and between the Company and PNC Bank, N.A. relating to the Supplementary Savings Plan, adopted 1 January 2000. (Filed as Exhibit 10.14(a) to the Company's Form 10–K Report for the fiscal year ended 30 September 2000.)*
10.8(b)	Amendment No. 2 to the Amended and Restated Trust Agreement by and between the Company and PNC Bank, N.A. relating to the Defined Contribution Plans, adopted 11 April 2007.
10.9	Form of Severance Agreements that the Company has with each of its U.S. Executive Officers. (Filed as Exhibit 10.16 to the Company's Form 10–K Report for the fiscal year ended 30 September 1999.)*
10.10	Form of Award Agreement under the Long Term Incentive Plan of the Company, used for the FY 2004 awards. (Filed as Exhibit 10.2 to the Company's Form 10–Q Report for the quarter ended 31 December 2003.)*
10.11	Amended and Restated Annual Incentive Plan of the Company, effective 1 October 2001. (Filed as Exhibit 10.2 to the Company's Form 10–Q Report for the quarter ended 31 March 2002.)*
10.11(a)	Amendment to the Amended and Restated Annual Incentive Plan of the Company effective 19 July 2006. (Filed as Exhibit 10.11(a) to the Company's Form 10–K Report for the fiscal year ended 30 September 2006.)*
10.12	Stock Incentive Program of the Company effective 1 October 1996. (Filed as Exhibit 10.21 to the Company's Form 10–K Report for the fiscal year ended 30 September 2002.)*
10.13	Terms and Conditions of the Global Employee Stock Option Awards of the Company effective 1 October 1995, 1997 and 1999. (Filed as Exhibit 10.22 to the Company's Form 10–K Report for the fiscal year ended 30 September 2002.)*
10.14	Terms and Conditions of the Stock Incentive Awards of the Company effective 1 October 1999, 2000, 2001 and 2002. (Filed as Exhibit 10.19 to the Company's Form 10–K Report for the fiscal year ended 30 September 2004.)*
10.15	Air Products and Chemicals, Inc. Corporate Executive Committee Retention/Separation Program, effective July 17, 2003. (Filed as Exhibit 10.22 to the Company's Form 10–K Report for the fiscal year ended 30 September 2003.)*
10.16	Form of Severance Agreement that the Company has with one U.S. Executive Officer, effective 20 November 2003. (Filed as Exhibit 10.25 to the Company's Form 10–K Report for the fiscal year ended 30 September 2003.)*
10.17	Form of Award Agreement under the Long Term Incentive Plan of the Company used for the FY 2005 awards. (Filed as Exhibit 10.1 to the Company's Form 10–Q Report for the quarter ended 31 December 2004.)*
10.18	Description of Performance Criteria under the Annual Incentive Plan of the Company. (Filed as Exhibit 10.3 to the Company's Form 10–Q Report for the quarter ended 31 December 2004.)*
10.19	Amended and Restated Deferred Compensation Program for Directors, effective 1 October 2005. Effective as of 23 January 2003, this program is offered under the Long–Term Incentive Plan. (Filed as Exhibit 10.26 to the Company's Form 10–K Report for the fiscal year ended 30 September 2005.)*
10.20	Form of Award Agreement under the Long–Term Incentive Plan of the Company, used for FY 2006 awards. (Filed as Exhibit 10.1 to the Company's Form 10–Q Report for the quarter ended 31 December 2005.)*

Exhibit No.	Description
10.21	Amended and Restated Long Term Incentive Plan of the Company, effective 26 January 2006. (Filed as Exhibit 10.1 to the Company's Form 10–Q Report for the quarter ended 31 March 2006.)*
10.21(a)	Amendments to the Amended and Restated Long Term Incentive Plan of the Company effective 18 May 2006 and 21 September 2006. (Filed as Exhibit 10.22(a) to the Company's Form 10–K Report for the fiscal year ended 30 September 2006.)*
10.22	Amended and Restated Deferred Compensation Plan of the Company, formerly known as the Supplementary Savings Plan, effective 1 January 2005, reflecting amendments through 1 September 2006. (Filed as Exhibit 10.23 to the Company's Form 10–K Report for the fiscal year ended 30 September 2006.)*
10.23	Amended and Restated Supplementary Pension Plan of the Company effective 1 January 2005 reflecting amendments through 30 September 2006. (Filed as Exhibit 10.24 to the Company's Form 10–K Report for the fiscal year ended 30 September 2006.)*
10.24	Compensation Program for Directors of the Company, effective 1 October 2006. (Filed as Exhibit 10.26 to the Company's Form 10–K Report for the fiscal year ended 30 September 2006.)*
10.25	Form of Award Agreement under the Long–Term Incentive Plan of the Company, used for FY 2007 awards. (Filed as Exhibit 10.1 to the Company's Form 10–Q Report for the quarter ended 31 December 2006.)*
10.26	Compensation Program for Nonemployee Directors of the Company, effective 1 October 2007.
10.27	Air Products and Chemicals, Inc. Retirement Savings Plan as amended and restated effective 1 October 2006 to reflect amendments through 30 September 2007.
12	Computation of Ratios of Earnings to Fixed Charges.
13	2006 Financial Review Section of the Annual Report to Shareholders for the fiscal year ended 30 September 2006, which is furnished to the Commission for information only and not filed except as portions are expressly incorporated by reference in this Report.
14	Code of Conduct. (Filed as Exhibit 14 to the Company's Form 10–K Report for the fiscal year ended 30 September 2005.)*
21	Subsidiaries of the registrant.
(23)	Consents of Experts and Counsel.
23.1	Consent of Independent Registered Public Accounting Firm.
24	Power of Attorney.
(31)	Rule 13a–14(a)/15d–14(a) Certifications.
31.1	Certification by the Principal Executive Officer pursuant to Rule 13a–14(a) or Rule 15d–14(a) of the Securities Exchange Act of 1934, as adopted pursuant to Section 302 of the Sarbanes–Oxley Act of 2002.
31.2	Certification by the Principal Financial Officer pursuant to Rule 13a–14(a) or Rule 15d–14(a) of the Securities Exchange Act of 1934, as adopted pursuant to Section 302 of the Sarbanes–Oxley Act of 2002.
(32)	Section 1350 Certifications.
32.1	Certification by the Principal Executive Officer and Principal Financial Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes–Oxley Act of 2002.

* Previously filed as indicated and incorporated herein by reference. Exhibits incorporated by reference are located in SEC File No. 1–4534.

BRISTOL MYERS SQUIBB CO (BMY)

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10-K

FORM 10-K
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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM 10–K

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

For the fiscal year ended December 31, 2007

Commission File Number 1–1136

BRISTOL–MYERS SQUIBB COMPANY
(Exact name of registrant as specified in its charter)

Delaware	**22–0790350**
(State or other jurisdiction of incorporation or organization)	**(IRS Employer Identification No.)**

345 Park Avenue, New York, N.Y. 10154
(Address of principal executive offices)

Telephone: (212) 546–4000

Securities registered pursuant to Section 12(b) of the Act:

Title of each class	Name of each exchange on which registered
Common Stock, $0.10 Par Value	**New York Stock Exchange**
$2 Convertible Preferred Stock, $1 Par Value	**New York Stock Exchange**

Securities registered pursuant to Section 12(g) of the Act: None

Indicate by check mark if the registrant is a well–known seasoned issuer, as defined in Rule 405 of the Securities Act. Yes ☒ No ☐

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act. Yes ☐ No ☒

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

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S–K is not contained herein, and will not be contained, to the best of the registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10–K or any amendment to this Form 10–K. ☐

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

Large accelerated filer ☒ Accelerated filer ☐ Non–accelerated filer ☐ Smaller reporting company ☐

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

The aggregate market value of the 1,978,987,106 shares of voting common equity held by non–affiliates of the registrant, computed by reference to the closing price as reported on the New York Stock Exchange, as of the last business day of the registrant's most recently completed second fiscal quarter (June 30, 2007) was approximately $62,456,833,065. Bristol–Myers Squibb has no non–voting common equity. At February 12, 2008, there were 1,979,387,706 shares of common stock outstanding.

DOCUMENTS INCORPORATED BY REFERENCE: Portions of the Proxy Statement for the registrant's Annual Meeting of Stockholders to be held May 6, 2008 are incorporated by reference into Part III of this Annual Report on Form 10–K.

PART I

Item 1. BUSINESS.

General

Bristol-Myers Squibb Company (which may be referred to as Bristol-Myers Squibb, BMS or the Company) was incorporated under the laws of the State of Delaware in August 1933 under the name Bristol-Myers Company, as successor to a New York business started in 1887. In 1989, Bristol-Myers Company changed its name to Bristol-Myers Squibb Company as a result of a merger. The Company, through its divisions and subsidiaries, is engaged in the discovery, development, licensing, manufacturing, marketing, distribution and sale of pharmaceuticals and other health care related products.

Acquisitions and Divestitures

In July 2007, the Company completed the sale of the BUFFERIN* and EXCEDRIN* brands in Japan, Asia (excluding China and Taiwan) and certain Oceanic countries to Lion Corporation (Japan) for $247 million in cash. As a result of this transaction, the Company recognized a pre-tax gain of $247 million ($144 million net of tax) in the third quarter of 2007.

In October 2007, the Company completed the acquisition of Adnexus Therapeutics, Inc. (Adnexus), developer of a new therapeutic class of biologics called ADNECTINS, for a net purchase price of $415 million. In addition, in the event that certain future development and regulatory milestones are achieved, the Company is obligated under the terms of the agreement to pay the former stockholders of Adnexus up to an additional $74 million.

In December 2007, the Company entered into a definitive agreement with Avista Capital Partners L.P. (Avista) for the sale of its Medical Imaging business for a purchase price of approximately $525 million in cash, subject to customary post-closing adjustments. The closing of the transaction was completed on January 7, 2008. As a result of this transaction, the Company expects to recognize a pre-tax gain of approximately $20 million to $40 million ($30 million to $50 million loss net of tax) in the first quarter of 2008, subject to the post-closing adjustments.

Bristol-Myers Squibb Website

The Company's internet website address is www.bms.com. The Company makes available free of charge on its website its annual, quarterly and current reports, including amendments to such reports, as soon as reasonably practicable after the Company electronically files such material with, or furnishes such material to, the U.S. Securities and Exchange Commission (SEC).

Information relating to corporate governance at Bristol-Myers Squibb, including the Company's Standards of Business Conduct and Ethics, Code of Ethics for Senior Financial Officers, Code of Business Conduct and Ethics for Directors, (collectively, the "Codes"), Corporate Governance Guidelines, and information concerning the Company's Executive Committee, Board of Directors, including Board Committees and Committee charters, and transactions in Bristol-Myers Squibb securities by Directors and executive officers, is available on the Company's website at www.bms.com under the "Investors—Corporate Governance" caption and in print to any stockholder upon request. Any waivers to the Codes by directors or executive officers and any material amendment to the Code of Business Conduct and Ethics for Directors and Code of Ethics for Senior Financial Officers will be posted promptly on the Company's website. Information relating to stockholder services, including the Company's Dividend Reinvestment Plan and direct deposit of dividends, is available on the Company's website at www.bms.com under the "Investors—Stockholder Services" caption.

The Company incorporates by reference certain information from parts of its proxy statement for the 2008 Annual Meeting of Stockholders. The SEC allows the Company to disclose important information by referring to it in that manner. Please refer to such information. The Company's proxy statement for the 2008 Annual Meeting of Stockholders and 2007 Annual Report will be available on the Company's website (www.bms.com) under the "Investors—SEC Filings" caption on or after March 21, 2008.

Business Segments

The Company has three reportable segments—Pharmaceuticals, Nutritionals and ConvaTec (previously a component of the Other Health Care operating segment). In January 2008, the Company completed the sale of its Medical Imaging business to Avista. The results of the Medical Imaging business previously included in the former Other Health Care operating segment, are presented as part of the Company's results from discontinued operations.

The Pharmaceuticals segment is made up of the global pharmaceutical and international consumer medicines business. The Pharmaceuticals segment accounted for 81% of the Company's sales in 2007, 80% of the Company's sales in 2006, and 83% of the Company's sales in 2005. U.S. Pharmaceuticals sales accounted for 58%, 54% and 54% of total Pharmaceutical sales in 2007, 2006 and 2005, respectively, while international Pharmaceutical sales accounted for 42%, 46% and 46% of total Pharmaceutical sales in 2007, 2006 and 2005, respectively.

The other two segments – Nutritionals and ConvaTec – comprise the Company's Health Care Group. The Nutritionals segment consists of Mead Johnson Nutritionals (Mead Johnson), primarily an infant formula and children's nutritionals business. The ConvaTec segment consists of the ostomy, wound and skin care business. Health Care Group sales accounted for 19% of the Company's sales in 2007, 20% of the Company's sales in 2006, and 17% of the Company's sales in 2005. U.S. Health Care Group sales accounted for 40%, 42% and 43% of total Health Care Group sales in 2007, 2006 and 2005, respectively, while international Health Care Group sales accounted for 60%, 58% and 57% of total Health Care Group sales in 2007, 2006 and 2005, respectively.

For additional information about these segments, see "Item 8. Financial Statements—Note 19. Segment Information."

Pharmaceuticals Segment

The Pharmaceuticals segment competes with other worldwide research–based drug companies, smaller research companies and generic drug manufacturers. These products are sold worldwide, primarily to wholesalers, retail pharmacies, hospitals, government entities and the medical profession. The Company manufactures these products in the U.S. and Puerto Rico and in 14 foreign countries. U.S Pharmaceuticals net sales accounted for 58%, 54% and 54% of total Pharmaceuticals net sales in 2007, 2006 and 2005, respectively, while Pharmaceuticals net sales in Europe, Middle East and Africa accounted for 25%, 28% and 29% of total Pharmaceuticals net sales in 2007, 2006 and 2005, respectively. Pharmaceuticals net sales in Japan accounted for 4% of total Pharmaceuticals net sales in each of 2007, 2006 and 2005.

The Company's key products include PLAVIX* (clopidogrel bisulfate), AVAPRO/AVALIDE* (irbesartan/irbesartan–hydrochlorothiazide), REYATAZ (atazanavir sulfate), ABILIFY* (aripiprazole), ERBITUX* (cetuximab), SPRYCEL (dasatinib), BARACLUDE (entecavir), ORENCIA (abatacept), the SUSTIVA Franchise (efavirenz) and IXEMPRA (ixabepilone).

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 other generic companies as well as in other less significant jurisdictions. As previously disclosed, on August 8, 2006, Apotex launched a generic clopidogrel bisulfate product that competes with PLAVIX*. The generic launch had a significant adverse impact on PLAVIX* sales, which the Company estimates to be in a range of $250 million to $350 million in 2007 and $1.2 billion to $1.4 billion in 2006. Estimated total U.S. prescription demand for clopidogrel bisulfate (branded and generic) increased 8% in 2007 compared to 2006, while estimated total U.S. prescription demand for branded PLAVIX* increased 34% in the same period. The Company believes that the supply of generic clopidogrel bisulfate that was sold into distribution channels following the Apotex at–risk launch in August 2006 has been substantially depleted. In June 2007, the U.S. District Court for the Southern District of New York (District Court) upheld the composition of matter patent for PLAVIX* and enjoined Apotex from engaging in any activity that infringes the patent, including marketing its generic product in the U.S. until after the patent expires. Apotex has appealed the District Court's decision. The Apotex appeal date has been set for March 2008. The damages phase of the trial is on–going. For more information about the pending PLAVIX* litigation, as well as the generic launch by Apotex, see "Item 8. Financial Statements —Note 22. Legal Proceedings and Contingencies."

Products

Most of the Company's pharmaceutical revenues come from products in the following therapeutic classes: cardiovascular; virology, including human immunodeficiency virus (HIV) infection; oncology; affective and other (psychiatric) disorders; and immunoscience.

In the pharmaceutical industry, the majority of an innovative product's commercial value is usually realized during the period in which the product has market exclusivity. Market exclusivity is based upon patent rights and/or certain regulatory forms of exclusivity. In the U.S. and some other countries, when these patent rights and other forms of exclusivity expire and generic versions of a medicine are approved and marketed, there are often very substantial and rapid declines in the sales of the original innovative product. The Company's business is focused on innovative pharmaceutical products, and the Company relies on patent rights and other forms of protection to maintain the market exclusivity of its products. For further discussion of patents rights and regulatory forms of exclusivity, see "—Intellectual Property and Product Exclusivity" below. For further discussion of the impact of generic competition on the Company's business, see "—Generic Competition" below.

An increasing portion of the Company's innovative pharmaceutical products are biological products, or biologics. Currently, generic versions of biological products cannot be approved under U.S. law. However, the law could change in the future. Even in the absence of new legislation, the U.S. Food and Drug Administration (FDA) is taking steps toward allowing generic versions of certain biologics. Competitors seeking approval of biological 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 chart below shows the net sales of key products in the Pharmaceuticals segment, together with the year in which the basic exclusivity loss (patent rights or data exclusivity) occurred or is currently estimated to occur in the U.S., the European Union (EU) and Japan. The Company also sells its pharmaceutical products in other countries; however, data is not provided on a country–by–country basis because individual country sales are not significant outside the U.S., the EU and Japan. In many instances, the basic exclusivity loss date listed below 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 listed in the chart 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 by submitting its own clinical trial data to obtain marketing approval prior to the expiration of data exclusivity.

The Company estimates the market exclusivity period for each of its products on a case–by–case basis for the purposes of business planning only. The length of market exclusivity for any of the Company's products is impossible to predict with certainty because of the complex interaction between patent and regulatory forms of exclusivity and the inherent uncertainties regarding patent litigation. Although the Company provides these estimates for business planning purposes, these are not intended as an indication of how the Company's patents might fare in any particular patent litigation brought against potential infringers. There can be no assurance that a particular product will enjoy market exclusivity for the full period of time that appears in the estimate or that the exclusivity will be limited to the estimate.

Pharmaceutical Products Dollars in Millions	2007	2006	2005	Past or Currently Estimated Year of U.S. Basic Exclusivity Loss	Past or Currently Estimated Year of EU Basic Exclusivity Loss (a)	Past or Currently Estimated Year of Japanese Basic Exclusivity Loss
Cardiovascular						
PLAVIX*	$ 4,755	$ 3,257	$ 3,823	2011	2008–2013	++
AVAPRO*/AVALIDE*	1,204	1,097	982	2012	2007–2013	++
PRAVACHOL	443	1,197	2,256	2006	2002–2008	++
COUMADIN	201	220	212	(b)	(b)	++
Virology						
REYATAZ	1,124	931	696	2017	2017	2017
SUSTIVA Franchise (total revenue)	956	791	680	2013(c)	2013(c)	++
BARACLUDE	275	83	12	2015	2011–2016	2016
Oncology						
ERBITUX*	692	652	413	2017(d)	++	++
TAXOL® (paclitaxel)	422	563	747	2000	2003	2006
SPRYCEL	158	25	—	2020	2020(e)	++
IXEMPRA	15	—	—	2018	2018	++
Affective (Psychiatric) Disorders						
ABILIFY* (total revenue)	1,660	1,282	912	2014(f)	2014(g)	++
Immunoscience						
ORENCIA	231	89	—	2016(d)	2012(h)	++
Other Pharmaceuticals						
EFFERALGAN	308	266	283	++	N/A	++

Note: The currently estimated year of basic exclusivity loss includes any statutory extensions of exclusivity that have been earned, but not those that are speculative. In some instances, there may be later-expiring patents that cover particular forms or compositions of the drug, as well as methods of manufacturing or methods of using the drug. Such patents may sometimes result in a favorable market position for the Company's product, but product exclusivity cannot be predicted or assured. Note also that, for products filed under a Biologics License Application (BLA) in the U.S., the year of exclusivity is listed as the year of patent expiration even though there is currently not a regulatory pathway for the approval of follow-on biologic products, as described in more detail in "—Intellectual Property" and "—Product Exclusivity" below.

* Indicates brand names of products which are registered trademarks not owned by the Company or its subsidiaries. Specific trademark ownership information can be found on page 152.

++ The Company does not currently market the product in the jurisdiction indicated.

(a) References to the EU throughout this Form 10-K include the following current 27 member states: Austria, Belgium, Bulgaria, Cyprus, Czech Republic, Denmark, Estonia, Finland, France, Germany, Greece, Hungary, Ireland, Italy, Latvia, Lithuania, Luxembourg, Malta, Netherlands, Poland, Portugal, Romania, Slovakia, Slovenia, Spain, Sweden, and the United Kingdom (UK). Basic patent applications have not been filed in all 27 current member states for all of the listed products. In some instances the date of basic exclusivity loss will be different in various EU member states. In such instances, the earliest and latest dates of basic exclusivity loss are listed. For those EU countries where the basic patent was not obtained, there may be data protection available.

(b) Basic exclusivity expired before BMS acquired the product.

(c) Exclusivity period relates to SUSTIVA brand only.

(d) Biologic product approved under a BLA. In the U.S., there is currently no regulatory approval path for generic biologics.

(e) Pending application. EU patent application was not filed in Estonia, Latvia, Lithuania, Malta, Slovakia and Slovenia.

(f) The Company's rights to commercialize aripiprazole in the U.S. terminate in 2012.

(g) The Company's rights to commercialize aripiprazole in the EU terminate in 2014.

(h) Data exclusivity in the EU expires in 2017.

Below is a summary of the indication, intellectual property position, licensing arrangements, if any, and third-party manufacturing arrangements, if any, for each of the above products in the U.S. and, where applicable, the EU and Japan.

Cardiovascular

PLAVIX*

Clopidogrel bisulfate is a platelet aggregation inhibitor, which is approved for protection against fatal or non-fatal heart attack or stroke in patients with a history of heart attack, stroke, peripheral arterial disease or acute coronary syndrome.

Clopidogrel bisulfate was codeveloped and is jointly marketed with Sanofi-Aventis (Sanofi). The worldwide alliance operates under the framework of two geographic territories: one in the Americas and Australia (the Company's primary territory) and the other in Europe and Asia (Sanofi's primary territory).

The composition of matter patent in the U.S. expires in 2011 (which includes a statutory patent term extension), and is currently the subject of patent litigation in the U.S. with Apotex and other generic companies, as well as in other less significant jurisdictions. The District Court has upheld the validity and enforceability of the composition of matter patent and Apotex has appealed that decision. The oral argument on the Apotex appeal date has been set for March 2008. It is not possible at this time reasonably to assess the outcome of the appeal by Apotex and/or the timing of any renewed generic competition from Apotex or potential additional generic competition from other generic pharmaceutical companies. However, if Apotex were to prevail in its appeal, the Company would expect renewed generic competition promptly thereafter. For more information about these litigation matters, as well as the generic launch by Apotex, see "Item 8. Financial Statements—Note 22. Legal Proceedings and Contingencies."

In the EU, regulatory data exclusivity expires in July 2008 in all the EU member countries and the key composition of matter patent expires in 2013 in the majority of the EU member countries.

The Company obtains its bulk requirements for clopidogrel bisulfate from Sanofi and a third party. Both the Company and Sanofi finish the product in their own facilities. For more information about the Company's arrangements with Sanofi, see "—Strategic Alliances" below and "Item 8. Financial Statements—Note 2. Alliances and Investments."

AVAPRO*/AVALIDE*

Irbesartan/irbesartan-hydrochlorothiazide is an angiotensin II receptor antagonist indicated for the treatment of hypertension and diabetic nephropathy.

Irbesartan was codeveloped and is jointly marketed with Sanofi. The worldwide alliance operates under the framework of two geographic territories: one in the Americas and Australia (the Company's primary territory) and the other in Europe and Asia (Sanofi's primary territory). In September 2006, the Company elected to terminate its copromotion of this product with Sanofi in Ireland, Sweden, Norway, Finland and Denmark.

The basic composition of matter patent in the U.S. expires in 2012 (including pediatric extension) and in the EU in 2013. Data exclusivity in the EU expires in August 2007 for AVAPRO* and in October 2008 for AVALIDE*.

Irbesartan is manufactured by both the Company and Sanofi. The Company manufactures its bulk requirements for irbesartan and finishes AVAPRO*/AVALIDE* in its own facilities. For AVALIDE*, the Company purchases bulk requirements for hydrochlorothiazide from a third party.

For more information about the Company's arrangements with Sanofi, see "—Strategic Alliances" below and "Item 8. Financial Statements—Note 2. Alliances and Investments."

PRAVACHOL

Pravastatin sodium is an HMG Co-A reductase inhibitor indicated as an adjunct to diet and exercise for patients with primary hypercholesterolemia, for lowering the risk of a first heart attack in people without clinically evident coronary heart disease who have elevated cholesterol, and for reducing the risk of heart attack and stroke in patients with clinically evident coronary heart disease.

The Company has licensed a patent covering pravastatin, marketed by the Company in the U.S. as PRAVACHOL, from Sankyo Company, Ltd. (Sankyo) of Japan, with key provisions of the agreement expiring as exclusivity expires on a market-by-market basis. Exclusivity in the U.S. under the patent (including pediatric extension) expired in April 2006. The Company entered into a distribution agreement with Watson Pharmaceutical (Watson) in November 2005 authorizing Watson to distribute generic pravastatin sodium tablets in the U.S.

In December 2006, LEK D.D. (LEK), a Slovenian generic company that is wholly-owned by Novartis AG (Novartis), filed suit against the Company and Watson in the U.S. District court for the Eastern District of Texas in Marshall, Texas. LEK's complaint alleges that the Company's sale of PRAVACHOL and Watson's sale of an authorized generic of PRAVACHOL infringe two patents of LEK. For more information about this litigation matter, see "Item 8. Financial Statements—Note 22. Legal Proceedings and Contingencies."

The composition of matter patent has expired in all countries in the EU.

The Company obtains its bulk requirements for pravastatin from Sankyo and finishes the product in its own facilities.

COUMADIN

Warfarin sodium is an oral anticoagulant used predominantly in patients with atrial fibrillation or deep venous thrombosis/pulmonary embolism.

Market exclusivity expired in the U.S. in 1997. Basic patent protection and regulatory data protection had expired before the Company acquired COUMADIN in 2001.

The Company obtains its bulk requirements for warfarin from a third party and produces the majority of finished goods in its own facilities.

Virology

REYATAZ

Atazanavir sulfate is a protease inhibitor for the treatment of HIV. REYATAZ was launched in the U.S. in July 2003.

The Company developed atazanavir under a worldwide license from Novartis for which it pays a royalty based on a percentage of net sales. The Company is entitled to promote REYATAZ for use in combination with NORVIR* (ritonavir) under a Non-Exclusive License Agreement between Abbott Laboratories and the Company dated July 30, 2003, as amended, for which it pays a royalty based on a percentage of net sales.

Market exclusivity for REYATAZ is expected to expire in 2017 in the U.S., in the major EU member countries and Japan. Data exclusivity in the EU expires in 2014.

The Company manufactures its bulk requirements for atazanavir and finishes the product in its own facilities.

SUSTIVA Franchise

Efavirenz, the active ingredient in SUSTIVA, is a non-nucleoside reverse transcriptase inhibitor (NNRTI) for the treatment of HIV. The SUSTIVA Franchise includes SUSTIVA, an antiretroviral drug used in the treatment of HIV, and as well as bulk efavirenz included in the combination therapy, ATRIPLA*, which is sold through a joint venture with Gilead Sciences, Inc. (Gilead). The Company and Gilead share responsibility for commercializing ATRIPLA* in the U.S. 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 Europe, the Company and Gilead share responsibility for commercializing ATRIPLA* throughout the EU and certain other European countries. Gilead will record revenues from future net sales of ATRIPLA* in most countries in Europe and the Company will record revenues at a percentage relative to the contribution represented by SUSTIVA. In December 2007, the European Commission granted marketing authorization for ATRIPLA*. For more information about the Company's arrangement with Gilead, see "—Strategic Alliances" below and "Item 8. Financial Statements—Note 2. Alliances and Investments."

Rights to market efavirenz in the U.S., Canada, the UK, France, Germany, Ireland, Italy and Spain are licensed from Merck & Co., Inc. for a royalty based on a percentage of net sales.

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 another company does, market efavirenz in Japan.

The Company obtains its bulk requirements for efavirenz from third parties and produces finished goods in its own facilities. The Company provides bulk efavirenz to Gilead, who is responsible for producing ATRIPLA* finished goods.

BARACLUDE

Entecavir is a potent and selective inhibitor of hepatitis B virus that was approved by the FDA in March 2005 for the treatment of chronic hepatitis B infection. BARACLUDE was discovered and developed internally. It has also been approved and marketed in over 50 countries outside of the U.S. including China, Japan and the EU. The Company has learned that in China several companies have filed for clinical trial permission since the Company received approval. The Company is not aware that any of the applications for clinical trial permission in China have been approved. Due to uncertainty about China's exclusivity laws, it is possible that one or more of these companies could receive marketing authorization from China's health authority by 2010.

The Company has a composition of matter patent that expires in the U.S. in 2010. An application for a patent term extension has been approved in the U.S., which extends the patent expiration to 2015. The composition of matter patent expires in the EU between 2011 and 2016 and in Japan in 2016. A patent term extension has been approved in Japan which extends the patent expiration to 2016. Supplementary protection certificates have been requested in the EU and approved in some EU countries, extending the exclusivity for the approved product to 2016.

The Company manufactures its bulk requirements for entecavir and finishes the product in its own facilities.

Oncology

ERBITUX*

ERBITUX* (cetuximab) is an IgG1 monoclonal antibody designed to exclusively target and block the Epidermal Growth Factor Receptor (EGFR), which is expressed on the surface of certain cancer cells in multiple tumor types as well as some normal cells. ERBITUX*, a biological product, is approved for the treatment in combination with irinotecan of patients with EGFR-expressing metastatic colorectal cancer (mCRC) who had failed an irinotecan-based regimen and as monotherapy for patients who are intolerant of irinotecan. In March 2006, the FDA approved ERBITUX* for use in the treatment of squamous cell carcinoma of the head and neck. Specifically, ERBITUX* was approved for use in combination with radiation therapy, for the treatment of locally or regionally advanced squamous cell carcinoma of the head and neck and, as a single agent, for the treatment of patients with recurrent or metastatic squamous cell carcinoma of the head and neck for whom prior platinum-based therapy has failed.

Also, in October 2007, the Company received FDA approval for a supplemental Biologics License Application (sBLA) filing to update the ERBITUX* product labeling to include overall survival data as a single agent in EGFR-expressing mCRC patients after failure of both irinotecan-based and oxaliplatin-based regimens.

ERBITUX* is marketed in North America by the Company under a distribution and copromotion agreement with ImClone Systems Incorporated (ImClone). The Company shares copromotion rights to ERBITUX* with Merck KGaA in Japan under a codevelopment and cocommercialization agreement signed in October 2007 among the Company, ImClone, Merck KGaA and Merck Japan. ERBITUX* is not yet marketed in Japan, although an application has been submitted with the Japanese Pharmaceuticals and Medical Devices Agency (PMDA) for the use of ERBITUX* in treating patients with advanced colorectal cancer. For a description of the Company's alliance with ImClone, see "—Strategic Alliances" below and "Item 8. Financial Statements—Note 2. Alliances and Investments."

In July 2007, the Company and ImClone amended the terms of their agreement for the codevelopment and copromotion of ERBITUX* in North America. Under this amendment, the companies have jointly agreed to expand the investment in the ongoing clinical development plan for ERBITUX* by up to several hundred million dollars. Development costs, up to a threshold value, will be the sole responsibility of the Company; costs in excess of this threshold will be shared by both companies according to a predetermined ratio.

There is no composition of matter patent that specifically claims ERBITUX*. ERBITUX* has been approved by the FDA and other health authorities for monotherapy, for which there is no use patent. The use of ERBITUX* in combination with an anti-neoplastic agent is approved by the FDA. Such combination use is claimed in a granted U.S. patent that expires in 2017. The inventorship of this use patent has been challenged by three researchers from Yeda Research and Development Company Ltd. (Yeda). In September 2006, the court granted Yeda the complete ownership of that patent. ImClone appealed the court's decision and also filed a declaratory judgment action alleging that if the Yeda researchers remain sole inventors of the patent, the patent is invalid.

Pursuant to a settlement agreement executed and announced in December 2007 by ImClone, Sanofi and Yeda to end worldwide litigation related to the use patent, Sanofi and Yeda granted ImClone a worldwide license under the use patent. The settlement agreement does not change ImClone's worldwide royalty rate for ERBITUX* sales. Under its commercial agreement with ImClone, the Company pays a royalty to ImClone on sales of ERBITUX* that is not impacted by the settlement agreement.

Yeda also has the right to license the use 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 also granted Amgen Inc. (Amgen) a license under the use patent. Amgen received FDA approval to market an EGFR-product that competes with ERBITUX*.

For more information about this litigation, see "Item 8. Financial Statements—Note 22. Legal Proceedings and Contingencies." The European equivalent of this use patent has been opposed. For more information about biologics patents, see "—Intellectual Property and Product Exclusivity" below.

The Company obtains its finished goods requirements for cetuximab for use in North America from ImClone. ImClone manufactures bulk requirements for cetuximab in its own facilities and finishing is performed by a third party for ImClone. For a description of the Company's supply agreement with ImClone, see "—Manufacturing and Quality Assurance" below.

TAXOL® (paclitaxel)

Paclitaxel is used in the treatment of refractory ovarian cancer, first-line treatment of ovarian cancer in combination with cisplatin, second-line treatment of acquired immunodeficiency syndrome (AIDS)-related Kaposi's Sarcoma, treatment of metastatic breast cancer after failure of combination chemotherapy, adjuvant treatment of node-positive breast cancer and in the treatment of non-small cell lung carcinoma with cisplatin.

The active ingredient in TAXOL® (paclitaxel) did not have patent protection in the U.S., the EU or Japan, but did have regulatory protection in the form of data exclusivity. Data exclusivity in the U.S. expired in 1997. An initial approval for a U.S. generic version of paclitaxel was granted in 2000, revoked by the FDA in 2001 and then reinstated in 2002. Data exclusivity in the EU expired in 2003. Data exclusivity for TAXOL® (paclitaxel) in Japan expired in 2003. A patent claiming the approved dosing and administration schedule expires in Japan in 2013. A nullity action filed in 2004 in the Japanese Patent Office invalidated this patent and the Company appealed the decision, but the invalidation decision was affirmed. Meanwhile, a generic paclitaxel was launched in Japan in 2006.

Paclitaxel was developed under a collaborative research and development agreement with the U.S. government. Under the agreement, the Company obtained rights to the U.S. government's TAXOL® (paclitaxel) data.

The Company manufactures its bulk requirements for paclitaxel and finishes the product in its own facilities.

SPRYCEL

Dasatinib is a multi–targeted tyrosine kinase inhibitor that was approved by the FDA in June 2006 for treatment of adults with chronic, accelerated, or myeloid or lymphoid blast phase chronic myeloid leukemia with resistance or intolerance to prior therapy including imatinib, and for the treatment of adults with Philadelphia chromosome–positive acute lymphoblastic leukemia with resistance or intolerance to prior therapy. Dasatinib was approved in the EU in November 2006. SPRYCEL was discovered and developed internally.

The basic composition of matter patent protecting dasatinib in the U.S. is due to expire in April 2020, and a patent term extension has been requested, which, upon grant, would extend the patent term until June 2020. In several EU countries, the patent is pending and upon grant, would expire in April 2020 (excluding term extensions). An EU patent application was not filed in Cyprus, Estonia, Latvia, Lithuania, Malta, Netherlands, Slovakia or Slovenia. In the U.S., New Chemical Entity Protection expires in 2011, and Orphan Drug Exclusivity expires in 2013, which protects the product from generic applications for the currently approved orphan indications only.

The Company manufactures its bulk requirements for dasatinib and finishes the product in its own facilities.

IXEMPRA

IXEMPRA (ixabepilone) is a microtubule inhibitor belonging to a class of antineoplastic agents, the epothilones and their analogs. In October 2007, the FDA approved ixabepilone in combination with capecitabine for the treatment of patients with metastatic or locally advanced breast cancer resistant to treatment with an anthracycline and a taxane, or whose cancer is taxane resistant and for whom further anthracycline therapy is contraindicated, and in monotherapy for the treatment of metastatic or locally advanced breast cancer in patients whose tumors are resistant or refractory to anthracyclines, taxanes, and capecitabine. Marketing authorization is currently being sought in EU and other countries.

The basic composition of matter patent protecting ixabepilone in the U.S. is due to expire in May 2018, and a patent term extension has been requested which, upon grant, would extend the patent term until September 2020. A corresponding patent also has been granted in EU countries which is due to expire in June 2018 (excluding term extensions). An EU patent application was not filed in Malta. In the U.S., New Chemical Entity Protection expires in 2012.

Ixabepilone was developed by the Company, but is subject to a license agreement with Helmholtz Zentrum fur Infektionsforschung GmbH (HZI), relating to epothilone technologies. Under the Agreement, HZI is entitled to royalties of 0.5% of net sales in all countries in which the product is sold.

The Company manufactures its bulk requirements for ixabepilone in its own facilities including manufacture of the active ingredient. The drug product which comprises a pharmaceutical kit is finished by Baxter Oncology GmbH.

Affective (Psychiatric) Disorders

ABILIFY*

Aripiprazole is an atypical antipsychotic agent for patients with schizophrenia, acute bipolar mania and Bipolar I Disorder.

Aripiprazole is copromoted in the U.S. by the Company and Otsuka Pharmaceutical Co., Ltd. (Otsuka). The Company's rights to commercialize aripiprazole in the U.S. terminate in 2012. Thereafter, Otsuka has the sole right to commercialize aripiprazole in the U.S. In Germany and Spain, the Company copromotes with an Otsuka affiliate. In the UK and France, the Company currently acts as distributor for the product and copromotes with an Otsuka affiliate. In all other European markets, the Company acts as exclusive distributor. The Company is the exclusive licensee for the product in the rest of the world, excluding Japan and certain other countries. In the U.S., Spain and Germany, the Company records alliance revenue for its contractual share of the net sales and records all expenses related to the product. Alliance revenue is recorded by the Company as net sales based upon 65% of third–party customer net sales in the copromotion countries. The Company recognizes this alliance revenue when ABILIFY* is shipped and all risks and rewards of ownership have transferred to third–party customers. In the UK, France and Italy, the Company currently records 100% of the net sales and related cost of products sold. In countries where the Company has an exclusive right to sell ABILIFY*, the Company also records 100% of the net sales and related cost of products sold. For more information about the Company's arrangement with Otsuka, see "—Strategic Alliances" below and "Item 8. Financial Statements—Note 2. Alliances and Investments."

The basic U.S. composition of matter patent for ABILIFY* expires in 2014 (including the granted patent term extension). In 2004, Otsuka filed with the U.S. Patent and Trademark Office (USPTO) a Request for Reexamination of a U.S. composition of matter patent, U.S. Patent No. 5,006,528 (the '528 Patent), covering ABILIFY*. In June 2006, the USPTO issued an Ex Parte Reexamination Certificate for the '528 Patent confirming the patentability of the original claims and approving additional new claims.

Otsuka has received formal notices from each of Teva Pharmaceuticals USA (Teva), Barr Pharmaceuticals, Inc. (Barr), Sandoz Inc. (Sandoz), Synthon Laboratories, Inc. (Synthon), Sun Pharmaceuticals Ltd. (Sun) and Apotex stating that each has filed an Abbreviated New Drug Application (aNDA) with the FDA for various dosage forms of aripiprazole, which the Company and Otsuka comarket in the U.S. as ABILIFY*. Each of the notices further states that its aNDA contains a p(IV) certification directed to '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 filed patent infringement actions based on the '528 Patent against Teva, Barr, Sandoz, Sun and Apotex in the U.S. District Court of New Jersey and against Synthon in the U.S. District Court for the Middle District of North Carolina. Otsuka has sole rights to enforce the '528 Patent.

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. There is no composition of matter patent in Austria, Belgium, Finland, Greece, Ireland, Luxembourg, Portugal, Latvia, Hungary, Cyprus, Czech Republic, Slovenia, Slovakia, Poland, Malta, Lithuania, Bulgaria and Estonia.

The Company obtains its bulk requirements for aripiprazole from Otsuka. Both Otsuka and the Company finish the product in their own facilities.

Immunoscience

ORENCIA

Abatacept, a biological product, is a fusion protein with novel immunosuppressive activity targeted initially at adult patients with moderate to severe rheumatoid arthritis, who have had an inadequate response to certain currently available treatments. Abatacept was approved by the FDA in December 2005 and made commercially available in the U.S. in February 2006.

ORENCIA was discovered and developed internally.

The Company has a series of patents covering abatacept and its method of use. The latest of the composition of matter patents expires in the U.S. in 2016. The Company has submitted its request for patent term extension for one of the composition of matter patents that expires in 2015, which could possibly extend the term of the patent. In the majority of the EU countries, the Company has a patent covering abatacept that expires in 2012. Data exclusivity in the EU expires in 2017. In January 2006, Repligen Corporation 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 alleging that the Company's then-anticipated sales of ORENCIA will infringe U.S. Patent No. 6,685,941. 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 No. 5,843,725 and 6,018,026. For more information about these litigations, see "Item 8. Financial Statements—Note 22. Legal Proceedings and Contingencies."

The Company obtains bulk abatacept from a third party and from its own manufacturing facilities. The Company finishes the product in its own facilities.

Other Pharmaceuticals

EFFERALGAN

EFFERALGAN is a formulation of acetaminophen first introduced in 1972 and distributed as an effervescent tablet. It is indicated for the treatment of fever or mild to moderate pain for adults and children, and marketed primarily in Europe. There is no composition of matter patent in Europe for EFFERALGAN.

In addition to the products discussed above, the Company's Pharmaceuticals segment also includes the Company's wholly-owned UPSA Consumer Medicines business in Europe, which includes EFFERALGAN, described above, as well as ASPIRINE UPSA, DAFALGAN and FERVEX in Europe and other overseas markets.

Strategic Alliances and Arrangements

The Company enters into strategic alliances and arrangements 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. The Company also enters into strategic alliances and arrangements with third parties, which give such third parties the rights to develop, manufacture, market and/or sell pharmaceutical products, the rights to which are owned by the Company. These alliances and arrangements can take many forms, including licensing arrangements, codevelopment and comarketing agreements, copromotion arrangements and joint ventures. Such alliances and arrangements reduce the risk of incurring all research and development expenses that do not lead to revenue-generating products; however, the gross margins on alliance products are generally lower, sometimes substantially so, than the gross margins on the Company's own products that are not partnered because profits from alliance products are shared with the Company's alliance partners. While there can be no assurance that new alliances will be formed, the Company actively pursues such arrangements and views alliances as an important complement to its own discovery and development activities.

The Company's most significant current alliances and arrangements for the Company's products are those with Sanofi for PLAVIX* and AVAPRO*/AVALIDE*, Otsuka for ABILIFY*, ImClone for ERBITUX* and Gilead for ATRIPLA*. The Company's most significant alliances and arrangements for investigational compounds under development are with Medarex, Inc. (Medarex) for ipilimumab, a monoclonal antibody being investigated as an anticancer treatment, the rights to which are owned by Medarex; with AstraZeneca PLC (AstraZeneca) for saxagliptin, an oral compound discovered by the Company for the potential treatment of diabetes that is a DPP-IV inhibitor, and dapagliflozin, an oral compound discovered by the Company for the potential treatment of diabetes that is a sodium-glucose cotransporter-2 (SGLT2) inhibitor; and with Pfizer, Inc. (Pfizer) for apixaban, an anticoagulant discovered by the Company being studied for the prevention and treatment of a broad range of venous and arterial thrombotic conditions. Each of these significant alliances and arrangements are discussed in more detail below. Additionally, the Company has licensing arrangements with Novartis for REYATAZ and with HZI for IXEMPRA, a novel microtubule-stabilizing agent for the treatment of breast cancer.

In general, the Company's strategic alliances and arrangements are for periods co-extensive with the periods of market exclusivity protection on a country-by-country basis. Based on the Company's current expectations with respect to the expiration of market exclusivity in the Company's significant markets, the licensing arrangements with Novartis for REYATAZ are expected to expire in 2017 in the U.S., the EU and Japan; and HZI for IXEMPRA are expected to expire in 2017 in the U.S., and on the 10th anniversary of the first commercial sale in the EU and Japan. For further discussion of market exclusivity protection, including a chart showing net sales of key products together with the year in which basic exclusivity loss occurred or is expected to occur in the U.S., the EU and Japan, see "—Products" above and "—Intellectual Property and Product Exclusivity" below.

Each of the Company's strategic alliances and arrangements with third parties who own the rights to manufacture, market and/or sell pharmaceutical products contain customary early termination provisions typically found in agreements of this kind and are generally based on the other party's material breach or bankruptcy (voluntary or involuntary) and product safety concerns. The amount of notice required for early termination generally ranges from immediately upon notice to 90 days after receipt of notice. Termination immediately upon notice is generally available where the other party files a voluntary bankruptcy petition or if a material safety issue arises with a product such that the medical risk/benefit is incompatible with the welfare of patients to continue to develop or commercialize this product. Termination upon 30 to 90 days notice is generally available where an involuntary bankruptcy petition has been filed (and has not been dismissed) or a material breach by the other party has occurred (and not been cured). Early termination due to product safety concerns typically arises when a product is determined to create significant risk of harm to patients due to concerns regarding the product's efficacy or level of toxicity. The Company's strategic alliances and arrangements typically do not otherwise contain provisions that provide the other party the right to terminate the alliance on short notice.

In general, where the other party to the Company's strategic alliance and arrangement will continue to have exclusivity protection upon the expiration or termination of the alliance, the Company does not retain any rights to the product or to the other party's intellectual property. The loss of rights to one or more products that are marketed and sold by the Company pursuant to strategic alliance arrangements with third parties in one or more countries or territories could be material to the Company's results of operations and cash flows and, in the case of PLAVIX*, could be material to its financial condition and liquidity. As is customary in the pharmaceutical industry, the terms of the Company's strategic alliances and arrangements generally are co-extensive with the exclusivity period, which is discussed above, and may vary on a country-by-country basis.

As discussed below, the Company's strategic alliance with Otsuka expires in November 2012 in the U.S. and Puerto Rico, which is prior to the expected expiration of market exclusivity protection for ABILIFY* in 2014 in the U.S. (including a granted patent term extension).

Current Marketed Products

Sanofi The Company has agreements for the codevelopment and cocommercialization of AVAPRO*/AVALIDE*, an angiotensin II receptor antagonist indicated for the treatment of hypertension and diabetic nephropathy, which is copromoted in certain countries outside the U.S. under the tradename APROVEL*/COAPROVEL* and comarketed in certain countries outside the U.S. by the Company under the tradename KARVEA*/KARVEZIDE*; and PLAVIX*, a platelet aggregation inhibitor, which is copromoted in certain countries outside the U.S. under the tradename PLAVIX* and comarketed in certain countries outside the U.S. by the Company under the tradename ISCOVER*.

The worldwide alliance operates under the framework of two geographic regions, one covering certain European and Asian countries, defined as Territory A, and one covering the U.S., Puerto Rico, Canada, Australia and certain Latin American countries, defined as Territory B. The region covering the U.S., Puerto Rico, Canada, Australia, and certain Latin American countries is managed by two separate territory agreements, one for U.S. and Puerto Rico AVAPRO*/AVALIDE* only, and a second agreement for U.S. and Puerto Rico PLAVIX* only, plus Canada, Australia, Mexico, Brazil, Colombia and Argentina for both products. Within each of Territory A and B, a Territory Partnership exists to supply product to the countries within each territory and to manage certain central expenses such as marketing, research and development and royalties. Countries within Territory A and B are structured so that the Company's local affiliate and Sanofi either comarket separate brands (e.g., each affiliate operates independently and sells a competing brand), or copromote a single brand.

Within Territory A, the comarketing countries include Germany, Spain, Italy (irbesartan only), Greece and China (clopidogrel bisulfate only). The Company sells ISCOVER* and KARVEA*/KARVEZIDE* and Sanofi sells PLAVIX* and APROVEL*/COAPROVEL* in these countries, except China, where the Company retains the right to, but does not currently comarket ISCOVER*. The Company and Sanofi copromote PLAVIX* and APROVEL*/COAPROVEL* in France, the UK, Belgium, Netherlands, Switzerland and Portugal. In addition, the Company and Sanofi copromote PLAVIX* in Austria, Italy, Ireland, Denmark, Finland, Norway, Sweden, Turkey, Taiwan, Korea, Singapore, Malaysia and Hong Kong, and APROVEL*/COAPROVEL* in certain French export countries. Sanofi acts as the operating partner for Territory A and owns a 50.1% majority financial controlling interest in this territory. The Company's ownership interest in 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 $526 million in 2007, $439 million in 2006 and $345 million in 2005.

Within Territory B, the Company and Sanofi copromote PLAVIX* in the U.S., Canada and Puerto Rico and AVAPRO*/AVALIDE* in Canada. The other Territory B countries, Australia, Mexico, Brazil, Colombia (clopidogrel bisulfate only) and Argentina are comarketing countries. In 2001, the Company and Sanofi modified their previous exclusive license to the Company for AVAPRO*/AVALIDE* in the U.S. and Puerto Rico to form a copromotion joint venture, as part of which the Company contributed the AVAPRO*/AVALIDE* intellectual property and Sanofi agreed to pay the Company $200 million in 2001 and $150 million in 2002. The Company accounts for these payments as a sale of an interest in a license and defers and amortizes the total amount of $350 million into other income over the expected useful life of the license, which is approximately 11 years from the date of the formation of the copromotion joint venture. The Company acts as the operating partner for Territory B and the U.S./Puerto Rico AVAPRO*/AVALIDE* Territory and owns a 50.1% majority controlling interest in these territories. As such, the Company consolidates all partnership results in these territories and records Sanofi's share of the results as a minority interest expense, net of taxes, which was $746 million in 2007, $428 million in 2006 and $578 million in 2005.

The Company recorded sales in Territory B, the U.S./Puerto Rico AVAPRO*/AVALIDE* Territory and Territory A comarketing countries of $5,958 million in 2007, $4,355 million in 2006 and $4,805 million in 2005.

In September 2006, the Company opted out of its copromotion rights with Sanofi for APROVEL*/COAPROVEL* in Ireland, Sweden, Denmark, Finland and Norway. The Company has also opted out of its comarketing or copromotion arrangements in a number of other countries prior to 2006. The Company receives a royalty payment from Sanofi based on a percentage of Sanofi's net sales in the opt–out countries.

The territory partnerships are governed by a series of committees with enumerated functions, powers and responsibilities. Each territory has two senior committees (Senior Committees) which have final decision making authority with respect to that territory as to the enumerated functions, powers and responsibilities within its jurisdiction.

The agreements with Sanofi 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 alliance arrangements may be terminated by the Company or Sanofi, either in whole or in any affected country or Territory, depending on the circumstances, in the event of (i) voluntary or involuntary bankruptcy or insolvency, which in the case of involuntary bankruptcy continues for 60 days or an order or decree approving same continues unstayed and in effect for 30 days; (ii) a

material breach of an obligation under a major alliance agreement that remains uncured for 30 days following notice of the breach except where commencement and diligent prosecution of cure has occurred within 30 days after notice; (iii) deadlocks of one of the Senior Committees which render the continued commercialization of the product impossible in a given country or Territory or, in the case of AVAPRO*/AVALIDE* in the U.S., with respect to advertising and promotion spending levels or the amount of sales force commitment; (iv) an increase in the combined cost of goods and royalty which exceeds a specified percentage of the net selling price of the product; or (v) a good faith determination by the terminating party that commercialization of a product should be terminated for reasons of patient safety.

In the case of each of these termination rights, the agreements include provisions for the termination of the relevant alliance with respect to the applicable product in the applicable country or territory or, in the case of a termination due to bankruptcy or insolvency or material breach, both products in the applicable territory. Each of these termination procedures is slightly different; however, in all events, the Company could lose all rights to either or both products, as applicable, in the relevant country or territory even in the case of a bankruptcy or insolvency or material breach where the Company is not the defaulting party.

For further discussion of the Company's strategic alliance with Sanofi, see "Item 8. Financial Statements—Note 2. Alliances and Investments."

Otsuka In 1999, the Company entered into a worldwide commercialization agreement with Otsuka, to codevelop and copromote ABILIFY* 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 Company began copromoting the product with Otsuka in the U.S. and Puerto Rico in November 2002. In June 2004, the Company received marketing approval from the European Commission. The product is currently copromoted with Otsuka in the UK, Germany, France and Spain. In the U.S., Germany and Spain, where the product is invoiced to third-party customers by the Company on behalf of Otsuka, the Company records alliance revenue for its 65% contractual share of third-party 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 third-party 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 or Otsuka to third-party customers. The agreement expires in November 2012 in the U.S. For the entire 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 10th anniversary of the first commercial sale in such country or expiration of the applicable patent in such country. Early termination is available based on the other party's voluntary or involuntary bankruptcy, failure to make minimum payments, failure to commence the first commercial sale within three months after receipt of all necessary approvals and material breach. The amount of notice required for early termination of the strategic alliance is immediately upon notice (i) in the case of voluntary bankruptcy, (ii) where minimum payments are not made to Otsuka, or (iii) if first commercial sale has not occurred within three months after receipt of all necessary approvals, 30 days where a material breach has occurred (and not been cured or commencement of cure has not occurred within 90 days after notice of such material breach) and 90 days in the case where an involuntary bankruptcy petition has been filed (and not been dismissed). In addition, termination is available to Otsuka upon 30 days notice in the event that the Company were to challenge Otsuka's patent rights or, on a market-by-market basis, the Company were to market a product in direct competition with ABILIFY*. Upon termination or expiration of the alliance, the Company does not retain any rights to ABILIFY*.

The Company recorded total revenue for ABILIFY* of $1,660 million in 2007, $1,282 million in 2006 and $912 million in 2005. Total milestone payments made to Otsuka under the agreement through 2007 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 into 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 each of 2007, 2006 and 2005. The unamortized capitalized payment balance was $29 million and $35 million as of December 31, 2007 and 2006, respectively.

For further discussion of the Company's strategic alliance with Otsuka, see "Item 8. Financial Statements—Note 2. Alliances and Investments."

ImClone In 2001, the Company purchased 14.4 million shares of ImClone for $70 per share, or $1,007 million, which represented approximately 19.9% of the ImClone shares outstanding just prior to the Company's commencement of a public tender offer for those ImClone shares. ImClone is a biopharmaceutical company focused on developing targeted cancer treatments, which include growth factor blockers, cancer vaccines and anti-angiogenesis therapeutics. The equity investment in ImClone is part of a strategic agreement between the Company and ImClone that also included a commercialization arrangement expiring in September 2018 for the codevelopment and copromotion of ERBITUX*, for a series of payments originally totaling $1 billion. The Company

paid ImClone a milestone payment of $200 million in 2001. In 2002, the agreement with ImClone was revised to reduce the total payments to $900 million from $1 billion. In accordance with the agreement, the Company paid ImClone $140 million in 2002, $60 million in 2003, $250 million in 2004 and $250 million in the first quarter of 2006. The 2004 payment was made upon the approval by the FDA of the BLA for ERBITUX* for use in combination with irinotecan in the treatment of patients with EGFR-expressing, mCRC who are refractory to irinotecan-based chemotherapy and for use as a single agent in the treatment of patients with EGFR-expressing, mCRC who are intolerant to irinotecan-based chemotherapy. The 2006 milestone payment was made upon FDA approval of ERBITUX* for use in the treatment of squamous cell carcinoma of the head and neck in combination with radiation or as monotherapy. The Company also has codevelopment and copromotion rights in Canada and Japan to the extent the product is commercialized in such countries. Under the agreement, covering North America, ImClone receives a distribution fee based on a flat rate of 39% of net sales in North America. The Company purchases all of its commercial requirements for bulk ERBITUX* from ImClone at a price equal to ImClone's manufacturing cost plus 10%.

In July 2007, the Company and ImClone amended the terms of their agreement for the codevelopment and copromotion of ERBITUX* in North America. Under this amendment, the companies have jointly agreed to expand the investment in the ongoing clinical development plan for ERBITUX* by up to several hundred million dollars. Development costs, up to a threshold value, will be the sole responsibility of the Company; costs in excess of this threshold will be shared by both companies according to a predetermined ratio.

The Company shares copromotion rights to ERBITUX* with Merck KGaA in Japan under a codevelopment and cocommercialization agreement signed in October 2007 among BMS, BMKK, E.R. Squibb & Sons, LLC, ImClone, Merck KGaA and Merck Japan. ERBITUX* is not yet marketed in Japan, although the Company and ImClone submitted in February 2007 an application to the PMDA for the use of ERBITUX* in treating patients with advanced colorectal cancer.

The Company accounts for the $500 million total approval milestones paid in 2004 and 2006 as license acquisitions, and amortizes the payments into the cost of products sold over the remaining term of the agreement, which ends in 2018. The Company amortized into cost of products sold $38 million, $34 million and $17 million for 2007, 2006 and 2005, respectively. The unamortized portion of the approval payments is recorded in other intangible assets, net, in the consolidated balance sheet and was $397 million and $435 million as of December 31, 2007 and 2006, respectively.

The Company determines its equity share in ImClone's net income or loss by eliminating from ImClone's results the milestone revenue ImClone recognized for the $400 million in pre-approval milestone payments made by the Company from 2001 through 2003. The Company recorded net income of $7 million and $43 million in 2007 and 2006, respectively, and net loss of $5 million in 2005 for its share of ImClone's results of operations. The Company records its share of the results in equity in net income of affiliates in the consolidated statement of earnings. The Company recorded net sales for ERBITUX* of $692 million in 2007, $652 million in 2006 and $413 million in 2005.

The Company's recorded investment and the market value of its holdings in ImClone common stock was $114 million and approximately $619 million as of December 31, 2007, respectively, and $109 million and approximately $385 million as of December 31, 2006, respectively. The Company holds 14.4 million shares of ImClone stock, representing approximately 17% of ImClone's shares outstanding at December 31, 2007 and 2006. 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, 2007 were $7.92 and $43.00, respectively, compared to $7.59 and $26.76, respectively, as of December 31, 2006.

Early termination is available based on material breach and is effective 60 days after notice of the material breach (and such material breach has not been cured or commencement of cure has not occurred), or upon six months notice from the Company if there exists a significant concern regarding a regulatory or patient safety issue that would seriously impact the long-term viability of the product. Upon termination or expiration of the alliance, the Company does not retain any rights to ERBITUX*.

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 Oncology Therapeutics Network 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 began expanding its distribution model to include wholesalers and distributors who hold ERBITUX* inventory. The Company recognizes revenue upon such shipment consistent with its revenue recognition policy.

For further discussion of the Company's strategic alliance with ImClone, see "Item 8. Financial Statements—Note 2. Alliances and Investments."

Gilead In 2004, the Company and Gilead entered into a joint venture to develop and commercialize a fixed-dose combination of the Company's SUSTIVA and Gilead's TRUVADA* (emtricitabine and tenofovir disoproxil fumarate) in the U.S. In July 2006, the FDA granted approval of ATRIPLA*, which is the first complete Highly Active Antiretroviral Therapy treatment product for HIV available in the U.S. in a fixed-dose combination taken once daily. Fixed-dose combinations contain multiple medicines formulated together and may help simplify HIV therapy for patients and providers. Guidelines issued by the U.S. Department of Health and Human Services list the combination of emtricitabine, tenofovir disoproxil fumarate and efavirenz as one of the preferred non-NNRTI-based treatments for use in appropriate patients that have never taken anti-HIV medicines before. In September 2006, the companies amended their agreements to commercialize ATRIPLA* in Canada. ATRIPLA* was approved by Health Canada in October 2007 and by the European Commission in December 2007 for commercialization in the 27 countries of the EU, as well as Norway and Iceland.

The Company and Gilead share responsibility for commercializing ATRIPLA* in the U.S., Canada, throughout the EU and certain other European countries, and both provide funding and field-based sales representatives in support of promotional efforts for ATRIPLA*. Gilead records 100% of ATRIPLA* revenues in the U.S., Canada and most countries in Europe. The Company records revenue for the bulk efavirenz component of ATRIPLA* upon sales of that product by the joint venture with Gilead 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. The Company recorded efavirenz revenues of $335 million in 2007 and $76 million in 2006 related to ATRIPLA* sales.

Gilead consolidates the results of the joint venture in their operating results and 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 $9 million in 2007, $6 million in 2006 and $4 million in 2005.

The joint venture between the Company and Gilead will continue until terminated by mutual agreement of the parties or otherwise as described below. In the event of a material breach by one party, the non-breaching party may terminate the joint venture only if both parties agree that it is both desirable and practicable to withdraw the combination product from the markets where it is commercialized. At such time as one or more generic versions of SUSTIVA appear on the market in the U.S., Gilead will have the right to terminate the joint venture and thereby acquire all the rights to the combination product, both in the U.S. and Canada; however, the Company will continue for three years to receive a percentage of the net sales based on the contribution of bulk efavirenz to ATRIPLA*, and otherwise retains all rights to SUSTIVA.

For further discussion of the Company's strategic alliance with Gilead, see "Item 8. Financial Statements—Note 2. Alliances and Investments."

Investigational Compounds Under Development

Medarex In 2004, the Company entered into a worldwide collaboration and share purchase agreement with Medarex to codevelop and copromote ipilimumab, a fully human antibody currently in Phase III development for the treatment of metastatic melanoma. The agreement became effective in January 2005 after the companies received certain governmental clearances and approvals, and the receipt of consent from the U.S. Public Health Service of the sublicense to the Company of Medarex's rights to MDX-1379 (gp100), a vaccine that is being developed in combination with ipilimumab. The FDA has granted Fast Track status to ipilimumab in combination with MDX-1379 for treatment of patients with late stage unresectable metastatic melanoma who have failed or are intolerant to first-line therapy.

In January 2005, under the terms of the agreement, the Company made a cash payment of $25 million to Medarex, which was expensed as research and development, and an additional $25 million equity investment in Medarex. Further milestone payments are expected to be made upon the successful achievement of various regulatory and sales-related stages. The Company and Medarex will also share in future development and commercialization costs. Medarex could receive up to $205 million if all regulatory milestones are met, and up to $275 million in sales-related milestones. Medarex will have an option to copromote and receive up to 45% of the profits with the Company in the U.S. The Company will receive an exclusive license outside of the U.S. and pay royalties to Medarex.

The agreement with Medarex does not expire unless and until one of the following events occurs: (1) the Company voluntarily terminates the agreement in its entirety or on a country–by–country basis by providing Medarex with six months prior written notice; (2) the Company voluntarily terminates the agreement on a product–by–product basis (but only if a second product is then in GLP toxicology studies or later) or a country–by–country basis by providing Medarex with six months prior written notice depending on the circumstances; (3) the Company terminates Medarex's copromotion option and rights in the U.S. on 60 days written notice after the end of the second calendar year in the event Medarex provides less than 60 percent of certain performance obligations in any two out of three consecutive calendar years (such termination right to be exercised only with respect to those indications as to which Medarex failed to meet such performance obligation). Upon any such termination by the Company via any of the scenarios in (1) – (3) above, Medarex will no longer have a right to share in the profits and losses of the product for the terminated indication(s) and, instead the Company will pay Medarex royalties on net sales of the product; or (4) Medarex terminates the agreement with respect to all products on 60 days written notice if the Company provides less than 60 percent of certain performance obligations in any two out of three consecutive calendar years. Generally, upon termination in (4), the Company will assign all rights to the product to Medarex and receive a royalty thereafter on intellectual property licensed by the Company to Medarex. Medarex may also elect not to copromote a product for one or more indications in the U.S., in which event it will receive a royalty on sales of the product for such indication. If there is a material breach as to manufacturing by a party, then the other party shall be limited to termination of such party's manufacturing rights only.

AstraZeneca In January 2007, the Company entered into two worldwide (except for Japan) codevelopment and cocommercialization agreements with AstraZeneca, one for the codevelopment and cocommercialization of saxagliptin, a DPP–IV inhibitor (Saxagliptin Agreement), and one for the codevelopment and cocommercialization of dapagliflozin, a SGLT2 inhibitor (SGLT2 Agreement). Both compounds are being studied for the treatment of diabetes and were discovered by the Company. Under the terms of the agreements, the Company received from AstraZeneca an upfront payment of $100 million in January 2007, which was deferred and is being recognized over the life of the agreements into other income. The Company amortized into other income $7 million in 2007. The unamortized portion of the upfront payment was $93 million as of December 31, 2007. Milestone payments are expected to be received by the Company upon the successful achievement of various development and regulatory events, as well as sales–related milestones. Under the Saxagliptin Agreement, the Company could receive up to $300 million if all development and regulatory milestones are met and up to an additional $300 million if all sales–based milestones are met. Under the SGLT2 Agreement, the Company could receive up to $350 million if all development and regulatory milestones are met and up to an additional $300 million if all sales–based milestones are met. Under each agreement, the Company and AstraZeneca also share in future development and commercialization costs. The majority of development costs under the initial development plans through 2009 will be paid by AstraZeneca and any additional development costs will generally be shared equally. The Company records in research and development expenses saxagliptin and dapagliflozin development costs net of its alliance partner's share. Under each agreement, the two companies will jointly develop the clinical and marketing strategy and share commercialization expenses and profits/losses equally on a global basis, excluding Japan, and the Company will manufacture both products and, with certain limited exceptions, record net sales.

Pfizer In April 2007, the Company and Pfizer entered into a worldwide codevelopment and cocommercialization agreement for apixaban, an anticoagulant discovered by the Company being studied for the prevention and treatment of a broad range of venous and arterial thrombotic conditions. In accordance with the terms of the agreement, Pfizer made an upfront payment of $250 million to the Company in May 2007, which was deferred and is being recognized over the life of the agreement into other income. In December 2007, the Company and Pfizer agreed to include Japan in the worldwide agreement. Pfizer made an upfront payment of $40 million in December 2007, which was deferred and is being recognized over the life of the agreement into other income. The Company amortized into other income $11 million in 2007. The unamortized portion of the upfront payments was $279 million as of December 31, 2007. Pfizer will fund 60% of all development costs effective January 1, 2007 going forward, and the Company will fund 40%. The Company records in research and development expenses apixaban development costs net of its alliance partner's share. The Company may also receive additional payments of up to $780 million from Pfizer based on development and regulatory milestones. The companies will jointly develop the clinical and marketing strategy of apixaban, and will share commercialization expenses and profits/losses equally on a global basis.

For further information on alliances relating to products under development and drug discovery, see "—Research and Development" below.

HEALTH CARE GROUP

Nutritionals Segment

The Nutritionals segment, through Mead Johnson, manufactures, markets, distributes and sells infant formulas and other nutritional products, including the entire line of ENFAMIL products. The ENFAMIL LIPIL product is the first infant formula in the U.S. to contain the nutrients docosahexaenoic acid (DHA) and arachidonic acid (ARA). Also naturally found in breast milk, DHA and ARA are believed to support infant brain and eye development. The Company obtains these nutrients from a sole provider pursuant to a non–exclusive worldwide license and supply agreement. The supply agreement, in force until at least 2011, provides no firm guarantee of supply and pricing is subject to change pursuant to a pricing formula. The license expires beginning in 2024 on a country–by–country basis 25 years after the Company commenced sales in a country.

The Company's Nutritionals products are generally sold by wholesalers and retailers and are promoted primarily to health care professionals. The Company also promotes Nutritionals products directly to consumers worldwide through advertising. The Company manufactures these products in the U.S. and in five foreign countries. Nutritionals sales accounted for 13% of the Company's sales in 2007, 14% of the Company's sales in 2006 and 12% of the Company's sales in 2005. U.S. Nutritionals sales accounted for 44%, 46% and 49% of total Nutritionals sales in 2007, 2006 and 2005, respectively, while international Nutritionals sales accounted for 56%, 54% and 51% of total Nutritionals sales in 2007, 2006 and 2005, respectively. Approximately one–half of U.S. gross sales of infant formula are subject to rebates issued under the Women, Infants and Children (WIC) program. Sales subject to WIC rebates have much lower margins than those of non–WIC program sales.

Key Nutritionals product lines and their sales are as follows:

Dollars in Millions	2007	2006	2005
Infant Formulas	$1,786	$1,637	$1,576
ENFAMIL	1,082	1,007	992
Toddler/Children's Nutritionals	693	606	529
ENFAGROW	295	262	206

ConvaTec Segment

The ConvaTec segment manufactures, distributes and sells ostomy and modern wound and skin care products. Principal brands of ConvaTec include NATURA, SUR-FIT, ESTEEM, AQUACEL, DUODERM and FLEXI-SEAL. These products are marketed worldwide, primarily to hospitals, medical professions and medical suppliers. The Company mainly relies on an internal sales force, and sales are made through various distributors around the world. The Company manufactures these products in the U.S., the UK and the Dominican Republic.

ConvaTec sales accounted for approximately 6% of the Company's sales in 2007, 6% of the Company's sales in 2006 and 5% of the Company's sales in 2005. U.S. ConvaTec sales accounted for 32%, 33% and 31% of total ConvaTec sales in 2007, 2006 and 2005, respectively, while international ConvaTec sales accounted for 68%, 67% and 69% of total ConvaTec sales in 2007, 2006 and 2005, respectively.

ConvaTec sales by business and key products are as follows:

Dollars in Millions	2007	2006	2005
ConvaTec	$1,155	$1,048	$992
Ostomy	594	554	550
Wound Therapeutics	488	441	416

Productivity Transformation Initiative

The Company undertook a broad range of actions in the fourth quarter of 2007 as part of the previously announced three-year Productivity Transformation Initiative (PTI), which is reducing costs, streamlining operations and rationalizing global manufacturing. The initiative, which is on track to achieve $1.5 billion in annual cost savings and cost avoidance on a pre-tax basis by 2010, is central to the Company's strategy to become a more nimble and flexible next generation biopharmaceutical enterprise.

Key productivity initiatives include reducing general and administrative operations by simplifying, standardizing and outsourcing, where appropriate, processes and services, rationalizing the Company's mature brands portfolio, consolidating its global manufacturing network while eliminating complexity and enhancing profitability, simplifying its geographic footprint and implementing a more efficient go-to-market model. Specific productivity goals include reducing the number of brands in the Company's mature products portfolio by 60 percent between 2007 and 2011, reducing the number of manufacturing facilities by more than 50 percent by the end of 2010, and reducing total headcount by approximately 10 percent between 2007 and 2010. Some positions have been eliminated in 2007, although the substantial majority of positions will be eliminated in 2008 and 2009. The Company has announced the impending closure of several manufacturing facilities, including Barceloneta, Puerto Rico and Mayaguez, Puerto Rico.

Costs associated with the implementation of the PTI are estimated to be between $0.9 billion to $1.1 billion on a pre-tax basis, with $292 million incurred in 2007 and approximately $500 million expected to be incurred in 2008. The ultimate timing of the recording of the charges cannot be predicted with certainty and will be affected by the occurrence of triggering events for expense recognition under U.S. Generally Accepted Accounting Principles (GAAP), among other factors.

Sources and Availability of Raw Materials

In general, the Company purchases its raw materials, medical devices and supplies required for the production of the Company's products in the open market. For some products, the Company purchases its raw materials, medical devices and supplies from a single source, which in certain circumstances is specified in the Company's product registrations, thereby requiring the Company to obtain such raw materials and supplies from that particular source. The Company attempts, if possible, to mitigate raw material supply risks to the Company, through inventory management and alternative sourcing strategies. For further discussion of sourcing, see "—Manufacturing and Quality Assurance" below and discussions of particular products.

Manufacturing and Quality Assurance

To meet all expected product demand, the Company operates and manages its manufacturing network, including its third–party contract manufacturers, and the inventory related thereto, in a manner that permits the Company to improve efficiency while maintaining flexibility in its ability to reallocate manufacturing capacity. Pharmaceutical production processes are complex, highly regulated and vary widely from product to product. Given that shifting or adding manufacturing capacity can be a very lengthy process requiring significant capital and out–of–pocket expenditures and regulatory approvals, the Company maintains and operates its flexible manufacturing network, consisting of internal and external resources, that minimizes unnecessary product transfers and inefficient uses of manufacturing capacity. For further discussion of the regulatory impact on the Company's manufacturing, see "—Government Regulation and Price Constraints" below.

Pharmaceutical manufacturing facilities require significant ongoing capital investment for both maintenance and compliance with increasing regulatory requirements. In addition, as the Company adds to its product line and realigns its focus over the next several years, the Company expects to modify its existing manufacturing network to meet complex processing standards that may be required for newly introduced products, including biologics. Biologics manufacturing involves more complex processes than those of traditional pharmaceutical operations. Although the Company does have the capacity to manufacture biologics for clinical trials and commercial launch, its capacity to manufacture larger commercial volumes is limited. As biologics become more important to the Company's product portfolio, the Company may continue to make arrangements with third–party manufacturers, and in addition expects to make substantial investments to increase its internal capacity to produce biologics on a commercial scale. 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 large scale multi–product bulk biologics manufacturing facility in Devens, Massachusetts. Construction of the Devens, Massachusetts facility began in early 2007, and the facility is projected to be operationally complete by 2009. The Company expects to submit the site for regulatory approval in 2010. Commercial production of biologic compounds is anticipated to begin by 2011.

The Company relies on third parties to manufacture, or to supply it with active ingredients necessary for it to manufacture certain products, including PLAVIX*, ABILIFY*, ERBITUX*, the SUSTIVA Franchise, ORENCIA*, PRAVACHOL, COUMADIN and TAXOL® (paclitaxel). To maintain a stable supply of these products, the Company takes a variety of actions designed to provide that there is a reasonable level of these ingredients held by the third–party supplier, the Company or both, so that the Company's manufacturing operations are not interrupted. As an additional protection, in some cases, the Company takes steps to maintain an approved back–up source where available. For example, the Company will rely on the combined capacity of its Devens, Massachusetts, Syracuse, New York, and Manati, Puerto Rico, facilities, and the capacity available at its third–party contract manufacturers to manufacture ORENCIA* and the commercial quantities of the Company's other investigational compounds in late–stage development should those compounds receive regulatory approval.

If the Company or any third–party manufacturer that the Company relies on for existing or future products is unable to maintain a stable supply of products, operate at sufficient capacity to meet its order requirements, comply with government regulations for manufacturing pharmaceuticals or meet the heightened processing requirements for biologics, the Company's business performance and prospects could be negatively impacted. Additionally, if the Company or any of its third–party suppliers were to experience extended plant shutdowns or substantial unplanned increases in demand or suspension of manufacturing for regulatory reasons, the Company could experience an interruption in supply of certain products or product shortages until production could be resumed or expanded.

In connection with divestitures, licensing arrangements or distribution agreements of certain of the Company's products, or in certain other circumstances, the Company has entered into agreements under which the Company has agreed to supply such products to third parties. In addition to liabilities that could arise from the Company's failure to supply such products under the agreements, these arrangements could require the Company to invest in facilities for the production of non–strategic products, result in additional regulatory filings and obligations or cause an interruption in the manufacturing of its own products.

The Company's success depends in great measure upon customer confidence in the quality of its products and in the integrity of the data that support their safety and effectiveness. Product quality arises from a total commitment to quality in all parts of the Company's operations, including research and development, purchasing, facilities planning, manufacturing, and distribution. The Company maintains quality–assurance procedures relating to the quality and integrity of technical information and production processes.

Control of production processes involves detailed specifications for ingredients, equipment and facilities, manufacturing methods, processes, packaging materials, and labeling. The Company performs tests at various stages of production processes and on the final product to ensure that the product meets all regulatory requirements and the Company's standards. These tests may involve chemical and physical chemical analyses, microbiological testing, or a combination of these along with other analyses. Quality control is provided by business unit/site quality assurance groups that monitor existing manufacturing procedures and systems used by the Company, its subsidiaries and third-party suppliers.

Intellectual Property and Product Exclusivity

The Company owns or licenses a number of patents in the U.S. and foreign countries primarily covering its products. The Company has also developed many brand names and trademarks for products in all areas. The Company considers the overall protection of its patent, trademark, license and other intellectual property rights to be of material value and acts to protect these rights from infringement.

In the pharmaceutical industry, the majority of an innovative product's commercial value is usually realized during the period in which the product has market exclusivity. In the U.S. and some other countries, when market exclusivity expires and generic versions of a product are approved and marketed, there can often be very substantial and rapid declines in the product's sales. The rate of this decline varies by country and by therapeutic category. For a discussion of how generic versions of a product can impact that product's sales, see "—Generic Competition" below.

A product's market exclusivity is generally determined by two forms of intellectual property: patent rights held by the innovator company and any regulatory forms of exclusivity to which the innovative drug is entitled.

Patents are a key determinant of market exclusivity for most branded pharmaceuticals. Patents provide the innovator with the right to exclude others from practicing an invention related to the medicine. Patents may cover, among other things, the active ingredient(s), various uses of a drug product, pharmaceutical formulations, drug delivery mechanisms and processes for (or intermediates useful in) the manufacture of products. Protection for individual products extends for varying periods in accordance with the expiration dates of patents in the various countries. The protection afforded, which may also vary from country to country, depends upon the type of patent, its scope of coverage and the availability of meaningful legal remedies in the country.

Market exclusivity is also sometimes influenced by regulatory intellectual property rights. Many developed countries provide certain non-patent incentives for the development of medicines. For example, the U.S., the EU and Japan each provide for a minimum period of time after the approval of a new drug during which the regulatory agency may not rely upon the innovator's data to approve a competitor's generic copy. Regulatory intellectual property rights are also available in certain markets as incentives for research on new indications, on orphan drugs and on medicines useful in treating pediatric patients.

Regulatory intellectual property rights are independent of any patent rights that the Company may possess and can be particularly important when a drug lacks broad patent protection. However, most regulatory forms of exclusivity do not prevent a competitor from gaining regulatory approval prior to the expiration of regulatory data exclusivity on the basis of the competitor's own safety and efficacy data on its drug, even when that drug is identical to that marketed by the innovator.

The Company estimates the likely market exclusivity period for each of its products on a case-by-case basis. It is not possible to predict the length of market exclusivity for any of the Company's products with certainty because of the complex interaction between patent and regulatory forms of exclusivity, and inherent uncertainties concerning patent litigation. There can be no assurance that a particular product will enjoy market exclusivity for the full period of time that the Company currently estimates or that the exclusivity will be limited to the estimate. For a discussion on market exclusivity, see "—Pharmaceuticals Segment" above.

In addition to patents and regulatory forms of exclusivity, the Company also holds intellectual property in the form of trademarks on products such as ENFAMIL. Trademarks have no effect on market exclusivity for a product, but are considered to have marketing value. Worldwide, all of the Company's important products are sold under trademarks that are considered in the aggregate to be of material importance. Trademark protection continues in some countries as long as used; in other countries, as long as registered. Registration is for fixed terms and can be renewed indefinitely.

Specific aspects of the law governing market exclusivity for pharmaceuticals vary from country to country. The following summarizes key exclusivity rules in markets representing significant Company sales:

United States

A company seeking to market an innovative pharmaceutical in the U.S. must file a complete set of safety and efficacy data to the FDA. The type of application filed depends on whether the drug is a chemical (a small molecule) or a biological product (a large molecule). If the innovative pharmaceutical is a chemical, the company files a New Drug Application (NDA). If the medicine is a biological product, a BLA is filed. The type of application filed affects regulatory exclusivity rights.

A competitor seeking to launch a generic substitute of a chemical innovative drug in the U.S. must file an aNDA with the FDA. In the aNDA, the generic manufacturer needs to demonstrate only "bioequivalence" between the generic substitute and the approved NDA drug. The aNDA relies upon the safety and efficacy data previously filed by the innovator in its NDA.

Medicines approved under a NDA can receive several types of regulatory data protection. An innovative chemical pharmaceutical (also known as a new chemical entity) is entitled to five years of regulatory data protection in the U.S., during which an aNDA cannot be filed with the FDA. If an innovator's patent is challenged, as described below, the generic manufacturer may file its aNDA after the fourth year of the five-year data protection period. A pharmaceutical drug product that contains an active ingredient that has been previously approved in a NDA, but is approved in a new formulation or for a new indication on the basis of new clinical trials, receives three years of data protection. Finally, a NDA that is designated as an Orphan Drug, which is a drug that gains an indication for treatment of a condition that occurs only rarely in the U.S., can receive seven years of exclusivity for the orphan indication. During this time period, neither NDAs nor aNDAs for the same drug product can be approved for the same orphan use.

Because a significant portion of patent life can be lost during the time it takes to obtain regulatory approval, the innovator can extend one patent to compensate the innovator for the lost patent term, at least in part. More specifically, the innovator may identify one patent, which claims the product or its approved method of use, and, depending on a number of factors, may extend the expiration date of that patent. There are two limits to these extensions. First, the maximum term a patent can be extended is five years, and second, the extension cannot cause the patent to be in effect for more than 14 years from the date of NDA approval.

A company may also earn six months of additional exclusivity for a drug where specific clinical trials are conducted at the written request of the FDA to study the use of the medicine to treat pediatric patients, and submission to the FDA is made prior to the loss of basic exclusivity. This six-month period extends most forms of exclusivity (patent and regulatory) that are listed with the FDA at the time the studies are completed and submitted to the FDA, but not against products already finally approved.

Currently, generic versions of biological 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 biological 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.

Many (but not all) innovative drugs are also covered by patents held by the NDA sponsor beyond the minimum period of regulatory exclusivity provided by U.S. law.

The innovator company is required to list certain of its patents covering the medicine with the FDA in what is commonly known as the Orange Book. Absent a successful patent challenge, the FDA cannot approve an aNDA until after the innovator's listed patents expire. However, after the innovator has marketed its product for four years, a generic manufacturer may file an aNDA and allege that one or more of the patents listed in the Orange Book under an innovator's NDA is either invalid or not infringed. This allegation is commonly known as a "Paragraph IV certification." The innovator then must decide whether to file a patent infringement suit against the generic manufacturer. If one or more of the NDA-listed patents are successfully challenged, or if the innovator chooses not to sue, the first filer of a Paragraph IV certification (or first filers if more than one generic qualifies) may be entitled to a 180-day period of market exclusivity against all other generic manufacturers. From time to time, aNDAs, including Paragraph IV certifications, are filed with respect to certain of the Company's products. The Company evaluates these aNDAs on a case-by-case basis and, where warranted, files suit against the generic manufacturer to protect its patent rights.

In the U.S., the increased likelihood of generic challenges to innovators' intellectual property has increased the risk of loss of innovators' market exclusivity. First, generic companies have increasingly sought to challenge innovators' basic patents covering major pharmaceutical products. For a discussion of one such litigation related to patent challenges by generic companies, see "Item 8. Financial Statements—Note 22. Legal Proceedings and Contingencies—PLAVIX* Litigation," and "—Other Intellectual Property Litigation." Second, statutory and regulatory provisions in the U.S. limit the ability of an innovator company to prevent generic drugs from being approved and launched while patent litigation is ongoing. Third, the FDA is actively considering ways to expand the use of a regulatory mechanism that allows for regulatory approval of drugs that are similar to (but not generic copies of) innovative drugs on the basis of less extensive data than is required for a full NDA. As a result of all of these developments, it is not possible to predict the length of market exclusivity for a particular Company product with certainty based solely on the expiration of the relevant patent(s) or the current forms of regulatory exclusivity. For more information about new legislation, see "—Government Regulation and Price Constraints" below.

European Union

Recent pharmaceutical legislation in the EU has an impact on the procedures for authorization of pharmaceutical products in the EU under both the centralized and mutual recognition procedures. In particular, the legislation contains new data protection provisions. All products (regardless of whether they have been approved under the centralized or the mutual recognition procedures) will be subject to an "8+2+1" regime. Eight years after the innovator has received its first community authorization for a medicinal product, a generic company may file a marketing authorization application for that product with the health authorities. However, the generic company may not commercialize the product until after either 10 or 11 years have elapsed from the initial marketing authorization granted to the innovator. The possible one–year extension is available if the innovator, during the first eight years of the marketing authorization, obtains an additional indication that is of significant clinical benefit in comparison with existing treatments. There is a transitional provision for these new data protection requirements, and these provisions will apply as new marketing authorization applications are submitted under the new legislation. For those products that continue to be covered under the old law, there is a 10–year period of data protection under the centralized procedures and a period of either six or 10 years under the mutual recognition procedure (depending on the member state). Regardless of the procedure used to obtain marketing authorization approval, a company then must obtain pricing and reimbursement for the pharmaceutical product, which is typically subject to member state law. The pricing and reimbursement procedure can take months and sometimes years to obtain.

Patents on pharmaceutical products are generally enforceable in the EU. However, in contrast to the U.S., patents are not listed with regulatory authorities. Generic copies can be approved after data protection expires, regardless of whether the innovator holds patents covering its drug. Thus, it is possible that an innovator may be seeking to enforce its patents against a generic competitor that is already marketing its product. Also, the European patent system has an opposition procedure in which generic manufacturers may challenge the validity of patents covering innovator products within nine months of grant. As in the U.S., patents in the EU may be extended to compensate for the patent term lost during the regulatory review process. Such extensions are granted on a country–by–country basis.

In general, EU law treats chemically–synthesized drugs and biologically–derived drugs the same with respect to intellectual property and market exclusivity. The European Medicines Evaluation Agency (EMEA) has issued a guideline that outlines what additional information has to be provided for biosimilar products, also known as generic biologics, in order for the EMEA to review an application for marketing approval.

Japan

In Japan, medicines of new chemical entities are generally afforded eight years (previously six years before 2007) of data exclusivity for approved indications and dosage. Patents on pharmaceutical products are enforceable. Generic copies can receive regulatory approval after data exclusivity and patent expirations. As in the U.S., patents in Japan may be extended to compensate for the patent term lost during the regulatory review process.

In general, Japanese law treats chemically–synthesized and biologically–derived drugs the same with respect to intellectual property and market exclusivity.

Rest of World

In countries outside of the U.S., the EU and Japan, there is a wide variety of legal systems with respect to intellectual property and market exclusivity of pharmaceuticals. Most other developed countries utilize systems similar to either the U.S. (e.g., Canada) or the EU (e.g., Switzerland). Among developing countries, some have adopted patent laws and/or regulatory exclusivity laws, while others have not. Some developing countries have formally adopted laws in order to comply with World Trade Organization (WTO) commitments, but have not taken steps to implement these laws in a meaningful way. Enforcement of WTO obligations is a long process, and there is no assurance of the outcome. Thus, in assessing the likely future market exclusivity of the Company's innovative drugs in developing countries, the Company takes into account not only formal legal rights but political and other factors as well.

Marketing, Distribution and Customers

The Company promotes its products in medical journals and directly to health care providers such as doctors, nurse practitioners, physician assistants, pharmacists, technologists, hospitals, Pharmacy Benefit Managers (PBMs), Managed Care Organizations (MCOs) and government agencies. The Company also markets directly to consumers in the U.S. through direct–to–consumer print, radio and television advertising. In addition, the Company sponsors general advertising to educate the public about its innovative medical research. For a discussion of the regulation of promotion and marketing of pharmaceuticals, see "—Government Regulation and Price Constraints" below.

Through the Company's sales and marketing organizations, the Company explains the approved uses and advantages of its products to medical professionals. The Company works to gain access to health authority, PBM and MCO formularies (lists of recommended or approved medicines and other products), including Medicare Part D plans and reimbursement lists by demonstrating

the qualities and treatment benefits of its products. Marketing of prescription pharmaceuticals is limited to the approved uses of the particular product, but the Company continues to develop information about its products and provides such information in response to unsolicited inquiries from doctors and other medical professionals. All drugs must complete clinical trials required by regulatory authorities to show they are safe and effective for treating one or more medical problems. A manufacturer may choose, however, to undertake additional studies, including comparative clinical trials with competitive products, to demonstrate additional advantages of a compound. Those studies can be costly and take years to complete, and the results are uncertain. Balancing these considerations makes it difficult to decide whether and when to undertake such additional studies. But, when they are successful, such studies can have a major impact on approved marketing claims and strategies.

The Company's operations include several pharmaceutical marketing and sales organizations. Each organization markets a distinct group of products supported by a sales force and is typically based on particular therapeutic areas or physician groups. These sales forces often focus on selling new products when they are introduced, and promotion to physicians is increasingly targeted at specialists and high value primary care physicians.

The Company's prescription pharmaceutical products are sold principally to wholesalers, but the Company also sells directly to distributors, retailers, hospitals, clinics, government agencies and pharmacies. In 2007, sales to three pharmaceutical wholesalers in the U.S., McKesson, Cardinal Health, Inc. (Cardinal) and AmerisourceBergen Corporation (AmerisourceBergen), accounted for approximately 19%, 16% and 12%, respectively, of the Company's total net sales. In 2006, sales to McKesson, Cardinal and AmerisourceBergen accounted for approximately 19%, 16% and 11%, respectively, of the Company's total net sales. In 2005, sales to McKesson, Cardinal and AmerisourceBergen accounted for approximately 21%, 18% and 12%, respectively, of the Company's total net sales. Sales to these U.S. wholesalers were concentrated in the Pharmaceuticals segment.

The Company's U.S. Pharmaceuticals business, through the Inventory Management Agreements (IMAs), has arrangements with substantially all of its direct wholesaler and distributor customers that allow the Company to monitor U.S. wholesaler inventory levels and require those wholesalers to maintain inventory levels that are no more than one month of their demand. The IMAs have a two–year term, through December 31, 2009, subject to certain termination provisions.

The Company sells ERBITUX* to intermediaries (such as wholesalers and specialty oncology distributors) and ships ERBITUX* directly to the end users of the product who are the customers of those intermediaries. The Company also sells ERBITUX* in the U.S. to other wholesalers and distributors who then hold ERBITUX* inventory. The Company recognizes revenue upon such shipment consistent with its revenue recognition policy.

For information on sales and marketing of Nutritionals and ConvaTec products, see "—Nutritionals Segment" and "—ConvaTec Segment" above.

Competition

The markets in which the Company competes are generally broad–based and highly competitive. The principal means of competition vary among product categories and business groups.

The Company's Pharmaceuticals segment competes with other worldwide research–based drug companies, many smaller research companies with more limited therapeutic focus and generic drug manufacturers. Important competitive factors include product efficacy, safety and ease of use, price and demonstrated cost–effectiveness, marketing effectiveness, product labeling, service and research and development of new products and processes. Sales of the Company's products can be impacted by new studies that indicate a competitor's product has greater efficacy for treating a disease or particular form of disease than one of the Company's products. The Company's sales also can be impacted by additional labeling requirements relating to safety or convenience that may be imposed on its products by the FDA or by similar regulatory agencies in different countries. If competitors introduce new products and processes with therapeutic or cost advantages, the Company's products can be subject to progressive price reductions or decreased volume of sales, or both.

To successfully compete for business with MCOs and PBMs, the Company must often demonstrate that its products offer not only medical benefits but also cost advantages as compared with other forms of care. Most new products that the Company introduces must compete with other products already on the market or products that are later developed by competitors. Manufacturers of generic pharmaceuticals typically invest far less in research and development than research–based pharmaceutical companies and therefore can price their products significantly lower than branded products. Accordingly, when a branded product loses its market exclusivity, it normally faces intense price competition from generic forms of the product. In certain countries outside the U.S., patent protection is weak or nonexistent and the Company must compete with generic versions shortly after it launches its innovative product. In addition, generic pharmaceutical companies may introduce a generic product before exclusivity has expired, and before the resolution of any related patent litigation. For a discussion of the generic launch of a clopidogrel bisulfate product that competes with PLAVIX*, see "Item 8. Financial Statements—Note 22. Legal Proceedings and Contingencies—PLAVIX* Litigation."

Many other companies, large and small, manufacture and sell one or more products that are similar to those marketed by the Company's Nutritionals and ConvaTec segments. Sources of competitive advantage include patents and trademarks, product quality and efficacy, brand identity, advertising and promotion, product innovation, broad distribution capabilities, customer satisfaction and price. Significant expenditures for advertising, promotion and marketing are generally required to achieve both consumer and trade acceptance of these products.

The Company believes its long-term competitive position depends upon its success in discovering and developing innovative, cost-effective products that serve unmet medical need, together with its ability to manufacture the products efficiently and to market them effectively in a highly competitive environment. There can be no assurance that the Company's research and development efforts will result in commercially successful products or that its products or processes will not become outmoded from time to time as a result of products or processes developed by its competitors.

Managed Care Organizations

The growth of MCOs in the U.S. has been a major factor in the competitive make-up of the health care marketplace. Over half the U.S. population now participates in some version of managed care. Because of the size of the patient population covered by MCOs, marketing of prescription drugs to them and the PBMs that serve many of those organizations has become important to the Company's business. MCOs can include medical insurance companies, medical plan administrators, health-maintenance organizations, Medicare Part D formularies, alliances of hospitals and physicians and other physician organizations. Those organizations have been consolidating into fewer, even larger entities, enhancing their purchasing strength and importance to the Company.

A major objective of MCOs is to contain and, where possible, reduce health care expenditures. They typically use formularies, volume purchases and long-term contracts to negotiate discounts from pharmaceutical providers. MCOs and PBMs typically develop formularies to reduce their cost for medications. Formularies can be based on the prices and therapeutic benefits of the available products. Due to their generally lower cost, generic medicines are often favored. The breadth of the products covered by formularies can vary considerably from one MCO to another, and many formularies include alternative and competitive products for treatment of particular medical problems. MCOs use a variety of means to encourage patients' use of products listed on their formularies.

Exclusion of a product from a formulary can lead to its sharply reduced usage in the MCO patient population. Consequently, pharmaceutical companies compete aggressively to have their products included. Where possible, companies compete for inclusion based upon unique features of their products, such as greater efficacy, better patient ease of use or fewer side effects. A lower overall cost of therapy is also an important factor. Products that demonstrate fewer therapeutic advantages must compete for inclusion based primarily on price. The Company has been generally, although not universally, successful in having its major products included on MCO formularies.

Generic Competition

One of the biggest competitive challenges that the Company faces in the U.S. and, to a lesser extent, internationally is from generic pharmaceutical manufacturers. Upon the expiration or loss of market exclusivity on a product, the Company can lose the major portion of sales of that product in a very short period of time. In the U.S., the FDA approval process exempts generics from costly and time-consuming clinical trials to demonstrate their safety and efficacy, and allows generic manufacturers to rely on the safety and efficacy of the innovator product. Therefore, generic competitors operate without the Company's large research and development expenses and its costs of conveying medical information about the product to the medical community. For more information about market exclusivity, see "—Intellectual Property and Product Exclusivity" above.

The rate of sales decline of a product after the expiration of exclusivity varies by country. In general, the decline in the U.S. market is more rapid than in most other developed countries. Also, the declines in developed countries tend to be more rapid than in developing countries.

The rate of sales decline after the expiration of exclusivity has also historically been influenced by product characteristics. For example, drugs that are used in a large patient population (e.g., those prescribed by primary care physicians) tend to experience more rapid declines than drugs in specialized areas of medicine (e.g., oncology). Drugs that are more complex to manufacture (e.g., sterile injectable products) usually experience a slower decline than those that are simpler to manufacture.

As noted above, MCOs that focus primarily on the immediate cost of drugs often favor generics over brand-name drugs. Many governments also encourage the use of generics as alternatives to brand-name drugs in their health care programs. Laws in the U.S. generally allow, and in many cases require, pharmacists to substitute generic drugs that have been rated under government procedures to be therapeutically equivalent to a brand-name drug. The substitution must be made unless the prescribing physician expressly forbids it. These laws and policies provide an added incentive for generic manufacturers to seek marketing approval as the automatic substitution removes the need for generic manufacturers to incur many of the sales and marketing costs, which innovators must incur.

Research and Development

The Company invests heavily in research and development because it believes it is critical to its long-term competitiveness. Bristol-Myers Squibb Pharmaceutical Research and Development has major facilities in Princeton, Hopewell and New Brunswick, New Jersey and Wallingford, Connecticut. Pharmaceutical research and development is also carried out at various other facilities in the U.S. and in Belgium, Canada, the UK and India. Management continues to emphasize leadership, innovation, productivity and quality as strategies for success in Bristol-Myers Squibb Pharmaceutical Research and Development.

The Company spent $3,282 million in 2007, $2,991 million in 2006 and $2,678 million in 2005 on Company-sponsored research and development activities. The Company-sponsored pharmaceutical research and development spending includes certain payments under third-party collaborations and contracts. At the end of 2007, the Company employed approximately 8,200 people in research and development throughout the Company, including a substantial number of physicians, scientists holding graduate or postgraduate degrees and higher-skilled technical personnel.

The Company concentrates its pharmaceutical research and development efforts in the following disease areas with significant unmet medical need: Affective (psychiatric) disorders, Alzheimer's/dementia, atherosclerosis/thrombosis, diabetes, hepatitis, HIV/AIDS, obesity, oncology, rheumatoid arthritis and related diseases and solid organ transplant. However, the Company continues to analyze and may selectively pursue promising leads in other areas. In addition to discovering and developing new molecular entities, the Company looks for ways to expand the value of existing products through new uses and formulations that can provide additional benefits to patients.

To supplement the Company's internal efforts, the Company collaborates with independent research organizations, including educational institutions and research-based pharmaceutical and biotechnology companies, and contracts with others for the performance of research in their facilities. The Company's drug discovery program includes many alliances and collaborative agreements. These agreements bring new products into the pipeline or help the Company remain on the cutting edge of technology in the search for novel medicines. In drug development, the Company engages the services of physicians, hospitals, medical schools and other research organizations worldwide to conduct clinical trials to establish the safety and effectiveness of new products.

Drug development is time consuming, expensive and risky. In the development of human health products, industry practice and government regulations, in the U.S. and most foreign countries, provide for the determination of effectiveness and safety of new molecular entities through preclinical tests and controlled clinical evaluation. Before a new drug may be marketed in the U.S., recorded data on preclinical and clinical experience are included in the NDA or the BLA to the FDA for the required approval. The development of certain other products is also subject to government regulations covering safety and efficacy in the U.S. and many foreign countries. There can be no assurance that a compound developed as a result of any program will obtain the regulatory approvals necessary for it to be marketed for any particular disease indication.

On average, only about one in 10,000 chemical compounds discovered by pharmaceutical industry researchers proves to be both medically effective and safe enough to become an approved medicine. The process from discovery to regulatory approval typically takes 10 years or longer. Drug candidates can fail at any stage of the process, and even late-stage product candidates sometimes fail to receive regulatory approval. The Company believes its investments in research, both internally and in collaboration with others, have been rewarded by the number of new pharmaceutical compounds and indications it has in all stages of development.

Listed below are several investigational compounds that the Company has in the later stages of development. All of these compounds are in Phase III clinical trials. Whether or not any of these investigational compounds ultimately becomes one of the Company's marketed products depends on the results of pre-clinical and clinical studies, the competitive landscape of the potential product's market and the manufacturing processes necessary to produce the potential product on a commercial scale, among other factors. However, as noted above, there can be no assurance that the Company will seek regulatory approval of any of these compounds or that, if such approval is sought, it will be obtained. At this stage of development, the Company cannot determine all intellectual property issues or all the patent protection that may, or may not, be available for these investigational compounds. The patent coverage highlighted below does not include potential patent term extensions.

Apixaban	Apixaban is an oral Factor Xa inhibitor, which is being developed internally and has recently entered Phase III clinical trials for the prevention of thromboembolic disorders. In April 2007, the Company entered into a worldwide agreement with Pfizer for the codevelopment and cocommercialization of apixaban. The Company owns an issued U.S. patent covering composition of matter and method of use of apixaban that expires in September 2022 (extended to February 2023 via patent term adjustment).
Saxagliptin	Saxagliptin is an oral compound for the potential treatment of diabetes, which was discovered internally and is currently in Phase III clinical trials. In January 2007, the Company entered into the Saxagliptin Agreement with AstraZeneca for the codevelopment and cocommercialization of saxagliptin. A patent application covering the composition of matter has been issued and will expire in 2021 in the U.S.

Ipilimumab	Ipilimumab, which is being codeveloped with Medarex and is currently in Phase III clinical trials, is a monoclonal antibody being investigated as an anticancer treatment. It is in a novel class of agents intended to potentiate elements of the immunologic response. The Company owns a composition of matter patent that expires in the U.S. in 2016 and has rights to method of use patents owned by Medarex that expire in the U.S. in 2015. The Company also has rights to a Medarex composition of matter patent that expires in 2020 (extended to 2022 via patent term adjustment) and pending Medarex patent applications covering composition of matter and method of use of ipilimumab.
Belatacept	Belatacept, a biological product, which is being developed internally and is in Phase III clinical trials, is a fusion protein with novel immunosuppressive activity targeted at prevention of solid organ transplant rejection. The Company has a composition of matter patent that expires in the U.S. in 2021.
Dapagliflozin	Dapagliflozin is an oral compound for the potential treatment of diabetes, which was discovered internally and is currently in Phase III clinical trials. In January 2007, the Company entered into the SGLT2 Agreement with AstraZeneca for the codevelopment and cocommercialization of dapagliflozin. A patent application covering the composition of matter has been issued and will expire in 2020 in the U.S.

In November 2007, the Company and Pierre Fabre Medicament S.A. announced the termination of the license agreement for the development of vinflunine, a chemotherapy agent under investigation for the treatment of advanced or metastatic bladder cancer and other tumor types.

The Company sometimes enters into agreements with respect to its own investigational compounds in order to share the costs and risks of development, and in some cases, facilitate their commercialization. These agreements can take many forms, including codevelopment, comarketing, copromotion and/or joint venture arrangements.

The Company's competitors also devote substantial funds and resources to research and development. In addition, the consolidation that has occurred in the pharmaceutical industry has created companies with substantial research and development resources. The extent to which the Company's competitors are successful in their research could result in erosion of the sales of its products and unanticipated product obsolescence.

Government Regulation and Price Constraints

The pharmaceutical industry is subject to extensive global regulation by regional, country, state and local agencies. The Federal Food, Drug, and Cosmetic Act (FDC Act), other Federal statutes and regulations, various state statutes and regulations, and laws and regulations of foreign governments govern to varying degrees the testing, approval, production, labeling, distribution, post-market surveillance, advertising, dissemination of information, and promotion of the Company's products. The lengthy process of laboratory and clinical testing, data analysis, manufacturing, development, and regulatory review necessary for required governmental approvals is extremely costly and can significantly delay product introductions in a given market. Promotion, marketing, manufacturing and distribution of pharmaceutical products are extensively regulated in all major world markets. In addition, the Company's operations are subject to complex Federal, state, local, and foreign environmental and occupational safety laws and regulations. The Company anticipates that the laws and regulations affecting the manufacture and sale of current products and the introduction of new products will continue to require substantial scientific and technical effort, time, expense and significant capital investment.

Of particular importance is the FDA in the U.S. It has jurisdiction over virtually all of the Company's businesses and imposes requirements covering the testing, safety, effectiveness, manufacturing, labeling, marketing, advertising and post-marketing surveillance of the Company's pharmaceutical products. The FDA also regulates most of the Company's Nutritionals and ConvaTec products. In many cases, the FDA's requirements have increased the amount of time and money necessary to develop new products and bring them to market in the U.S.

The Company's pharmaceutical products, as well as the medical device products it sells through its ConvaTec business, are subject to pre-market approval requirements in the U.S. New drugs are approved under, and are subject to, the FDC Act and related regulations. Biological drugs are subject to both the FDC Act and the Public Health Service Act (PHS Act), and related regulations. Biological drugs are licensed under the PHS Act. Medical devices are subject to the FDC Act including Medical Device Amendments. The Company's Nutritionals products are regulated by the FDA, primarily under the Infant Formula Act of 1980 and its amendments.

The FDA mandates that drugs be manufactured, packaged and labeled in conformity with current Good Manufacturing Practices (cGMP) established by the FDA. In complying with cGMP regulations, manufacturers must continue to expend time, money and effort in production, record keeping and quality control to ensure that the product meets applicable specifications and other requirements to ensure product safety and efficacy. The FDA periodically inspects drug manufacturing facilities to ensure compliance with applicable cGMP requirements. Failure to comply with the statutory and regulatory requirements subjects the manufacturer to possible legal or regulatory action, such as suspension of manufacturing, seizure of product or voluntary recall of a product. Adverse experiences with the use of products must be reported to the FDA and could result in the imposition of market restrictions through labeling changes or in product removal. Product approvals may be withdrawn if compliance with regulatory requirements is not maintained or if problems concerning safety or efficacy of the product occur following approval.

The Federal government has extensive enforcement powers over the activities of pharmaceutical and medical device manufacturers, including authority to withdraw product approvals, commence actions to seize and prohibit the sale of unapproved or non-complying products, to halt manufacturing operations that are not in compliance with cGMPs, and to impose or seek injunctions, voluntary recalls, and civil monetary and criminal penalties. Such a restriction or prohibition on sales or withdrawal of approval of products marketed by the Company could materially adversely affect its business, financial condition and results of operations and cash flows. The Federal government has similar powers with respect to the manufacturing operations of the Nutritionals business.

Marketing authorization for the Company's products is subject to revocation by the applicable governmental agencies. In addition, modifications or enhancements of approved products or changes in manufacturing locations are in many circumstances subject to additional FDA approvals, which may or may not be received and which may be subject to a lengthy application process.

The distribution of pharmaceutical products is subject to the Prescription Drug Marketing Act (PDMA) as part of the FDC Act, which regulates such activities at both the Federal and state level. Under the PDMA and its implementing regulations, states are permitted to require registration of manufacturers and distributors who provide pharmaceuticals even if such manufacturers or distributors have no place of business within the state. States are also permitted to adopt regulations limiting the distribution of product samples to licensed practitioners. The PDMA also imposes extensive licensing, personnel recordkeeping, packaging, quantity, labeling, product handling and facility storage and security requirements intended to prevent the sale of pharmaceutical product samples or other diversions. For discussion of recent settlement of certain investigations of drug pricing and sales and marketing activities, see "Item 8. Financial Statements—Note 22. Legal Proceedings and Contingencies."

The FDA Amendments Act of 2007 imposed additional obligations on pharmaceutical companies and delegated more enforcement authority to the FDA in the area of drug safety. Key elements of this legislation give the FDA new authority to (1) require that companies conduct post-marketing safety studies of drugs, (2) impose certain drug labeling changes relating to safety, (3) mandate risk mitigation measures such as the education of healthcare providers and the restricted distribution of medicines, (4) require companies to publicly disclose data from clinical trials and (5) pre-review television advertisements.

The marketing practices of all U.S. pharmaceutical manufacturers are subject to Federal and state health care laws that are used to protect the integrity of government health care programs. The Office of Inspector General of the U.S. Department of Health and Human Services (OIG) oversees compliance with applicable Federal laws, in connection with the payment for products by government funded programs (primarily Medicaid and Medicare). These laws include the Federal anti-kickback statute, which criminalizes the offering of something of value to induce the recommendation, order or purchase of products or services reimbursed under a government health care program. The OIG has issued a series of Guidances to segments of the health care industry, including the 2003 Compliance Program Guidance for Pharmaceutical Manufacturers (the OIG Guidance), which includes a recommendation that pharmaceutical manufacturers, at a minimum, adhere to the PhRMA Code, a voluntary industry code of marketing practices. The Company subscribes to the PhRMA Code, and has implemented a compliance program to address the requirements set forth in the OIG Guidance and the Company's compliance with the health care laws. Failure to comply with these health care laws could subject the Company to administrative and legal proceedings, including actions by the state and Federal government agencies. Such actions could result in the imposition of civil and criminal sanctions, which may include fines, penalties and injunctive remedies, the impact of which could materially adversely affect the Company's business, financial condition and results of operations and cash flows.

The Company is also subject to the jurisdiction of various other Federal and state regulatory and enforcement departments and agencies, such as the Federal Trade Commission, the Department of Justice and the Department of Health and Human Services in the U.S. The Company is also licensed by the U.S. Drug Enforcement Agency to procure and produce controlled substances. The Company is, therefore, subject to possible administrative and legal proceedings and actions by those organizations. Such actions may result in the imposition of civil and criminal sanctions, which may include fines, penalties and injunctive or administrative remedies.

The Company's activities outside the U.S. are also subject to regulatory requirements governing the testing, approval, safety, effectiveness, manufacturing, labeling and marketing of the Company's products. These regulatory requirements vary from country to country. In the EU, there are two ways that a company can obtain marketing authorization for a pharmaceutical product. The first route is the "centralized procedure." This procedure is compulsory for certain pharmaceutical products, in particular those using biotechnological processes, but also is available for certain new chemical compounds and products. The second route to obtain marketing authorization in the EU is the "mutual recognition procedure." Applications are made to a single member state, and if the member state approves the pharmaceutical product under a national procedure, then the applicant may submit that approval to the mutual recognition procedure of some or all other member states. As set forth above, pricing and reimbursement of the product continues to be the subject of member state law.

Whether or not FDA approval or approval of the EMEA has been obtained for a product, approval of the product by comparable regulatory authorities of countries outside of the U.S. or the EU, as the case may be, must be obtained prior to marketing the product in those countries. The approval process may be more or less rigorous from country to country and the time required for approval may be longer or shorter than that required in the U.S. Approval in one country does not assure that such product will be approved in another country.

In many markets outside the U.S., the Company operates in an environment of government-mandated, cost-containment programs. Several governments have placed restrictions on physician prescription levels and patient reimbursements, emphasized greater use of generic drugs and/or enacted across-the-board price cuts as methods of cost control. Most European countries do not provide market pricing for new medicines, except the UK and Germany. Pricing freedom is limited in the UK by the operation of a profit control plan and in Germany by the operation of a reference price system. Companies also face significant delays, mainly in France, Spain, Italy and Belgium, in market access for new products, and more than two years can elapse before new medicines become available on some national markets. Additionally, member states of the EU have regularly imposed new or additional cost containment measures for pharmaceuticals. In recent years, Italy, for example, has imposed mandatory price decreases. The existence of price differentials within Europe due to the different national pricing and reimbursement laws leads to significant parallel trade flows.

In recent years, 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. Similar cost containment issues exist in many foreign countries where the Company does business.

Federal and state governments also have pursued direct methods to reduce the cost of drugs for which they pay. The Company participates 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. Rebates under Medicaid and related state programs reduced revenues by $169 million in 2007, $174 million in 2006 and $595 million in 2005. The decrease in 2006 as compared to 2005 was primarily due to the exclusivity loss of PRAVACHOL and lower PLAVIX* sales. The shift in patient enrollment from Medicaid to Medicare under Medicare Part D also resulted in a decrease in Medicaid rebates, which was partially offset by a corresponding increase in the Company's managed health care rebates. The Company also participates 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. These entities receive minimum discounts based off a defined "non-federal average manufacturer price" for purchases. Other prime vendor programs in which the Company participates provide discounts for outpatient medicines purchased by certain Public Health Service entities and other hospitals meeting certain criteria. The Company recorded discounts related to the prime vendor programs of $662 million in 2007, $703 million in 2006 and $1,090 million in 2005.

In the U.S., governmental cost containment efforts have extended to the federally funded Special Supplemental Nutrition Program for WIC. All states participate in the WIC program and have sought and obtained rebates from manufacturers of infant formula whose products are used in the program. All states have conducted competitive bidding for infant formula contracts, which require the use of specific infant formula products by the state WIC program, unless a physician requests a non-contract formula for a WIC customer. States participating in the WIC program are required to engage in competitive bidding or to use other cost containment measures that yield savings equal to or greater than the savings generated by a competitive bidding system. Mead Johnson participates in this program and approximately half of its gross U.S. sales are subject to rebates under the WIC program. Rebates under the WIC program reduced revenues by $848 million in 2007, $872 million in 2006 and $843 million in 2005.

For further discussion of these rebates and programs, see "Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations—Results of Operations."

Environmental Regulation

The Company's facilities and operations are subject to extensive U.S. and foreign laws and regulations relating to environmental protection and human health and safety, including those governing discharges of pollutants into the air and water, the use, management and disposal of hazardous, radioactive and biological materials and wastes, and the cleanup of contamination. Pollution controls and permits are required for many of the Company's operations, and these permits are subject to modification, renewal or revocation by the issuing authorities.

An environment, health and safety group within the Company monitors operations around the world, providing the Company with an overview of regulatory requirements and overseeing the implementation of Company standards for compliance. The Company also incurs operating and capital costs for such matters on an ongoing basis. The Company expended approximately $38 million, $50 million and $45 million on capital environmental projects undertaken specifically to meet environmental requirements in 2005, 2006 and 2007, respectively, and expects to spend approximately $46 million in 2008. Although the Company believes that it is in

substantial compliance with applicable environmental, health and safety requirements and the permits required for its operations, the Company nevertheless could incur additional costs, including civil or criminal fines or penalties, clean-up costs, or third-party claims for property damage or personal injury, for violations or liabilities under these laws.

Many of the Company's current and former facilities have been in operation for many years, and, over time, the Company and other operators of those facilities have generated, used, stored or disposed of substances or wastes that are considered hazardous under Federal, state and foreign environmental laws, including the U.S. Comprehensive Environmental Response, Compensation, and Liability Act (CERCLA). As a result, the soil and groundwater at or under certain of these facilities is or may be contaminated, and the Company may be required to make significant expenditures to investigate, control and remediate such contamination, and in some cases to provide compensation and/or restoration for damages to natural resources. Currently, the Company is involved in investigation and remediation at 13 current or former Company facilities. The Company has also been identified as a "potentially responsible party" (PRP) under applicable laws for environmental conditions at approximately 30 former waste disposal or reprocessing facilities operated by third parties at which investigation and/or remediation activities are ongoing.

The Company may face liability under CERCLA and other Federal, state and foreign laws for the entire cost of investigation or remediation of contaminated sites, or for natural resource damages, regardless of fault or ownership at the time of the disposal or release. In addition, at certain sites the Company bears remediation responsibility pursuant to contract obligations. Generally, at third-party operator sites involving multiple PRPs, liability has been or is expected to be apportioned based on the nature and amount of hazardous substances disposed of by each party at the site and the number of financially viable PRPs. For additional information about these matters, see "Item 8. Financial Statements—Note 22. Legal Proceedings and Contingencies."

Employees

The Company employed approximately 42,000 people at December 31, 2007.

In late 2007, the Company undertook a broad range of actions, as part of the previously announced three-year PTI. As part of this multi-year PTI, the Company is implementing a comprehensive cost reduction program that includes workforce reductions in some areas and the rationalization of some facilities. Specific productivity goals include reducing total headcount by approximately 10 percent between 2007 and 2010.

Some positions have been eliminated in 2007, although the substantial majority of positions will be eliminated in 2008 and 2009. During 2007, the Company recorded pre-tax charges of $189 million, relating to the termination benefits and other related costs for workforce reductions of approximately 2,800 manufacturing, selling and administrative personnel, across all geographic regions.

For further discussion of this initiative and 2007 restructuring activities, see "—Productivity Transformation Initiative" above and "Item 8. Financial Statements—Note 3. Restructuring."

Foreign Operations

The Company has significant operations outside the U.S. They are conducted both through the Company's subsidiaries and through distributors, and involve all three of the same business segments as the Company's U.S. operations —Pharmaceuticals, Nutritionals and ConvaTec.

Revenues from operations outside the U.S. of $8.5 billion accounted for 44% of the Company's total revenues in 2007. In 2007, revenues exceeded $500 million in each of France, Canada, Spain, Japan, Italy, Mexico and Germany. In 2006, revenues exceeded $500 million in each of France, Japan, Canada, Spain, Italy and Mexico. In 2005, revenues exceeded $500 million in each of France, Japan, Spain, Canada, Italy and Germany. No single country outside the U.S. contributed more than 10% of the Company's total revenues in 2007, 2006 or 2005. For a geographic breakdown of net sales, see the table captioned Geographic Areas in "Item 8. Financial Statements—Note 19. Segment Information" and for further discussion of the Company's sales by geographic area see "Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations—Geographic Areas."

International operations are subject to certain risks, which are inherent in conducting business abroad, including, but not limited to, currency fluctuations, possible nationalization or expropriation, price and exchange controls, counterfeit, limitations on foreign participation in local enterprises and other restrictive governmental actions. The Company's international businesses are also subject to government-imposed constraints, including laws on pricing or reimbursement for use of products.

Depending on the direction of change relative to the U.S. dollar, foreign currency values can increase or reduce the reported dollar value of the Company's net assets and results of operations. In 2007, the change in foreign exchange rates had a net favorable impact on the growth rate of revenues. While the Company cannot predict with certainty future changes in foreign exchange rates or the effect they will have on it, the Company attempts to mitigate their impact through operational means and by using various financial instruments. See the discussions under "Item 7A. Quantitative and Qualitative Disclosures About Market Risk" and "Item 8. Financial Statements—Note 18. Financial Instruments."

Item 1A. RISK FACTORS.

Any of the factors described below could significantly and negatively affect the Company's business, prospects, financial condition, operating results, or credit ratings, which could cause the trading price of the Company's common stock to decline. Additional risks and uncertainties not presently known to the Company, or risks that the Company currently considers immaterial, may also impair the Company's operations.

The Company faces competition from other pharmaceutical manufacturers, including from lower-priced generic products, and it is possible that the Company may lose market exclusivity of a product earlier than expected.

Competition from manufacturers of competing products, including lower-priced generic versions of the Company's products is a major challenge, both within the United States (U.S.) and internationally. Such competition may include (i) new products developed by competitors that have lower prices or superior performance features or that are otherwise competitive with the Company's current products; (ii) technological advances and patents attained by competitors; (iii) results of clinical studies related to the Company's products or a competitor's products; (iv) problems with licensors, suppliers and distributors; and (v) business combinations among the Company's competitors and major customers.

In the pharmaceutical industry, the majority of an innovative product's commercial value is usually realized during the period in which the product has market exclusivity. In the U.S. and some other countries, when market exclusivity expires and generic versions of a product are approved and marketed, there can often be very substantial and rapid declines in the product's sales. The rate of this decline varies by country and by therapeutic category.

Market exclusivity for the Company's products is based upon patent rights and/or certain regulatory forms of exclusivity. The scope of the Company's patent rights may vary from country to country. In some countries, including in certain European Union member states, basic patent protection for the Company's products may not exist because historically certain countries did not offer the right to obtain certain types of patents and/or the Company (or its licensors) did not file in those markets. Absent relevant patent protection for a product, once the data exclusivity period expires, generic versions of the product can be approved and marketed. In addition, prior to the expiration of data exclusivity, a competitor could seek regulatory approval by submitting its own clinical trial data to obtain marketing approval. Manufacturers of generic products are also increasingly seeking to challenge patents before they expire, and may in some cases launch a generic product before the expiration of the applicable patent(s) and/or before the final resolution of patent litigation. The length of market exclusivity for any of the Company's products is impossible to predict with certainty and there can be no assurance that a particular product will enjoy market exclusivity for the full period of time that appears in the estimates disclosed in this Form 10-K.

For a discussion of how generic versions of a product can impact that product's sales, see "Item 1. Business—Competition—Generic Competition" above. For more information about market exclusivity, see "Item 1. Business—Products" and "Item 1. Business—Intellectual Property and Product Exclusivity" above.

The patent infringement lawsuit with Apotex Inc. and Apotex Corp. (Apotex) involving PLAVIX* is ongoing, and there is a risk of generic competition from Apotex and from other generic pharmaceutical companies.

Although, as previously disclosed, the U.S. District Court for the Southern District of New York (District court) issued an opinion and order upholding the validity and enforceability of the U.S. Patent No. 4,847,265 relating to PLAVIX, ruled that Apotex's generic clopidogrel bisulfate product infringed the patent and enjoined Apotex from engaging in any activity that infringes that patent, the PLAVIX* patent infringement lawsuit is still ongoing and there is a risk that the Company could face generic competition from Apotex and from other generic pharmaceutical companies. Apotex has filed a notice of appeal with the U.S. Court of Appeals for the Federal Circuit. If Apotex were to prevail in its appeal of the District court's decision, the Company could face renewed generic competition for PLAVIX* from Apotex promptly thereafter. Loss of market exclusivity for PLAVIX* and/or sustained generic competition would be material to the Company's results of operations and cash flows and could be material to its financial condition and liquidity. It is not possible at this time reasonably to assess the outcomes of the appeal by Apotex of the District court's decision, or 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.*

The Company has recorded deferred tax assets related to the U.S. foreign tax credit, research tax credit and charitable contribution carryforwards. The charitable contribution carryforwards expire in varying amounts beginning in 2009, while the foreign tax credit and research tax credit carryforwards expire in varying amounts beginning in 2012. Realization of the foreign tax credit, research tax credit and charitable contribution 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 amount of foreign tax credit, research tax credit and charitable contribution 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 additional valuation allowances against these U.S. federal deferred tax assets. For a discussion of PLAVIX* related matters, see "Item 8. Financial Statements—Note 22. Legal Proceedings and Contingencies."*

The Company may be adversely impacted by economic factors beyond its control and may incur additional impairment charges to its investment portfolio.

As of December 31, 2007, the Company had $811 million of principal invested in auction rate securities (ARS), representing interests in collateralized debt obligations supported by pools of residential and commercial mortgages or credit cards, insurance securitizations and other structured credits, including corporate bonds. Some of the underlying collateral for the ARS held by the Company consists of sub-prime mortgages. The estimated market value of the Company's ARS holdings at December 31, 2007 was $419 million, which reflects a $392 million adjustment to the principal value of $811 million. Although the ARS continue to pay interest according to their stated terms, based on valuation models and an analysis of other-than-temporary impairment factors, the Company has recorded an impairment charge of $275 million in the fourth quarter, reflecting the portion of ARS holdings that the Company has concluded have an other-than-temporary decline in value. In addition, the Company recorded an unrealized pre-tax loss of $142 million in other comprehensive income as a reduction in shareholders' equity, reflecting $117 million of adjustments to ARS holdings and $25 million of other marketable securities that the Company has concluded have a temporary decline in value.

The credit and capital markets have continued to deteriorate in 2008. If uncertainties in these markets continue, these markets deteriorate further or the Company experiences any additional ratings downgrades on any investments in its portfolio (including on ARS), the Company may incur additional impairments to its investment portfolio, which could negatively affect the Company's financial condition, cash flow and reported earnings.

The Company also has significant operations outside of the U.S. Revenue from operations outside of the U.S. accounted for 44% of the Company's revenues in 2007. As such, the Company is exposed to changes in fluctuation of foreign currency exchange rates. For more information on the Company's foreign currency exchange exposure, see "Item 7A. Quantitative and Qualitative Disclosures About Market Risk." The Company also has significant borrowings which are exposed to changes in interest rates. At December 31, 2007, the Company had short-term borrowings and long-term debt of $6.3 billion. For more information on the Company's interest rate exposure, see "Item 7A. Quantitative and Qualitative Disclosures About Market Risk." The Company is also exposed to other economic factors over which the Company has no control.

The Company may experience difficulties and delays in the manufacturing and sale of its products.

The Company may experience difficulties and delays inherent in manufacturing and sale, such as (i) seizure or recalls of pharmaceutical products or forced closings of manufacturing plants; (ii) the failure to obtain, the imposition of limitations on the use of, or loss of patent and other intellectual property rights; (iii) failure of the Company or any of its vendors or suppliers to comply with Current Good Manufacturing Practices and other application regulations and quality assurance guidelines that could lead to temporary manufacturing shutdowns, product shortages and delays in product manufacturing; (iv) construction delays related to the construction of new facilities or the expansion of existing facilities, including those intended to support future demand for the Company's biologics products; and (v) other manufacturing or distribution problems including changes in manufacturing production sites and limits to manufacturing capacity due to regulatory requirements, changes in types of products produced, such as biologics, or physical limitations that could impact continuous supply.

The Company may experience difficulties or delays in the development and commercialization of new products.

The Company may experience difficulties and delays in the development and commercialization of new products, including the inherent risks and uncertainties associated with product development, such as (i) compounds or products that may appear promising in development but fail to reach market within the expected or optimal timeframe, or fail ever to reach market, or to be approved for additional indications for any number of reasons, including efficacy or safety concerns, the delay or denial of necessary regulatory approvals and the difficulty or excessive cost to manufacture; (ii) failure to enter into or successfully implement optimal alliances where appropriate for the discovery and/or commercialization of products, or otherwise to maintain a consistent scope and variety of promising late-stage products; (iii) failure of one or more of the Company's products to achieve or maintain commercial viability.

There are legal matters in which adverse outcomes could negatively affect the Company's business.

The Company is currently involved in various lawsuits, claims, proceedings and government investigations, any of which can preclude or delay commercialization of products or adversely affect operations, profitability, liquidity or financial condition, including (i) intellectual property disputes; (ii) sales and marketing practices in the U.S. and internationally; (iii) adverse decisions in litigation, including product liability and commercial cases; (iv) recalls or withdrawals of pharmaceutical products or forced closings of manufacturing plants; (v) the failure to fulfill obligations under supply contracts with the government and other customers which may result in liability; (vi) product pricing and promotion matters; (vii) lawsuits and claims asserting violations of securities, antitrust, federal and state pricing and other laws; (viii) environmental, health and safety matters; and (ix) tax liabilities. There can be no assurance that there will not be an increase in scope of these matters or there will not be additional lawsuits, claims, proceedings or investigations in the future; nor is there any assurance that these matters will not have a material adverse impact on the Company.

U.S. and foreign regulations may negatively affect the Company's sales and profit margins.

The Company could become subject to new government laws and regulations, such as (i) health care reform initiatives in the U.S. at the state and Federal level and in other countries; (ii) changes in the U.S. Food and Drug Administration (FDA) and foreign regulatory approval processes that may cause delays in approving, or preventing the approval of, new products; (iii) tax changes such as the phasing out of tax benefits heretofore available in the U.S. and certain foreign countries; (iv) new laws, regulations and judicial or other governmental decisions affecting pricing or marketing within or across jurisdictions; (v) changes in intellectual property law; and (vi) other matters such as compulsory licenses that could alter the protections afforded one or more of its products.

The Company faces increased pricing pressure in the U.S. and abroad from managed care organizations, institutional purchasers, and government agencies and programs that could negatively affect the Company's sales and profit margins.

Pharmaceutical products are subject to increasing price pressures and other restrictions in the U.S. and worldwide, including (i) rules and practices of managed care groups and institutional and governmental purchasers, (ii) judicial decisions and governmental laws and regulations related to Medicare, Medicaid and healthcare reform, including the Medicare Prescription Drug, Improvement, and Modernization Act of 2003, (iii) the potential impact of importation restrictions, legislative and/or regulatory changes, pharmaceutical reimbursement, Medicare Part D Formularies and product pricing in general, and (iv) other developments in technology and/or industry practices that could directly or indirectly impact the reimbursement policies and practices of third-party payers.

The Company relies on third parties to meet their contractual, regulatory, and other obligations.

The Company relies on vendors, partners, including alliances with other pharmaceutical companies for the development and commercialization of products, and other third parties to meet their contractual, regulatory, and other obligations in relation to their arrangements with the Company. The failure of these parties to meet their obligations, and/or the development of significant disagreements or other factors that materially disrupt the ongoing commercial relationship and prevent optimal alignment between the partners and their activities, could have a material adverse impact on the Company.

Failure to execute the Company's business strategy could adversely impact its growth and profitability.

As part of its strategy, the Company currently is implementing a comprehensive cost reduction program that includes workforce reductions in some areas and the rationalization of some facilities. The Company expects to incur restructuring and other charges in connection with this program in the range of $0.9 billion to $1.1 billion on a pre-tax basis over the next three years, with $292 million of those charges having been incurred in the fourth quarter of 2007 and approximately $500 million in charges expected to be incurred in 2008.

The Company may not be able to fully execute the strategic transformation of its business to attain a new period of sustainable revenue and earnings growth. The Company continues to invest in its key products and pipeline as part of a focus on addressing areas of significant unmet medical need. Failure to realize the expected cost savings in 2008, to achieve and maintain a competitive cost base, or to successfully transition the product portfolio, however, could materially and adversely affect the Company's results of operations. In addition, the Company's failure to hire and retain personnel with the right expertise and experience in operations that are critical to its business functions could adversely impact the execution of its business strategy. Changes in the Company's structure, operations, revenues, costs, or efficiency resulting from acquisitions, divestitures, mergers, alliances, restructurings or other strategic initiatives, could result in greater than expected costs and other difficulties, including the need for regulatory approvals, as appropriate.

The Company is increasingly dependent on its information technology and outsourcing arrangements.

The Company is increasingly dependent on information technology systems and any significant breakdown, invasion, destruction or interruption of these systems could negatively impact operations. The Company is also increasing its dependence on third-party providers for certain services, including information technology systems. The failure of these service providers to meet their obligations and/or the development of significant disagreements or other factors that materially disrupt the Company's ongoing relationship with these providers could negatively affect operations.

Item 1B. UNRESOLVED STAFF COMMENTS.

None.

Item 2. PROPERTIES.

The Company's world headquarters is located at 345 Park Avenue, New York, NY, where it leases approximately 375,000 square feet of floor space, approximately 215,000 square feet of which is sublet to others.

The Company manufactures products at 36 major worldwide locations with an aggregate floor space of approximately 11.7 million square feet. All facilities are owned by the Company. The following table illustrates the geographic location of the Company's significant manufacturing facilities by business segment.

	Total Company	Pharmaceuticals	Nutritionals	ConvaTec
United States	8	5	2	1
Europe, Middle East and Africa	14	11	1	2
Other Western Hemisphere	7	5	1	1
Pacific	7	4	3	—
Total	36	25	7	4

Portions of these facilities and other facilities owned or leased by the Company in the U.S. and elsewhere are used for research, administration, storage and distribution. For further information about the Company's facilities, see "Item 1. Business—Manufacturing and Quality Assurance."

Item 3. LEGAL PROCEEDINGS.

Information pertaining to legal proceedings can be found in "Item 8. Financial Statements—Note 22. Legal Proceedings and Contingencies" and is incorporated by reference herein.

Item 4. SUBMISSION OF MATTERS TO A VOTE OF SECURITY HOLDERS.

No matters were submitted to a vote of security holders during the fourth quarter of the year ended December 31, 2007.

Executive Officers of the Registrant

Listed below is information on executive officers of the Company as of February 21, 2008. Executive officers are elected by the Board of Directors for an initial term, which continues until the first Board meeting following the next annual meeting of stockholders and thereafter are elected for a one-year term or until their successors have been elected. All executive officers serve at the pleasure of the Board of Directors.

Name and Current Position	Age	Employment History for the Past 5 Years
James M. Cornelius *Chairman of the Board and Chief Executive Officer* *Member of the Management Council*	64	2000 to 2005 – Chief Executive Officer and Chairman of the Board, Guidant Corporation. 2005 to 2006 – Interim Chief Executive Officer and Chairman of the Board, Guidant Corporation. 2006 to 2007 –Interim Chief Executive Officer and Director of the Company. 2007 to 2008 – Chief Executive Officer and Director of the Company 2008 to present – Chairman of the Board and Chief Executive Officer of the Company.
Lamberto Andreotti *Executive Vice President and President, Worldwide Pharmaceuticals* *Member of the Management Council*	57	2002 to 2005 – Senior Vice President and President International, Worldwide Medicines Group, a division of the Company. 2005 to present – Executive Vice President and President, Worldwide Pharmaceuticals, a division of the Company.
Stephen E. Bear *Senior Vice President, Human Resources, Corporate Staff* *Member of the Management Council*	57	2001 to present – Senior Vice President, Human Resources, Corporate Staff of the Company.
Andrew R. J. Bonfield *Executive Vice President and Chief Financial Officer, Corporate Staff* *Member of the Management Council*	45	2002 to present – Chief Financial Officer, Corporate Staff of the Company.
Joseph C. Caldarella *Vice President and Corporate Controller, Corporate Staff*	52	1998 to 2005 – Vice President, Finance, Pharmaceutical Research Institute, a division of the Company. 2005 to present – Vice President and Corporate Controller, Corporate Staff of the Company.
John E. Celentano *President, Health Care Group* *Member of the Management Council*	48	2002 to 2005 – President, Latin America and Canada, Worldwide Medicines Group, a division of the Company. 2005 to present – President, Health Care Group, a division of the Company.
Anthony C. Hooper *President, U.S. Pharmaceuticals* *Member of the Management Council*	53	2002 to 2004 – President, Europe, Middle East & Africa, Worldwide Medicines Group, a division of the Company. 2004 to present – President, U.S. Pharmaceuticals, Worldwide Medicines Group, a division of the Company.
Sandra Leung *Senior Vice President and General Counsel Corporate Staff* *Member of the Management Council*	47	2002 to 2006 – Vice President and Corporate Secretary, Corporate Staff of the Company. 2006 to 2007 – Vice President, Corporate Secretary and Acting General Counsel, Corporate Staff of the Company. 2007 to present – Senior Vice President and General Counsel, Corporate Staff of the Company.

Elliott Sigal, M.D., Ph.D. *Executive Vice President, Chief Scientific Officer and President, Pharmaceutical Research and Development* *Member of the Management Council*	56	2002 to 2004 – Senior Vice President, Global Clinical and Pharmaceutical Development, Pharmaceutical Research Institute, a division of the Company. 2004 to present – Chief Scientific Officer and President, Pharmaceutical Research and Development, a division of the Company.
Robert T. Zito *Senior Vice President, Corporate and Business Communications and Chief Communications Officer* *Member of the Management Council*	54	1999 to 2004 – Executive Vice President, Communications, New York Stock Exchange. 2004 to present – Senior Vice President, Corporate Affairs, Corporate Staff of the Company.

PART II

Item 5. MARKET FOR THE REGISTRANT'S COMMON STOCK AND OTHER STOCKHOLDER MATTERS.

Market Prices

Bristol-Myers Squibb common and preferred stocks are traded on the New York Stock Exchange (NYSE) and were traded on the NYSE Arca, Inc, formerly the Pacific Exchange, Inc. (symbols: BMY; BMYPR). On December 1, 2006, the Company voluntarily withdrew its securities from listing on the NYSE Arca, Inc. A quarterly summary of the high and low market prices is presented below:

Common:

	2007		2006	
	High	Low	High	Low
First Quarter	$29.39	$25.73	$25.95	$21.21
Second Quarter	32.25	27.00	25.97	23.21
Third Quarter	32.35	26.38	26.14	20.08
Fourth Quarter	30.35	26.52	26.41	23.93

Preferred:

	2007		2006	
	High	Low	High	Low
First Quarter	$600.00	$460.00	$360.00	$355.00
Second Quarter	500.00	500.00	*	*
Third Quarter	503.00	475.00	420.00	318.00
Fourth Quarter	475.37	450.00	430.00	400.00

* During the second quarter of 2006, there were no trades of the Company's preferred stock. The preferred stock pays a quarterly dividend of $.50 per share.

Holders of Common Stock

The number of record holders of common stock at December 31, 2007 was 69,254.

The number of record holders is based upon the actual number of holders registered on the books of the Company at such date and does not include holders of shares in "street names" or persons, partnerships, associations, corporations or other entities identified in security position listings maintained by depository trust companies.

Voting Securities and Principal Holders

Reference is made to the 2008 Proxy Statement to be filed on or about March 21, 2008 with respect to voting securities and principal holders, which is incorporated herein by reference and made a part hereof in response to the information required by this Item 5.

Dividends

The Board of Directors of the Company declared the following dividends per share, which were paid in 2007 and 2006 in the quarters indicated below:

	Common		Preferred	
	2007	2006	2007	2006
First Quarter	$ .28	$ .28	$ .50	$ .50
Second Quarter	.28	.28	.50	.50
Third Quarter	.28	.28	.50	.50
Fourth Quarter	.28	.28	.50	.50
	$1.12	$1.12	$2.00	$2.00

In December 2007, the Board of Directors of the Company declared a quarterly dividend of $.31 per share on the common stock of the Company and of $.50 per share on the preferred stock of the Company, which was paid on February 1, 2008 to shareholders of record as of January 4, 2008.

Unregistered Sales of Equity Securities and Use of Proceeds

The following table summarizes the surrenders of the Company's equity securities in connection with stock option and restricted stock programs during the 12-month period ended December 31, 2007:

Period Dollars in Millions, except per share data	Total Number of Shares Purchased(a)	Average Price Paid per Share(a)	Total Number of Shares Purchased as Part of Publicly Announced Plans or Programs(b)	Approximate Dollar Value of Shares that May Yet Be Purchased Under the Plans or Programs(b)
January 1 to 31, 2007	11,191	$ 26.10	—	$2,220
February 1 to 28, 2007	8,819	$ 28.13	—	$2,220
March 1 to 31, 2007	290,683	$ 26.91	—	$2,220
Three months ended March 31, 2007	310,693			
April 1 to 30, 2007	11,307	$ 27.33	—	$2,220
May 1 to 31, 2007	203,148	$ 30.16	—	$2,220
June 1 to 30, 2007	7,448	$ 30.91	—	$2,220
Three months ended June 30, 2007	221,903			
July 1 to 31, 2007	28,362	$ 31.56	—	$2,220
August 1 to 31, 2007	6,956	$ 29.42	—	$2,220
September 1 to 30, 2007	31,477	$ 28.27	—	$2,220
Three months ended September 30, 2007	66,795			
October 1 to 31, 2007	26,955	$ 29.02	—	$2,220
November 1 to 30, 2007	12,955	$ 29.01	—	$2,220
December 1 to 31, 2007	4,242	$ 29.38	—	$2,220
Three months ended December 31, 2007	44,152			
Twelve months ended December 31, 2007	643,543		—	

(a) Reflects the following transactions during the 12 months ended December 31, 2007: (i) the surrender to the Company of 166,630 shares of Common Stock to pay the exercise price and to satisfy tax withholding obligations in connection with the exercise of employee stock options, and (ii) the surrender to the Company of 476,913 shares of Common Stock to satisfy tax withholding obligations in connection with the vesting of restricted stock issued to employees.

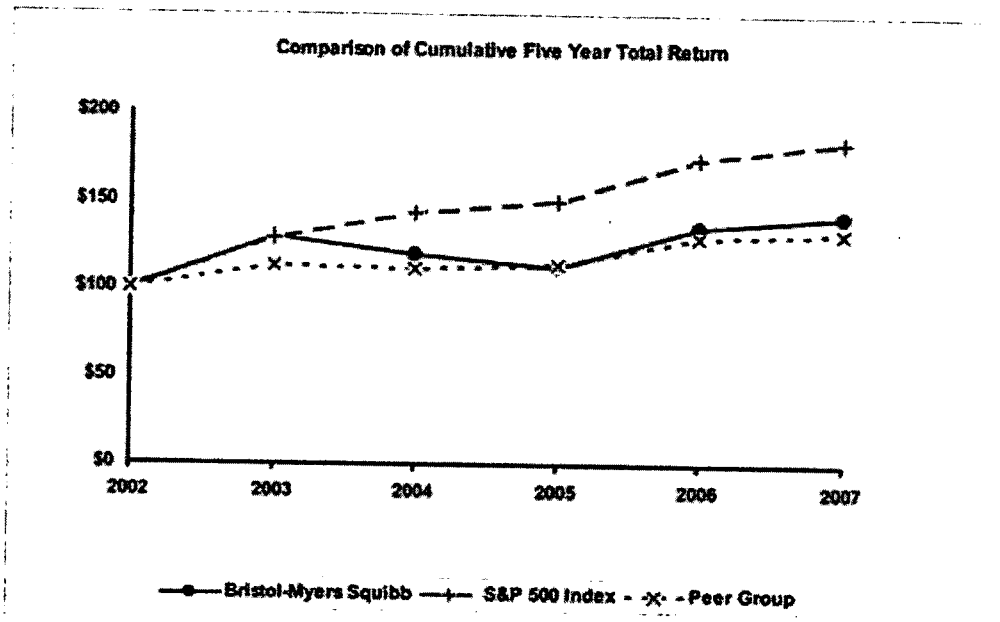
(b) In June 2001, the Company announced that the Board of Directors authorized the purchase of up to $14 billion of Company common stock. During the 12 months ended December 31, 2007, no shares were repurchased pursuant to this program and no purchases of any shares under this program are expected in 2008.

Performance Graph

The following performance graph compares the performance of Bristol–Myers Squibb for the periods indicated with the performance of the Standard & Poor's 500 Stock Index (S&P 500) and the average performance of a group consisting of our peer corporations on a line–of–business basis. The corporations making up our peer companies group are Abbott Laboratories, AstraZeneca PLC, Eli Lilly and Company, GlaxoSmithKline plc, Johnson & Johnson, Merck & Co., Inc., Novartis AG, Pfizer, Inc., Sanofi–Aventis (including the performance of Aventis prior to its merger with Sanofi), Schering–Plough Corporation and Wyeth.

Total return indices reflect reinvested dividends and are weighted using beginning–period market capitalization for each of the reported time periods. We measured our performance against this same group in the 2007 Proxy Statement.

Comparison of Five–Year Cumulative Total Return



	12/31/02	12/31/03	12/31/04	12/31/05	12/31/06	12/31/07
Bristol–Myers Squibb	$ 100	$ 129	$ 120	$ 112	$ 135	$ 141
S&P 500 Index	$ 100	$ 129	$ 143	$ 150	$ 173	$ 183
Peer Group	$ 100	$ 113	$ 111	$ 114	$ 129	$ 131

Assumes $100 invested on 12/31/02 in Bristol–Myers Squibb Common Stock, S&P 500 Index and Peer Companies Group Index. Values are as of December 31 of specified year assuming dividends are reinvested.

Item 6. SELECTED FINANCIAL DATA.

Five-Year Financial Summary

Amounts in Millions, except per share data	2007	2006	2005	2004	2003
Income Statement Data:[1][2]					
Net Sales	$19,348	$17,256	$18,605	$18,791	$18,145
Earning from Continuing Operations Before Minority Interest and Income Taxes	3,534	2,400	4,304	4,210	4,529
Net Earnings from Continuing Operations	1,968	1,422	2,842	2,213	2,978
Net Earnings from Continuing Operations per Common Share:					
Basic	$ 1.00	$ 0.73	$ 1.45	$ 1.14	$ 1.54
Diluted[3]	$ 0.99	$ 0.73	$ 1.44	$ 1.12	$ 1.53
Average common shares outstanding:					
Basic	1,970	1,960	1,952	1,942	1,937
Diluted[3]	1,980	1,963	1,983	1,976	1,950
Dividends paid on common and preferred stock	$ 2,213	$ 2,199	$ 2,186	$ 2,174	$ 2,169
Dividends declared per Common Share	$ 1.15	$ 1.12	$ 1.12	$ 1.12	$ 1.12
Financial Position Data at December 31:					
Total Assets[4][5]	$26,172	$25,575	$28,138	$30,435	$27,448
Cash and cash equivalents	1,801	2,018	3,050	3,680	2,549
Marketable securities	424	1,995	2,749	3,794	3,013
Long-term debt	4,381	7,248	8,364	8,463	8,522
Stockholders' Equity	10,562	9,991	11,208	10,202	9,786

(1) The Company recorded items that affected the comparability of results. For a discussion of these items for the years 2007, 2006 and 2005, see "Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations—Expenses;" "Item 8. Financial Statements—Note 2. Alliances and Investments;" "—Note 3. Restructuring;" "—Note 4. Acquisitions and Divestitures;" "—Note 5. Discontinued Operations and Assets Held for Sale;" "—Note 9. Cash, Cash Equivalents and Marketable Securities;" "—Note 15. Short-Term Borrowings and Long-Term Debt;" and "—Note 22. Legal Proceedings and Contingencies."

(2) Excludes discontinued operations of Medical Imaging for years 2003 through 2007 and Oncology Therapeutics Network for years 2003 through 2005.

(3) In 2007 and 2006, the 29 million weighted-average shares issuable, as well as $38 million and $35 million, respectively, 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 anti-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 "Item 8. Financial Statements—Note 21. Pension and Other Postretirement Benefits."

(5) In 2007, includes Medical Imaging and other assets classified as held for sale.

Item 7. 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 global biopharmaceutical 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 ConvaTec. The Pharmaceuticals segment consists of the global pharmaceutical/biotechnology and international consumer medicines business, which accounted for approximately 81% of the Company's 2007 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 2007 net sales. The ConvaTec segment consists of ostomy, wound and skin care business, which accounted for approximately 6% of the Company's 2007 net sales and was previously included in the Other Health Care operating segment. In January 2008, the Company completed the sale of its Medical Imaging business to Avista Capital Partners L.P. (Avista). The results of the Medical Imaging business, previously included in the former Other Health Care operating segment, are presented as part of the Company's results from discontinued operations.

2007 Financial Highlights

Worldwide net sales from continuing operations for 2007 increased 12% to $19.3 billion compared to 2006. PLAVIX* (clopidogrel bisulfate) sales grew 46%, primarily reflecting the adverse impact of generic competition from August 2006 to mid-2007, as well as strong underlying sales growth. The other key products within the Company's Pharmaceuticals segment, including AVAPRO*/AVALIDE* (irbesartan/irbesartan-hydrochlorothiazide), REYATAZ (atazanavir sulfate), the SUSTIVA (efavirenz) Franchise and ABILIFY* (aripiprazole) experienced double digit sales growth for the year. Sales of the Company's newer specialty and biologics medicines BARACLUDE (entecavir), ORENCIA (abatacept) and SPRYCEL (dasatinib) continue to be strong. In addition, the Company launched IXEMPRA (ixabepilone) for the treatment of metastatic or locally advanced breast cancer. Overall worldwide sales growth, however, was moderated by a significant decline in PRAVACHOL (pravastatin sodium) sales due to generic competition.

Net earnings from continuing operations were $2.0 billion in 2007 compared with $1.4 billion in 2006. The 2007 results include a $230 million charge for acquired in-process research and development related to the purchase of Adnexus Therapeutics, Inc. (Adnexus), a $292 million charge in connection with the Company's three-year Productivity Transformation Initiative (PTI) and a $275 million impairment charge of the Company's investment in certain auction rate securities (ARS). 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. Additionally, the Company also recorded gains on sale of product assets and properties of $273 million and $200 million in 2007 and 2006, respectively.

In December 2007, the Company announced that the Board of Directors (the Board) declared an 11 percent dividend increase, the first increase since 2002. The dividend increase will result in a quarterly dividend of thirty-one cents ($.31) per share on the Company's Common Stock for an indicative dividend for the full year of 2008 of $1.24 per share, subject to the normal quarterly review by the Board.

Business Environment

The Company conducts its business primarily within the pharmaceutical/biotechnology 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 competition of new products that competitors may introduce in the future. 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/biotechnology 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. Currently, generic versions of biological products cannot be approved under U.S. law. However, the law could change in the future. Even in the absence of new legislation, the U.S. Food and Drug Administration (FDA) is taking steps toward allowing generic versions of certain biologics. Competitors seeking approval of biological 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.

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, the Medicare Prescription Drug Improvement and Modernization Act provides outpatient prescription drug coverage to senior citizens in the U.S. This legislation has had a modest favorable impact on the Company, as a result of an increase in the number of seniors with drug coverage. There continues to be a potential negative impact on the U.S. pharmaceutical business that could result from 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 and more than two years can elapse after drug approval before new medicines become available in some national markets.

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/biotechnology 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 to make substantial investments to increase its internal capacity to produce biologics on a commercial scale. One such investment is the building of a new state-of-the-art manufacturing facility for the production of biologics in Devens, Massachusetts, the construction of which began in May 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 need. Recently, several of the Company's competitors have announced cost reduction programs in an effort to reduce their respective cost bases and increase their productivity and competitiveness. The Company has also announced a three-year PTI to reduce costs, streamline operations and rationalize global manufacturing as part of its efforts to become a more productive and competitive biopharmaceutical company.

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. For additional discussion of legal matters, see "Item 8. Financial Statements—Note 22. Legal Proceedings and Contingencies."

Strategy

In December 2007, the Company outlined its multi-year strategy designed to transform the Company into a next-generation biopharmaceutical company. The strategy encompasses all aspects and all geographies of the business and will yield substantial cost savings and cost avoidance and increase the Company's financial flexibility to take advantage of attractive market opportunities that may arise.

As the Company develops into a next-generation biopharmaceutical company, it will continue to invest in key growth products, including specialty and biologic medicines, and cardiovascular and metabolic drugs. The Company continues to execute its ongoing strategy for long-term growth through the scale back of assets in its profitable, though declining, mature brands and increased focus

on key and new growth products, which include PLAVIX*, ABILIFY*, AVAPRO*/AVALIDE*, REYATAZ, the SUSTIVA Franchise, ERBITUX* (cetuximab), ORENCIA, BARACLUDE, SPRYCEL and IXEMPRA. The Company experienced the last of a series of major anticipated exclusivity losses in 2006 and does not expect any significant new exclusivity losses for the next several years.

In order to support the production of specialty products in the pharmaceutical portfolio, including biologics, the Company completed a land purchase in 2007 of an 89-acre site to locate its new large-scale, expandable multi-project bulk biologics manufacturing facility in Devens, Massachusetts. The Company has committed $750 million to fund the construction of the facility which began in May 2007. The facility is projected to be operationally complete in 2009, and the Company plans to submit the site for regulatory approval in 2010. Commercial production of biologic compounds is anticipated to begin in 2011. In addition, the Company expanded its Manati, Puerto Rico facility, with the expansion targeted for start-up in 2008.

The new state-of-the-art facility, as well as the expanded Manati, Puerto Rico facility, will support the filling and finishing of the Company's sterile products and biologic compounds, including ORENCIA, the Company's first internally discovered and developed biologic medicine, and commercial quantities of compounds currently in development should those compounds receive regulatory approval.

In keeping with its strategy, the Company invested $3.3 billion in research and development, representing a 10% growth rate over 2006. Research and development dedicated to pharmaceutical products, including milestone payments for in-licensing and development programs, was $3.1 billion compared to $2.8 billion in 2006.

Consistent with the Company's objective to maximize the value of its non-pharmaceutical businesses, in January 2008, the Company completed the sale of its Medical Imaging business to Avista. The Company will continue to seek opportunities to maximize the value of its remaining Health Care Group businesses.

As it transitions into a next-generation biopharmaceutical company, the Company seeks to reallocate resources to enable strategic acquisitions, such as the acquisition of Adnexus in October 2007, as well as pursue partnerships and other collaborative arrangements, such as the worldwide alliance with AstraZeneca PLC (AstraZeneca) to discover, develop and commercialize saxagliptin and dapagliflozin and the two separate agreements with Pfizer Inc. (Pfizer) for the research, development and commercialization of a Pfizer discovery program and for the development and commercialization of apixaban.

Productivity Transformation Initiative

The Company undertook a broad range of actions in the fourth quarter of 2007 as part of the previously announced three-year PTI, which is reducing costs, streamlining operations and rationalizing global manufacturing. The initiative, which is on track to achieve $1.5 billion in annual cost savings and cost avoidance on a pre-tax basis by 2010, is central to the Company's strategy to become a more nimble and flexible next generation biopharmaceutical enterprise.

Key productivity initiatives include reducing general and administrative operations by simplifying, standardizing and outsourcing, where appropriate, processes and services, rationalizing the Company's mature brands portfolio, consolidating its global manufacturing network while eliminating complexity and enhancing profitability, simplifying its geographic footprint and implementing a more efficient go-to-market model. Specific productivity goals include reducing the number of brands in the Company's mature products portfolio by 60 percent between 2007 and 2011, reducing the number of manufacturing facilities by more than 50 percent by the end of 2010, and reducing total headcount by approximately 10 percent between 2007 and 2010. Some positions have been eliminated in 2007, although the substantial majority of positions will be eliminated in 2008 and 2009. Among the many productivity activities across the entire organization in the fourth quarter of 2007 are the impending closure of several manufacturing facilities, including Mayaguez, Puerto Rico and Barceloneta, Puerto Rico.

Costs associated with the implementation of the PTI are estimated to be between $0.9 billion to $1.1 billion on a pre-tax basis, with $292 million incurred in 2007 and approximately $500 million expected to be incurred in 2008. The ultimate timing of the recording of the charges cannot be predicted with certainty and will be affected by the occurrence of triggering events for expense recognition under U.S. Generally Accepted Accounting Principles (GAAP), among other factors.

New Product and Pipeline Developments

In December 2007, the Company and Medarex, Inc. (Medarex) announced top-line data from the three registrational trials (008, 022, 007) that constitute the monotherapy program for ipilimumab in patients with metastatic melanoma. The results from study 008, conducted under Special Protocol Assessment, did not meet the primary endpoint, which was to rule out a best objective response rate of less than 10 percent. However, the totality of data from the registrational program included a clear dose response effect observed in study 022 and best objective response rates across the three studies ranging from mid-single digits to mid-teens as determined by independent radiology review. After the receipt of additional data from ongoing clinical trials, the companies plan to meet with the FDA to discuss the regulatory pathway, with the goal of submitting a regulatory filing by the middle of 2008, if supported by the data.

In November 2007, the Company and Pierre Fabre Medicament S.A. (Pierre Fabre) announced the termination of the license agreement for the development of vinflunine, a chemotherapy agent under investigation for the treatment of advanced or metastatic bladder cancer and other tumor types.

In November 2007, ABILIFY* was approved by the FDA as adjunctive, or add-on, treatment to antidepressant therapy in adults with major depressive disorder (MDD). ABILIFY* is the first medication approved by the FDA as add-on treatment for MDD. The FDA also approved ABILIFY* for the treatment of schizophrenia in adolescent patients (ages 13-17) and accepted for Priority Review the supplemental New Drug Application (sNDA) for the treatment of pediatric patients (ages 10-17) with Bipolar I Disorder.

An update to the SPRYCEL label to include a lower recommended starting dose of 100 mg once daily, from 70 mg twice daily, as a starting dose for patients with chronic-phase chronic myeloid leukemia resistant or intolerant to imatinib was approved by the FDA in November 2007 and by the European Commission in August 2007. During the first quarter of 2007, SPRYCEL received approval and/or reimbursement in additional European markets, including Ireland, Norway, Sweden and Greece, and was also approved in Canada and New Zealand.

In October 2007, ATRIPLA* (efavirenz 600 mg/emtricitabine 200 mg/tenofovir disoproxil fumarate 300 mg) was approved in Canada as the first once-daily single-tablet regimen for the treatment of human immunodeficiency virus-1 infection in adults. In December 2007, the European Commission granted marketing authorization for ATRIPLA*, formally approving it for commercialization in the 27 countries of the European Union (EU), as well as in Norway and Iceland. ATRIPLA* has been launched in the UK, Germany and Austria.

In October 2007, the Company launched IXEMPRA, for the treatment of patients with metastatic or locally advanced breast cancer, in the U.S. In addition, the Japanese New Drug Application for ixabepilone was submitted in December 2007, and the Marketing Authorization Application for ixabepilone is under review by the European Medicines Evaluation Agency (EMEA), following submission in September 2007.

In October 2007, the Company acquired privately-held Adnexus, developer of a new therapeutic class of biologics called ADNECTINS. ADNECTINS are a proprietary class of targeted biologics based on a naturally occurring protein found in human serum.

In October 2007, the Company and ImClone Systems Incorporated (ImClone) announced that the FDA approved an update to the ERBITUX* product labeling to include overall survival data as a single agent in epidermal growth factor inhibitor (EGFR)-expressing metastatic colorectal cancer (mCRC) patients after the failure of both irinotecan- and oxaliplatin-based regiments. In September, the Company and ImClone announced that a Phase III study of ERBITUX* in combination with platinum-based chemotherapy, conducted by Merck KGaA, met its primary endpoint of increasing overall survival compared with chemotherapy alone in patients with advanced non-small cell lung cancer. As previously disclosed, an earlier study conducted by ImClone and the Company evaluating the use of ERBITUX* in combination with a different platinum-based therapy did not meet its primary endpoint of increasing progression-free survival in patients with advanced non-small cell lung cancer. Key secondary endpoints of this study, however, were statistically significant and favored the ERBITUX*-containing arm.

In September 2007, the FDA approved a sNDA for a single 300 mg tablet of PLAVIX*. The 300 mg loading dose has been proven effective in a broad acute coronary syndrome patient population. The 300 mg tablet of clopidogrel bisulfate was launched in the U.S. in December 2007 and is currently under EMEA review.

In August 2007, the Company and Pfizer finalized the collaborative agreement for the research, development and commercialization of a Pfizer discovery program which includes advanced pre-clinical compounds with potential applications for the treatment of metabolic disorders, including obesity and diabetes. The Company recorded an upfront charge of $60 million in accordance with the terms of the agreement. Pfizer will be responsible for all research and early-stage development activities for the metabolic disorders program, and the companies will jointly conduct Phase III development and commercialization activities. The companies will share all development and commercialization expenses along with profits/losses on a 60%-40% basis, with Pfizer assuming the larger share of both expenses and profits/losses.

In August 2007, the FDA accepted, for filing and review, the supplemental Biologics License Application for ORENCIA for the treatment of pediatric patients with juvenile idiopathic arthritis. ORENCIA was approved by the European Commission in May 2007, and has received approval and/or reimbursement in several European markets, including the UK, Germany, Austria, Sweden, the Netherlands and Denmark. In April 2007, the FDA approved an update to the ORENCIA product labeling regarding the progression of structural joint damage – an important measure in the treatment of rheumatoid arthritis (RA). The indication was strengthened from "slowing" to "inhibiting" the progression of structural damage in adult patients with moderately to severely active RA who have had an inadequate response to one or more disease–modifying anti–rheumatic drugs, such as methotrexate or tumor necrosis factor antagonists.

In July 2007, the Company and ImClone amended the terms of their agreement for the codevelopment and copromotion of ERBITUX* in North America. Under this amendment, the companies have jointly agreed to expand the investment in the ongoing clinical development plan for ERBITUX*. Development costs, up to a threshold value, will be the sole responsibility of the Company; costs in excess of this threshold will be shared by both companies according to a pre–determined ratio. With this additional funding, the companies intend to further explore the use of ERBITUX* in additional tumor types including brain, breast, bladder, gastric, lung, pancreas and prostate.

In May 2007, the Company and Isis Pharmaceuticals, Inc. (Isis) entered into a collaborative agreement to discover, develop and commercialize novel antisense drugs targeting proprotein convertase subtilisin kexin 9 for the prevention and treatment of cardiovascular disease. The Company made an upfront payment of $15 million to Isis as part of this agreement and will provide Isis with at least $9 million in research funding over a period of three years.

In April 2007, the Company and Pfizer entered into a worldwide collaboration to develop and commercialize apixaban, an anticoagulant discovered by the Company being studied for the prevention and treatment of a broad range of venous and arterial thrombotic conditions. In accordance with the terms of the agreement, Pfizer made upfront payments of $250 million and $40 million to the Company in May 2007 and December 2007, respectively. Pfizer will fund 60% of all development costs effective January 1, 2007 going forward, and the Company will fund 40%. The Company may also receive additional payments of up to $780 million from Pfizer based on development and regulatory milestones. The companies will jointly develop the clinical and marketing strategy of apixaban, and will share commercialization expenses and profits/losses equally on a global basis.

In February 2007, BARACLUDE was added to the American Association for the Study of Liver Disease treatment guidelines for hepatitis B as a first–line treatment option. BARACLUDE also received approval and/or reimbursement in additional European markets, including Italy, throughout the first quarter of 2007.

In January 2007, the Company entered into two worldwide (except for Japan) codevelopment and cocommercialization agreements with 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. In July 2007, the companies decided to move the investigational compound dapagliflozin, a selective inhibitor of the sodium–glucose transporter 2 being studied for the treatment of diabetes, into Phase III testing based on results of Phase II clinical trials.

In December 2006, the Company entered into a collaboration agreement with Exelixis Pharmaceuticals, Inc. (Exelixis) to discover, develop and commercialize novel targeted therapies for the treatment of cancer. The agreement became effective in January 2007 and in accordance with the terms of the agreement, the Company made an upfront payment of $60 million to Exelixis. In January 2008, the Company exercised an option to develop and commercialize compounds targeting one therapeutic target and paid Exelixis $20 million in February 2008. Exelixis is also eligible to receive $20 million for each of up to two additional investigational drug candidates selected by the Company. At the option of Exelixis, the companies will share equally all development costs along with commercial profits in the U.S.; otherwise, the Company will be responsible for development and will pay development milestones and royalties to Exelixis.

RESULTS OF OPERATIONS

The following discussions of the Company's results of continuing operations exclude the results related to the Medical Imaging business, which was previously presented as a component of the former Other Health Care operating segment prior to its divestiture in January 2008, and the Oncology Therapeutics Network (OTN) business, which was previously presented as a separate operating segment prior to its divestiture in 2005. These businesses 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	2007	2006	2005	% Change 2007 vs. 2006	% Change 2006 vs. 2005
Net Sales	$19,348	$17,256	$18,605	12%	(7)%
Earnings from Continuing Operations Before Minority Interest and Income Taxes	$ 3,534	$ 2,400	$ 4,304	47%	(44)%
% of net sales	*18.3%*	*13.9%*	*23.1%*		
Provision for Income Taxes	$ 803	$ 538	$ 870	49%	(38)%
Effective tax rate	*22.7%*	*22.4%*	*20.2%*		
Net Earnings from Continuing Operations	$ 1,968	$ 1,422	$ 2,842	38%	(50)%
% of net sales	*10.2%*	*8.2%*	*15.3%*		

Net Sales

Net sales from continuing operations for 2007 increased 12% to $19.3 billion, including a 3% favorable foreign exchange impact, compared to 2006. U.S. net sales in 2007 increased 18% to $10.8 billion compared to 2006. International net sales in 2007 increased 5% to $8.5 billion compared to 2006, including a 7% favorable foreign exchange impact.

In 2006, net sales from continuing operations decreased 7% to $17.3 billion, compared to 2005. U.S. net sales in 2006 decreased 8% to $9.2 billion compared to 2005, while international net sales decreased 7% to $8.1 billion in 2006 as compared to 2005.

The composition of the change in net sales were as follows:

		Analysis of % Change		
	Total Change	Volume	Price	Foreign Exchange
2007 vs. 2006	12%	7%	2%	3%
2006 vs. 2005	(7)%	(9)%	2%	—

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 key pharmaceutical products and new products sold by the U.S. Pharmaceuticals business.

The Company operates in three reportable segments—Pharmaceuticals, Nutritionals and ConvaTec (previously a component of the Other Health Care operating segment). In January 2008, the Company completed the sale to Avista of the Medical Imaging business, which was previously presented as a component of the Other Health Care operating segment. In May 2005, the Company completed the sale of OTN, which was previously presented as a separate operating segment. As such, the results of operations for Medical Imaging and 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, Medical Imaging and 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	
	2007	2006	2005	2007 vs. 2006	2006 vs. 2005
Pharmaceuticals	$15,622	$13,861	$15,408	13%	(10)%
% of net sales	*81%*	*80%*	*83%*		
Nutritionals	2,571	2,347	2,205	10%	6%
% of net sales	*13%*	*14%*	*12%*		
ConvaTec	1,155	1,048	992	10%	6%
% of net sales	*6%*	*6%*	*5%*		
Health Care Group	3,726	3,395	3,197	10%	6%
Total	$19,348	$17,256	$18,605	12%	(7)%

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,		
	2007	2006	2005
Gross Sales	$22,175	$20,120	$22,389
Gross-to-Net Sales Adjustments			
Prime Vendor Charge-Backs	(662)	(703)	(1,090)
Women, Infants and Children (WIC) Rebates	(848)	(872)	(843)
Managed Health Care Rebates and Other Contract Discounts	(387)	(322)	(502)
Medicaid Rebates	(169)	(174)	(595)
Cash Discounts	(251)	(224)	(271)
Sales Returns	(160)	(230)	(164)
Other Adjustments	(350)	(339)	(319)
Total Gross-to-Net Sales Adjustments	(2,827)	(2,864)	(3,784)
Net Sales	$19,348	$17,256	$18,605

The slight decrease in gross-to-net sales adjustments in 2007 compared to 2006 was affected by a number of factors. Sales returns decreased primarily due to higher accruals in 2006 for Cardiovascular non-exclusive brands and from the discontinued commercialization of TEQUIN (gatifloxacin). The decrease in prime vendor charge-backs was primarily due to lower sales of TAXOL® (paclitaxel) as a result of loss of exclusivity. This was partially offset by increases in managed health care rebates and other contract discounts, primarily as a result of higher PLAVIX* sales and the reversal of reserves in 2006 related to the TRICARE Retail Pharmacy Refund Program, partially offset by lower sales of PRAVACHOL due to loss of exclusivity. Additionally, the increase in cash discounts was primarily due to higher PLAVIX* sales volumes.

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. 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 lower sales of PRAVACHOL due to loss of exclusivity and lower PLAVIX* sales volumes. The increase in sales returns was primarily due to higher returns trends for non-exclusive brands as well as from the discontinued commercialization of TEQUIN.

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, 2006	$ 107	$ 252	$ 167	$ 326	$ 26	$ 185	$ 124	$ 1,187
Provision related to sales made in current period	706	867	355	174	221	200	348	2,871
Provision related to sales made in prior periods	(3)	5	(33)	—	3	30	(9)	(7)
Returns and payments	(747)	(894)	(380)	(363)	(232)	(196)	(343)	(3,155)
Impact of foreign currency translation	—	—	1	—	—	2	4	7
Discontinued operations	—	—	1	—	—	—	—	1
Balance at December 31, 2006	63	230	111	137	18	221	124	904
Provision related to sales made in current period	662	845	394	176	250	142	352	2,821
Provision related to sales made in prior periods	—	3	(7)	(7)	1	18	(2)	6
Returns and payments	(655)	(880)	(360)	(181)	(245)	(207)	(356)	(2,884)
Impact of foreign currency translation	—	—	6	—	—	4	10	20
Discontinued operations	—	—	(10)	—	—	—	—	(10)
Balance at December 31, 2007	$ 70	$ 198	$ 134	$ 125	$ 24	$ 178	$ 128	$ 857

In 2007, the Company recorded gross-to-net sales adjustments related to sales made in prior periods. The significant items included charges for sales returns of $18 million primarily related to higher than expected returns for certain non-exclusive products.

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.

No other significant revisions were made to the estimates for gross-to-net sales adjustments in 2007 and 2006.

Pharmaceuticals

The composition of the change in pharmaceutical sales were as follows:

		Analysis of % Change		
	Total Change	Volume	Price	Foreign Exchange
2007 vs. 2006	13%	8%	2%	3%
2006 vs. 2005	(10)%	(12)%	2%	—

In 2007, Worldwide Pharmaceuticals sales increased 13% to $15,622 million, including a 3% favorable foreign exchange impact, compared to the same period in 2006. U.S. Pharmaceuticals sales increased 21% to $8,992 million from $7,417 million in 2006, primarily due to increased PLAVIX* sales reflecting the adverse impact of generic competition from August 2006 to mid–2007, as well as strong underlying sales growth. The sales growth was also attributed to increased sales of ABILIFY*, the SUSTIVA Franchise, REYATAZ, AVAPRO*/AVALIDE* and ERBITUX*, and sales of newer products SPRYCEL, ORENCIA, BARACLUDE and IXEMPRA. The increase was partially offset by increased generic competition for PRAVACHOL. International Pharmaceuticals sales increased 3%, including a 6% favorable foreign exchange impact, to $6,630 million in 2007 from $6,444 million in 2006. Excluding the impact of foreign exchange, the decrease in sales was primarily due to increased generic competition for PRAVACHOL and TAXOL® (paclitaxel), partially offset by sales growth of ABILIFY*, REYATAZ, PLAVIX* and AVAPRO*/AVALIDE* and newer products BARACLUDE and SPRYCEL.

In 2006, Worldwide Pharmaceuticals sales decreased 10% to $13,861 million. U.S. Pharmaceuticals sales decreased 11% to $7,417 million from $8,338 million in 2005, primarily due to lower sales of PLAVIX* resulting from the launch of generic clopidogrel bisulfate in August 2006 and loss of exclusivity of PRAVACHOL, partially offset by continued growth of ABILIFY*, ERBITUX*, REYATAZ, the SUSTIVA Franchise and AVAPRO*/AVALIDE* and sales of newer products including ORENCIA,

BARACLUDE and SPRYCEL. International Pharmaceuticals sales decreased 9% to $6,444 million in 2006 from $7,070 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.

Key pharmaceutical products and their sales, representing 80%, 75% and 71% of total pharmaceutical sales in 2007, 2006 and 2005, respectively, were as follows:

Dollars in Millions	2007	2006	2005	% Change 2007 vs. 2006	% Change 2006 vs. 2005
Cardiovascular					
PLAVIX*	$4,755	$3,257	$3,823	46%	(15)%
AVAPRO*/AVALIDE*	1,204	1,097	982	10%	12%
PRAVACHOL	443	1,197	2,256	(63)%	(47)%
COUMADIN	201	220	212	(9)%	4%
Virology					
REYATAZ	1,124	931	696	21%	34%
SUSTIVA Franchise (total revenue)	956	791	680	21%	16%
BARACLUDE	275	83	12	**	**
Oncology					
ERBITUX*	692	652	413	6%	58%
TAXOL® (paclitaxel)	422	563	747	(25)%	(25)%
SPRYCEL	158	25	—	**	—
IXEMPRA	15	—	—	—	—
Affective (Psychiatric) Disorders					
ABILIFY* (total revenue)	1,660	1,282	912	29%	41%
Immunoscience					
ORENCIA	231	89	—	160%	—
Other Pharmaceuticals					
EFFERALGAN	308	266	283	16%	(6)%

** Change is in excess of 200%.

- Sales of PLAVIX*, a platelet aggregation inhibitor that is part of the Company's alliance with Sanofi, increased 46%, including a 1% favorable foreign exchange impact, to $4,755 million in 2007 from $3,257 million in 2006. U.S. sales increased 53% to $4,060 million in 2007 from $2,655 million in 2006. The Company estimates the adverse effect of generic clopidogrel bisulfate, launched in August 2006, to be in the range of $1.2 billion to $1.4 billion for 2006. For 2007, the Company estimates the negative impact of generic clopidogrel bisulfate to be in the range of $250 million to $350 million, as inventory of generic clopidogrel bisulfate in the distribution channels was substantially depleted by June 30, 2007. Estimated total U.S. prescription demand for clopidogrel bisulfate (branded and generic) increased approximately 8% in 2007 compared to 2006, while estimated total U.S. prescription demand for branded PLAVIX* increased 34% in the same period. In 2006, sales decreased 15% to $3,257 million from $3,823 million in 2005. U.S. sales decreased 18% to $2,655 million in 2006 from $3,235 million in 2005. 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. Data exclusivity for PLAVIX* expires in July 2008 in the EU, and the key composition of matter patent expires in 2013 in the majority of the EU member countries. For additional information on the PLAVIX* litigations see "Item 8. Financial Statements—Note 22. Legal Proceedings and Contingencies."
- Sales of AVAPRO*/AVALIDE*, an angiotensin II receptor blocker for the treatment of hypertension that is also part of the Sanofi alliance, increased 10%, including a 3% favorable foreign exchange impact, to $1,204 million in 2007 from $1,097 million in 2006. U.S. sales increased 7% to $692 million in 2007 from $647 million in 2006, primarily due to higher average net selling prices. Estimated total U.S. prescription demand decreased approximately 4% in 2007 compared to 2006. International sales increased 14%, including an 8% favorable foreign exchange impact, to $512 million from $450 million in 2006. In 2006, sales increased 12%, including a 1% favorable foreign exchange impact, to $1,097 million from $982 million in 2005. U.S. sales increased 13% to $647 million in 2006 from $574 million in 2005, while international sales increased 10%, including a 2% favorable foreign exchange impact, to $450 million from $408 million in 2005. 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 2012–2013 in most countries in the EU; the Company does not, but others do, market AVAPRO*/AVALIDE* in Japan.
- Sales of PRAVACHOL, an HMG Co–A reductase inhibitor, decreased 63%, including a 2% favorable foreign exchange impact, to $443 million in 2007 from $1,197 million in 2006, due to increased generic competition in the U.S. and key European markets. Estimated total U.S. prescription demand decreased approximately 82% in 2007 compared to 2006. In 2006, sales decreased 47%

to $1,197 million from $2,256 million in 2005, due to market exclusivity expiration in April 2006 resulting in generic competition for most strengths in the U.S. and generic competition in key European markets. Market exclusivity in the EU ended in 2004, with the exception of Sweden, where expiration occurred in March 2006; Italy, where expiration occurred 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 Pharmaceutical to distribute pravastatin sodium tablets in the U.S.

- Sales of COUMADIN, an oral anticoagulant used predominantly in patients with atrial fibrillation or deep venous thrombosis/pulmonary embolism, decreased 9%, including a 1% favorable foreign exchange impact, to $201 million in 2007 from $220 million in 2006, primarily due to lower demand driven by continued competition, partially offset by higher average net selling prices. Estimated total U.S. prescription demand decreased approximately 16% in 2007 compared to 2006. In 2006, sales increased 4% to $220 million from $212 million in 2005, primarily due to higher average net selling prices, partially offset by lower demand driven by continued competition. Market exclusivity for COUMADIN expired in the U.S. in 1997.

- Sales of REYATAZ, a protease inhibitor for the treatment of HIV, increased 21%, including a 4% favorable foreign exchange impact, to $1,124 million in 2007 from $931 million in 2006, primarily due to increased demand in the majority of the markets. U.S. sales increased 14% to $587 million in 2007 from $514 million in 2006, primarily due to higher demand. Estimated total U.S. prescription demand increased approximately 13% in 2007 compared to 2006. International sales increased 29%, including an 8% favorable foreign exchange impact, to $537 million in 2007 from $417 million in 2006. In 2006, sales increased 34% to $931 million from $696 million in 2005, primarily due to increased demand in the U.S., Europe and Latin America. Market exclusivity for REYATAZ is expected to expire in 2017 in the U.S., in countries in the EU and Japan. Data exclusivity in the EU expires in 2014.

- Total revenue for the SUSTIVA Franchise, a non-nucleoside reverse transcriptase inhibitor for the treatment of HIV, increased 21%, including a 4% favorable foreign exchange impact, to $956 million in 2007 from $791 million in 2006. U.S. sales increased 22% to $604 million from $495 million in 2006 primarily due to higher demand, resulting from the successful launch of ATRIPLA* in July 2006. Estimated total U.S. prescription demand for the SUSTIVA Franchise increased approximately 20% in 2007 compared to 2006. International sales increased 19%, including a 10% favorable foreign exchange impact, to $352 million from $296 million in 2006, primarily due to higher demand across all markets. In July 2006, the Company and Gilead Sciences, Inc. (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 joint venture with Gilead to third-party customers. In 2006, sales increased 16% to $791 million from $680 million in 2005 due to higher demand and the launch of ATRIPLA* in the third quarter of 2006. 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 "Item 8. Financial Statements—Note 2. Alliances and Investments."

- Sales of BARACLUDE, an oral antiviral agent for the treatment of chronic hepatitis B, increased to $275 million in 2007 from $83 million in 2006 due to continued growth across all markets, including the U.S., China, Japan and Korea. In 2006, sales increased to $83 million from $12 million in 2005. BARACLUDE was launched in the U.S. in April 2005, China in February 2006, 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 2015, in the EU between 2011 and 2016 and in Japan in 2016. As previously disclosed, there is uncertainty about China's exclusivity laws, and due to this uncertainty, it is possible that one or more companies in China could receive marketing authorization from China's health authority by 2010.

- Sales of ERBITUX*, which is sold by the Company almost exclusively in the U.S., increased 6% to $692 million in 2007 from $652 million in 2006, primarily due to increased demand for usage in the treatment of head and neck cancer and a transition to a broader distribution model. In 2006, sales increased 58% to $652 million from $413 million in 2005. 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 biological 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 biological 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 District court granted Yeda the complete ownership of that patent. Pursuant to a settlement agreement executed by ImClone, Sanofi and Yeda announced in December 2007 to end worldwide litigation related to the use patent. The settlement agreement does not change ImClone's worldwide royalty rate for ERBITUX* sales. Under its commercial agreement with ImClone, the Company pays a royalty to ImClone on sales of ERBITUX* that is not impacted by the settlement agreement. For further information pertaining to legal proceedings involving ERBITUX*, see "Item 8. Financial Statements—Note 22. Legal Proceedings and Contingencies," and "—Note 2. Alliances and Investments."

- Sales of TAXOL® (paclitaxel), an anti-cancer agent sold almost exclusively in the non-U.S. markets, decreased 25%, including a 1% favorable foreign exchange impact, to $422 million in 2007 from $563 million in 2006, primarily due to increased generic competition in Europe and Japan. In 2006, sales decreased 25%, including a 2% unfavorable foreign exchange impact, to $563 million from $747 million in 2005, primarily due to increased generic competition in Europe and generic entry in Japan during the third quarter of 2006. 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 both have entered the market.

- Sales of 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), increased to $158 million in 2007 from $25 million in 2006. SPRYCEL was launched in the U.S. in July 2006 and in certain European markets beginning in the fourth quarter of 2006. Market exclusivity for SPRYCEL is expected to expire in 2020 in the U.S. In several EU countries, the patent is pending and, if granted, would expire in 2020.

- Sales of IXEMPRA, a microtubule inhibitor for the treatment of patients with metastatic or locally advanced breast cancer, were $15 million in 2007. IXEMPRA was launched in the U.S. in October 2007. The Company has a composition of matter patent in the U.S and a corresponding patent in EU countries, both expiring in 2018. The Company has submitted its request for patent term extension for the composition of matter patent in the U.S., which could possibly extent the term of that patent. The corresponding patent in EU countries may be eligible for patent term restoration, which could possibly extend the term of the patent in EU countries.

- Total revenue for ABILIFY*, an antipsychotic agent for the treatment of schizophrenia, acute bipolar mania and bipolar disorder, increased 29%, including a 2% favorable foreign exchange impact, to $1,660 million in 2007 from $1,282 million in 2006. U.S. sales increased 24% to $1,305 million in 2007 from $1,052 million in 2006, primarily due to higher demand and higher average net selling prices. Estimated total U.S. prescription demand increased approximately 12% in 2007 compared to 2006. In 2006, sales increased 41% to $1,282 million from $912 million in 2005, primarily due to higher demand and higher average net selling prices. 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 Pharmaceutical Co., Ltd. (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). For information on patent litigations relating to ABILIFY*, see "Item 8. Financial Statements—Note 22. Legal Proceedings and Contingencies." 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 "Item 8. Financial Statements—Note 2. Alliances and Investments."

- Sales of ORENCIA, a fusion protein indicated for adult patients with moderate to severe RA who have had an inadequate response to one or more currently available treatments, such as methotrexate or anti-tumor necrosis factor therapy, increased 160%, including a 1% favorable foreign exchange impact, to $231 million in 2007 from $89 million in 2006, primarily due to demand. Substantially all sales of ORENCIA are currently in the U.S., where it was launched in February 2006. ORENCIA was launched in Europe in May 2007. The Company has submitted its request for patent term extension for one of the composition of matter patents that expires in 2015, which could possibly extend the term of the patent. As noted above, generic versions of biological products cannot be approved under U.S. law, but the law could change in the future.

- Sales of EFFERALGAN (paracetamol), a formulation of acetaminophen for pain relief sold principally in Europe, increased 16%, including a 9% favorable foreign exchange impact, to $308 million in 2007 from $266 million in 2006, primarily due to a severe 2007 flu season. In 2006, sales decreased 6% to $266 million from $283 million in 2005, primarily due to a change in government reimbursement.

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.

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 data is based on the Next-Generation Prescription Service (NGPS) version 2.0 provided by IMS Health (IMS), a supplier of market research for the pharmaceutical industry, as described below.

The Company has calculated the estimated total U.S. prescription change based on NGPS version 2.0 data on a weighted-average basis to reflect the fact that mail order prescriptions include a greater volume of product supplied compared to retail prescriptions. Mail order prescriptions typically reflect a 90-day prescription whereas retail prescriptions typically reflect a 30-day prescription. The calculation is derived by multiplying NGPS mail order prescription data by a factor that approximates three and adding to this the NGPS retail prescriptions. The Company believes that this calculation of the estimated total U.S. prescription change based on the weighted-average approach with respect to the retail and mail order channels provides a superior estimate of total prescription demand. The Company uses this methodology for its internal demand forecasts.

Estimated End-User Demand

The following tables set forth for each of the Company's key pharmaceutical products sold by the U.S. Pharmaceuticals business, for the years ended December 31, 2007, 2006 and 2005: (i) total U.S. net sales for the period; (ii) change in reported U.S. net sales for the period; (iii) estimated total U.S. prescription change for the retail and mail order channels calculated by the Company based on NGPS version 2.0 on a weighted-average basis and (iv) months of inventory on hand in the distribution channel. Prior year prescription data were adjusted to conform to the NGPS 2.0 version data.

	Year Ended December 31, 2007			As of December 31, 2007
Dollars in Millions	Total U.S. Net Sales	% Change in U.S. Net Sales[a]	% Change in U.S. Total Prescriptions [b]	Months on Hand
PLAVIX*	$ 4,060	53	34	0.5
AVAPRO*/AVALIDE*	692	7	(4)	0.5
PRAVACHOL	139	(75)	(82)	0.7
COUMADIN	164	(12)	(16)	0.8
REYATAZ	587	14	13	0.6
SUSTIVA Franchise [c] (total revenue)	604	22	20	0.6
BARACLUDE [d]	88	76	77	0.6
ERBITUX* [e]	683	6	N/A	0.5
SPRYCEL [f]	58	164	**	0.9
IXEMPRA [e, g]	15	—	N/A	0.9
ABILIFY* (total revenue) [f, h]	1,305	24	12	0.5
ORENCIA	216	145	N/A	0.5

	Year Ended December 31, 2006			As of December 31, 2006
Dollars in Millions	Total U.S. Net Sales	% Change in U.S. Net Sales [a]	% Change in U.S. Total Prescriptions [b]	Months on Hand
PLAVIX*	$ 2,655	(18)	(21)	0.6
AVAPRO*/AVALIDE*	647	13	2	0.5
PRAVACHOL	553	(57)	(59)	0.6
COUMADIN	186	2	(22)	0.8
REYATAZ	514	27	14	0.7
SUSTIVA Franchise [c] (total revenue)	495	23	9	0.7
BARACLUDE [d]	50	**	**	0.7
ERBITUX* [e]	646	57	N/A	0.4
SPRYCEL [f]	22	—	—	1.4
IXEMPRA [e, g]	—	—	N/A	—
ABILIFY* (total revenue) [f, h]	1,052	40	21	0.5
ORENCIA	88	—	N/A	0.4

Dollars in Millions	Year Ended December 31, 2005 Total U.S. Net Sales	% Change in U.S. Net Sales (a)	% Change in U.S. Total Prescriptions (b)	As of December 31, 2005 Months on Hand
PLAVIX*	$ 3,235	14	14	0.6
AVAPRO*/AVALIDE*	574	2	10	0.6
PRAVACHOL	1,274	(10)	(17)	0.6
COUMADIN	183	(20)	(20)	0.8
REYATAZ	405	33	42	0.5
SUSTIVA Franchise (c) (total revenue)	403	11	7	0.6
BARACLUDE (d)	11	—	—	0.7
ERBITUX* (e)	411	58	N/A	—
SPRYCEL (f)	—	—	—	—
IXEMPRA (e, g)	—	—	N/A	—
ABILIFY* (total revenue) (h)	750	35	42	0.6
ORENCIA	—	—	N/A	—

(a) Reflects percentage change in net sales in dollar terms, including change in average selling prices and wholesaler buying patterns.
(b) Derived by multiplying NGPS mail order prescription data by a factor that approximates three and adding to this the NGPS retail prescriptions.
(c) 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 change in U.S. total prescriptions growth for the SUSTIVA Franchise includes both branded SUSTIVA and ATRIPLA* prescription units.
(d) BARACLUDE was launched in the U.S. in April 2005.
(e) ERBITUX*, ORENCIA and IXEMPRA are parenterally administered products and do not have prescription-level data as physicians do not write prescriptions for these products.
(f) SPRYCEL was launched in the U.S. in July 2006.
(g) IXEMPRA was launched in the U.S. in October 2007.
(h) ORENCIA was launched in the U.S. in February 2006.
** Change is in excess of 200%.

The estimated prescription change data reported throughout this Annual Report on Form 10-K 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 recordkeeping processes and are themselves estimates based on IMS' sampling procedures, subject to the inherent limitations of estimates based on sampling and a margin of error.

The Company continuously seeks to improve the quality of its estimates of prescription change amounts 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.

Pursuant to the U.S. Securities and Exchange Commission (SEC) Consent Order described below under "—SEC Consent Order", the Company monitors the level of inventory on hand in the U.S. wholesaler distribution channel and, outside of the U.S., in the direct customer distribution channel. The Company is obligated to disclose products with levels of inventory in excess of one month on hand or expected demand, subject to a de minimis exception. The following products had estimated levels of inventory in the distribution channel in excess of one month on hand as of (1) in the case of the Company's U.S. Pharmaceuticals products, December 31, 2007 and (2) in the case of the Company's International Pharmaceuticals, Nutritionals and ConvaTec products, December 31, 2007 and/or September 30, 2007.

At December 31, 2007, KENALOG had approximately 1.1 months of inventory on hand in the U.S. wholesaler distribution channel. The estimated value of KENALOG inventory in the U.S. wholesaler distribution channel over one month on hand was approximately $0.3 million at December 31, 2007. The increased level of inventory on hand at December 31, 2007 was due to the volatile demand for the product in the fourth quarter of 2007 as a result of a temporary product supply shortage. The Company expects to work down wholesaler inventory levels to one month on hand or less in the first quarter of 2008.

As of December 31, 2007, DAFALGAN, an analgesic product sold principally in Europe, had approximately 1.2 months of inventory on hand at direct customers compared to approximately 1.1 months of inventory on hand at September 30, 2007. The increased 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 December 31, 2007, MONOPRIL, a cardiovascular product, had approximately 1.1 months of inventory on hand at direct customers compared to 1.2 months of inventory on hand at September 30, 2007. The increased level of inventory on hand as of December 31, 2007 was due primarily to initial stocking of a new, exclusive distributor in Poland and stocking in support of the launch of MONOPRIL in Poland in 2007.

As of December 31, 2007, VIDEX/VIDEX EC, an antiviral product, had approximately 1.3 months of inventory on hand at direct customers compared to 1.4 months of inventory on hand at September 30, 2007. 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.

As of December 31, 2007, the Ostomy business had approximately 1.1 months of inventory on hand at direct customers, compared to 0.9 months of inventory on hand at September 30, 2007. The increased level of inventory was due primarily to increased purchases by a significant wholesaler in anticipation of a price increase.

In the U.S., for all products sold exclusively through wholesalers or through distributors, the Company determines its months on hand estimates using information with respect to inventory levels of product on hand and the amount of out–movement of products provided by the Company's three largest wholesalers, which accounted for approximately 90% of total gross sales of U.S. Pharmaceuticals products in 2007, and provided by the Company's distributors. 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.

For pharmaceutical products in the U.S. that are not sold exclusively through wholesalers or distributors and for the Company's Pharmaceuticals business outside of the U.S., Nutritionals and ConvaTec 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. 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. 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. 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.

HEALTH CARE GROUP

The Health Care Group consists of the Nutritionals and the ConvaTec operating segments. The Nutritionals operating segment consists of Mead Johnson Nutritionals, primarily an infant formula and children's nutritionals business. The ConvaTec operating segment consists of the ostomy, wound and skin care business. The following discussions exclude sales related to the Medical Imaging business, a discontinued operation, which was previously included as a component of the former Other Health Care segment.

The combined 2007 revenues from the Health Care Group increased 10% to $3,726 million from 2006. The combined 2006 revenues from the Health Care Group increased 6% to $3,395 million from $3,197 million in 2005.

Nutritionals

The composition of the change in Nutritionals sales were as follows:

	Total Change	Analysis of % Change Volume	Price	Foreign Exchange
2007 vs. 2006	10%	3%	4%	3%
2006 vs. 2005	6%	2%	3%	1%

Key Nutritionals product lines and their sales, representing 96%, 96% and 95% of total Nutritional sales in 2007, 2006 and 2005, respectively, were as follows:

Dollars in Millions	2007	2006	2005	% Change 2007 vs. 2006	2006 vs. 2005
Infant Formulas	$1,786	$1,637	$1,576	9%	4%
ENFAMIL	1,082	1,007	992	7%	2%
Toddler/Children's Nutritionals	693	606	529	14%	15%
ENFAGROW	295	262	206	13%	27%

Worldwide Nutritionals sales increased 10%, including a 3% favorable foreign exchange impact, to $2,571 million in 2007 from 2006. In 2006, Worldwide Nutritionals sales were $2,347 million, an increase of 6%, including a 1% favorable foreign exchange impact, from $2,205 million in 2005.

International Nutritionals sales increased 15%, including a 6% favorable foreign exchange impact, to $1,443 million in 2007 from 2006, primarily due to increased sales of toddler and children's nutritional products and ENFAMIL, the Company's best selling infant formula. In 2006, international Nutritionals sales increased 11%, including a 3% favorable foreign exchange impact, to $1,256 million from $1,135 million in 2005, primarily due to increased sales of children's nutritional products.

U.S. Nutritionals sales were $1,128 million, $1,091 million and $1,070 million in 2007, 2006 and 2005, respectively. The 3% increase in sales in 2007 and the 2% increase in sales in 2006 were primarily due to increased sales for ENFAMIL.

ConvaTec

The composition of the change in ConvaTec sales was as follows:

	Total Change	Analysis of % Change Volume	Price	Foreign Exchange
2007 vs. 2006	10%	6%	(1)%	5%
2006 vs. 2005	6%	5%	—	1%

ConvaTec sales by business and key products sales for the years ended December 31 were as follows:

Dollars in Millions	2007	2006	2005	% Change 2007 vs. 2006	2006 vs. 2005
ConvaTec	$1,155	$1,048	$992	10%	6%
Ostomy	594	554	550	7%	1%
Wound Therapeutics	488	441	416	11%	6%

Worldwide ConvaTec sales increased 10%, including a 5% favorable foreign exchange impact, to $1,155 million in 2007 from 2006. Ostomy sales increased 7% to $594 million in 2007, including a 6% favorable foreign exchange impact. Sales of wound therapeutic products increased 11%, including a 6% favorable foreign exchange impact, to $488 million in 2007 from 2006, primarily due to continued growth of the AQUACEL Franchise. In 2006, Worldwide ConvaTec sales increased 6%, including a 1% favorable foreign exchange impact, to $1,048 million from $992 million in 2005, primarily due to sales of Flexi-Seal and AQUACEL.

International ConvaTec sales increased 11%, including a 8% favorable foreign exchange impact, to $784 million in 2007 from 2006, primarily due to continued growth of AQUACEL. In 2006, international ConvaTec sales increased 4%, including a 1% favorable foreign exchange impact, to $705 million from 2005, primarily due to growth of AQUACEL.

U.S. ConvaTec sales increased 8% to $371 million in 2007 from 2006, primarily due to Flexi-Seal and continued growth of the AQUACEL brand. In 2006, U.S. ConvaTec sales increased 10% to $343 million from 2005, primarily due to Flexi-Seal and continued growth of the AQUACEL brand.

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, Canada, Spain, Japan, Italy, Mexico and Germany. The Company's sales by geographic areas were as follows:

Dollars in Millions	2007	2006	2005	% Change 2007 vs. 2006	% Change 2006 vs. 2005
United States	$10,808	$ 9,140	$ 9,924	18%	(8)%
% of Total	*56%*	*53%*	*53%*		
Europe, Middle East and Africa	4,635	4,518	5,111	3%	(12)%
% of Total	*24%*	*26%*	*28%*		
Other Western Hemisphere	1,704	1,580	1,561	8%	1%
% of Total	*9%*	*9%*	*8%*		
Pacific	2,201	2,018	2,009	9%	—
% of Total	*11%*	*12%*	*11%*		
Total	$19,348	$17,256	$18,605	12%	(7)%

Sales in the U.S. increased 18% in 2007, primarily due to increased PLAVIX* sales, the continued growth of ABILIFY*, the SUSTIVA Franchise, ERBITUX*, AVAPRO*/AVALIDE* and REYATAZ, as well as sales of newer products, BARACLUDE, ORENCIA and SPRYCEL, partially offset by increased generic competition for PRAVACHOL. In 2006, sales in the U.S. decreased 8%, primarily as a result of lower sales of PLAVIX* and the loss of exclusivity of PRAVACHOL in April 2006, partially offset by growth of the remaining pharmaceutical products, including recently launched products.

Sales in Europe, Middle East and Africa increased 3%, including an 8% favorable foreign exchange impact. Excluding the impact of foreign exchange, the decrease in sales was primarily due to increased generic competition for PRAVACHOL and TAXOL® (paclitaxel), partially offset by sales growth in major European markets for SPRYCEL, REYATAZ, the SUSTIVA Franchise and ABILIFY*. In 2006, sales decreased 12% as a result of sales decline of PRAVACHOL and TAXOL® (paclitaxel) due to increased generic competition. This decrease in sales was partially offset by increased sales in major European markets of REYATAZ and AVAPRO*/AVALIDE*.

Sales in the Other Western Hemisphere countries increased 8%, including a 4% favorable foreign exchange impact, primarily due to increased sales of PLAVIX* in Canada and Mexico, and key nutritional products and AVAPRO*/AVALIDE* in Canada, partially offset by the discontinued commercialization of TEQUIN. In 2006, sales increased 1%, including a 3% favorable foreign exchange impact. Excluding the impact of foreign exchange, the decrease in sales was primarily due to decreased sales of TEQUIN and other pharmaceutical products, partially offset by increased sales of AVAPRO*/AVALIDE* in Canada and key nutritional products.

Sales in the Pacific region increased 9%, including a 5% favorable foreign exchange impact, primarily due to increased sales of BARACLUDE in China, Japan and Korea and key nutritional products, partially offset by decreased sales of TAXOL® (paclitaxel) and PRAVACHOL due to increased generic competition. In 2006, sales remained consistent compared to 2005.

Expenses

Dollars in Millions	2007	2006	2005	% Change 2007 vs. 2006	% Change 2006 vs. 2005
Cost of products sold	$ 6,218	$ 5,739	$ 5,737	8%	—
% of Net Sales	*32.1%*	*33.3%*	*30.8%*		
Marketing, selling and administrative	$ 4,855	$ 4,800	$ 4,989	1%	(4)%
% of Net Sales	*25.1%*	*27.8%*	*26.8%*		
Advertising and product promotion	$ 1,465	$ 1,340	$ 1,464	9%	(8)%
% of Net Sales	*7.6%*	*7.8%*	*7.9%*		
Research and development	$ 3,282	$ 2,991	$ 2,678	10%	12%
% of Net Sales	*17.0%*	*17.3%*	*14.4%*		
Acquired in-process research and development	$ 230	$ —	$ —	—	—
% of Net Sales	*1.2%*	—	—		
Provision for restructuring, net	$ 183	$ 59	$ 32	**	84%
% of Net Sales	*0.9%*	*0.3%*	*0.2%*		
Litigation expense, net	$ 14	$ 302	$ 269	(95)%	12%
% of Net Sales	*0.1%*	*1.8%*	*1.5%*		
Gain on sale of product assets and businesses	$ (273)	$ (200)	$ (569)	(37)%	65%
% of Net Sales	*(1.4)%*	*(1.2)%*	*(3.1)%*		
Equity in net income of affiliates	$ (524)	$ (474)	$ (334)	(11)%	(42)%
% of Net Sales	*(2.7)%*	*(2.7)%*	*(1.8)%*		
Other expense, net	$ 364	$ 299	$ 35	22%	**
% of Net Sales	*1.8%*	*1.7%*	*0.2%*		
Total Expenses, net	$15,814	$14,856	$14,301	6%	4%
% of Net Sales	*81.7%*	*86.1%*	*76.9%*		

** Change is in excess of 200%.

- Cost of products sold, as a percentage of sales, decreased to 32.1% in 2007 compared to 2006. The margin improvement was primarily due to sales growth of higher margin products, including increased sales of PLAVIX*. In 2006 and 2005, cost of products sold, as a percentage of sales, was 33.3% and 30.8%, respectively. 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.

- Marketing, selling and administrative expenses increased 1% to $4,855 million as compared to 2006, primarily due to an unfavorable impact of foreign exchange and higher marketing expenses, partially offset by lower sales force expenses. In 2006, marketing, selling and administrative expenses decreased 4% to $4,800 million from $4,989 million in 2005, primarily due to above-mentioned reclassification, 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. Marketing, selling and administrative expenses as a percentage of sales were 25.1%, compared with 27.8%, which included a 0.5% decrease from the reclassification, and 26.8% in 2006 and 2005, respectively.

- Advertising and product promotion expenditures increased 9% to $1,465 million as compared to 2006, primarily driven by increased spending for direct-to-customer advertising for PLAVIX*, ABILIFY* and ORENCIA, investments to support the launch of IXEMPRA, higher spending on newer products in Europe and an unfavorable impact of foreign exchange in 2007. In 2006, advertising and product promotion expenditures decreased 8% to $1,340 million compared to $1,464 million in 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.

- The Company's investment in research and development was $3,282 million in 2007, an increase of 10% over 2006. In 2006, the investment in research and development was $2,991 million, which represented a 12% increase over $2,678 million in 2005. The increases in both 2007 and 2006 reflect the Company's strategy with continued investments in late-stage compounds and developing a pipeline in disease areas that address significant unmet medical need. The 2007 increase was partially offset by sharing of codevelopment costs with alliance partners AstraZeneca and Pfizer. Research and development costs also included

charges of $162 million in 2007 for upfront and milestone payments to Exelixis, Pfizer, Adnexus and Isis. Research and development costs also included charges of $85 million and $72 million in 2006 and 2005, respectively, consisting primarily of upfront and milestone payments to Exelixis and Solvay Global in 2006 and Medarex and Pierre Fabre in 2005. Research and development spending dedicated to pharmaceutical products was 20.0% of pharmaceutical sales in 2007, compared to 20.2% and 16.5% in 2006 and 2005, respectively.

- Acquired in-process research and development charge of $230 million in 2007 was in connection with the purchase of Adnexus in the fourth quarter of 2007. For additional information on the acquisition, see "Item 8. Financial Statements—Note 4. Acquisitions and Divestitures."
- Restructuring programs in 2007, including those under the PTI, which began in late 2007, as well as those in 2006 and 2005, 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. The PTI is expected to generate approximately $1.5 billion in cost reductions and cost avoidance by 2010. For additional information on restructuring, see "Item 8. Financial Statements—Note 3. Restructuring" and for additional information on the PTI, see "—Productivity Transformation Initiative" above.
- Litigation expense, net of settlement income and insurance recoveries, was $14 million in 2007, $302 million in 2006 and $269 million in 2005. The $14 million expense in 2007 was related to reserves recorded for the proposed settlement of certain pharmaceutical pricing and sales litigations. The $302 million net expense 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 expense 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. For additional information on litigation, see "Item 8. Financial Statements—Note 22. Legal Proceedings and Contingencies."
- The gain on sale of product assets of $273 million ($161 million net of tax) in 2007 was for the sale of the BUFFERIN* and EXCEDRIN* brands in Japan, as well as certain assets related to dermatology products. The gain on sale of product assets of $200 million ($130 million net of tax) in 2006 was for the sale of inventory, 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. For additional information on these transactions, see "Item 8. Financial Statements—Note 4. Acquisitions and Divestitures."
- Equity in net income of affiliates for 2007 was $524 million, compared with $474 million and $334 million in 2006 and 2005, respectively. Equity in net income of affiliates is principally related to the Company's joint venture with Sanofi and investment in ImClone. In 2007, the $50 million increase in equity in net income of affiliates was primarily due to increased net income in the Sanofi joint venture, partially offset by decreased net income from the equity 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. For additional information on equity in net income of affiliates, see "Item 8. Financial Statements—Note 2. Alliances and Investments."
- Other expense, net, was $364 million, $299 million and $35 million in 2007, 2006 and 2005, 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, impairment of marketable securities, gains and losses on disposal of property, plant and equipment, gains and losses on sale of marketable securities, insurance recoveries, deferred income recognized and certain other litigation matters. The $65 million increase in other expense, net in 2007 from 2006 was primarily due to an impairment charge of $275 million on the Company's investment in ARS and net unfavorability in foreign exchange in 2007, partially offset by lower net interest expense in 2007 and debt retirement costs incurred in 2006. The $264 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 $143 million of non-recurring income in 2005 resulting from the termination of the muraglitazar collaborative agreement, partially offset by lower net foreign exchange losses. For additional information, see "Item 8. Financial Statements—Note 7. Other Expense, Net", "—Note 9. Cash, Cash Equivalents and Marketable Securities" and "—Note 15. Short-Term Borrowing and Long-Term Debt."

Stock-based compensation expense recognized under SFAS No. 123 (revised 2004), *Share-Based Payment* (SFAS No. 123(R)) for the years ended December 31, 2007 and 2006 was $133 million and $112 million, respectively. These expenses 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 year ended December 31, 2005 was $31 million. These expenses were recorded in marketing, selling and administrative expenses.

During the years ended December 31, 2007, 2006 and 2005, the Company recorded several expense/(income) items that affected the comparability of results of the periods presented herein, which are set forth in the following table. For a discussion of these items, see "Item 8. Financial Statements—Note 2. Alliances and Investments;" "—Note 3. Restructuring and Other Items;" "—Note 4. Acquisitions and Divestitures;" "—Note 8. Income Taxes;" "—Note 9. Cash, Cash Equivalents and Marketable Securities;" "—Note 15. Short-Term Borrowings and Long-Term Debt;" and "—Note 22. Legal Proceedings and Contingencies."

Year ended December 31, 2007	Cost of products sold	Marketing, selling and administrative	Research and development	Acquired in-process research and development	Provision for restructuring, net	Litigation expense, net	Gain on sale of product assets and businesses	Other expense, net	Total
Dollars in Millions									
Productivity Transformation Initiative:									
Downsizing and streamlining of worldwide operations	$ —	$ —	$ —	$ —	$ 139	$ —	$ —	$ 6	$ 145
Accelerated depreciation and asset impairment	102	8	—	—	—	—	—	—	110
Process standardization implementation costs	—	5	—	—	—	—	—	32	37
	102	13	—	—	139	—	—	38	292
Other:									
Litigation settlement	—	—	—	—	—	14	—	—	14
Insurance recovery	—	—	—	—	—	—	—	(11)	(11)
Product liability	—	—	—	—	—	—	—	15	15
Upfront and milestone payments and acquired in-process research and development	—	—	162	230	—	—	—	—	392
Auction rate securities impairment	—	—	—	—	—	—	—	275	275
Downsizing and streamlining of worldwide operations	—	—	—	—	44	—	—	—	44
Accelerated depreciation, asset impairment and contract termination	77	—	—	—	—	—	—	23	100
Gain on sale of properties and product assets	—	—	—	—	—	—	(273)	(9)	(282)
	$ 179	$ 13	$ 162	$ 230	$ 183	$ 14	$ (273)	$ 331	839
Income taxes on items above									(33)
Change in estimate for taxes on a prior year item									(39)
(Increase)/Decrease to Net Earnings from Continuing Operations									$ 767

Year ended December 31, 2006	Cost of products sold	Marketing, selling and administrative	Research and development	Provision for restructuring, net	Litigation expense, net	Gain on sale of product assets and businesses	Other expense, net	Total
Dollars in Millions								
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	4	15	—	—	—	—	186
Upfront and milestone payments	—	—	70	—	—	—	—	70
Downsizing and streamlining of worldwide operations	—	—	—	59	—	—	—	59
Gain on sale of product asset	—	—	—	—	—	(200)	—	(200)
	$ 167	$ 4	$ 85	$ 59	$ 302	$ (200)	$ 244	661
Income taxes on items above								(149)
Change in estimate for taxes on prior year items								39
(Increase)/Decrease to Net Earnings from Continuing Operations								$ 551

Year ended December 31, 2005	Cost of products sold	Research and development	Provision for restructuring, net	Litigation expense, net	Gain on sale of product assets and businesses	Other expense, net	Total
Dollars in Millions							
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
Downsizing and 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	$ 269	$ (569)	$ (83)	(177)
Income taxes on items above							126
Adjustment on taxes on repatriation of foreign earnings							(135)
(Increase)/Decrease to Net Earnings from Continuing Operations							$(186)

Earnings From Continuing Operations Before Minority Interest and Income Taxes

Dollars in Millions	Earnings From Continuing Operations Before Minority Interest and Income Taxes 2007	2006	2005	% Change 2007 vs. 2006	2006 vs. 2005
Pharmaceuticals	$ 3,471	$ 2,569	$ 3,739	35%	(31)%
Nutritionals	708	696	677	2%	3%
ConvaTec	348	315	288	10%	9%
Health Care Group	1,056	1,011	965	4%	5%
Total segments	4,527	3,580	4,704	26%	(24)%
Corporate/Other	(993)	(1,180)	(400)	16%	(195)%
Total	$ 3,534	$ 2,400	$ 4,304	47%	(44)%

In 2007, earnings from continuing operations before minority interest and income taxes increased 47% to $3,534 million from $2,400 million in 2006. The increase was primarily driven by increased PLAVIX* sales, strong sales growth of other key products, improved gross margins and an increase in equity in net income of affiliates, partially offset by the net impact of items that affect the comparability of results as discussed above, investment in advertising, product promotion, and research and development.

In 2006, earnings from continuing operations before minority interest and income taxes decreased 44% to $2,400 million from $4,304 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.

Pharmaceuticals

Earnings from continuing operations before minority interest and income taxes increased 35% to $3,471 million in 2007 from 2006. The increase in 2007 from 2006 was primarily due to increased PLAVIX* sales, strong sales growth of other key products, improved gross margins and an increase in equity in net income of affiliates, partially offset by acquired in-process research and development charge, continued investment in research and development, including upfront and milestone payments, and investment in advertising and product promotion. Earnings from continuing operations before minority interest and income taxes decreased 31% to $2,569 million in 2006 from $3,739 million in 2005, 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 products and new products.

Nutritionals

Earnings from continuing operations before minority interest and income taxes increased 2% to $708 million in 2007 from 2006, primarily due to growth of key products, partially offset by lower gross margins, primarily due to higher dairy costs, increased investment in advertising and product promotion and the establishment of an allowance for a doubtful account in 2007. Earnings from continuing operations before minority interest and income taxes increased 3% to $696 million in 2006 from $677 million in 2005, primarily due to sales growth of children's nutritional products, partially offset by increased investments in advertising expense and research and development programs.

ConvaTec

Earnings from continuing operations before minority interest and income taxes increased 10% to $348 million in 2007 from 2006, primarily due to increased growth of key products and improved gross margins, partially offset by increased investment in research and development programs and in product promotion. Earnings from continuing operations before minority interest and income taxes increased 9% to $315 million in 2006 from $288 million in 2005, primarily driven by increased sales.

Corporate/Other

Loss from continuing operations before minority interest and income taxes decreased to $993 million in 2007 from 2006. The 2007 and 2006 results included gains on sale of product assets of $273 million and $200 million, respectively. The additional difference was primarily due to debt retirement costs and increases in reserves for a pricing and sales litigation settlement, both in 2006, and lower net interest expense in 2007, partially offset by impairments of certain ARS and other properties, and higher restructuring charges. Loss from continuing operations before minority interest and income taxes increased to $1,180 million in 2006 from $400 million in 2005, primarily due to lower gain on sale of a product asset in 2006 compared to the gain on sale for Consumer Medicines business in 2005, higher debt retirement costs in 2006 compared to 2005, and a $143 million income item 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.

Income Taxes

The effective income tax rate on earnings from continuing operations before minority interest and income taxes was 22.7% in 2007 compared with 22.4% in 2006 and 20.2% in 2005. The 2007 tax rate was unfavorably impacted by the impairment on the Company's investment in certain ARS with no tax benefit and the non-deductible write-off of acquired in-process research and development expenses related to the acquisition of Adnexus, partially offset by a tax benefit of $105 million in the first quarter of 2007 due to the favorable resolution of certain tax matters with the U.S. Internal Revenues Service (IRS) related to the deductibility of litigation settlement expenses and the impact of foreign tax credits. The effective tax rate for 2006 was unfavorably impacted by the elimination 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, partially offset by favorable U.S. tax legislation enacted in 2006 related to the tax treatment of certain intercompany transactions amongst the Company's foreign subsidiaries, and the implementation of tax planning strategies related to the utilization of certain charitable contributions. The increase in the 2006 effective tax rate from 2005 was primarily due to the aforementioned Section 936 benefit elimination, the treatment of provisions for a portion of certain litigation reserves as non-deductible, 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, partially offset by favorable U.S. tax legislation enacted in 2006 related to the tax treatment of certain intercompany 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 Company has recorded significant deferred tax assets at December 31, 2007 related to U.S. foreign tax credit carryforwards of approximately $1,140 million, U.S. research tax credit carryforwards of approximately $275 million and charitable contribution carryforwards of $80 million. The charitable contribution carryforwards expire in varying amounts beginning in 2009, while the foreign tax credit and research tax credit carryforwards expire in varying amounts beginning in 2012. The foreign tax credit and research tax credit have been reduced due to derecognition under FIN No. 48. Realization of these credits and the charitable contribution 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 its PTI, 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, research tax credit and charitable contribution carryforwards.

Minority Interest

Minority interest, net of taxes increased to $763 million in 2007 from 2006, primarily due to higher earnings in the Company's partnership with Sanofi for the territory covering the Americas. 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. The changes in the three years reflect the negative impact of generic clopidogrel bisulfate from August 2006 to mid–2007.

Discontinued Operations

In December 2007, the Company entered into a definitive agreement with Avista for the sale of its Medical Imaging business for a purchase price of approximately $525 million in cash, subject to customary post–closing adjustments. The closing of the transaction was completed on January 7, 2008. As a result of this transaction, the Company expects to recognize a pre–tax gain of approximately $20 million to $40 million ($30 million to $50 million loss net of tax) in the first quarter of 2008, subject to the post–closing adjustments. Medical Imaging was previously included in the former Other Health Care operating segment.

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.

The following summarized financial information related to the Medical Imaging and OTN businesses 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 Medical Imaging and OTN. Such costs, which were not allocated by the Company to Medical Imaging and 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, 2007	2006	2005
Net sales	$629	$658	$1,617
Earnings/(loss) before incomes taxes	$273	$235	$ 204
Provision for income taxes	76	72	59
Net earnings/(loss) from discontinued operations	$197	$163	$ 145

Financial Position, Liquidity and Capital Resources

Cash, cash equivalents and marketable securities were approximately $2.2 billion at December 31, 2007, compared to $4.0 billion at December 31, 2006. The Company continues to maintain a sufficient level of working capital, which was approximately $1.7 billion at December 31, 2007, decreasing from $3.8 billion at December 31, 2006. In 2008 and future periods, the Company expects cash generated by its U.S. operations, together with existing cash, cash equivalents, marketable securities 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 outside the U.S.

As of December 31, 2007, the Company had approximately $14.1 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, 2007 and 2006 primarily consisted of bank deposits, time deposits and money market funds. 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. The Company maintains cash and cash equivalent balances in U.S. dollars and foreign currencies which are subject to currency rate risk. In January 2008, the Company converted a substantial portion of its cash equivalents from money market funds to U.S. Treasury bills and similar investments.

Marketable securities at December 31, 2007 consisted of U.S. dollar–denominated floating rate securities (FRS), which are primarily 'AAA/Aaa' rated. FRS are long–term debt securities with coupons that are reset periodically against a benchmark interest rate. The underlying assets of the Company's FRS consist of primarily investment grade corporate bonds and loans. The carrying value of FRS was reduced by $25 million, from $362 million to $337 million at December 31, 2007, reflecting the change in fair market value. The Company assessed this decline in fair market value to be temporary, and recorded a pre–tax $25 million reduction ($16 million net of tax) in shareholders' equity in accumulated other comprehensive income (OCI).

As previously disclosed, in September 2006, the Company and Sanofi each posted $200 million towards a $400 million bond with the U.S. District Court for the Southern District of New York (District court) as collateral in support of the preliminary injunction issued on August 31, 2006. This collateral was reported as marketable securities on the Company's consolidated balance sheet at December 31, 2006. As a result of the outcome of the PLAVIX* patent litigation noted above, on June 21, 2007, the District court ordered release of the $400 million bond and release of the issuer of the bond from any liability in connection with the bond. As such, the Company's obligations under the collateral arrangements with respect to the bond were effectively terminated.

In addition, at December 31, 2007, the Company had $811 million of principal invested in ARS. The ARS held by the Company are private placement securities with long-term nominal maturities for which the interest rates are reset through a dutch auction each month. The monthly auctions historically have provided a liquid market for these securities. The Company's investments in ARS represent interests in collateralized debt obligations supported by pools of residential and commercial mortgages or credit cards, insurance securitizations and other structured credits, including corporate bonds. Some of the underlying collateral for the ARS held by the Company consists of sub-prime mortgages.

Consistent with the Company's investment policy guidelines, the ARS investments held by the Company all had AAA/Aaa credit ratings at the time of purchase. With the liquidity issues experienced in global credit and capital markets, the ARS held by the Company at December 31, 2007 have experienced multiple failed auctions as the amount of securities submitted for sale has exceeded the amount of purchase orders. In addition, in the fourth quarter of 2007, $79 million of principal invested in ARS held by the Company were downgraded and others were placed on credit watch. All of these securities retained at least one AAA rating as of December 31, 2007.

The estimated market value of the Company's ARS holdings at December 31, 2007 was $419 million, which reflects a $392 million adjustment to the principal value of $811 million. Although the ARS continue to pay interest according to their stated terms, based on valuation models and an analysis of other-than-temporary impairment factors, the Company has recorded a pre-tax impairment charge of $275 million in the fourth quarter of 2007, reflecting the portion of ARS holdings that the Company has concluded have an other-than-temporary decline in value. In addition, the Company recorded an unrealized loss of $117 million (pre-tax and net of tax) in accumulated OCI as a reduction in shareholders' equity, reflecting adjustments to ARS holdings that the Company has concluded have a temporary decline in value. The $275 million impairment charge does not have a material impact on the Company's liquidity or financial flexibility.

Historically, given the liquidity created by the auctions, ARS were presented as current assets under marketable securities. Given the failed auctions, the Company's ARS are illiquid until there is a successful auction for them. Accordingly, the entire amount of such remaining ARS has been reclassified from marketable securities to non-current other assets.

The credit and capital markets have continued to deteriorate in 2008. If uncertainties in these credit and capital markets continue, these markets deteriorate further or the Company experiences any additional ratings downgrades on any investments in its portfolio (including on ARS), the Company may incur additional impairments to its investment portfolio, which could negatively affect the Company's financial condition, cash flow and reported earnings. The Company believes that based on the Company's current cash, cash equivalents and marketable securities balances of $2.2 billion at December 31, 2007 and expected operating cash flows, the current lack of liquidity in the credit and capital markets will not have a material impact on the Company's liquidity, cash flow, financial flexibility or its ability to fund its operations, including the dividend.

On February 21, 2008, the Company completed the sale and leaseback of an administrative facility in Paris, France, for approximately €155 million. The Company expects to record a gain, of which the majority will be deferred and will reduce future lease rental costs over the lease period. In December 2006, the Company completed the sale and leaseback of several administrative facilities in New Jersey for $283 million, which resulted in a pre-tax gain from the transaction of $154 million, of which $145 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 2007 and 2006 were $1.9 billion and $187 million, respectively. The Company maintains cash balances and short-term investments in excess of short-term borrowings. The $108 million of 1.10% Yen Notes, due 2008; the $31 million of 1.43% Yen Notes, due 2008; the $400 million of 4.00% Notes, due 2008, and associated unamortized discount and interest rate swap valuation; and the $1.2 billion of Floating Rate Convertible Debentures, due 2023 (with a 2008 put/call), were reclassified from long-term debt to short-term borrowings in 2007.

Long-term debt was $4.4 billion at December 31, 2007 compared to $7.2 billion at December 31, 2006. The $2.8 billion reduction was primarily due to the reclassification to short-term borrowings noted above and the September 2007 repayment of the remaining $1.3 billion balance of the Floating Rate Bank Term Facility, due 2010.

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. In addition, the Company repaid $1.2 billion of its $2.5 billion Floating Rate Bank Term Facility, due 2010.

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 facility. There were no borrowings outstanding under the revolving credit facility at December 31, 2007.

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 $2.6 billion and €1 billion ($1.5 billion at December 31, 2007) of its long-term debt. Pre-tax interest expense, net of interest swap gains, was $422 million, $498 million and $349 million, in 2007, 2006 and 2005, respectively. The decrease in interest expense in 2007 from 2006 was primarily due to the effects of the 2006 debt restructuring, and the increase in interest expense in 2006 from 2005 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. Moody's long-term credit rating remains on stable outlook. Standard & Poor's (S&P) long-term and short-term credit ratings for the Company are currently A+ and A-1, respectively. In the second quarter of 2007, S&P revised its long-term credit rating outlook to stable from negative. Fitch Ratings (Fitch) long-term and short-term credit ratings for the Company are currently A+ and F1, respectively. In the third quarter of 2007, Fitch revised its long-term credit rating outlook to stable from negative.

Working capital for the years ended December 31, 2007 and 2006 were as follows:

Dollars in Millions	December 31,	
	2007	2006
Working capital	$1,704	$3,806

The decrease in working capital of $2.1 billion from December 31, 2006 to December 31, 2007 was impacted by:

- Decrease in marketable securities due to a reduction to the carrying value of floating rate securities and certain other ARS to fair market value and the subsequent reclassifications of the remaining value of ARS to other non-current assets.
- Increase in short-term borrowings from long-term debt due to the reclassifications as noted above.
- Increase in accrued royalties resulting from increased PLAVIX* sales.
- Increase in receivables primarily due to increased PLAVIX* sales in the U.S.
- Reclassification of Medical Imaging and other assets and liabilities to held for sale in 2007.
- Reclassification of certain tax contingencies from current U.S. and foreign income taxes payable to non-current upon the adoption of FIN No. 48 on January 1, 2007.

The following discussions of the Company's cash flow activities include discontinued operations. The Company's cash flow activities for the years ended December 31, 2007, 2006 and 2005 were as follows:

Dollars in Millions	Year Ended December 31,		
	2007	2006	2005
Cash flow provided by/(used in):			
Operating activities	$ 3,153	$ 2,083	$ 1,836
Investing activities	(202)	206	1,191
Financing activities	(3,213)	(3,351)	(3,637)

Net cash provided by operating activities was $3.2 billion in 2007 and $2.1 billion in 2006. The $1,070 million increase in 2007 compared to 2006 is attributable to higher net earnings of $580 million, higher net changes in adjustments to net earnings of $8 million and higher net changes in operating assets and liabilities of $482 million.

Net positive changes in adjustments to net earnings in 2007 compared to 2006, of $8 million, mainly included:

- A $288 million negative cash flow variance due to lower litigation settlement expenses in 2007.
- A $259 million positive cash flow variance resulting from impairment charges and asset write-offs mainly from the reduction of the carrying value of ARS to fair value and from the impending closure of manufacturing facilities.
- A $230 positive cash flow variance for acquired in-process research and development related to the acquisition of Adnexus in 2007.
- A $180 million negative cash flow variance in deferred income tax benefit. The 2007 adjustments included the deferred tax benefits from the restructuring of the Company's international operations, upfront cash receipts from alliance partners and the resolution of an audit issue with the IRS, partially offset by litigation payments. The 2006 adjustments included a net deferred tax charge for the payment of litigation settlements offset by the deferred tax benefit on additional litigation accruals, the accrual of additional foreign tax credits and the deferred tax benefit on equity-based compensation.
- A $124 million positive cash flow variance due to higher provision for restructuring in 2007 in connection with the PTI.

Net positive changes in operating assets and liabilities in 2007 compared to 2006, of $482 million, mainly included:

- A $966 million positive cash flow variance from accounts payable and accrued expenses is primarily due to an increase in accrued royalties in 2007 resulting from increased PLAVIX* sales, higher purchases of raw materials, a significant paydown of payables in early 2006 resulting from lower payment of invoices in December 2005 and a reduction of accrued rebates and returns in the first quarter of 2006, primarily resulting from lower sales volume.
- A $671 million negative cash flow variance from receivables, primarily due to increased PLAVIX* sales in 2007 and lower collection in 2007 resulting from lower PRAVACHOL sales.
- A $368 million positive cash flow variance in deferred income and other liabilities, mainly due to upfront cash receipts from alliance partners in 2007.
- A $132 million negative cash flow variance from inventories, primarily due to an increase in inventories in 2007 in anticipation of new product launches and strategic builds for existing products, and the reduction in inventories in 2006 resulting from PRAVACHOL exclusivity loss.
- A $108 million negative cash flow variance from income taxes payable, primarily related to payments to settle various tax issues for the 2002-2003 IRS audit.

Net cash used in investing activities was $202 million in 2007 and net cash provided by investing activities was $206 million in 2006. The $408 million negative cash flow variance is primarily attributable to:

- A $432 million negative cash flow variance from the acquisition of Adnexus.
- A $281 million negative cash flow variance for proceeds from the disposal of properties in connection with a sales and leaseback transaction in 2006.
- A $280 million positive cash flow variance from licensing milestone payments in 2006 to ImClone and Somerset Pharmaceuticals, Inc.

Net cash used in financing activities was $3,213 million in 2007 and $3,351 million in 2006. The $138 million positive cash flow variance is mainly attributable to:

- A $163 million positive cash flow variance mainly from higher cash proceeds from the exercise of stock options in 2007 compared to 2006.

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 deferred income tax 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 is 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 is 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 for 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 leaseback 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.

Cash provided from operations and borrowings was primarily used over the past three years to pay dividends of approximately $6.6 billion. The Company has also invested approximately $2.4 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 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 $1.15 for 2007 and $1.12 for each of 2006 and 2005. In December 2007, the Company declared a quarterly dividend of $.31 per common share and indicated a dividend for the full year 2008 of $1.24 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, 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*, and by additional impairments to its investment portfolio. For more information, see "Item 8. Financial Statements—Note 2. Alliances and Investments," "—Note 9. Cash, Cash Equivalents and Marketable Securities," "—Note 15. Short-Term Borrowings and Long-Term Debt" and "—Note 22. Legal Proceedings and Contingencies."

Contractual Obligations

Payments due by period for the Company's contractual obligations at December 31, 2007 were as follows:

Dollars in Millions	Obligations Expiring by Period						
	Total	2008	2009	2010	2011	2012	Later Years
Short-term borrowings	$ 1,891	$1,891	$—	$—	$—	$—	$—
Long-term debt	4,381	—	9	31	—	—	4,341
Operating leases	704	143	116	90	72	71	212
Purchase obligations	3,415	830	514	488	471	434	678
Stand-by letters of credit/performance guarantees	236	175	45	10	3	1	2
Uncertain tax positions (2)	195	195	—	—	—	—	—
Pension and other liabilities	1,253	126	173	117	113	111	613
Total	$12,075	$3,360	$857	$736	$659	$617	$ 5,846

(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, 2007 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.

(2) Due to the uncertainty related to the timing of the reversal of uncertain tax positions, only the short-term uncertain tax benefits have been provided in the table above. The long-term amounts excluded from the table above total $537 million.

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, for which the specific timing cannot be predicted. 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 "Item 8. Financial Statements—Note 15. Short-Term Borrowings and Long-Term Debt;" "—Note 18. Financial Instruments;" "—Note 20. Leases;" and "—Note 21. Pension and Other Postretirement Benefit Plans."

SEC Consent Order

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.

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 approximately 90% of total gross sales of U.S. Pharmaceuticals products in 2007, 2006 and 2005. 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. Pharmaceutical business's wholesaler customers other than the three largest wholesalers by extrapolating from the months on hand calculated for the three largest wholesalers. In contrast, for the Company's Pharmaceutical business outside of the U.S., Nutritionals and ConvaTec 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 believes the above-described procedures provide a reasonable basis to ensure compliance with the Consent.

As previously disclosed, on June 15, 2005, the Company entered into a DPA with the U.S. Attorney's Office 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 agreed to defer prosecution of the Company and dismiss the complaint after two years if the Company satisfied 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 and is incorporated by reference hereto as Exhibit 10w to the Form 10-K for the fiscal year ended December 31, 2006. Under the terms of the DPA, the Company agreed to retain a Monitor. The Monitor had defined powers and responsibilities under the DPA, including 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. These powers and responsibilities of the Monitor ended on April 12, 2007. The Monitor filed a final report with the USAO on June 8, 2007. On June 15, 2007 the DPA expired and the complaint has been dismissed. The Company has no on-going obligations under the DPA.

Recently Issued Accounting Standards

At its December 2007 meeting, the Financial Accounting Standards Board (FASB) ratified the consensus reached by the Emerging Issues Task Force (EITF) in Issue No. 07-1, *Accounting for Collaborative Arrangements Related to the Development and Commercialization of Intellectual Property*. The EITF concluded that a collaborative arrangement is one in which the participants are actively involved and are exposed to significant risks and rewards that depend on the ultimate commercial success of the endeavor. Revenues and costs incurred with third parties in connection with collaborative arrangements would be presented gross or net based on the criteria in EITF 99-19, *Reporting Revenue Gross as a Principal versus Net as an Agent*, and other accounting literature. Payments to or from collaborators would be evaluated and presented based on the nature of the arrangement and its terms, the nature of the entity's business and whether those payments are within the scope of other accounting literature. The nature and purpose of collaborative arrangements are to be disclosed along with the accounting policies and the classification and amounts of significant financial statement amounts related to the arrangements. Activities in the arrangement conducted in a separate legal entity should be accounted for under other accounting literature; however, required disclosure under EITF 07-1 applies to the entire collaborative agreement. This Issue is effective for fiscal years beginning after December 15, 2008, and is to be applied retrospectively to all periods presented for all collaborative arrangements existing as of the effective date. The Company is currently in the process of evaluating the impact of adopting this pronouncement.

In December 2007, the FASB issued SFAS No. 141(R), *Business Combinations*, which replaces SFAS No. 141, *Business Combinations*, and requires an acquirer to recognize the assets acquired, the liabilities assumed, and any non-controlling interest in the acquiree at the acquisition date, measured at their fair values as of that date, with limited exceptions. This Statement also requires the acquirer in a business combination achieved in stages to recognize the identifiable assets and liabilities, as well as the non-controlling interest in the acquiree, at the full amounts of their fair values. SFAS No. 141(R) makes various other amendments to authoritative literature intended to provide additional guidance or to confirm the guidance in that literature to that provided in this Statement. This Statement applies to business combinations for which the acquisition date is in fiscal years beginning after December 15, 2008. The Company is currently in the process of evaluating the impact of adopting this pronouncement.

In December 2007, FASB issued SFAS No. 160, *Noncontrolling Interests in Consolidated Financial Statements—an amendment of ARB No.51*. SFAS No. 160 establishes accounting and reporting standards that require the ownership interests in subsidiaries held by parties other than the parent to be clearly identified, labeled and presented in the consolidated statement of financial position within equity, but separate from the parent's equity. This Statement also requires the amount of consolidated net income attributable to the parent and to the noncontrolling interest to be clearly identified and presented on the face of the consolidated statement of income. Changes in a parent's ownership interest while the parent retains its controlling financial interest in its subsidiary must be accounted for consistently, and when a subsidiary is deconsolidated, any retained noncontrolling equity investment in the former subsidiary must be initially measured at fair value. The gain or loss on the deconsolidation of the subsidiary is measured using the fair value of any noncontrolling equity investment. The Statement also requires entities to provide sufficient disclosures that clearly identify and distinguish between the interests of the parent and the interests of the noncontrolling owners. This Statement is effective for fiscal years beginning after December 15, 2008. The Company is currently in the process of evaluating the impact of adopting this pronouncement.

In June 2007, the EITF reached a consensus on Issue No. 07-3, *Accounting for Nonrefundable Advance Payments for Goods or Services Received to Be Used in Future Research and Development Activities*. Nonrefundable advance payments for goods or services that will be used or rendered for future research and development activities should be deferred and capitalized. Such amounts should be recognized as an expense as the related goods are delivered or the services are performed, or when the goods or services are no longer expected to be provided. This Issue is effective for fiscal years beginning after December 15, 2007, and earlier application is not permitted. The pronouncement is not expected to have a material effect on the Company's consolidated financial statements.

In February 2007, the FASB issued SFAS No. 159, *The Fair Value Option for Financial Assets and Financial Liabilities—Including an amendment of FASB Statement No. 115*, 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 did not elect early adoption of this pronouncement as permitted. 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 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. On November 14, 2007, the FASB agreed to a one-year deferral for the implementation of SFAS No. 157 for other non-financial assets and liabilities. The adoption of this accounting pronouncement is not expected to have a material effect on the Company's consolidated financial statements for financial assets and liabilities and any other assets and liabilities carried at fair value. The Company is currently in the process of evaluating the impact of adopting this pronouncement for other non-financial assets or liabilities.

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 reporting period including a tabular reconciliation of unrecognized tax benefits. The Company adopted FIN No. 48 on January 1, 2007. As a result of the adoption of this accounting pronouncement, the Company recognized $27 million of previously unrecognized tax benefits, which was accounted for as an increase to the opening balance of retained earnings. In May 2007, the FASB issued FASB Staff Position (FSP) FIN No. 48-1, *Definition of Settlement in FASB Interpretation No. 48*, which is effective retroactively to January 1, 2007. FSP FIN No. 48-1 provides guidance on how to determine whether a tax position is effectively settled for the purpose of recognizing previously unrecognized tax benefits. The adoption of FSP FIN No. 48-1 did not have any 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 did not 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 did not 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—a replacement of APB Opinion No. 20 and FASB Statement No. 3*. 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—an interpretation of FASB Statement No. 143*. 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. This Interpretation was effective no later than the end of fiscal years ending after December 15, 2005. 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 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 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 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).

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. 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 (net of the gross–to–net sales adjustments discussed below, all of which involve significant estimates and judgments) when title and substantially all the risks and rewards of ownership have transferred to the customer, which generally occurs on the date of shipment.

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 "Item 8. Financial Statements—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 EITF 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 2007, 2006 and 2005, the provision for sales returns was $160 million, $230 million and $164 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 businesses. 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 recordkeeping 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. Pharmaceutical products. Prior to the third quarter of 2005, the Company had historically reported estimated total U.S. prescription growth and estimated therapeutic category shares based on data from the IMS National Prescription Audit (NPA) under IMS' legacy national projection methodology, which IMS made available on a subscription basis, and reported these data based on a simple unweighted sum of projected U.S. prescriptions in the retail and mail order channels. In the third quarter of 2005, the Company began disclosing these NPA prescription growth and therapeutic category share data based on Version 1.0 of IMS' new and revised NGPS projection methodology. For consistency, NGPS Version 1.0 data were used for both current and comparative time periods to properly account for trend breaks under the new projection methodology. Coincident with the change to reporting IMS data on an NGPS Version 1.0 basis, the Company also began reporting retail and mail prescription growth and category shares on a weighted, retail-equivalent basis, which accounts for the significantly larger size of the average mail order prescription, as compared to the size of the average retail prescription. Retail equivalization calculations were applied to mail order volumes and shares for each reported product and time period. In 2007, IMS further refined and improved its NGPS projection methodology and fully rolled out NGPS Version 2.0 to all NPA subscribers, which resulted in newly revised volume estimates for historic time periods. Therefore, since the first quarter of 2007, the Company has used the new IMS standard NGPS Version 2.0 projection methodology and has applied NGPS Version 2.0 data for reporting prescription growth and market shares to all periods presented in the Annual Report on Form 10-K. The Company has also continued the practice of combining retail and mail prescription volume on a retail-equivalent basis. The Company 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 75% 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, 2007, the fair market value of plan assets for the Company's defined benefit plans increased to $6,019 million from $5,658 million at December 31, 2006. For the U.S. plans, assets were allocated 67% to equity securities (compared to 69% at the end of 2006), 24% to fixed income securities (compared to 23% at the end of 2006) and 9% to private equity and other investments (compared to 8% at the end of 2006). Bristol–Myers Squibb common stock represented less than 1% of assets for the U.S. plans at the end of 2007 and 2006.

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 2007, net pension expense for the Company's defined benefit pension plans included in earnings before minority interest and income taxes was $313 million compared to $332 million in 2006.

The U.S. plans' pension expense for 2007 was determined using a 6.0% assumed discount rate and a 3.56% assumed rate of compensation increase. The present value of benefit obligations at December 31, 2007 for the U.S. plans was determined using a 6.75% 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 2007 had been reduced by 0.25%, such expense would have increased by approximately $17 million. If the assumed rate of compensation increase used in determining the U.S. plans' pension expense for 2007 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, 2007 had been reduced by 0.25%, the accumulated benefit obligation would have increased by $115 million.

The U.S. plans' pension expense for 2007 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 2007 had been reduced by 1%, such expense would have increased by $41 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
2007	10.3%	2002	(13.4)%
2006	14.9%	2001	(6.1)%
2005	9.8%	2000	3.5%
2004	12.6%	1999	18.2%
2003	25.0%	1998	13.3%

At December 31, 2007, the Company increased its assumed discount rate for U.S. plans from 6.00% to 6.75% 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, 2007 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 2008.

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 $20 million lower in 2008 than the $313 million in 2007, reflecting primarily the increase in the discount rate.

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, 2007 and 2006. Rates of 6.75% and 6.00%, respectively, were used for pension benefits versus 6.50% and 5.75%, respectively, for other postretirement benefits to reflect the shorter duration of the other postretirement liabilities at December 31, 2007 and 2006, respectively.

U.S. health care costs for the retiree population are assumed to increase 9.5% in 2008 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 2007 net periodic postretirement benefit cost (a reduction of $11 million) and accumulated postretirement benefit obligation at January 1, 2007 (a reduction of $98 million).

Recognition of Actuarial Gains and Losses

In 2006, SFAS No. 158 required 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), is 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 $98 million in 2008 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 $323 million and $325 million to the defined benefit plans in 2007 and 2006, respectively.

For discussions on retirement benefits, see "Item 8. Financial Statements—Note 21. 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 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 "Item 8. Financial Statements—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 "Item 8. Financial Statements—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 "Item 8. Financial Statements—Note 2. Alliances and Investments."

For discussions on equity investments, see "Item 8. Financial Statements—Note 1. Accounting Policies—Investments" and "—Note 2. Alliances and Investments."

Marketable Securities

The Company's marketable securities at December 31, 2007 consisted of U.S. dollar denominated FRS, which are primarily 'AAA/Aaa' rated. FRS are long long-term debt securities with coupons that are reset periodically against a benchmark interest rate. The underlying assets of the Company's FRS consist of primarily investment grade corporate bonds and loans. The Company accounts for its marketable securities in accordance with SFAS No. 115, *Accounting for Certain Investments in Debt and Equity Securities*, and classifies them as "available for sale."

In addition, at December 31, 2007, the Company had principal invested in ARS. The ARS held by the Company are private placement securities with long-term nominal maturities for which the interest rates are reset through a dutch auction each month. The monthly auctions historically have provided a liquid market for these securities. The Company's investments in ARS represent interests in collateralized debt obligations supported by pools of residential and commercial mortgages or credit cards, insurance securitizations and other structured credits, including corporate bonds. Some of the underlying collateral for the ARS held by the Company consists of sub-prime mortgages.

Due to the lack of availability of observable market quotes on the Company's investment portfolio of marketable securities and ARS, the Company utilizes valuation models including those that are based on expected cash flow streams and collateral values, including assessments of counterparty credit quality, default risk underlying the security, discount rates and overall capital market liquidity. The valuation of the Company's investment portfolio is subject to uncertainties that are difficult to predict. Factors that may impact the Company's valuation include changes to credit ratings of the securities as well as to the underlying assets supporting those securities, rates of default of the underlying assets, underlying collateral value, discount rates, counterparty risk and ongoing strength and quality of market credit and liquidity.

The credit and capital markets have continued to deteriorate in 2008. If uncertainties in these markets continue, these markets deteriorate further or the Company experiences any additional ratings downgrades on any investments in its portfolio (including on ARS), the Company may incur additional impairments to its investment portfolio, which could negatively affect the Company's financial condition, cash flow and reported earnings.

For discussions on marketable securities, see "Item 8. Financial Statements—Note 9. Cash, Cash Equivalents and Marketable Securities."

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 $6 million, $14 million and $1 million were recorded in 2007, 2006 and 2005, respectively, and reflect changes in estimates for restructuring actions taken in prior periods.

For discussions on restructuring, see "Item 8. Financial Statements—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, and product and environmental liability. 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. These estimates are subject to uncertainties that are difficult to predict and, as such, actual results could vary from these estimates.

For discussions on contingencies, see "Item 8. Financial Statements—Note 1. Accounting Policies—Contingencies;" and "—Note 22. 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, 2007 and 2006, the Company had net deferred tax assets of $3,483 million and $3,154 million, respectively, net of valuation allowances of $1,950 million and $625 million, respectively.

The Company has recorded significant deferred tax assets at December 31, 2007 related to U.S. foreign tax credit carryforwards of approximately $1,140 million, U.S. research tax credit carryforwards of approximately $275 million and charitable contribution carryfowards of $80 million. The charitable contribution carryforwards expire in varying amounts beginning in 2009, while the foreign tax credit and research tax credit carryforwards expire in varying amounts beginning in 2012. The foreign tax credit and research credit have been reduced due to derecognition under FIN No. 48. Realization of these credits and charitable contribution 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 its PTI, 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, research tax credit and charitable contribution carryforwards.

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 Company adopted FIN No. 48 on January 1, 2007. As a result of the adoption of this accounting pronouncement, the Company recognized $27 million of previously unrecognized tax benefits, which was accounted for as an increase to the opening balance of retained earnings.

As previously reported, upon the adoption of FIN No. 48, the Company's total amount of uncertain tax benefits as of January 1, 2007, net of deferred income tax benefits, and excluding interest and penalties, was $960 million. In addition, the Company derecognized on adoption $180 million of unrecognized tax benefits for which there is no tax rate impact when settled. As such, the gross unrecognized tax benefits at January 1, 2007 were $1,140 million. The total amount of unrecognized tax benefits on December 31, 2007, excluding amounts recorded as reductions in deferred tax assets, and excluding interest and penalties decreased to $798 million. This reduction is primarily due to tax benefits recognized from the favorable resolution of uncertain tax positions, partially offset by additional uncertain tax benefits accrued during 2007. For additional information on unrecognized tax benefits, see "Item 8. Financial Statements—Note 8. Income Taxes"

As of December 31, 2007, the Company had approximately $14.1 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 "Item 8. Financial Statements—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 years ended December 31, 2007 and 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 years ended December 31, 2007 and 2006 was $133 million and $112 million, respectively ($88 million and $73 million, net of tax, respectively) or $0.04 and $0.04 per share, respectively, 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 ($20 million, net of tax), was recognized for the year ended December 31, 2005 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 years ended December 31, 2007 and 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 2007, 2006 and 2005 was estimated as $ 6.56 per common share, $4.74 per common share and $5.49 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:

	2007	2006	2005
Expected volatility	28.9%	26.7%	29.4%
Risk–free interest rate	4.7%	4.6%	4.4%
Dividend yield	4.5%	4.8%	4.6%
Expected life	6.2 yrs	6.3 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 statements of earnings for the year ended December 31, 2007 and 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 revises, 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, particularly under "Item 1A. Risk Factors," 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.

Item 7A. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK.

The Company is exposed to market risk due to changes in currency exchange rates, interest rates and the deterioration of the credit and capital markets. 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, Canadian dollar, Japanese yen, Mexican peso and Chinese renminbi. 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 table below summarizes the Company's outstanding foreign exchange forward contracts as of December 31, 2007. 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.

Dollars in Millions, except currency rates	Weighted–Average Strike Price	Notional Amount	Fair Value Asset/(Liability)	Maturity
Foreign Exchange Forwards:				
Cash Flow Hedges				
Australian Dollar	0.80	$ 72	$ (6)	2008
British Pound	2.01	79	1	2008
Canadian Dollar	1.08	130	(12)	2008
Euro	1.36	636	(43)	2008
Japanese Yen	107.62	159	3	2008
Mexican Peso	10.95	54	1	2008
Polish Zloty	2.53	18	—	2008
Swedish Krona	6.48	47	—	2008
Swiss Franc	1.16	30	—	2008
Total Cash Flow Hedges		1,225	(56)	
Non–Qualifying Hedges[1]				
Australian Dollar	0.90	71	3	2008
British Pound	2.06	41	2	2008
Canadian Dollar	0.95	131	6	2008
Euro	1.45	13	(1)	2008
Japanese Yen	106.78	71	2	2008
Polish Zloty	2.53	61	(1)	2008
Turkish Lira	1.27	43	(2)	2008
Total Non–Qualifying Hedges		431	9	
Total Contracts		$ 1,656	$ (47)	

(1) Non–qualifying hedges are hedges that do not qualify for hedge accounting treatment as prescribed by SFAS 133, *Accounting for Derivative Instruments and Hedging Activities.*

At December 31, 2007, the Company held foreign exchange option contracts to buy and sell Japanese Yen. The total notional and fair market value for buy contracts is $145 million and $1 million, respectively, which are fully offset by the total notional and fair market value for sell contracts of $145 million and $1 million, respectively. At December 31, 2007, the Company held foreign exchange forward contracts with maturity dates in 2008; their notional amounts and fair values are expressed in the table below, dollars in millions:

Year of Maturity	Notional Amount	Fair Value
2008	$ 1,656	$ (47)

At December 31, 2007, the fair value of the Company's foreign exchange forward contracts was a net liability of $47 million, of which $16 million was recorded as a non-current asset and $63 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, 2007, with all other variables held constant, would decrease by $170 million or increase by $155 million, respectively, the fair value of foreign exchange forward contracts held at December 31, 2007.

The Company is obligated to settle foreign exchange forward contracts based on the specified contract rates. As of December 31, 2007, the balance of deferred losses on foreign exchange forward contracts included in accumulated other comprehensive income (OCI) on a pre-tax basis was $54 million ($37 million net of tax), all of which is expected to be reclassified into earnings within the next 12 months.

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.

For the years ended December 31, 2007, 2006 and 2005, the impact of hedge ineffectiveness on earnings was not significant. Additionally, for the years ended December 31, 2007, 2006 and 2005, the impact of discontinued hedges was a pre-tax loss of $12 million, a pre-tax loss of $10 million and a pre-tax gain of $2 million, respectively. Furthermore, the Company uses foreign exchange forward contracts to offset its exposure to certain assets and liabilities and earnings denominated in foreign currencies. 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. The notional and fair value amounts of foreign exchange forward contracts at December 31, 2007 are described in the table above. There were no foreign exchange forward contracts of this type outstanding at December 31, 2006. In 2007, the impact of foreign exchange forward contracts that are not designated as hedges was a pre-tax gain of $4 million. 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.

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 expense, net. The notional and fair value amounts of purchased foreign exchange forward contracts were not material at December 31, 2007, and were $24 million and a $1 million asset, respectively, at December 31, 2006. There were no notional and fair value amounts of sold foreign exchange forward contracts at December 31, 2007, and $22 million and a $1 million liability, respectively, at December 31, 2006.

The Company uses non-U.S. dollar borrowings, primarily the €500 Million Notes due 2016 and the €500 Million Notes due 2021 to hedge the foreign currency exposures of the Company's net investment in certain foreign affiliates. These non-U.S. dollar borrowings 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 accumulated OCI. At December 31, 2007 and 2006, $168 million and $27 million in losses, respectively, were recorded in the foreign currency translation component of accumulated OCI.

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 ($1.3 billion at inception) of the Company's newly issued fixed rate debt to be paid in 2016, 2021 and 2036 to variable rate debt. The total notional amount of outstanding interest rate swaps were $2.6 billion and €1 billion ($1.5 billion) as of December 31, 2007 and $2.6 billion and €1 billion ($1.3 billion) as of December 31, 2006. In accordance with SFAS No. 133, *Accounting for Derivative Instruments and Hedging Activities*, the Company recognized a net increase in interest expense of $13 million and $18 million in 2007 and 2006, respectively, and a net reduction in interest expense of $54 million in 2005 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 $72 million and current liabilities of $96 million, and a reduction in long-term debt of $24 million at December 31, 2007, and 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. 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 OCI and amortized to earnings over the remaining life of the debt. The following tables summarize the interest rate swaps outstanding as of December 31, 2007 and the earnings impact from terminated interest rate swap contracts for 2007, 2006 and 2005:

Interest Rate Swaps Outstanding

Interest Rate Contracts Dollars in Millions	Notional Amount of Underlying Debt	Variable Rate Received	Year of Transaction	Maturity	Fair Value
Swaps associated with:					
4.00% Notes due 2008	$ 400	1 month U.S. $ LIBOR +0.35%	2003	2008	$ (2)
5.25% Notes due 2013	600	1 month U.S. $ LIBOR +0.42%	2003	2013	16
4.375% €500 Million Notes due 2016	725	3 month EUR € EURIBOR +0.40%	2006	2016	(37)
4.625% €500 Million Notes due 2021	725	3 month EUR € EURIBOR +0.56%	2006	2021	(57)
7.15% Notes due 2023	350	1 month U.S. $ LIBOR +1.66%	2004	2023	20
5.875% Notes due 2036	1,250	1 month U.S. $ LIBOR +0.62%	2006	2036	36
	$ 4,050				$ (24)

Earnings Impact from Terminated Interest Rate Swap Contracts

Interest Rate Contracts Dollars in Millions	Year of Termination	Notional Amount of Underlying Debt	Total Pre-Tax Deferred Gain/(Loss)	Pre-Tax Income/(Expense) Recognized 2007	2006	2005
Interest rate swap lock associated with:						
5.75% Notes due 2011 (1)	2001	$ 2,500	$ (58)	$ —	$ (37)	$ (5)
4.75% Note due 2006 (2)	2001	2,000	(48)	—	—	(15)
Swaps associated with:						
4.75% Notes due 2006 (2)	2005	2,000	(13)	—	—	(13)
5.75% Notes due 2011 (1)	2005	500	(23)	—	(21)	(2)
6.8% Notes due 2026 (3)	2005	350	39	1	1	—
5.75% Notes due 2011 (1)	2006	2,000	(62)	—	(62)	—
			$ (165)	$ 1	$ (119)	$ (35)

(1) The underlying 2011 Notes were extinguished in 2006.
(2) The underlying 2006 Notes were extinguished in 2005.
(3) The underlying 2026 Notes have not been extinguished.

At December 31, 2007, the Company held interest rate swap contracts with a notional value of $2.6 billion and €1.0 billion ($1.5 billion) and a fair value of a net liability of $24 million. It is estimated that an increase or decrease of 100 and 200 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 $4,381 million and $7,248 million of long-term debt outstanding at December 31, 2007 and 2006, respectively. For additional information, see "Item 8. Financial Statements—Note 15. Short-Term Borrowings and Long-Term Debt" and "—Note 18. Financial Instruments."

The Company's marketable securities at December 31, 2007 consisted of U.S. dollar denominated floating rate securities (FRS), which are primarily 'AAA/Aaa' rated. FRS are long long–term debt securities with coupons that are reset periodically against a benchmark interest rate. The underlying assets of the Company's FRS consist of primarily investment grade corporate bonds and loans. The Company accounts for its marketable securities in accordance with SFAS No. 115, *Accounting for Certain Investments in Debt and Equity Securities*, and classifies them as "available for sale." The carrying value of FRS was reduced by $25 million, from

$362 million to $337 million at December 31, 2007, reflecting the change in fair market value. The Company assessed this decline in fair market value to be temporary, and recorded a pre–tax $25 million reduction ($16 million net of tax) in shareholders' equity in accumulated OCI.

In addition, at December 31, 2007, the Company had $811 million of principal invested in auction rate securities (ARS). The ARS held by the Company are private placement securities with long–term nominal maturities for which the interest rates are reset through a dutch auction each month. The monthly auctions historically have provided a liquid market for these securities. The Company's investments in ARS represent interests in collateralized debt obligations supported by pools of residential and commercial mortgages or credit cards, insurance securitizations and other structured credits, including corporate bonds. Some of the underlying collateral for the ARS held by the Company consists of sub–prime mortgages.

Consistent with the Company's investment policy guidelines, the ARS investments held by the Company all had AAA/Aaa credit ratings at the time of purchase. With the liquidity issues experienced in global credit and capital markets, the ARS held by the Company at December 31, 2007 have experienced multiple failed auctions as the amount of securities submitted for sale has exceeded the amount of purchase orders. In addition, in the fourth quarter of 2007, $79 million of principal invested in ARS held by the Company were downgraded and others were placed on credit watch. All of these securities retain at least one AAA rating as of December 31, 2007.

The estimated market value of the Company's ARS holdings at December 31, 2007 was $419 million, which reflects a $392 million adjustment to the principal value of $811 million. Although the ARS continue to pay interest according to their stated terms, based on third–party valuation models and an analysis of other–than–temporary impairment factors, the Company has recorded a pre–tax impairment charge of $275 million in the fourth quarter of 2007, reflecting the portion of ARS holdings that the Company has concluded have an other–than–temporary decline in value. In addition, the Company recorded an unrealized loss of $117 million (pre–tax and net of tax) in accumulated OCI as a reduction in shareholders' equity, reflecting adjustments to ARS holdings that the Company has concluded have a temporary decline in value. The $275 million impairment charge does not have a material impact on the Company's liquidity or financial flexibility.

Due to the lack of availability of observable market quotes on the Company's investment portfolio of marketable securities and ARS, the Company utilizes valuation models including those that are based on expected cash flow streams and collateral values, including assessments of counterparty credit quality, default risk underlying the security, discount rates and overall capital market liquidity. The valuation of the Company's investment portfolio is subject to uncertainties that are difficult to predict. Factors that may impact the Company's valuation include changes to credit ratings of the securities as well as to the underlying assets supporting those securities, rates of default of the underlying assets, underlying collateral value, discount rates, counterparty risk and ongoing strength and quality of market credit and liquidity.

The credit and capital markets have continued to deteriorate in 2008. If uncertainties in these markets continue, these markets deteriorate further or the Company experiences any additional ratings downgrades on any investments in its portfolio (including on ARS), the Company may incur additional impairments to its investment portfolio, which could negatively affect the Company's financial condition, cash flow and reported earnings.

Marketable securities at December 31, 2006 consisted of U.S. dollar–denominated ARS and FRS. The principal values of ARS and FRS were $1,462 million and $466 million, respectively. The Company's carrying value of ARS and FRS at December 31, 2006 was at principal value, which approximated fair value.

BRISTOL-MYERS SQUIBB COMPANY
CONSOLIDATED STATEMENTS OF EARNINGS
Dollars and Shares in Millions, Except Per Share Data

Item 8. FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA.

	Year Ended December 31,		
	2007	2006	2005
EARNINGS			
Net Sales	$19,348	$17,256	$18,605
Costs of products sold	6,218	5,739	5,737
Marketing, selling and administrative	4,855	4,800	4,989
Advertising and product promotion	1,465	1,340	1,464
Research and development	3,282	2,991	2,678
Acquired in-process research and development	230	—	—
Provision for restructuring, net	183	59	32
Litigation expense, net	14	302	269
Gain on sale of product assets and businesses	(273)	(200)	(569)
Equity in net income of affiliates	(524)	(474)	(334)
Other expense, net	364	299	35
Total expenses, net	15,814	14,856	14,301
Earnings from Continuing Operations Before Minority Interest and Income Taxes	3,534	2,400	4,304
Provision for income taxes	803	538	870
Minority interest, net of taxes	763	440	592
Net Earnings from Continuing Operations	1,968	1,422	2,842
Discontinued Operations:			
Earnings, net of taxes	197	163	145
Gain on disposal, net of taxes	—	—	13
	197	163	158
Net Earnings	$ 2,165	$ 1,585	$ 3,000
Earnings per Common Share			
Basic:			
Net Earnings from Continuing Operations	$ 1.00	$ 0.73	$ 1.45
Discontinued Operations:			
Earnings, net of taxes	0.10	0.08	0.07
Gain on disposal, net of taxes	—	—	0.01
Net Earnings per Common Share	$ 1.10	$ 0.81	$ 1.53
Diluted:			
Net Earnings from Continuing Operations	$ 0.99	$ 0.73	$ 1.44
Discontinued Operations:			
Earnings, net of taxes	0.10	0.08	0.07
Gain on disposal, net of taxes	—	—	0.01
Net Earnings per Common Share	$ 1.09	$ 0.81	$ 1.52
Average Common Shares Outstanding			
Basic	1,970	1,960	1,952
Diluted	1,980	1,963	1,983
Dividends declared per common share	$ 1.15	$ 1.12	$ 1.12

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

BRISTOL-MYERS SQUIBB COMPANY
CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME AND RETAINED EARNINGS
Dollars in Millions

	Year Ended December 31,		
	2007	2006	2005
COMPREHENSIVE INCOME			
Net Earnings	$ 2,165	$ 1,585	$ 3,000
Other Comprehensive Income/(Loss):			
Foreign currency translation, no tax effect in 2007 and 2006 and net of tax liability of $3 in 2005	99	129	(270)
Deferred gains/(losses) on derivatives qualifying as hedges, net of tax benefit of $9 in 2007 and $10 in 2006 and net of tax liability of $122 in 2005	(14)	(39)	325
Minimum pension liability adjustment, net of tax liability of $44 in 2006 and net of tax benefit of $4 in 2005	—	82	(6)
Deferred gains on pension and other postretirement benefits, net of tax liability of $102 in 2007	238	—	—
Deferred gains/(losses) on available for sale securities, net of tax benefit of $19 in 2007, net of tax liability of $6 in 2006 and net of tax benefit of $12 in 2005	(139)	12	(22)
Total Other Comprehensive Income	184	184	27
Comprehensive Income	$ 2,349	$ 1,769	$ 3,027
RETAINED EARNINGS			
Retained Earnings, January 1	$19,845	$20,464	$19,651
Cumulative effect of adoption of FIN No. 48	27	—	—
Net earnings	2,165	1,585	3,000
Cash dividends declared	(2,275)	(2,204)	(2,187)
Retained Earnings, December 31	$19,762	$19,845	$20,464

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

BRISTOL-MYERS SQUIBB COMPANY
CONSOLIDATED BALANCE SHEETS
Dollars in Millions, Except Per Share Data

	December 31, 2007	2006
ASSETS		
Current Assets:		
Cash and cash equivalents	$ 1,801	$ 2,018
Marketable securities	424	1,995
Receivables, net of allowances of $180 and $150	4,240	3,247
Inventories, net	2,162	2,079
Deferred income taxes, net of valuation allowances	851	649
Prepaid expenses	310	314
Assets held for sale	560	—
Total Current Assets	10,348	10,302
Property, plant and equipment, net	5,650	5,673
Goodwill	4,998	4,829
Other intangible assets, net	1,330	1,852
Deferred income taxes, net of valuation allowances	2,716	2,577
Other assets	1,130	342
Total Assets	$ 26,172	$ 25,575
LIABILITIES		
Current Liabilities:		
Short-term borrowings	$ 1,891	$ 187
Accounts payable	1,442	1,239
Accrued expenses	2,951	2,332
Deferred income	447	411
Accrued rebates and returns	763	823
U.S. and foreign income taxes payable	296	444
Dividends payable	614	552
Accrued litigation liabilities	205	508
Liabilities related to assets held for sale	35	—
Total Current Liabilities	8,644	6,496
Pension liabilities and other postretirement liabilities	782	942
Deferred income	714	354
U.S. and foreign income taxes payable	537	—
Other liabilities	552	544
Long-term debt	4,381	7,248
Total Liabilities	15,610	15,584
Commitments and contingencies (Note 22)		
STOCKHOLDERS' EQUITY		
Preferred stock, $2 convertible series: Authorized 10 million shares; issued and outstanding 5,815 in 2007 and 6,001 in 2006, 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 2007 and 2006	220	220
Capital in excess of par value of stock	2,722	2,626
Restricted stock	(97)	(128)
Accumulated other comprehensive loss	(1,461)	(1,645)
Retained earnings	19,762	19,845
	21,146	20,918
Less cost of treasury stock — 226 million common shares in 2007 and 238 million in 2006	(10,584)	(10,927)
Total Stockholders' Equity	10,562	9,991
Total Liabilities and Stockholders' Equity	$ 26,172	$ 25,575

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

BRISTOL-MYERS SQUIBB COMPANY
CONSOLIDATED STATEMENTS OF CASH FLOWS
Dollars in Millions

	Year Ended December 31,		
	2007	2006	2005
Cash Flows From Operating Activities:			
Net earnings	$ 2,165	$ 1,585	$ 3,000
Adjustments to reconcile net earnings to net cash provided by operating activities:			
Depreciation	542	564	577
Amortization	350	363	352
Deferred income tax benefits	(416)	(236)	(812)
Litigation settlement expense, net of recoveries	14	302	269
Stock-based compensation expense	133	112	—
Provision for restructuring	183	59	32
Gain on sale of product asset and businesses	(273)	(207)	(632)
Deferred income recognized	—	—	(143)
Acquired in-process research and development	230	—	—
Impairment charges and asset write-offs	379	120	42
Loss on disposal of property, plant and equipment and investment in other companies	50	26	36
Deferred expenses on extinguishment of long-term debt	—	62	—
(Under)/over distribution of earnings from affiliates	(36)	(35)	50
Unfunded pension expense	(10)	8	(31)
Changes in operating assets and liabilities:			
Receivables	(461)	210	539
Inventories	(54)	78	(370)
Prepaid expenses and other assets	33	(43)	38
Litigation settlement payments, net of insurance recoveries	(318)	(272)	11
Accounts payable and accrued expenses	506	(460)	(378)
Product liability	(21)	(50)	(48)
U.S. and foreign income taxes payable	(199)	(91)	(534)
Deferred income and other liabilities	356	(12)	(162)
Net Cash Provided by Operating Activities	3,153	2,083	1,836
Cash Flows From Investing Activities:			
Proceeds from marketable securities	20,634	31,479	29,532
Purchases of marketable securities	(19,878)	(30,717)	(28,489)
Additions to property, plant and equipment and capitalized software	(843)	(785)	(738)
Proceeds from disposal of property, plant and equipment and investment in other companies	44	10	73
Proceeds from sale of product assets and businesses	273	226	843
Proceeds from sale and leaseback of properties	—	281	—
Milestone payments	—	(280)	—
Purchase of Adnexus Therapeutics, net of cash acquired	(432)	—	—
Purchases of other investments	—	(8)	(30)
Net Cash (Used in)/Provided by Investing Activities	(202)	206	1,191
Cash Flows From Financing Activities:			
Short-term (repayments)/borrowings	(33)	30	(1,625)
Long-term borrowings	—	2,506	2,510
Long-term debt repayments	(1,300)	(3,700)	(2,502)
Charges on extinguishment of long-term debt	—	(158)	—
Issuances of common stock under stock plans and excess tax benefits from share-based payment arrangements	333	170	166
Dividends paid	(2,213)	(2,199)	(2,186)
Net Cash Used in Financing Activities	(3,213)	(3,351)	(3,637)
Effect of Exchange Rates on Cash and Cash Equivalents	45	30	(20)
Decrease in Cash and Cash Equivalents	(217)	(1,032)	(630)
Cash and Cash Equivalents at Beginning of Period	2,018	3,050	3,680
Cash and Cash Equivalents at End of Period	$ 1,801	$ 2,018	$ 3,050

The consolidated statements of cash flows include the activities of the Medical Imaging business.

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

Note 1 ACCOUNTING POLICIES

Basis of Consolidation

The consolidated financial statements, prepared in conformity with United States (U.S.) generally accepted accounting principles (GAAP), 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 requires the use of estimates and assumptions, based on complex judgments that are considered reasonable, 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, tax assets and tax liabilities, stock-based compensation costs, retirement and postretirement benefits (including the actuarial assumptions), financial instruments with no observable market quotes, as well as in estimates used in applying the revenue recognition policy. 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 title and 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 ConvaTec segments and certain non-U.S. businesses within the Pharmaceuticals segment, revenue is recognized on the date of receipt by the purchaser. In accordance with Statements of Financial Accounting Standards (SFAS) No. 48, *Revenue Recognition When Right of Return Exists*, revenues are reduced at the time of recognition to reflect expected returns that are estimated based on historical experience and business trends. Additionally, in accordance with Emerging Issues Task Force (EITF) Issue No. 01-9, *Accounting for Consideration Given by a Vendor to a Customer (Including a Reseller of the Vendor's Products)*, 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 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 $125 million and $137 million at December 31, 2007 and 2006, respectively; Women, Infants and Children (WIC) rebate accruals were $198 million and $230 million at December 31, 2007 and 2006, respectively; sales return accruals were $178 million and $221 million at December 31, 2007 and 2006, respectively; and managed health care rebate and other contractual discount accruals were $134 million and $111 million at December 31, 2007 and 2006, 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 $70 million and $63 million at December 31, 2007 and 2006, 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, 2007 and 2006, the Company had net deferred tax assets of $3,483 million and $3,154 million, respectively, net of valuation allowances of $1,950 million and $625 million, respectively.

Note 1 ACCOUNTING POLICIES (Continued)

The Company has recorded significant deferred tax assets at December 31, 2007 related to U.S. foreign tax credit carryforwards of approximately $1,140 million, U.S. research tax credit carryforwards of approximately $275 million and charitable contribution carryforwards of $80 million. The charitable contribution carryforwards expire in varying amounts beginning in 2009, while the foreign tax credit and research tax credit carryforwards expire in varying amounts beginning in 2012. The foreign tax credit and research credit have been reduced due to derecognition under Financial Accounting Standards Board (FASB) Interpretation (FIN) No. 48, *Accounting for Uncertainty in Income Taxes – an Interpretation of FASB Statement No. 109.* Realization of these credits and charitable contribution 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 its Productivity Transformation Initiative (PTI), 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, research tax credit and charitable contribution carryforwards.

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 in "—Note 8. Income Taxes."

In July 2006, the FASB issued FIN No. 48, which, in the case of the Company, was 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 reporting period including a tabular reconciliation of unrecognized tax benefits. The Company adopted FIN No. 48 on January 1, 2007. As a result of the adoption of this accounting pronouncement, the Company recognized $27 million of previously unrecognized tax benefits, which was accounted for as an increase to the opening balance of retained earnings. In May 2007, the FASB issued FASB Staff Position (FSP) FIN No. 48–1, *Definition of Settlement in FASB Interpretation No. 48*, which is effective retroactively to January 1, 2007. FSP FIN No. 48–1 provides guidance on how to determine whether a tax position is effectively settled for the purpose of recognizing previously unrecognized tax benefits. The adoption of FSP FIN No. 48–1 did not have any effect on the Company's consolidated financial statements.

As previously reported, upon the adoption of FIN No. 48, the Company's total amount of uncertain tax benefits as of January 1, 2007, net of deferred income tax benefits, and excluding interest and penalties, was $960 million. In addition, the Company derecognized on adoption $180 million of unrecognized tax benefits, for which there is no tax rate impact when settled. As such, the gross unrecognized tax benefits at January 1, 2007 were $1,140 million.

As of December 31, 2007, the Company had approximately $14.1 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

Cash and cash equivalents primarily consist of bank deposits, time deposits and money market funds. 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. The Company maintains cash and cash equivalent balances in U.S. dollars and foreign currencies which are subject to currency rate risk.

Marketable Securities

The Company accounts for marketable securities in accordance with 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, 2007 and 2006, all of the Company's investments in marketable securities were reported at fair value. Fair value is determined based on observable market quotes or valuation models using assessments of

Note 1 ACCOUNTING POLICIES (Continued)

counterparty credit worthiness, credit default risk or underlying security and overall capital market liquidity. Declines in fair value that are considered other than temporary are charged to earnings and those that are considered temporary are reported as a component of accumulated other comprehensive income (OCI) in stockholders' equity. The Company uses the average cost method of determining the cost basis in computing realized gains and losses on the sale of its available–for–sale securities. 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 $248 million and $291 million at December 31, 2007 and 2006, respectively. Amortization expense was $116 million, $124 million and $116 million for the years ended December 31, 2007, 2006 and 2005, 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

In accordance with SFAS No. 142, *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 completed its annual goodwill impairment assessment in the first quarter of 2007 and monitored for any potential impairment in the remaining quarters of 2007, neither of which indicated an 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. Such intangible assets, other than capitalized software, are deemed to be impaired if their net carrying value exceeds their estimated fair value. Capitalized software is evaluated for impairment as described under "—Impairment of Long-Lived Assets" above.

Note 1 ACCOUNTING POLICIES (Continued)

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 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 22. 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 OCI 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 $262 million in 2007, $251 million in 2006 and $230 million in 2005.

Advertising Costs

Advertising costs are expensed as incurred. Advertising expense was $505 million, $474 million and $500 million in 2007, 2006 and 2005, respectively.

Note 1 ACCOUNTING POLICIES (Continued)

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. The Company records research and development, net of reimbursements, in connection with collaboration agreements.

Acquired In-Process Research and Development

The fair value of in-process research and development acquired in a business combination is determined 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 OCI.

Recently Issued Accounting Standards

At its December 2007 meeting, the FASB ratified the consensus reached by the EITF in issue No. 07-1, *Accounting for Collaborative Arrangements Related to the Development and Commercialization of Intellectual Property*. The EITF concluded that a collaborative arrangement is one in which the participants are actively involved and are exposed to significant risks and rewards that depend on the ultimate commercial success of the endeavor. Revenues and costs incurred with third parties in connection with collaborative arrangements would be presented gross or net based on the criteria in EITF 99-19, *Reporting Revenue Gross as a Principal versus Net as an Agent*, and other accounting literature. Payments to or from collaborators would be evaluated and presented based on the nature of the arrangement and its terms, the nature of the entity's business, and whether those payments are within the scope of other accounting literature. The nature and purpose of collaborative arrangements are to be disclosed along with the accounting policies and the classification and amounts of significant financial statement amounts related to the arrangements. Activities in the arrangement conducted in a separate legal entity should be accounted for under other accounting literature; however required disclosure under EITF 07-1 applies to the entire collaborative agreement. This Issue is effective for fiscal years beginning after December 15, 2008, and is to be applied retrospectively to all periods presented for all collaborative arrangements existing as of the effective date. The Company is currently in the process of evaluating the impact of adopting this pronouncement.

In December 2007, the FASB issued SFAS No. 141(R), *Business Combinations*, which replaces SFAS No. 141, *Business Combinations*, and requires an acquirer to recognize the assets acquired, the liabilities assumed, and any non-controlling interest in the acquiree at the acquisition date, measured at their fair values as of that date, with limited exceptions. This Statement also requires the

acquirer in a business combination achieved in stages to recognize the identifiable assets and liabilities, as well as the non-controlling interest in the acquiree, at the full amounts of their fair values. SFAS No. 141(R) makes various other amendments to authoritative literature intended to provide additional guidance or to confirm the guidance in that literature to that provided in this Statement. This Statement applies to business combinations for which the acquisition date is on or after December 15, 2008. The Company is currently in the process of evaluating the impact of adopting this pronouncement.

In December 2007, FASB issued SFAS No. 160, *Noncontrolling Interests in Consolidated Financial Statements—an amendment of ARB No. 51.* SFAS No. 160 establishes accounting and reporting standards that require the ownership interests in subsidiaries held by parties other than the parent to be clearly identified, labeled and presented in the consolidated statement of financial position within equity, but separate from the parent's equity. This statement also requires the amount of consolidated net income attributable to the parent and to the noncontrolling interest to be clearly identified and presented on the face of the consolidated statement of income. Changes in a parent's ownership interest while the parent retains its controlling financial interest in its subsidiary must be accounted for consistently, and when a subsidiary is deconsolidated, any retained noncontrolling equity investment in the former subsidiary must be initially measured at fair value. The gain or loss on the deconsolidation of the subsidiary is measured using the fair value of any noncontrolling equity investment. The Statement also requires entities to provide sufficient disclosures that clearly identify and distinguish between the interests of the parent and the interests of the noncontrolling owners. This Statement is effective for fiscal years beginning after December 15, 2008. The Company is currently in the process of evaluating the impact of adopting this pronouncement.

In June 2007, the EITF reached a consensus on Issue No. 07-3, *Accounting for Nonrefundable Advance Payments for Goods or Services Received to Be Used in Future Research and Development Activities.* Nonrefundable advance payments for goods or services that will be used or rendered for future research and development activities should be deferred and capitalized. Such amounts should be recognized as an expense as the related goods are delivered or the services are performed, or when the goods or services are no longer expected to be provided. This Issue is effective for fiscal years beginning after December 15, 2007, and earlier application is not permitted. The pronouncement is not expected to have a material effect on the Company's consolidated financial statements.

In February 2007, the FASB issued SFAS No. 159, *The Fair Value Option for Financial Assets and Financial Liabilities—Including an amendment of FASB Statement No. 115,* 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 did not elect early adoption of this pronouncement as permitted. 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 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. On November 14, 2007, the FASB agreed to a one-year deferral for the implementation of SFAS No. 157 for other non-financial assets and liabilities. The adoption of this accounting pronouncement is not expected to have a material effect on the Company's consolidated financial statements for financial assets and liabilities and any other assets and liabilities carried at fair value. The Company is currently in the process of evaluating the impact of adopting this pronouncement for other non-financial assets or liabilities.

Note 1 ACCOUNTING POLICIES (Continued)

In September 2006, the U.S. Securities and Exchange Commission (SEC) issued 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 reporting period including a tabular reconciliation of unrecognized tax benefits. The Company adopted FIN No. 48 on January 1, 2007. As a result of the adoption of this accounting pronouncement, the Company recognized $27 million of previously unrecognized tax benefits, which was accounted for as an increase to the opening balance of retained earnings. In May 2007, the FASB issued FSP FIN No. 48–1, *Definition of Settlement in FASB Interpretation No. 48,* which is effective retroactively to January 1, 2007. FSP FIN No. 48–1 provides guidance on how to determine whether a tax position is effectively settled for the purpose of recognizing previously unrecognized tax benefits. The adoption of FSP FIN No. 48–1 did not have any 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 did not 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 did not 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—a replacement of APB Opinion No. 20 and FASB Statement No. 3.* 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 effected 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—an interpretation of FASB Statement No. 143.* 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. This Interpretation was effective no later than the end of fiscal years ending after December 15, 2005. 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 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 SEC issued SAB No. 107, *Share-Based*

Note 1 ACCOUNTING POLICIES (Continued)

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 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).

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), 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 $746 million in 2007, $428 million in 2006 and $578 million in 2005. The Company recorded sales in this territory and in comarketing countries in the territory covering Europe and Asia of $5,958 million in 2007, $4,355 million in 2006 and $4,805 million in 2005.

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 $526 million in 2007, $439 million in 2006 and $345 million in 2005.

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. The $350 million was deferred and is being amortized 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 $32 million, $31 million and $31 million in 2007, 2006 and 2005, respectively. The unamortized portion of the deferred income is recorded in the liabilities section of the consolidated balance sheet and was $154 million and $186 million as of December 31, 2007 and 2006, respectively.

Note 2 ALLIANCES AND INVESTMENTS (Continued)

The following is the summarized financial information for the Company's equity investments in the partnership with Sanofi for the territory covering Europe and Asia:

Dollars in Millions	2007	2006	2005
Revenues	$3,090	$2,785	$2,436
Gross profit	2,379	2,156	1,875
Net income	1,070	942	709
Current assets	1,727	1,595	1,398
Current liabilities	1,727	1,595	1,398

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 invoiced to third-party customers by the Company on behalf of Otsuka, the Company records alliance revenue for its 65% contractual share of third-party 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 third-party 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 or Otsuka to third-party customers. The agreement expires in November 2012 in the U.S. For the entire European Union, 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 10th 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 $1,660 million in 2007, $1,282 million in 2006 and $912 million in 2005. Total milestone payments made to Otsuka under the agreement through December 2007 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 each of 2007, 2006 and 2005. The unamortized capitalized payment balance was $29 million and $35 million as of December 31, 2007 and 2006, 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 for ERBITUX* for use in combination with irinotecan in the treatment of patients with Epidermal Growth Factor Receptor (EGFR)-expressing, metastatic colorectal cancer (mCRC) who are refractory to irinotecan-based chemotherapy and for use as a single agent in the treatment of patients with EGFR-expressing mCRC who are intolerant to irinotecan-based chemotherapy. 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 October 2007, the Company and ImClone amended their codevelopment agreement with Merck KGaA to provide for cocommercialization of ERBITUX* in Japan, which expires in 2032. ImClone has the ability to terminate the agreement after 2018 if they determine that it is commercially unreasonable for them to continue. 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 total approval milestones paid in 2004 and 2006 as license acquisitions, and amortizes the payments into the cost of products sold over the remaining term of the agreement, which ends in 2018. In 2007, 2006 and 2005, the Company amortized into cost of products sold $38 million, $34 million and $17 million, respectively. The unamortized portion of the approval payments is recorded in other intangible assets, and was $397 million and $435 million at December 31, 2007 and 2006, respectively.

Note 2 ALLIANCES AND INVESTMENTS (Continued)

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 $114 million and approximately $619 million as of December 31, 2007, respectively, and $109 million and approximately $385 million as of December 31, 2006, respectively. The Company holds 14.4 million shares of ImClone stock, representing approximately 17% of ImClone's shares outstanding at December 31, 2007 and 2006. 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, 2007 were $7.92 and $43.00, respectively, compared to $7.59 and $26.76, respectively, as of December 31, 2006.

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 $7 million in 2007, net income of $43 million in 2006 and a net loss of $5 million in 2005. The Company recorded net sales for ERBITUX* of $692 million in 2007, $652 million in 2006 and $413 million in 2005.

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. 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 infection in adults. In September 2006, the companies amended their agreements to commercialize ATRIPLA* in Canada. ATRIPLA* was approved by Health Canada in October 2007 and by the European Commission in December 2007 for commercialization in the 27 countries of the EU, as well as Norway and Iceland.

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 joint venture with Gilead 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. The Company recorded efavirenz revenues of $335 million in 2007 and $76 million in 2006, respectively, 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 $9 million in 2007, $6 million in 2006 and $4 million in 2005.

AstraZeneca

In January 2007, the Company entered into two worldwide (except for Japan) codevelopment and cocommercialization agreements with AstraZeneca PLC (AstraZeneca), one for the codevelopment and cocommercialization of saxagliptin, a DPP-IV inhibitor (Saxagliptin Agreement), and one for the codevelopment and cocommercialization of dapagliflozin, a sodium-glucose contransporter-2 (SGLT2) inhibitor (SGLT2 Agreement). Both compounds are being studied for the treatment of diabetes and were discovered by the Company. Under the terms of the agreements, the Company received from AstraZeneca an upfront payment of $100 million in January 2007, which was deferred and is being recognized over the useful life of the products into other income. The Company amortized into other income $7 million of upfront payments in 2007. The unamortized portion of the upfront payment was $93 million as of December 31, 2007. Milestone payments are expected to be received by the Company upon the successful achievement of various development and regulatory events as well as sales-related milestones. Under the Saxagliptin Agreement, the Company could receive up to $300 million if all development and regulatory milestones are met and up to an additional $300 million if all sales-based milestones are met. Under the SGLT2 Agreement, the Company could receive up to $350 million if all development and regulatory milestones are met and up to an additional $300 million if all sales-based milestones are met. Under each agreement, the Company and AstraZeneca also share in development and commercialization costs. The majority of development costs under the initial development plans through 2009 will be paid by AstraZeneca and any additional development costs will generally be shared equally. The Company records development costs related to saxagliptin and dapagliflozin net of AstraZeneca's share in research and development expenses. Under each agreement, the two companies will jointly develop the clinical and marketing strategy and share commercialization expenses and profits/losses equally on a global basis, excluding Japan, and the Company will manufacture both products.

Pfizer

In April 2007, the Company and Pfizer Inc. (Pfizer) entered into a worldwide codevelopment and cocommercialization agreement for apixaban, an anticoagulant discovered by the Company being studied for the prevention and treatment of a broad range of venous and arterial thrombotic conditions. In accordance with the terms of the agreement, Pfizer made an upfront payment of $250

Note 2 ALLIANCES AND INVESTMENTS (Continued)

million to the Company in May 2007, which was deferred and is being recognized over the life of the agreement into other income. In December 2007, the Company and Pfizer agreed to include Japan in the worldwide agreement. In connection with the Japan agreement, Pfizer made an additional upfront payment of $40 million in December 2007 which was deferred and is being recognized over the useful life of the product into other income. The Company amortized into other income $11 million of the two upfront payments in 2007. The unamortized portion of the upfront payment is $279 million as of December 31, 2007. Pfizer will fund 60% of all development costs effective January 1, 2007 going forward, and the Company will fund 40%. The Company records apixaban development costs net of Pfizer's share in research and development expenses. The Company may also receive additional payments of up to $780 million from Pfizer based on development and regulatory milestones. The companies will jointly develop the clinical and marketing strategy, will share commercialization expenses and profits/losses equally on a global basis and will manufacture product under this arrangement.

Note 3 RESTRUCTURING

2007 Activities

In December 2007, the Company announced a three–year plan to fundamentally change the way it runs its business to meet the challenges of a changing business environment and to take advantage of the diverse opportunities in the marketplace as the Company is transformed into a next–generation biopharmaceutical company. With its previously announced PTI, the Company aims to achieve a culture of continuous improvement that will enhance its efficiency, effectiveness and competitiveness and substantially improve its cost base.

During 2007, the Company recorded pre–tax charges of $189 million, relating to the termination benefits and other related costs for workforce reductions of approximately 2,800 manufacturing, selling and administrative personnel across all geographic regions. These charges were offset by $6 million of adjustments reflecting changes in estimates for restructuring actions taken in prior periods.

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

Dollars in Millions	Termination Benefits	Other Exit Costs	Total
Pharmaceuticals	$ 156	$ —	$156
Nutritionals	3	—	3
ConvaTec	6	—	6
Corporate/Other	23	1	24
Subtotal	188	1	189
Changes in estimates	(6)	—	(6)
Provision for restructuring, net	$ 182	$ 1	$183

2006 Activities

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

The following table presents 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
ConvaTec	6	—	6
Subtotal	71	2	73
Changes in estimates	(13)	(1)	(14)
Provision for restructuring, net	$ 58	$ 1	$ 59

Note 3 RESTRUCTURING (Continued)

2005 Activities

During 2005, the Company recorded pre–tax charges of $33 million, relating to the termination benefits and other related costs for workforce reductions of approximately 640 selling and administrative personnel primarily in North America, Latin America, Europe, Africa and Asia. This charge includes the restructuring of the U.S. cardiovascular/metabolics primary care sales organization. These charges were offset by $1 million of adjustments reflecting changes in estimates for restructuring actions taken in prior periods.

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

Dollars in Millions	Termination Benefits	Other Exit Costs	Total
Pharmaceuticals	$ 27	$ 3	$ 30
Nutritionals	1	—	1
ConvaTec	2	—	2
Subtotal	30	3	33
Changes in estimates	(3)	2	(1)
Provision for restructuring, net	$ 27	$ 5	$ 32

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

Dollars in Millions	Employee Termination Liability	Other Exit Cost Liability	Total
Balance at January 1, 2005	$ 78	$ 2	$ 80
Charges	30	2	32
Spending	(45)	(6)	(51)
Changes in estimates	(3)	2	(1)
Balance at December 31, 2005	60	—	60
Charges	71	2	73
Spending	(44)	—	(44)
Changes in estimates	(13)	(1)	(14)
Balance at December 31, 2006	74	1	75
Charges	188	1	189
Spending	(88)	(3)	(91)
Changes in estimates	(6)	—	(6)
Balance at December 31, 2007	$ 168	$ (1)	$167

In addition to these charges, the Company recorded $110 million, $186 million and $110 million of accelerated depreciation and fixed asset impairment charges primarily related to the rationalization of its manufacturing network in 2007, 2006 and 2005, respectively. These charges were primarily recorded in cost of products sold on the consolidated statement of operations and primarily related to the Pharmaceuticals segment.

Note 4 ACQUISITIONS AND DIVESTITURES

In October 2007, the Company completed the acquisition of Adnexus Therapeutics, Inc. (Adnexus), developer of a new therapeutic class of biologics called ADNECTINS, for a net purchase price of $415 million. In addition, in the event that certain future development and regulatory milestones are achieved, the Company is obligated under the terms of the agreement to pay the former stockholders of Adnexus up to an additional $74 million. The net purchase price for the acquisition was preliminarily allocated to tangible and identifiable intangible assets acquired and liabilities assumed based on their estimated fair values at the acquisition date. Of the $415 million, $230 million was allocated to acquired in–process research and development, which was immediately expensed, and $27 million was assigned to identifiable intangible assets, predominantly related to existing process technology to be used in future discovery. The excess of the purchase price and associated transaction costs 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. Pro forma supplemental financial information for 2007 is not included as the impact of the business combination is not material.

In July 2007, the Company completed the sale of the BUFFERIN* and EXCEDRIN* brands in Japan, Asia (excluding China and Taiwan) and certain Oceanic countries to Lion Corporation (Japan) for $247 million in cash. As a result of this transaction, the Company recognized a pre–tax gain of $247 million ($144 million net of tax) in the third quarter of 2007.

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 received 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.

Note 4 ACQUISITIONS AND DIVESTITURES (Continued)

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.

Note 5 DISCONTINUED OPERATIONS AND ASSETS HELD FOR SALE

In December 2007, the Company entered into a definitive agreement with Avista Capital Partners L.P. (Avista) for the sale of its Medical Imaging business, for a purchase price of approximately $525 million in cash, subject to customary post-closing adjustments. The closing of the transaction was completed on January 7, 2008. The Company expects to recognize a pre-tax gain of approximately $20 million to $40 million ($30 million to $50 million loss net of tax) in the first quarter of 2008, subject to the post-closing adjustments. The results of the Medical Imaging business, which previously were included in the former Other Health Care operating segment, are included in income/(loss) from discontinued operations, net of tax, for all periods presented. The net assets associated with the Medical Imaging business, totaling approximately $483 million, as well as other assets totaling $42 million, have been reclassified to assets held for sale as of December 31, 2007.

For a period of time, the Company will continue to generate cash flows and to report income statement activity in income/(loss) from discontinued operations, net of tax, associated with the Medical Imaging business. The activities that give rise to these cash flows and income statement activities are transitional in nature and generally result from agreements that ensure and facilitate the orderly transfer of business operations. The agreements include services for accounting, customer service, distribution and manufacturing. These activities are not expected to be material to the Company's results of operations or cash flows. These agreements extend for periods generally less than 24 months, with the majority ranging between 3 to 6 months.

The following assets and liabilities have been segregated and classified as assets held for sale and liabilities related to assets held for sale, as appropriate, in the consolidated balance sheet as of December 31, 2007. These assets and liabilities relate to the Medical Imaging business described above, totaling $483 million, as well as other assets totaling $42 million. The balances as of December 31, 2006 were not reclassified. The amounts presented below were adjusted to exclude cash and intercompany receivables and payables between the business held for sale and the Company, which were excluded from the divestiture. In addition, goodwill at December 31, 2007 of $2 million has been excluded from the following summary of net assets held for sale, which will be considered in determining the gain on sale in 2008.

Dollars in millions	December 31, 2007
Assets	
Receivables, net of allowances of $2	$ 62
Inventories, net	20
Other assets	31
Property, plant and equipment, net	174
Other intangible assets, net	273
Total assets held for sale	560
Liabilities	
Accounts payable	12
Accrued liabilities	23
Total liabilities related to assets held for sale	35
Net assets held for sale	$ 525

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.

Note 5 DISCONTINUED OPERATIONS AND ASSETS HELD FOR SALE (Continued)

The following summarized financial information related to the Medical Imaging and OTN businesses 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 Medical Imaging and OTN by the Company. Such costs, which were not allocated by the Company to Medical Imaging and 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,		
	2007	2006	2005
Net sales	$629	$658	$1,617
Earnings before incomes taxes	$273	$235	$ 204
Provision for income taxes	76	72	59
Net earnings from discontinued operations	$197	$163	$ 145

The consolidated statement of cash flows includes the Medical Imaging and OTN businesses 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.

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, 2007	2006	2005
Basic:			
Net Earnings from Continuing Operations	$1,968	$1,422	$2,842
Discontinued Operations			
Earnings, net of taxes	197	163	145
Gain on disposal, net of taxes	—	—	13
Net Earnings	$2,165	$1,585	$3,000
Basic Earnings Per Share:			
Average Common Shares Outstanding – Basic	1,970	1,960	1,952
Net Earnings from Continuing Operations	$ 1.00	$ 0.73	$ 1.45
Discontinued Operations			
Earnings, net of taxes	0.10	0.08	0.07
Gain on disposal, net of taxes	—	—	0.01
Net Earnings per Common Share	$ 1.10	$ 0.81	$ 1.53
Diluted:			
Net Earnings from Continuing Operations	$1,968	$1,422	$2,842
Interest expense on conversion of convertible debt, net of taxes [a]	—	—	22
Net Earnings from Continued Operations used for Diluted Earnings per Common Share Calculation	1,968	1,422	2,864
Discontinued Operations			
Earnings, net of taxes	197	163	145
Gain on disposal, net of taxes	—	—	13
Net Earnings	$2,165	$1,585	$3,022
Diluted Earnings Per Share:			
Average Common Shares Outstanding	1,970	1,960	1,952
Conversion of convertible debt [a]	—	—	29
Incremental shares outstanding assuming the exercise/vesting of dilutive stock options/restricted stock	10	3	2
Average Common Shares Outstanding – Diluted	1,980	1,963	1,983
Net Earnings from Continuing Operations	$ 0.99	$ 0.73	$ 1.44
Discontinued Operations			
Earnings, net of taxes	0.10	0.08	0.07
Gain on disposal, net of taxes	—	—	0.01
Net Earnings per Common Share	$ 1.09	$ 0.81	$ 1.52

Weighted–average shares issuable upon the exercise of stock options, which were not included in the diluted earnings per share calculation because they were anti–dilutive, were 107 million in 2007, 164 million in 2006 and 156 million in 2005, respectively.

(a) In 2007 and 2006, the 29 million weighted–average shares issuable, as well as $38 million and $35 million, respectively, 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 anti–dilutive.

Note 7 OTHER EXPENSE, NET

The components of other expense, net were as follows:

Dollars in Millions	Year Ended December 31, 2007	2006	2005
Interest expense	$ 422	$ 498	$ 349
Interest income	(241)	(274)	(148)
Foreign exchange transaction losses	28	6	56
Other, net	155	69	(222)
Other expense, net	$ 364	$ 299	$ 35

In 2007, interest expense was increased by net interest swap losses of $13 million. In 2006, interest expense was increased by net interest swap losses of $18 million, and in 2005, interest expense was reduced by net interest swap gains of $54 million. Other, net includes income from third-party contract manufacturing, royalty income and expense, debt retirement costs, impairment of marketable securities, gains and losses on disposal of property, plant and equipment, gains and losses on sale of marketable securities, insurance recoveries, deferred income recognized and certain other litigation matters. See "Item 8. Financial Statements—Note 18. Financial Instruments." for additional discussion on terminated swap contracts.

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, 2007	2006	2005
U.S.	$1,047	$ (903)	$ 632
Non-U.S.	2,487	3,303	3,672
	$3,534	$2,400	$4,304

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, 2007	2006	2005
Current:			
U.S.	$ 274	$ 82	$ 995
Non-U.S.	751	693	687
	1,025	775	1,682
Deferred:			
U.S.	(162)	(204)	(852)
Non-U.S.	(60)	(33)	40
	(222)	(237)	(812)
	$ 803	$ 538	$ 870

Note 8 INCOME TAXES (Continued)

Effective Tax Rate

The Company's provision for income taxes in 2007, 2006 and 2005 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					
	2007		2006		2005	
Earnings from Continuing Operations Before Minority Interest and Income Taxes	$3,534		$2,400		$4,304	
U.S. statutory rate	1,237	35.0%	840	35.0%	1,506	35.0%
Foreign tax effect of operations in Ireland, Puerto Rico and Switzerland	(492)	(13.9)%	(616)	(25.7)%	(708)	(16.4)%
State and local taxes (net of valuation allowance)	10	0.3%	42	1.8%	2	0.1%
U.S. Federal & foreign contingent tax matters	(60)	(1.7)%	87	3.6%	114	2.6%
Dividend repatriation under AJCA	—	—	—	—	(135)	(3.1)%
U.S. Federal research tax credit	(98)	(2.8)%	(85)	(3.5)%	(63)	(1.5)%
Acquired in-process research and development expense	81	2.3%	—	—	—	—
Impairment of auction rate securities	96	2.7%	—	—	—	—
U.S. Federal and foreign valuation allowance	—	—	(24)	(1.0)%	32	0.7%
Foreign and other	29	0.8%	294	12.2%	122	2.8%
	$ 803	22.7%	$ 538	22.4%	$ 870	20.2%

The effective income tax rate on earnings from continuing operations before minority interest and income taxes was 22.7% in 2007 compared with 22.4% in 2006 and 20.2% in 2005. The 2007 tax rate was unfavorably impacted by the impairment on the Company's investment in certain auction rate securities (ARS) with no tax benefit and the non-deductible write-off of acquired in-process research and development expenses related to the acquisition of Adnexus, partially offset by a tax benefit of $105 million in the first quarter of 2007 due to the favorable resolution of certain tax matters with the U.S. Internal Revenues Service (IRS) related to the deductibility of litigation settlement expenses and the impact of foreign tax credits. The effective tax rate for 2006 was unfavorably impacted by the elimination 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, partially offset by favorable U.S. tax legislation enacted in 2006 related to the tax treatment of certain intercompany transactions amongst the Company's foreign subsidiaries, and the implementation of tax planning strategies related to the utilization of certain charitable contributions. The increase in the 2006 effective tax rate from 2005 was primarily due to the aforementioned Section 936 benefit elimination, the treatment of provisions for a portion of certain litigation reserves as non-deductible, 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, partially offset by favorable U.S. tax legislation enacted in 2006 related to the tax treatment of certain intercompany transactions amongst the Company's foreign subsidiaries, and the implementation of tax planning strategies in 2006 related to the utilization of certain charitable contributions.

Note 8 INCOME TAXES (Continued)

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, 2007	2006
Acquired in–process research and development	$ 839	$ 891
Intercompany profit and other inventory items	263	248
U.S. Federal foreign tax credit carryforward	1,140	1,071
Deferred income	276	99
U.S. Federal research and development tax credit carryforward	275	258
U.S. Federal charitable contribution carryforward	80	40
State net operating loss carryforwards	451	394
Foreign net operating loss carryforwards	1,461	196
Other foreign deferred tax assets	146	120
Pension and postretirement benefits	248	403
Depreciation	(131)	(155)
Share based compensation	78	47
Repatriation of foreign earnings	150	—
Legal settlements	47	101
Other, net	110	66
	5,433	3,779
Valuation allowance	(1,950)	(625)
Deferred tax assets, net	$ 3,483	$3,154
Recognized as:		
Deferred Income Taxes – Current	$ 851	$ 649
Deferred Income Taxes – Non–Current	2,716	2,577
U.S. and Foreign Income Taxes Payable	(4)	(4)
Other Liabilities – Non–Current	(80)	(68)
Total	$ 3,483	$3,154

The Company has recorded significant deferred tax assets at December 31, 2007 related to U.S. foreign tax credit carryforwards of approximately $1,140 million, U.S. research tax credit carryforwards of approximately $275 million and charitable contribution carryforwards of $80 million. The charitable contribution carryforwards expire in varying amounts beginning in 2009, while the foreign tax credit and research tax credit carryforwards expire in varying amounts beginning in 2012. The foreign tax credit and research tax credit have been reduced due to derecognition under FIN No. 48. Realization of these credits and the charitable contribution 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 its PTI, 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, research tax credit and charitable contribution carryforwards.

The Company also recorded deferred tax assets related to foreign net operating loss carryforwards of $1,461 million at December 31, 2007, an increase of $1,265 million compared to $196 million at December 31, 2006, primarily due to an international reorganization of two of the Company's foreign affiliates. These operating loss carryforwards related to the international reorganization were fully offset by the establishment of a valuation allowance of $1,261 million, reflecting the Company's view that the loss carryfowards are not expected to be realized.

The valuation allowance of $1,950 million at December 31, 2007 relates to $72 million of state deferred tax assets, $1,448 million of foreign net operating loss and tax credit carryforwards, $426 million of state net operating loss and tax credit carryforwards that the Company believes, more likely than not, will not be realized, and $4 million of state deferred tax assets related to the Adnexus acquisition that was offset against goodwill.

Income taxes paid during the year were $994 million, $741 million and $1,556 million in 2007, 2006 and 2005, respectively.

In October 2007, the Company filed a refund claim with the IRS for the years 2000 and 2001 to carry back foreign tax credits to recover taxes paid in 2000 and 2001. The principal amount of the refund claim is approximately $334 million. In the fourth quarter of 2007, the Company accrued interest income on this refund claim for approximately $45 million, net of federal benefit, which has been reflected in provision for income taxes.

Note 8 INCOME TAXES (Continued)

The current tax benefit realized upon the exercise of stock options is credited to capital in excess of par value of stock and amounted to $5 million, $10 million and $19 million in 2007, 2006 and 2005, respectively.

As of December 31, 2007, the Company had approximately $14.1 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.

The Company adopted the provisions of FIN No. 48 on January 1, 2007, resulting in the recognition of $27 million of previously unrecognized tax benefits which was accounted for as an increase to the opening balance of retained earnings. A reconciliation of the Company's changes in uncertain tax positions from January 1, 2007 to December 31, 2007 is as follows:

Dollars in Millions	Unrecognized Federal, State and Foreign Tax Benefits	Interest	Penalties	Unrecognized Income Tax Benefits, Including Interest and Penalties	Deferred Income Tax Benefits	Unrecognized Income Tax Benefits, Including Interest and Penalties, Net of Deferred Income Tax Benefits
Total uncertain tax positions that, if recognized, would impact the effective tax rate as of January 1, 2007	$ 898	$ 72	$ 22	$ 992	$ (56)	$ 936
Add: Tax attributable to deferred tax items at January 1, 2007	242	—	—	242	—	242
Balance, gross uncertain tax positions, January 1, 2007	1,140	72	22	1,234	(56)	1,178
Gross additions to tax positions related to current year	208	—	1	209	(3)	206
Gross reductions to tax positions related to current year	(4)	—	—	(4)	—	(4)
Gross additions to tax positions related to prior years	193	79	6	278	(27)	251
Gross reductions to tax positions related to prior years	(253)	(20)	(1)	(274)	17	(257)
Settlements	(240)	(54)	(3)	(297)	10	(287)
Reductions to tax positions related to lapse of statute	(1)	—	(1)	(2)	—	(2)
Cumulative translation adjustment	15	4	3	22	—	22
Balance, gross uncertain tax positions, December 31, 2007	1,058	81	27	1,166	(59)	1,107
Less: Tax attributable to deferred tax items at December 31, 2007	(264)	—	—	(264)	—	(264)
Total uncertain tax positions that, if recognized, would impact the effective tax rate as of December 31, 2007	$ 794	$ 81	$ 27	$ 902	$ (59)	$ 843

The uncertain tax benefits as of December 31, 2007 are recorded against the Company's deferred tax assets to the extent the uncertainty directly related to that asset; otherwise, they are recorded as either current or non–current income tax payable.

As previously reported, upon the adoption of FIN No. 48, the Company's total amount of uncertain tax benefits as of January 1, 2007, net of deferred income tax benefits and excluding interest and penalties, was $960 million. In addition, the Company derecognized upon adoption $180 million of unrecognized tax benefits, for which there is no tax rate impact when settled. As such, the gross unrecognized tax benefits at January 1, 2007 were $1,140 million.

Note 8 INCOME TAXES (Continued)

Included in the balance of unrecognized tax benefits was $242 million of uncertain tax positions as of January 1, 2007 and $264 million as of December 31, 2007, for which the ultimate deductibility is highly certain but for which there is uncertainty as to the timing of such deductibility. Because of the impact of deferred tax accounting, other than interest and penalties, if applicable, the disallowance of the shorter deductibility period would not affect the annual effective tax rate but would accelerate the payment of cash to the taxing authority or utilization of tax attributes to an earlier period.

The amounts of unrecognized tax benefits that, if recognized, would impact the effective tax rate were $898 million as of January 1, 2007, and $794 million as of December 31, 2007.

The Company classifies interest and penalties related to unrecognized tax benefits as income tax expense. These amounts are reflected separately on the reconciliation above. The total amount of interest and penalties related to uncertain tax positions and recognized in the statement of earnings for 2007 was $59 million for interest and $5 million for penalties. The total amount of interest and penalties related to uncertain tax positions and recognized in the balance sheet as of December 31, 2007 was $81 million for interest and $27 million for penalties.

The Company is currently under examination by a number of tax authorities, including all of the major tax jurisdictions listed in the table below, which have proposed adjustments to tax for issues such as transfer pricing, certain tax credits and the deductibility of certain expenses. The Company estimates that it is reasonably possible that the balance of unrecognized tax benefits as of December 31, 2007 will decrease in the range of approximately $175 million to $215 million in the next twelve months as a result of the anticipated effective settlement of certain tax audits for the jurisdictions listed below. Such settlements will involve the payment of additional taxes, the adjustment of certain deferred taxes and/or the recognition of tax benefits. The Company also anticipates that it is reasonably possible that new issues will be raised by tax authorities who may require increases to the balance of unrecognized tax benefits; however, an estimate of such increases cannot be made. The Company believes that it has adequately provided for all open tax years by tax jurisdiction under FIN No. 48.

The Company files income tax returns in the U.S. Federal jurisdiction and various state and foreign jurisdictions. With few exceptions, the Company is subject to U.S. Federal, state and local, and non–U.S. income tax examinations by tax authorities. The following is a summary of major tax jurisdictions for which tax authorities may assert additional taxes against the Company based upon tax years currently under audit and subsequent years that will likely be audited:

U.S.	2002 to 2007
Canada	2001 to 2007
France	2004 to 2007
Germany	1999 to 2007
Italy	2002 to 2007
Mexico	2002 to 2007

Note 9 CASH, CASH EQUIVALENTS AND MARKETABLE SECURITIES

Cash and cash equivalents at December 31, 2007 and 2006 primarily consisted of bank deposits, time deposits and money market funds. 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. The Company maintains cash and cash equivalent balances in U.S. dollars and foreign currencies which are subject to currency rate risk.

Marketable securities at December 31, 2007 consisted of U.S. dollar–denominated floating rate securities (FRS), which are primarily 'AAA/Aaa' rated. FRS are long–term debt securities with coupons that are reset periodically against a benchmark interest rate. The underlying assets of the Company's FRS consist of primarily investment grade corporate bonds and loans. The Company accounts for its marketable securities in accordance with SFAS 115, *Accounting for Certain Investments in Debt and Equity Securities*, and classifies them as "available for sale." The carrying value of FRS was reduced by $25 million, from $362 million to $337 million at December 31, 2007, reflecting the change in fair market value. The Company assessed this decline in fair market value to be temporary, and recorded a pre–tax $25 million reduction ($16 million net of tax) in shareholders' equity in accumulated OCI.

In addition, at December 31, 2007, the Company had $811 million of principal invested in ARS. The ARS held by the Company are private placement securities with long–term nominal maturities for which the interest rates are reset through a dutch auction each month. The monthly auctions historically have provided a liquid market for these securities. The Company's investments in ARS represent interests in collateralized debt obligations supported by pools of residential and commercial mortgages or credit cards, insurance securitizations and other structured credits, including corporate bonds. Some of the underlying collateral for the ARS held by the Company consists of sub–prime mortgages.

Consistent with the Company's investment policy guidelines, the ARS investments held by the Company all had AAA/Aaa credit ratings at the time of purchase. With the liquidity issues experienced in global credit and capital markets, the ARS held by the Company at December 31, 2007 have experienced multiple failed auctions as the amount of securities submitted for sale has exceeded the amount of purchase orders. In addition, in the fourth quarter of 2007, $79 million of principal invested in ARS held by the Company were downgraded and others were placed on credit watch. All of these securities retained at least one AAA rating as of December 31, 2007.

The estimated market value of the Company's ARS holdings at December 31, 2007 was $419 million, which reflects a $392 million adjustment to the principal value of $811 million. Although the ARS continue to pay interest according to their stated terms, based on valuation models and an analysis of other–than–temporary impairment factors, the Company has recorded a pre–tax impairment charge of $275 million in the fourth quarter of 2007, reflecting the portion of ARS holdings that the Company has concluded have an other–than–temporary decline in value. In addition, the Company recorded an unrealized loss of $117 million (pre–tax and net of tax) in accumulated OCI as a reduction in shareholders' equity, reflecting adjustments to ARS holdings that the Company has concluded have a temporary decline in value. The $275 million impairment charge does not have a material impact on the Company's liquidity or financial flexibility.

ARS were classified in prior periods as current assets under marketable securities. Given the failed auctions, the Company's ARS are illiquid until there is a successful auction for them. Accordingly, the entire amount of such remaining ARS has been reclassified from marketable securities to non–current other assets.

Marketable securities at December 31, 2006 consisted of U.S. dollar–denominated ARS and FRS. The principal values of ARS and FRS were $1,462 million and $466 million, respectively. The Company's carrying value of ARS and FRS at December 31, 2006 was at principal value, which approximates fair value.

The following tables summarize the Company's available for sale debt securities at December 31, 2007 and December 31, 2006:

December 31, 2007 Dollars in Millions	Cost	Fair Value	Carrying Value	Unrealized Loss in Accumulated OCI
Short–term				
Floating rate securities	$362	$ 337	$ 337	$ (25)
Other	87	87	87	—
Total short–term	$449	$ 424	$ 424	$ (25)
Long–term				
Available for sale				
Auction rate securities[(a)]	$811	$ 419	$ 419	$ (117)
Total long–term	$811	$ 419	$ 419	$ (117)

(a) The Company recorded a pre–tax other–than–temporary impairment charge of $275 million in earnings at December 31, 2007 related to these securities.

Note 9 CASH, CASH EQUIVALENTS AND MARKETABLE SECURITIES (Continued)

December 31, 2006 Dollars in Millions	Cost	Fair Value	Carrying Value	Unrealized Loss in Accumulated OCI
Short-term				
Auction rate securities	$1,462	$ 1,462	$ 1,462	$ —
Floating rate securities	466	466	466	—
Other	67	67	67	—
Total short-term	$1,995	$ 1,995	$ 1,995	$ —

The contractual maturities of the carrying value of the available-for-sale debt securities as of December 31, 2007, follow:

Dollars in Millions	Within 1 Year	Over 1 to 5 Years	Over 5 to 10 Years	Over 10 Years	Total
Available for Sale Debt Securities					
Floating Rate Securities	$ 100	$ 204	$ 33	$ —	$337
Auction Rate Securities	—	—	201	218	419
Other	87	—	—	—	87
Total Debt Securities	$ 187	$ 204	$ 234	$ 218	$843

In 2007, 2006 and 2005, the Company purchased $19.9 billion, $30.7 billion and $28.5 billion of debt securities respectively; and sold $20.6 billion, $31.5 billion and $29.5 billion of debt securities, respectively. The purchase and sale value of the debt securities approximated the principal value of the security.

Note 10 RECEIVABLES

The major categories of receivables were as follows:

Dollars in Millions	December 31, 2007	2006
Trade receivables	$2,805	$2,400
Miscellaneous receivables	1,615	997
	4,420	3,397
Less allowances	180	150
Receivables, net	$4,240	$3,247

Miscellaneous receivables for 2007 and 2006 include $824 million and $647 million, respectively, of receivables from alliance partners. Miscellaneous receivables for 2007 also included $472 million of income tax refund claims. For additional information on the Company's alliance partners, see "—Note 2. Alliances and Investments."

Note 11 INVENTORIES

The major categories of inventories were as follows:

Dollars in Millions	December 31, 2007	2006
Finished goods	$ 904	$1,003
Work in process	834	682
Raw and packaging materials	424	394
Inventories, net	$2,162	$2,079

Note 12 PROPERTY, PLANT AND EQUIPMENT

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

Dollars in Millions	December 31, 2007	2006
Land	$ 185	$ 254
Buildings	4,696	4,630
Machinery, equipment and fixtures	4,418	4,540
Construction in progress	915	720
	10,214	10,144
Less accumulated depreciation	4,564	4,471
Property, plant and equipment, net	$ 5,650	$ 5,673

Capitalized interest is $35 million, $18 million and $9 million in the years ended December 31, 2007, 2006 and 2005, respectively, and is included in the categories of property, plant and equipment shown above.

Note 13 GOODWILL

The changes in the carrying amount of goodwill for the years ended December 31, 2007 and 2006 were as follows:

Dollars in Millions	Pharmaceuticals Segment	Nutritionals Segment	ConvaTec Segment	Discontinued Operations	Total
Balance as of January 1, 2006	$ 4,448	$ 113	$ 260	$ 2	$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	269	2	4,829
Adjustments:					
Purchase price and other adjustments	158	—	11	—	169
Balance as of December 31, 2007	$ 4,603	$ 113	$ 280	$ 2	$4,998

Goodwill of $156 million was recorded in 2007 by the Pharmaceuticals segment as a result of the acquisition of Adnexus. The Medical Imaging goodwill of $2 million is reported as discontinued operations and will be written off as part of the pre-tax gain on disposal in 2008. For a discussion of acquisitions, see "—Note 4. Acquisitions and Divestitures."

Note 14 OTHER INTANGIBLE ASSETS

As of December 31, 2007 and 2006, other intangible assets consisted of the following:

Dollars in Millions	December 31, 2007	2006
Patents/Trademarks	$ 179	$ 258
Less accumulated amortization	99	145
Patents/Trademarks, net	80	113
Licenses	663	659
Less accumulated amortization	215	162
Licenses, net	448	497
Technology	1,214	1,787
Less accumulated amortization	660	836
Technology, net	554	951
Capitalized Software	917	844
Less accumulated amortization	669	553
Capitalized Software, net	248	291
Total other intangible assets, net	$1,330	$1,852

Note 14 OTHER INTANGIBLE ASSETS (Continued)

Included in the decrease in patents/trademarks and technology is the $273 million reclassification of Medical Imaging assets to held for sale.

Amortization expense for other intangible assets for the years ended December 31, 2007, 2006 and 2005 was $350 million, $363 million and $352 million, respectively, and includes $65 million, $67 million and $68 million of amortization expense related to Medical Imaging discontinued operations for the years ended December 31, 2007, 2006 and 2005, respectively.

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

Years Ending December 31,	Dollars in Millions
2008	$ 244
2009	226
2010	211
2011	199
2012	156
Later Years	294

Note 15 SHORT-TERM BORROWINGS AND LONG-TERM DEBT

Short-term borrowings at the end of 2007 and 2006 were $1.9 billion and $187 million, respectively. Long-term debt was $4.4 billion at December 31, 2007 compared to $7.2 billion at December 31, 2006.

In 2007, the Company reclassified from long-term debt to short-term borrowings the $108 million of 1.10% Yen Notes, due 2008; the $31 million of 1.43% Yen Notes, due 2008; the $400 million of 4.00% Notes, due 2008, and associated unamortized discount and interest rate swap valuation; and the $1.2 billion of Floating Rate Convertible Debentures, due 2023 (with a 2008 put/call).

In September 2007, the Company repaid the $1.3 billion remaining balance of the five-year tranche of its Floating Rate Bank Term Facility, due 2010.

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 at inception) aggregate principal amount of 4.375% Notes due 2016 and €500 million ($641 million at inception) 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 OCI the pre-tax unamortized portion of $32 million ($21 million net of tax) 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, 2007. The Company has unused short-term lines of credit and available trade finance facilities with foreign banks of $109 million and $402 million at December 31, 2007 and 2006, respectively.

Note 15 SHORT–TERM BORROWINGS AND LONG–TERM DEBT (Continued)

The components of long–term debt were as follows:

Dollars in Millions	December 31, 2007	2006
Floating Rate Bank Term Facility, due 2010	$ —	$1,300
5.875% Notes, due 2036	1,284	1,238
Floating Rate Convertible Debentures, due 2023 (1)	—	1,200
4.375% Euro Notes, due 2016	688	645
4.625% Euro Notes, due 2021	662	634
5.25% Notes, due 2013	614	588
4.00% Notes, due 2008	—	391
6.80% Debentures, due 2026	383	383
7.15% Debentures, due 2023	365	352
6.88% Debentures, due 2097	296	296
1.10% Yen Notes, due 2008	—	104
5.75% Industrial Revenue Bonds, due 2024	34	34
1.43% Yen Notes, due 2008	—	30
1.81% Yen Notes, due 2010	31	29
Variable Rate Industrial Revenue Bonds, due 2030	15	15
Other	9	9
	$4,381	$7,248

(1) The Company's outstanding $1.2 billion of convertible debentures pay interest quarterly at an annual rate equal to three–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 $4.1 billion (U.S. dollar value at December 31, 2007) of its long–term debt. In 2006, in conjunction with the new issuance of $1.25 billion 5.875% Notes due 2036 and €1.0 billion Notes ($1.3 billion at inception), 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. For the years ended December 31, 2007 and 2006, the Company realized net increases in interest expense of $13 million and $18 million, respectively, as a result of the higher 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 amortized to interest expense, with $3 million and $2 million 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 pre–tax 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, pre–tax, was recognized in 2007 and 2006.

Cash payments for interest, including payments due to interest rate swaps, were $610 million, $682 million and $598 million in 2007, 2006 and 2005, respectively. The Company's cash receipts from interest rate swaps were $210 million, $205 million and $275 million in 2007, 2006 and 2005, respectively, and were excluded from cash payments for interest.

Dollars in Millions (2)	Payments due by period						
	Total	2008	2009	2010	2011	2012	Later years
Long–Term Debt	$4,381	$—	$ 9	$ 31	$—	$—	$ 4,341

(2) 2008 obligations are included in short–term borrowings on the Company's consolidated balance sheet at December 31, 2007 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.

Note 15 SHORT-TERM BORROWINGS AND LONG-TERM DEBT (Continued)

At December 31, 2007, the Company had provided a total of $236 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 16 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, 2005	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)
Issued pursuant to stock plans and options	—	(12)	359	64	(4)
Amortization of restricted stock	—	—	—	30	22
Lapses and forfeitures of restricted stock	—	—	(16)	2	13
Balance at December 31, 2007	2,205	226	$ (10,584)	$ 2,722	$ (97)

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 2007, 2006 and 2005 were due to conversions into shares of common stock.

Dividends declared per common share were $1.15 in 2007, $1.12 in 2006 and $1.12 in 2005.

The accumulated balances related to each component of OCI, 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, 2005	$ (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)
Other comprehensive income/(loss)	99	(14)	—	238	(139)	184
Balance at December 31, 2007	$ (325)	$ (37)	$ —	$ (973)	$ (126)	$ (1,461)

Note 17 EMPLOYEE STOCK BENEFIT PLANS

Employee Stock Plans

On May 1, 2007, the stockholders approved the Company's 2007 Stock Award and Incentive Plan (the 2007 Plan). The 2007 Plan replaced the 2002 Stock Incentive Plan (the 2002 Plan) that expired on May 31, 2007. The 2007 Plan provides for 42 million new shares of common stock reserved for delivery to participants, plus shares remaining available for new grants under the 2002 Plan and shares recaptured from outstanding awards under the 2002 Plan. Only the number of shares actually delivered to participants in connection with an award after all restrictions have lapsed will be counted against the number of shares reserved. 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 continue to be available and reserved. At December 31, 2007, 352 million shares of common stock were reserved for issuance pursuant to stock plans, options and conversions of preferred stock. There were 98 million and 39 million shares available to be granted for the active plans as of December 31, 2007 and 2006, respectively, adjusted for the combination of plans.

Under the Company's 2007 Plan and the 2002 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.

The 2007 Plan and the 2002 Plan provide 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. During the first quarter of 2007, the Company began granting restricted stock units instead of restricted stock.

The 2007 Plan and the 2002 Plan also incorporate 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 2007 to 2009, the awards have annual goals set at the beginning of each performance period and are based 50% on earnings per share and 50% on sales. Maximum performance will result in a maximum payout of 220%. The goals for the 2005 through 2007 and the 2006 through 2008 awards are set for the three-year period and are 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. Maximum performance for all three measures will result in a maximum payout of 253% of target. If threshold targets are not met for the performance period, no payment will be made under the plan.

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 35.6 million shares have been exercised under the plan as of December 31, 2007.

The Company's results of operations for the years ended December 31, 2007 and 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 year ended December 31, 2005 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, 2007, 2006 and 2005:

Dollars in Millions	Years Ended December 31, 2007	2006	2005
Cost of products sold	$ 13	$ 11	$—
Marketing, selling and administrative	80	67	31
Research and development	40	34	—
Total stock-based compensation expense	133	112	31
Deferred tax benefit	45	39	11
Stock-based compensation, net of tax	$ 88	$ 73	$ 20

Note 17 EMPLOYEE STOCK BENEFIT PLANS (Continued)

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

Dollars in Millions, except per share data	Year Ended December 31, 2005
Net Earnings:	
As reported	$ 3,000
Total stock-based employee compensation expense, included in reported net earnings, net of related tax effects	20
Total stock-based employee compensation expense determined under fair value-based method for all awards, net of related tax effects	(112)
Pro forma	$ 2,908
Basic Earnings per Share:	
As reported	$ 1.53
Pro forma	1.49
Diluted Earnings per Share:	
As reported	$ 1.52
Pro forma	1.48

Stock Options

A summary of option activities were as follows:

Shares in Millions	Shares of Common Stock Issued Under Plan	Weighted-Average Exercise Price of Shares
Balance at January 1, 2005	163	$ 38.87
Granted	20	25.37
Exercised	(9)	16.26
Expired or forfeited	(10)	37.67
Balance at December 31, 2005	164	38.45
Granted	16	23.18
Exercised	(8)	21.00
Expired or forfeited	(9)	33.53
Balance at December 31, 2006	163	38.16
Granted	15	26.31
Exercised	(13)	27.02
Expired or forfeited	(17)	32.84
Balance at December 31, 2007	148	38.53

Note 17 EMPLOYEE STOCK BENEFIT PLANS (Continued)

Information related to stock option grants and exercises under both the 2007 Plan and the 2002 Plan are summarized as follows:

Amounts in Millions, except per share data	For the Years Ending December 31, 2007	2006	2005
Available for stock option awards	97.7	39.4	33.5
Stock options granted	15.3	15.3	20.2
Weighted–average grant–date fair value (per share)	$ 6.56	$ 4.74	$ 5.49
Total intrinsic value of stock options exercised	$ 37	$ 17	$ 69
Cash proceeds from exercise of stock options	$ 345	$ 167	$ 137

As of December 31, 2007, there was $104 million of total unrecognized compensation cost related to stock options and is expected to be recognized over a weighted–average period of 2.5 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	130	$ 37.88	98
Equity compensation plans not approved by security holders (1)	18	43.22	—
	148	38.53	98

(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, 2007 (amounts in millions, except per share data):

	Options Outstanding				Options Exercisable			
Range of Exercise Prices	Number Outstanding	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)
$1 – $20	1	9.16	$ 4.33	$ 12	—	8.60	$ 1.36	$ —
$20 – $30	78	6.94	25.67	109	45	5.97	25.63	71
$30 – $40	—	8.38	30.90	—	—	4.42	30.15	—
$40 – $50	40	1.78	47.04	—	40	1.78	47.04	—
$50 – $60	12	2.99	58.19	—	11	2.96	58.06	—
$60 and up	17	1.48	63.30	—	17	1.48	63.30	—
	148	4.58	38.53	$ 121	113	3.50	42.21	$ 71
Vested or expected to vest	146	4.53	38.69	$ 118				

The aggregate intrinsic value in the preceding table represents the total pre–tax intrinsic value, based on the Company's closing stock price of $26.52 on December 31, 2007, 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, 2007 was 28 million. As of December 31, 2006, 123 million outstanding options were exercisable and the weighted–average exercise price was $42.03.

Note 17 EMPLOYEE STOCK BENEFIT PLANS (Continued)

The fair value of employee stock options granted in 2007 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:

	2007	2006	2005
Expected volatility	28.9%	26.7%	29.4%
Risk–free interest rate	4.7%	4.6%	4.4%
Dividend yield	4.5%	4.8%	4.6%
Expected life	6.2 yrs	6.3 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 12 months ended December 31, 2007 and 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.

The Company acquired Adnexus on October 19, 2007. As part of the acquisition agreement, the Company assumed 24 million shares of Adnexus incentive stock options (ISOs) and replaced them with 0.6 million shares of Company ISOs. The converted options retain their original vesting schedules, including the vesting commencement date, as well as the expiration date. A Black–Scholes model was used to determine the expected term and the individual ISOs valuations. The result was a weighted–average expected term of 5.2 years and a weighted–average fair value on October 19, 2007 of $20.34.

Note 17 EMPLOYEE STOCK BENEFIT PLANS (Continued)

Restricted Stock Awards and Restricted Stock Units

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, 2005	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
Granted	3,584	27.14
Vested	(1,360)	25.51
Forfeited	(892)	25.13
Nonvested shares at December 31, 2007	8,223	25.48
Expected to vest	7,772	25.48

As of December 31, 2007 and 2006, there was $145 million and $126 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 2.6 years for the balance at December 31, 2007 and 2.75 years for the balance at December 31, 2006. The total cost of non–vested shares and share units granted that was recognized as compensation expense during the twelve months ended December 31, 2007, 2006 and 2005 was $53 million, $34 million and $27 million, respectively. The total fair value of shares and share units that vested during the 12 months ended December 31, 2007, 2006 and 2005 was $35 million, $21 million and $14 million, respectively.

Performance Awards

Prior to the adoption of SFAS No. 123(R), compensation expense related to 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.

Since the adoption of SFAS No. 123(R), the fair value of the 2006 through 2008 performance award was estimated on the date of grant using a Monte Carlo simulation model due to a market condition. 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. For the 2007 through 2009 performance award, because the award does not contain a market condition, the fair value was based on the closing trading price of the Company's common stock on the grant date.

The valuation model for the 2006 through 2008 award 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 five–year zero coupon U.S. Treasury bonds, based on the performance shares' contractual term. The fair value of the performance awards is amortized over the performance period of the award.

Note 17 EMPLOYEE STOCK BENEFIT PLANS (Continued)

Information related to performance awards under both the 2007 Plan and the 2002 Plan is summarized as follows:

Shares in Thousands	Performance Cycle		Weighted–Average	Performance Shares Outstanding	
Grant Date	Measurement Date	Shares Granted	Grant Date Fair Value	December 31, 2007	December 31, 2006
3/2/04	12/31/06	456	$ 28.11	—	417
3/1/05	12/31/07	1,087	25.45	830	894
3/7/06	12/31/08	640	20.00	415	461
3/6/07	Annually on 12/31	219	27.01	209	—
5/1/07	Annually on 12/31	57	28.68	57	—
Total outstanding				1,511	1,772

At December 31, 2007 and 2006, there was $11 million and $2 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 1.8 years and 2.0 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 years ended December 31, 2007 and 2006 was $133 million and $112 million, respectively, ($88 million and $73 million, net of tax, respectively) or $0.04 per share and $0.04 per share, respectively, with a corresponding amount recorded in additional paid–in capital within stockholders' equity. Additionally, in 2006, $10 million related to performance awards was reclassified from liabilities to stockholders' equity in connection with the adoption of SFAS No. 123(R).

Note 18 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, Canadian dollar, Japanese yen, Mexican peso and Chinese renminbi.

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, 2007 and 2006 were $1,656 million and $1,585 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.

The table below summarizes the Company's outstanding foreign exchange forward contracts as of December 31, 2007. 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.

Dollars in Millions, except currency rates	Weighted–Average Strike Price	Notional Amount	Fair Value Asset/(Liability)	Maturity
Foreign Exchange Forwards:				
Cash Flow Hedges				
Australian Dollar	0.80	$ 72	$ (6)	2008
British Pound	2.01	79	1	2008
Canadian Dollar	1.08	130	(12)	2008
Euro	1.36	636	(43)	2008
Japanese Yen	107.62	159	3	2008
Mexican Peso	10.95	54	1	2008
Polish Zloty	2.53	18	—	2008
Swedish Krona	6.48	47	—	2008
Swiss Franc	1.16	30	—	2008
Total Cash Flow Hedges		1,225	(56)	
Non–Qualifying Hedges[1]				
Australian Dollar	0.90	71	3	2008
British Pound	2.06	41	2	2008
Canadian Dollar	0.95	131	6	2008
Euro	1.45	13	(1)	2008
Japanese Yen	106.78	71	2	2008
Polish Zloty	2.53	61	(1)	2008
Turkish Lira	1.27	43	(2)	2008
Total Non–Qualifying Hedges		431	9	
Total Contracts		$ 1,656	$ (47)	

(1) Non–qualifying hedges are hedges that do not qualify for hedge accounting treatment as prescribed by SFAS No. 133, *Accounting for Derivative Instruments and Hedging Activities.*

At December 31, 2007, the Company held foreign exchange option contracts to buy and sell Japanese Yen. The total notional and fair market value for buy contracts is $145 million and $1 million, respectively, which are fully offset by the total notional and fair market value for sell contracts of $145 million and $1 million, respectively.

During 2007, 2006 and 2005, the Company reclassified pre–tax deferred losses of $56 million, $18 million and $130 million, respectively, from accumulated OCI to earnings, the majority of which was classified as cost of products sold. As of December 31, 2007, the balance of deferred losses on foreign exchange forward contracts included in accumulated OCI on a pre–tax basis was $54 million ($37 million net of tax), all of which is expected to be reclassified into earnings within the next 12 months.

Note 18 FINANCIAL INSTRUMENTS (Continued)

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, 2007 and 2006, the impact of hedge ineffectiveness on earnings was not significant. Additionally, for the years ended December 31, 2007 and 2006, the impact of discontinued hedges was a pre–tax loss of $12 million and a pre–tax loss of $10 million, respectively. Furthermore, the Company uses foreign exchange forward contracts to offset its exposure to certain currency assets and liabilities and earnings denominated in certain foreign currencies. 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 other income, net, as they occur. The notional and fair value amounts of foreign exchange forward contracts at December 31, 2007 are described in the table above. There were no foreign exchange forward contracts of this type outstanding at December 31, 2006. In 2007, the impact of foreign exchange forward contracts that are not designated as hedges was a pre–tax gain of $4 million. In 2006 and 2005, the amounts recognized in earnings related to these types of 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 $47 million at December 31, 2007, of which $16 million was recorded as a non–current asset and $63 million was recorded as a current liability. 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 all foreign exchange contracts is based on year–end currency rates (and the Black–Scholes model in the case of option contracts).

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 expense, net. The notional and fair value amount of purchased foreign exchange forward contracts was not material at December 31, 2007, and $24 million and a $1 million asset, respectively, at December 31, 2006. There were no notional and fair value amounts of sold foreign exchange forward contracts at December 31, 2007, and $22 million and a $1 million liability, respectively, at December 31, 2006.

The Company also uses non–U.S. dollar borrowings, primarily the €500 Million Notes due 2016 and the €500 Million Notes due 2021, to hedge the foreign currency exposures of the Company's net investment in certain foreign affiliates. These non–U.S. dollar borrowings 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 accumulated OCI. At December 31, 2007 and 2006, $168 million and $27 million in losses, respectively, were recorded in the foreign currency translation component of accumulated OCI.

The Company had unhedged exposures to net foreign currency–denominated assets and liabilities of approximately $1.9 billion and $1.6 billion at December 31, 2007 and 2006, respectively, primarily in Mexico, Japan, the UK, China, Australia and Canada.

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 ($1.3 billion at inception) of the Company's newly–issued fixed rate debt to be paid in 2016, 2021 and 2036 to variable rate debt. The total notional amounts of outstanding interest rate swaps were $2.6 billion and €1 billion ($1.5 billion) as of December 31, 2007 and $2.6 billion and €1 billion ($1.3 billion) as of December 31, 2006. In accordance with SFAS No. 133, *Accounting for Derivative Instruments and Hedging Activities*, the Company recognized a net increase in interest expense of $13 million and $18 million in 2007 and 2006, respectively, and a net reduction in interest expense of $54 million in 2005 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 $72 million, current liabilities of $96 million and a reduction in long–term debt of $24 million at December 31, 2007; and an increase in non–current assets of $7 million, current liabilities of $57 million and a reduction in long–term debt of $50 million at December 31, 2006. 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 OCI and amortized to earnings over the remaining life of the debt. The following tables summarize the interest rate swaps outstanding as of December 31, 2007 and 2006 the earnings impact from terminated interest rate swap contracts for 2007, 2006 and 2005:

Note 18 FINANCIAL INSTRUMENTS (Continued)

Interest Rate Swaps Outstanding

Interest Rate Contracts Dollars in Millions	Notional Amount of Underlying Debt	Variable Rate Received	Year of Transaction	Maturity	Fair Value
Swaps associated with:					
4.00% Notes due 2008	$ 400	1 month U.S. $ LIBOR +0.35%	2003	2008	$ (2)
5.25% Notes due 2013	600	1 month U.S. $ LIBOR +0.42%	2003	2013	16
4.375% €500 Million Notes due 2016	725	3 month EUR € EURIBOR +0.40%	2006	2016	(37)
4.625% €500 Million Notes due 2021	725	3 month EUR € EURIBOR +0.56%	2006	2021	(57)
7.15% Notes due 2023	350	1 month U.S. $ LIBOR +1.66%	2004	2023	20
5.875% Notes due 2036	1,250	1 month U.S. $ LIBOR +0.62%	2006	2036	36
	$ 4,050				$ (24)

Earnings Impact from Terminated Interest Rate Swap Contracts

Interest Rate Contracts Dollars in Millions	Year of Termination	Notional Amount of Underlying Debt	Total Pre-Tax Deferred Gain/(Loss)	Pre-Tax Income/(Expense) Recognized 2007	2006	2005
Interest rate swap lock associated with:						
5.75% Notes due 2011 (1)	2001	$ 2,500	$ (58)	$ —	$ (37)	$ (5)
4.75% Note due 2006 (2)	2001	2,000	(48)	—	—	(15)
Swaps associated with:						
4.75% Notes due 2006 (2)	2005	2,000	(13)	—	—	(13)
5.75% Notes due 2011 (1)	2005	500	(23)	—	(21)	(2)
6.8% Notes due 2026 (3)	2005	350	39	1	1	—
5.75% Notes due 2011 (1)	2006	2,000	(62)	—	(62)	—
			$ (165)	$ 1	$(119)	$ (35)

(1) The underlying 2011 Notes were extinguished in 2006.
(2) The underlying 2006 Notes were extinguished in 2005.
(3) The underlying 2026 Notes have not been extinguished.

The carrying amount of the Company's other financial instruments, which includes cash, cash equivalents, accounts receivable and accounts payable, approximates their fair value at December 31, 2007 and 2006. For a discussion on cash, cash equivalents and marketable securities, see "—Note 9. Cash, Cash Equivalents and Marketable Securities" above. For long-term debt, the difference between the fair value and carrying value is not material.

Note 19 SEGMENT INFORMATION

The Company is organized in three reportable segments—Pharmaceuticals, Nutritionals and ConvaTec. 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 ConvaTec segment consists of the ostomy, wound and skin care business.

In December 2007, the Company entered into a definitive agreement with Avista for the sale of its Medical Imaging business. The closing of the transaction was completed in January 2008. The results of the Medical Imaging business, which previously was included in the former Other Health Care operating segment, are included in income from discontinued operations, net of tax, for all periods. The net assets associated with the Medical Imaging business, totaling approximately $483 million, as well as other assets totaling $42 million, have been reclassified to assets held for sale as of December 31, 2007 and are included in Corporate/Other below. In May 2005, the Company completed the sale of OTN to One Equity Partners LLC. The results of OTN, which previously was presented as a separate operating segment, are included in income from discontinued operations, net of tax, for the year ended December 31, 2005. The results of both the Medical Imaging business and OTN are not included in the tables below.

In the third quarter of 2005, the Company completed the sale of its Consumer Medicines business, which is included in the Pharmaceuticals operating segment. For additional information on the sale of Consumer Medicines, see "—Note 4. Acquisitions and Divestitures."

Note 19 SEGMENT INFORMATION (Continued)

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 19%, 16% and 12%, respectively, of the Company's total net sales in 2007. In 2006, sales to these wholesalers accounted for approximately 19%, 16% and 11%, respectively, of the Company's total net sales. In 2005, the same three wholesalers accounted for 21%, 18% and 12%, respectively, of the Company's total net sales. These sales were concentrated in the Pharmaceuticals segment.

Dollars in Millions	Net Sales			Earnings From Continuing Operations Before Minority Interest and Income Taxes			Year-end Assets	
	2007	2006	2005	2007	2006	2005	2007	2006
Pharmaceuticals	$15,622	$13,861	$15,408	$ 3,471	$ 2,569	$ 3,739	$12,549	$11,644
Nutritionals	2,571	2,347	2,205	708	696	677	1,274	1,167
ConvaTec	1,155	1,048	992	348	315	288	715	666
Health Care Group	3,726	3,395	3,197	1,056	1,011	965	1,989	1,833
Total segments	19,348	17,256	18,605	4,527	3,580	4,704	14,538	13,477
Corporate/Other	—	—	—	(993)	(1,180)	(400)	11,634	12,098
Total	$19,348	$17,256	$18,605	$ 3,534	$ 2,400	$ 4,304	$26,172	$25,575

Net sales of the Company's key products were as follows:

Dollars in Millions	Sales by Products		
	2007	2006	2005
Pharmaceuticals			
PLAVIX*	$ 4,755	$ 3,257	$ 3,823
AVAPRO*/AVALIDE*	1,204	1,097	982
PRAVACHOL	443	1,197	2,256
COUMADIN	201	220	212
REYATAZ	1,124	931	696
SUSTIVA Franchise (total revenue)	956	791	680
BARACLUDE	275	83	12
ERBITUX*	692	652	413
TAXOL® (paclitaxel)	422	563	747
SPRYCEL	158	25	—
IXEMPRA	15	—	—
ABILIFY* (total revenue)	1,660	1,282	912
Other Pharmaceuticals	3,717	3,763	4,675
Total Pharmaceuticals	15,622	13,861	15,408
Nutritionals			
ENFAMIL	1,082	1,007	992
ENFAGROW	295	262	206
Other Nutritionals	1,194	1,078	1,007
Total Nutritionals	2,571	2,347	2,205
ConvaTec			
Ostomy	594	554	550
Wound Therapeutics	488	441	416
Other ConvaTec	73	53	26
Total ConvaTec	1,155	1,048	992
Total	$19,348	$17,256	$18,605

Corporate/Other consists principally of interest income, interest expense, certain administrative expenses and allocations to the business segments of certain corporate programs, litigation expense, impairment of auction rate securities, debt retirement costs, gain on sale of businesses and product assets, deferred income recognized from collaboration agreement and restructuring charges. Corporate/Other assets include cash and cash equivalents, marketable securities, assets of discontinued operations and certain other assets.

Note 19 SEGMENT INFORMATION (Continued)

Dollars in Millions	Capital Expenditures			Depreciation		
	2007	2006	2005	2007	2006	2005
Pharmaceuticals	$639	$538	$545	$430	$453	$475
Nutritionals	63	65	65	44	41	38
ConvaTec	25	19	25	19	18	20
Health Care Group	88	84	90	63	59	58
Total segments	727	622	635	493	512	533
Corporate/Other[a]	74	58	58	49	52	44
Total	$801	$680	$693	$542	$564	$577

(a) The Corporate/Other amounts include the activities of the Medical Imaging business, including capital expenditures of $5 million, $14 million and $13 million for 2007, 2006 and 2005, respectively, and depreciation expense of $9 million, $10 million and $7 million for 2007, 2006 and 2005, respectively.

Geographic Areas

Dollars in Millions	Net Sales			Year-end Assets	
	2007	2006	2005	2007	2006
United States	$10,808	$ 9,140	$ 9,924	$17,283	$16,942
Europe, Middle East and Africa	4,635	4,518	5,111	5,198	5,032
Other Western Hemisphere	1,704	1,580	1,561	2,271	2,237
Pacific	2,201	2,018	2,009	1,420	1,364
Total	$19,348	$17,256	$18,605	$26,172	$25,575

Note 20 LEASES

Minimum rental commitments under all non–cancelable operating leases, primarily real estate and motor vehicles, in effect at December 31, 2007, were as follows:

Years Ending December 31,	Dollars in Millions
2008	$ 143
2009	116
2010	90
2011	72
2012	71
Later years	212
Total minimum payments	704
Less total minimum sublease rentals	39
Net minimum rental commitments	$ 665

Operating lease rental expense (net of sublease rental income of $17 million in 2007, $21 million in 2006 and $15 million in 2005) was $166 million in 2007, $149 million in 2006 and $150 million in 2005.

In December 2006, the Company completed the sale and leaseback of several administrative facilities in New Jersey for $283 million, which resulted in a pre–tax gain from the transaction of $154 million, of which $145 million was deferred and will reduce future lease rental costs over the lease periods ranging from 8 to 12 years.

Note 21 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 net periodic benefit cost of the Company's defined benefit pension and postretirement benefit plans included the following components:

Dollars in Millions	Pension Benefits			Other Benefits[a]		
	2007	2006	2005	2007	2006	2005
Service cost — benefits earned during the year	$ 249	$ 238	$ 223	$ 8	$ 9	$ 9
Interest cost on projected benefit obligation	352	326	314	36	34	36
Expected return on plan assets	(442)	(410)	(361)	(25)	(22)	(20)
Amortization of prior service cost/(benefit)	11	12	13	(3)	(3)	(4)
Amortization of loss	140	166	203	6	4	7
Amortization of transitional obligation	—	1	—	—	—	—
Net periodic benefit cost	310	333	392	22	22	28
Curtailments and settlements	3	(1)	—	1	—	—
Total net periodic benefit cost	$ 313	$ 332	$ 392	$ 23	$ 22	$ 28

(a) The Company has recognized the impact of the Medicare Prescription Drug Improvement and Modernization Act of 2003 in 2007, 2006 and 2005, and in accordance with FSP No. 106–2, *Accounting and Disclosure Requirements Related to the Medicare Prescription Drug, Improvement and Modernization Act of 2003*, recorded $11 million for each of 2007, 2006 and 2005, respectively, as a reduction in net periodic benefit costs.

Note 21 PENSION AND OTHER POSTRETIREMENT BENEFIT PLANS (Continued)

Net actuarial loss and prior service cost/(benefit) amortized from accumulated OCI into net periodic benefit costs for 2007 were $140 million and $11 million, respectively, for pension benefits; and were $6 million and a benefit of $3 million, respectively, for other benefits. The estimated net actuarial loss and prior service cost that will be amortized from accumulated OCI into net periodic benefit cost in 2008 are:

Dollars in Millions	Pension Benefits	Other Benefits
Amortization of net actuarial loss	$ 98	$ 6
Amortization of prior service cost/(benefit)	11	(3)
	$ 109	$ 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, 2007 and 2006, for the Company's defined benefit and postretirement benefit plans, were as follows:

Dollars in Millions	Pension Benefits		Other Benefits(b)	
	2007	2006	2007	2006
Benefit obligation at beginning of year	$6,186	$5,918	$ 651	$ 643
Service cost—benefits earned during the year	249	238	9	9
Interest cost on projected benefit obligation	352	326	36	34
Plan participants' contributions	4	3	16	12
Curtailments and settlements	(28)	(2)	(2)	—
Actuarial losses/(gains)	(179)	10	11	27
Plan amendments	2	7	—	—
Retiree Drug Subsidy Received	—	—	5	6
Benefits paid	(496)	(432)	(87)	(81)
Special termination benefit	4	—	2	—
Exchange rate (gains)/losses	90	118	5	1
Benefit obligation at end of year	$6,184	$6,186	$ 646	$ 651
Fair value of plan assets at beginning of year	$5,658	$5,017	$ 291	$ 253
Actual return on plan assets	458	649	29	38
Employer contribution	323	325	66	63
Plan participants' contributions	4	3	16	12
Settlements	(9)	—	—	—
Retiree Drug Subsidy Received	—	—	5	6
Benefits paid	(496)	(432)	(87)	(81)
Exchange rate (losses)/gains	81	96	—	—
Fair value of plan assets at end of year	$6,019	$5,658	$ 320	$ 291
Funded status	$ (165)	$ (528)	$(326)	$(360)
Amounts recognized in the balance sheet consist of:				
Other assets	$ 291	$ 45	$ —	$ —
Accrued expenses	(27)	(25)	(58)	(56)
Pension and other postretirement liabilities (accrued benefit cost)	(429)	(548)	(268)	(304)
Net amount recognized	$ (165)	$ (528)	$(326)	$(360)
Amounts recognized in accumulated other comprehensive loss				
Net actuarial loss	$1,358	$1,711	$ 117	$ 117
Net obligation at adoption	2	2	—	—
Prior service cost	46	55	(20)	(24)
	$1,406	$1,768	$ 97	$ 93

(b) The Company has recognized the impact of the Medicare Prescription Drug Improvement and Modernization Act of 2003 in 2007, 2006 and 2005, and in accordance with FSP No. 106-2, recorded $98 million and $94 million in 2007 and 2006, respectively, as a reduction in accumulated postretirement benefit obligation.

Several plans had underfunded accrued benefit obligations that exceeded their accrued benefit liabilities at December 31, 2006. 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 against accumulated OCI upon the adoption of SFAS No. 158.

Note 21 PENSION AND OTHER POSTRETIREMENT BENEFIT PLANS (Continued)

The accumulated benefit obligation for all defined benefit pension plans was $5,417 million and $5,422 million at December 31, 2007 and 2006, respectively.

Information related to the Company's pension plans at December 31 was as follows:

Dollars in Millions	December 31, 2007	2006
Pension plans with projected benefit obligations in excess of plan assets:		
Projected benefit obligation	$1,376	$1,646
Fair value of plan assets	921	1,073
Pension Plans with accumulated benefit obligation in excess of plan assets:		
Accumulated benefit obligation	$ 352	$1,137
Fair value of plan assets	62	795

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 2007	2006	2005	Other Benefits 2007	2006	2005
(Decrease)/Increase in minimum liability, including the impact of foreign currency fluctuations, included in other comprehensive income	$ —	$ (96)	$ (20)	$ —	$ —	$ —

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

	Pension Benefits 2007	2006	Other Benefits 2007	2006
Discount rate	6.46%	5.74%	6.46%	5.73%
Rate of compensation increase	3.67%	3.63%	3.60%	3.60%

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

	Pension Benefits 2007	2006	2005	Other Benefits 2007	2006	2005
Discount rate	5.74%	5.49%	5.57%	5.73%	5.49%	5.52%
Expected long-term return on plan assets	8.30%	8.39%	8.41%	8.75%	8.75%	8.75%
Rate of compensation increase	3.63%	3.60%	3.59%	3.60%	3.61%	3.59%

At December 31, 2007, 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, 2007 were 8.2% for 10 years, 10.4% for 15 years and 10.6% for 20 years.

U.S. pension plan assets represented approximately 75% of total Company pension plan assets at December 31, 2007. The 8.30% disclosed above for total Company expected return on assets for 2007 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 2007, as the relevant assets are invested in the same manner as U.S. pension plan assets and there are no international plan assets.

Note 21 PENSION AND OTHER POSTRETIREMENT BENEFIT PLANS (Continued)

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

	2007	2006	2005
Health care cost trend rate assumed for next year	9.37%	9.87%	7.93%
Rate to which the cost trend rate is assumed to decline (the ultimate trend rate)	4.49%	4.49%	4.42%
Year that the rate reaches the ultimate trend rate	2018	2018	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	36	(27)

The Company's asset allocation for pension and postretirement benefits at December 31, 2007 and 2006, were as follows:

	Pension Benefits		Other Benefits	
	2007	2006	2007	2006
Public equity securities	65.1%	67.2%	67.3%	69.2%
Debt securities (including cash)	27.3	26.9	23.7	23.3
Private equity	6.7	5.6	8.7	7.2
Other	0.9	0.3	0.3	0.3
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 well diversified within each of the three major asset categories. About 30% 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, 2007 and 2006.

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 $238 million, $235 million and $318 million in 2007, 2006 and 2005, respectively. The Company also plans to make a cash contribution to the U.S. pension plans in 2008.

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 $85 million, $90 million and $105 million in 2007, 2006 and 2005, respectively. Contributions to the international plans are now expected to be in the range of $70 million to $90 million in 2008.

Note 21 PENSION AND OTHER POSTRETIREMENT BENEFIT PLANS (Continued)

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	Other Benefits Medicare Subsidy	Other Benefits Net
2008	$ 376	$ 69	$ 9	$ 60
2009	371	69	9	60
2010	390	70	10	60
2011	418	70	11	59
2012	442	69	12	57
Years 2013 – 2017	2,553	328	57	271

Adoption of SFAS No. 158

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	Pre-SFAS No. 158	SFAS No. 158 Adjustments Pre-tax	SFAS No. 158 Adjustments Tax	SFAS No. 158 Adjustments Net	Post-SFAS No. 158
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)

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 $60 million in 2007, $56 million in 2006 and $51 million in 2005.

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 EITF Issue No. 88-1, *Determination of Vested Benefit Obligation for a Defined Benefit Pension Plan*. The total pension liability recorded for these obligations was $70 million at December 31, 2007 and $75 million at December 31, 2006.

Note 22 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, employment matters, 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 pending matters or that any future lawsuits, claims, proceedings or investigations will not be material.

INTELLECTUAL PROPERTY

PLAVIX* Litigation

PLAVIX* is currently the Company's largest product ranked by net sales. Net sales of PLAVIX* were approximately $4.8 billion for the year ended December 31, 2007, $3.3 billion for the year ended December 31, 2006 and $3.8 billion for the year ended December 31, 2005, and U.S. net sales of PLAVIX* were $4.1 billion in 2007, $2.7 billion in 2006 and $3.2 billion in 2005. The PLAVIX* patents are subject to a number of challenges in the U.S., including the litigation with Apotex Inc. and Apotex Corp. (Apotex) described below, and in 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*, results of operations and cash flows, and could be material to the Company's financial condition and liquidity. The Company and its product partner, Sanofi, (the Companies) intend to vigorously pursue enforcement of their patent rights in PLAVIX*.

PLAVIX* Litigation – United States

Patent Infringement Litigation against Apotex and Related Matters

As previously disclosed, 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 (District court) entitled Sanofi–Synthelabo, Sanofi–Synthelabo, Inc. and Bristol–Myers Squibb Sanofi Pharmaceuticals Holding Partnership v. Apotex. The suit 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 Apotex's filing of their Abbreviated New Drug Application (aNDA) with the FDA, seeking approval to sell generic clopidogrel bisulfate prior to the expiration of the composition of matter patent in 2011. Apotex has alleged that the patent is invalid and/or unenforceable.

As previously disclosed, in March 2006, the Company and Sanofi announced that they had executed a proposed settlement agreement (the March Agreement) with Apotex to settle the pending patent infringement lawsuit. In response to concerns expressed by the Federal Trade Commission (FTC) and state attorneys general, the parties modified the March Agreement (the Modified Agreement) in May 2006. 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 31, 2006, the District court issued a preliminary injunction ordering Apotex to halt sales of generic clopidogrel bisulfate, but not to recall product from its customers. On June 19, 2007, the District court issued an opinion and order upholding the validity and enforceability of the '265 Patent, maintaining the main patent protection for PLAVIX* in the U.S. until November 2011. The District court also ruled that Apotex's generic clopidogrel bisulfate product infringed the '265 Patent and permanently enjoined Apotex from engaging in any activity that infringes the '265 Patent, including marketing its generic product in the U.S. until after the patent expires. The amount of damages will be set at a later time. Apotex's appeal of the District court's decision is pending before the U.S. Court of Appeals for the Federal Circuit with a hearing scheduled for March 2008. The District court has stayed certain antitrust counterclaims brought by Apotex pending the outcome of the appeal. Activities relating to the damages phase of the litigation are continuing.

As also previously disclosed, 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 '265 Patent. A trial date for the action against Dr. Reddy's has not been set. On January 14, 2008, Dr. Reddy's received final approval of its aNDA. On January 24, 2008, the court entered an order that requires Dr. Reddy's to give the Company 10 business days notice of its intent to launch. The patent infringement actions against Teva and Cobalt were stayed pending resolution of the Apotex litigation, and the parties to those actions agreed to be bound by the outcome of the litigation against Apotex, although Teva and Cobalt can appeal the outcome of the litigation.

Note 22 LEGAL PROCEEDINGS AND CONTINGENCIES (continued)

Consequently, on July 12, 2007, the District court entered judgments against Cobalt and Teva and permanently enjoined Cobalt and Teva from engaging in any activity that infringes the '265 Patent until after the Patent expires. Cobalt and Teva have each filed an appeal. Each of Dr. Reddy's, Teva and Cobalt have filed an aNDA with the FDA, and all exclusivity periods and statutory stay periods under the Hatch–Waxman Act have expired. 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.

As previously disclosed, in March 2007, the Company was served with a Civil Investigative Demand by the FTC requesting documents and information related to the proposed settlement. In addition, as previously disclosed, in April 2007, the Company received a subpoena from the New York State Attorney General's Office — Antitrust Bureau for documents related to the proposed settlement. The Company is cooperating fully with the investigations. It is not possible at this time reasonably to assess the outcomes of the investigations or their impact on the Company.

As also previously disclosed, 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. (Watson). The suit was filed in October 2004 and was based on U.S. Patent No. 6,429,210 (the '210 Patent), 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. In April 2007, Pharmastar filed a request for *inter partes* reexamination of the '210 Patent. The U.S. Patent and Trademark Office granted this request in July of 2007. Thus, the '210 Patent is currently under reexamination.

It is not possible at this time reasonably to assess the outcomes of the appeal by Apotex of the District court's decision, or 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 in an appeal of the patent litigation, the Company would expect to face renewed generic competition for PLAVIX* from Apotex promptly thereafter. 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. Additionally, it is not possible at this time reasonably to assess the amount of damages that could be recovered by the Company and Apotex's ability to pay such damages in the event the Company prevails in Apotex's appeal of the District court decision.

See "Antitrust Litigation", "Shareholder Derivative Actions" and "Securities Litigation" below for a further discussion of certain other U.S. litigations relating to PLAVIX*.

PLAVIX* Litigation – International

PLAVIX – Canada (Apotex, Inc.)

As previously disclosed, 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 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. 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. In December 2006, the Federal Court of Appeal dismissed Apotex's appeal and upheld the Federal Court's issuance of the order of prohibition. In February 2007, Apotex filed leave to appeal this decision to the Supreme Court of Canada. In July 2007, the Supreme Court of Canada granted Apotex leave to appeal the decision of the Canadian Federal Court of Appeal. BIOTECanada, the Canadian Generic Pharmaceutical Association and Canada's Research–Based Pharmaceutical Companies were granted leave to intervene. The oral hearing is scheduled for April 2008.

As also previously disclosed, in April 2007, Apotex filed a lawsuit in Canada in the Ontario Superior Court of Justice entitled Apotex Inc. and Apotex Corp. v. Sanofi–Aventis, Sanofi–Synthelabo Inc., Bristol–Myers Squibb Company, and Bristol–Myers Squibb Sanofi Pharmaceuticals Holding Partnership, seeking a payment of $60 million, plus interest related to the break–up of the proposed settlement agreement. Defendants filed motions to dismiss on the grounds of forum non conveniens and subject matter jurisdiction. The motions were granted on January 14, 2008.

Note 22 LEGAL PROCEEDINGS AND CONTINGENCIES (Continued)

PLAVIX* – Canada (Cobalt)

As previously disclosed, 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.

PLAVIX* – Korea

As previously disclosed, in June 2006, the Korean Intellectual Property Tribunal (KIPT) 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 appealed. In January 2008, the Patent Court affirmed the KIPT decision. The Company and Sanofi are considering its options, including an appeal. 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.

PLAVIX* – Australia

As previously disclosed, Sanofi was notified that in August 2007, GenRx Proprietary Limited (GenRx) obtained regulatory approval of an application for clopidogrel bisulfate 75mg tablets in Australia. In August 2007, GenRx filed an application in the Federal Court of Australia seeking revocation of Sanofi's Australian Patent No. 597784 (Case No. NSD 1639 of 2007). Sanofi filed counterclaims of infringement and sought an injunction. On September 21, 2007, the Australian court granted Sanofi's injunction and scheduled a trial date for April 2008.

OTHER INTELLECTUAL PROPERTY LITIGATION

ABILIFY*

As previously disclosed, Otsuka has filed patent infringement actions against Teva, Barr Pharmaceuticals, Inc. (Barr), Sandoz Inc. (Sandoz), Synthon Laboratories, Inc (Synthon), Sun Pharmaceuticals (Sun) and Apotex relating to U.S. Patent No. 5,006,528, which covers aripiprazole and expires in October 2014. Aripiprazole is comarketed by the Company and Otsuka in the U.S. as ABILIFY*. The lawsuits are currently pending in the U.S. District Court for the District of New Jersey.

It is not possible at this time reasonably to assess the outcome of these lawsuits or their impact on the Company.

ERBITUX*

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 District court. The complaint alleged that if the Yeda researchers remain sole inventors of the '866 Patent, the patent is invalid. Under its commercial agreement with ImClone, the Company pays a royalty to ImClone on sales of ERBITUX* that was not impacted by the Court's decision.

Pursuant to a settlement agreement executed by ImClone, Sanofi and Yeda announced on December 7, 2007 to end worldwide litigation related to the '866 Patent, Yeda and Sanofi granted ImClone a worldwide license under the '866 Patent, and the parties agreed that Yeda is the sole owner of the '866 Patent in the U.S. and Yeda and Sanofi are co–owners of the '866 Patent foreign counterparts. The settlement agreement does not change ImClone's worldwide royalty rate for ERBITUX* sales. Under its commercial agreement with ImClone, the Company pays a royalty to ImClone on sales of ERBITUX* that is not impacted by the settlement agreement.

Note 22 LEGAL PROCEEDINGS AND CONTINGENCIES (Continued)

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 licensed the patent to Amgen Inc. (Amgen). Amgen received FDA approval to market an EGFR product that competes with ERBITUX*.

Abbott Laboratories

As previously disclosed, in February 2007, Abbott Laboratories (Abbott) filed suit against ImClone in the U.S. District Court for the District of Massachusetts alleging that ImClone's manufacture and sale of ERBITUX* infringe U.S. Patent No. 5,665,578 (the '578 Patent), and seeking damages for that alleged infringement. Pursuant to settlement and sublicensing agreements executed by ImClone and Repligen Corporation (Repligen) announced on September 10, 2007, Repligen granted ImClone a royalty-free, irrevocable worldwide sublicense for the future use of other patented technology, including the '578 Patent, owned by Abbott and licensed to Repligen under an agreement between Abbott and Repligen. The Company's commercial agreements with ImClone include provisions pursuant to which certain financial consequences to the Company resulting from the settlement and sublicensing agreements would be the responsibility of ImClone. The settlement and sublicensing agreements, however, do not end this lawsuit.

It is not possible at this time to assess the outcome of this lawsuit or the potential 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. A court-ordered mediation is scheduled for March 4, 2008, and the trial is scheduled to commence in April 2008.

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 now expected to commence in 2009.

PRAVACHOL

In December 2006, LEK D.D. (LEK), a Slovenian generic company that is wholly-owned by Novartis, filed suit against the Company and Watson in the U.S. District Court for the Eastern District of Texas in Marshall, Texas. LEK's complaint alleges that the Company's sale of PRAVACHOL and Watson's sale of an authorized generic of PRAVACHOL infringe two patents of LEK. The patents are U.S. Patents Nos. 6,740,775, issued May 25, 2004 and 7,078,558, issued July 18, 2006. The Company filed an Answer to the Complaint in June 2007. The Company believes that it has a strong defense to this suit and intends to defend itself vigorously. The trial is scheduled to commence in August 2009.

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

As previously disclosed, 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. In December 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.

Note 22 LEGAL PROCEEDINGS AND CONTINGENCIES (Continued)

RxUSA Wholesale Litigation

As previously disclosed, 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, 15 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 in November 2006. That motion remains 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.

ANTITRUST LITIGATION

As previously disclosed, 18 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. These lawsuits allege, among other things, that the purported settlement with Apotex of the patent infringement litigation violated 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 were filed on October 19, 2007. Defendants filed a consolidated motion to dismiss on December 11, 2007. It is not possible at this time reasonably to assess the outcome of these lawsuits or their impact on the Company.

SHAREHOLDER DERIVATIVE ACTIONS

On July 31, 2007, certain members of the Board of Directors, current and former officers and the Company were named in two derivative actions filed in the New York State Supreme Court, *John Frank v. Peter Dolan, et al. (07-602580)* and *Donald Beebout v. Peter Dolan, et al. (07-602579)*, and one derivative action filed in the federal district court, *Steven W. Sampson v. James D. Robinson, III, et al. (07-CV-6890)*. The complaints allege breaches of fiduciary duties for allegedly failing to disclose material information relating to efforts to settle the PLAVIX* patent infringement litigation with Apotex. Plaintiffs seek monetary damages on behalf of the Company, contribution and indemnification. By decision filed on December 13, 2007, the state court granted motions to dismiss the complaints, *Frank* and *Beebout*, relating to certain members of the Board of Directors, but did not dismiss the complaints as to the former officers. The Company filed a motion to dismiss in the federal district court action, *Sampson*, which is pending.

SECURITIES LITIGATION

In Re Bristol-Myers Squibb Co. Securities Litigation

As previously disclosed, in June and July 2007, two putative class action complaints, *Minneapolis Firefighters' Relief Assoc. v. Bristol-Myers Squibb Co., et al., 07 CV 5867* and *Jean Lai v. Bristol-Myers Squibb Company, et al.*, were filed in the U.S. District for the Southern District of New York against the Company, the Company's former Chief Executive Officer, Peter Dolan and current Chief Financial Officer, Andrew Bonfield. The complaints allege violations of securities laws for allegedly failing to disclose material information relating to efforts to settle the PLAVIX* patent infringement litigation with Apotex. On September 20, 2007, the Court dismissed the *Lai* case without prejudice, changed the caption of the case to *In re Bristol-Myers Squibb, Co. Securities Litigation*, and appointed Ontario Teachers' Pension Plan Board as lead plaintiff. On October 15, 2007, Ontario Teachers' Pension Plan Board filed an amended complaint making similar allegations as the earlier filed complaints, but no longer naming Andrew Bonfield as a defendant. Motions to dismiss have been filed.

The Company intends to defend itself vigorously in this litigation. It is not possible at this time to reasonably assess the outcome of these lawsuits, or the potential impact on the Company.

Note 22 LEGAL PROCEEDINGS AND CONTINGENCIES (Continued)

PRICING, SALES AND PROMOTIONAL PRACTICES LITIGATION AND INVESTIGATIONS

As previously disclosed, 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.

On September 28, 2007, the Company, the Department of Justice (DOJ) and the Office of the U.S. Attorney for the District of Massachusetts finalized the previously disclosed agreement in principle to settle several investigations involving the Company's drug pricing, sales and marketing activities. The settlement agreement, which provides for a civil resolution, resolves matters that have been actively investigated by and discussed with the 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 that subsidiary 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. There will be no criminal charges against the Company with respect to those matters. Pursuant to the agreement, the Company agreed to pay $499 million plus interest to resolve the Federal and state claims, resulting in a total amount of approximately $516 million as of the settlement date. The Company has paid the federal portion of the global settlement, approximately $317 million plus interest. The state portion of the global settlement, approximately $182 million, plus interest, will not be disbursed unless and until the states approve the settlement. There can be no assurances that any or all states will approve the settlement. In connection with the settlement, the Company has entered into a five-year Corporate Integrity Agreement with the Office of the Inspector General of the Department of Health and Human Services. The settlement only covers those matters outlined above, and the 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 settlement, and in that event, such matters could result in the assertion of civil and/or criminal claims.

Also as previously disclosed, as a result of the agreement in principle, the Company had recorded aggregate reserves in the amount of $499 million plus interest for these matters. With payment of the federal portion of the global settlement now having been made, the remaining reserve at December 31, 2007 was $182 million plus interest. If certain states choose not to participate, the amount reserved may not reflect eventual losses.

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

Litigation

As previously disclosed, 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 numerous states, many New York counties, and the City of New York. 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. Twelve state attorneys' general suits are pending in federal and state courts around the country. A case in Alabama state court is scheduled to be the first to proceed to trial in February 2008. One set of class actions, a suit by the Arizona attorney general and several suits filed by New York Counties and the City of New York, have been consolidated 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. In June 2007, in a non-jury trial in the AWP MDL, the Court found the Company liable for violations of Massachusetts' consumer protection laws with respect to certain oncology drugs for certain years and awarded damages in the amount of $183 thousand for Class 3 (private third-party payors) and instructed the parties to apply the Court's opinion to determine damages for Class 2 (Medigap insurers). In August, 2007, the Court found damages of $187 thousand for Class 2. The Company has appealed the June 2007 decision to the U.S. Court of Appeals for the First Circuit. As previously disclosed, in June 2007, the Company settled in principle the claims of Class 1 (Medicare Part B beneficiaries nationwide) for $13 million, plus half the costs of class notice up to a maximum payment of $1 million and the parties are finalizing the terms of the settlement. A hearing will be scheduled thereafter for preliminary approval of the Class 1 settlement.

The Company has recorded reserves of $14 million for these matters. In accordance with GAAP, the reserve reflects the Company's estimate of probable loss with respect to these matters, assuming the settlement is finalized. If the settlement is not finalized, the amount reserved may not reflect eventual losses. 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.

Note 22 LEGAL PROCEEDINGS AND CONTINGENCIES (Continued)

PRODUCT LIABILITY LITIGATION

The Company is a party to various product liability lawsuits. In addition to lawsuits, the Company also faces unfiled claims involving other products. At this time, the Company does not believe that any of the on-going matters or the potential unfiled claims of which it is aware have the potential to result in a material effect on the Company's financial results or operations.

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, 2007, the Company estimated its share of the total future costs for these sites to be approximately $69 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).

Puerto Rico Air Emissions Civil Litigation

As previously disclosed, the Company is one of several defendants in a class action suit filed in Superior Court in Puerto Rico relating to air emissions from a government-owned and operated wastewater treatment facility. The Court certified the class on August 9, 2007 and on August 15, 2007 the parties executed a global settlement agreement, resolving all claims in the litigation. A hearing to approve the settlement was held on October 26, 2007. Under the terms of the settlement, certain measures, including capital improvements, will be implemented at the wastewater treatment facility to minimize the potential for future odor emissions. The Company's share of the payment to plaintiffs will be approximately $700 thousand. On November 6, 2007, the court entered Final Judgment approving the settlement. This concludes the Company's involvement in the litigation, except for the Company's payment of its share of the cost of the capital improvements, which will be finalized in early 2008.

Passaic River (NJ) Remediation and Natural Resource Damages Claims

As previously disclosed, in September 2003, the New Jersey Department of Environmental Protection (NJDEP) issued an administrative enforcement Directive requiring the Company and 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 (LPR). The Directive named the Company due to releases from a nearby bulk chemical reprocessing facility operated by a predecessor of McKesson Corp. Subsequently, the EPA issued a notice letter to numerous parties, but not the Company, requesting performance of a Remedial Investigation/Feasibility Study (RI/FS) of conditions in the LPR. Under a consent agreement with EPA in 2004, a group of these other parties committed to pay roughly half of the $20 million estimated for the RI/FS by EPA at that time. The EPA thereafter substantially increased its estimate of the scope and cost of the RI/FS and, as a result, the EPA agreed to allow the group to perform most of the remaining RI/FS tasks. By the group's estimate, total costs to complete the RI/FS and related tasks now exceed $50 million. The group has negotiated an amended consent agreement with the EPA to conduct the remaining RI/FS work, which became effective in May 2007. As part of that deal, the Company and McKesson have bought out of remaining RI/FS tasks.

Separately, the Company has agreed to pay approximately $110 thousand towards RI/FS tasks previously funded by McKesson and work cooperatively going forward. In addition, in mid-2007 the EPA announced plans to seek implementation of "early-action" remedial measures to address the most highly-contaminated portions of the LPR while the RI/FS is being completed. The EPA has indicated it expects to select any such actions early in 2008. Also, a group of federal natural resource trustee agencies have proposed that the private party group enter into an agreement to assess natural resource damages in the LPR. The group expects to discuss the proposal with the trustees in the near future. The extent of any liability the Company may face for these and related requirements cannot yet be determined.

North Brunswick Township Board of Education

As previously disclosed, in October 2003, the Company was contacted by counsel representing the North Brunswick, NJ Board of Education (BOE) regarding a site where waste materials from E.R. Squibb and Sons may have been disposed from the 1940's through the 1960's. Fill material containing industrial waste and heavy metals in excess of residential standards was discovered 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 and ground water investigation work under a work plan approved by NJDEP, and have asked the Company to contribute to the cost. 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 continues to actively monitor the clean-up project, including its costs. To date, neither the school board nor the Township has asserted any claim against the Company. Instead, the Company and the local entities have negotiated an agreement to attempt to resolve the matter by mediation; a central component of the anticipated agreement is provision by the Company of interim funding to help defray cleanup costs. The agreement has been executed by all parties, and the Company has transmitted an initial interim funding payment in January 2008. The parties have recently commenced work to prepare for mediation, which is expected to conclude by mid-2008.

ODS Regulatory Compliance

As previously disclosed, 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 the 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)

As previously disclosed, 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.

WAGE & HOUR LITIGATION

As previously disclosed, two putative class action complaints have been filed against the Company by former sales representatives.

In *Kin Fung, et al. v. Bristol-Myers Squibb Company, et al., (Case Number RG07333147),* filed in June 2007 in the Superior Court of the State of California for the County of Alameda, the plaintiff alleges that the Company violated California wage and hour laws by, among other things, not paying overtime compensation to him and a putative class of similarly situated sales employees. Plaintiff filed an Amended Complaint on September 24, 2007 to add a cause of action for penalties under California Labor Code §2699, the Private Attorney General Act. California Labor Code §2699 allows a plaintiff to collect civil penalties for violations of any provision of the California Labor Code, 75% of which is collected by the Labor and Workforce Development Agency. California Labor Code §2699 has a one-year statute of limitations, and allows for the recovery of a penalty for each outstanding violation per pay period, and could be interpreted to require a penalty per employee per pay period. On January 4, 2008, the Court dismissed the *Kin Fung* matter in its entirety due to Mr. Fung's assertion that he did not wish to participate as plaintiff in the matter.

In *Beth Amendola v. Bristol-Myers Squibb Company, et al. (Docket No. 07-CV-6088),* filed in June 2007 in the District court, the plaintiff alleges that the Company violated the federal Fair Labor Standards Act by, among other things, not paying overtime compensation to her and a putative class of similarly situated sales employees. The parties are currently engaged in preliminary discovery in the *Amendola* matter.

Note 22 LEGAL PROCEEDINGS AND CONTINGENCIES (Continued)

The Company intends to vigorously defend itself in these lawsuits. As the above matters are in the very early stages of litigation, it is not possible at this time reasonably to assess the outcome of the litigation matters described above, but it is not expected that their outcome would be material to the Company's results of operations and cash flows, or be material to its financial condition and liquidity.

OTHER PROCEEDINGS

SEC Germany Investigation

As previously disclosed, 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 was under investigation as a result of the activities of two of its employees in the region. The investigation also involved a number of doctors, pharmacists, pharmaceutical companies and their sales representatives. The main allegation was that the parties were engaged in a plan to defraud the National Health Service, and that the companies lacked appropriate compliance controls and/or processes and procedures to control the activities of their sales representatives. In February 2007, the Company and the Bari Prosecutor reached an agreement in principle to settle the matter. The agreement requires final approval by the Civil Court, and a final hearing in the matter should occur during 2008. The Company has paid an administrative fine in an amount which is not material to the Company.

ConvaTec – Italy Investigation

The Italian competition authorities investigated a complaint lodged by a hospital in the Ferrara region of Italy relating to an allegation that four medical device companies, including ConvaTec, boycotted tenders in 2003 and 2004 (the Ferrara tenders). ConvaTec responded to the allegations earlier this year. In May 2007, ConvaTec received a statement of objections from the Italian competition authorities, whereby the authorities alleged that four medical device companies, including ConvaTec, acted in a concerted manner with regard not only to the Ferrara tenders, but tenders or pricing discussions in three other regions and acted in such a way to prevent competition throughout Italy. A hearing on the matter was held in July 2007. In August 2007, the competition authorities issued their decision, and found that the four medical device companies had infringed Italian anti–trust law by not participating in the Ferrara tenders, and imposed a fine of €2,345,200 against ConvaTec. (As ConvaTec is a division of BMS Italy, the fine was imposed against BMS Italy). The fine is based on ConvaTec's market share and turnover in 2004. The other companies also were fined, but the amounts were smaller. ConvaTec has appealed the decision to the Administrative Court. A hearing on the appeal is expected in early or mid 2008, with a decision likely to issue soon thereafter.

Note 23 SUBSEQUENT EVENTS

In December 2007, the Company entered into a definitive agreement with Avista for the sale of its Medical Imaging business, for a purchase price of approximately $525 million in cash, subject to customary post–closing adjustments. The closing of the transaction was completed on January 7, 2008. The Company expects to recognize a pre–tax gain of approximately $20 million to $40 million ($30 million to $50 million loss net of tax) in the first quarter of 2008, subject to the post–closing adjustments.

On February 21, 2008, the Company completed the sale and leaseback of an administrative facility in Paris, France for approximately €155 million. The Company expects to record a gain, of which the majority will be deferred and will reduce future lease rental costs over the lease period.

Note 24 SELECTED QUARTERLY FINANCIAL DATA (UNAUDITED)

Dollars in Millions, except per share data	First Quarter	Second Quarter	Third Quarter	Fourth Quarter	Year
2007:[6]					
Net Sales	$ 4,317	$ 4,757	$ 4,893	$ 5,381	$19,348
Gross Margin	2,977	3,265	3,324	3,564	13,130
Net Earnings/(Loss) from Continuing Operations[5]	643	650	808	(133)	1,968
Net Earnings from Discontinued Operations, net	47	56	50	44	197
Net Earnings/(Loss)	690	706	858	(89)	2,165
Earnings per Common Share[1]:					
Basic:					
Net Earnings/(Loss) from Continuing Operations[5]	$ 0.33	$ 0.33	$ 0.41	$ (0.07)	$ 1.00
Net Earnings from Discontinued Operations, net	0.02	0.03	0.02	0.02	0.10
Net Earnings/(Loss) per common share	$ 0.35	$ 0.36	$ 0.43	$ (0.05)	$ 1.10
Diluted[2][3][4]:					
Net Earnings/(Loss) from Continuing Operations[5]	$ 0.33	$ 0.33	$ 0.41	$ (0.07)	$ 0.99
Net Earnings from Discontinued Operations, net	0.02	0.03	0.02	0.02	0.10
Net Earnings/(Loss) per common share	$ 0.35	$ 0.36	$ 0.43	$ (0.05)	$ 1.09
Dividends declared per common share	$ 0.28	$ 0.28	$ 0.28	$ 0.31	$ 1.15
Cash and cash equivalents	$ 2,214	$ 2,379	$ 1,647	$ 1,801	$ 1,801
Marketable securities	1,798	2,267	1,935	424	424
2006:[6]					
Net Sales	$ 4,495	$ 4,703	$ 4,001	$ 4,057	$17,256
Gross Margin	3,079	3,186	2,590	2,662	11,517
Net Earnings/(Loss) from Continuing Operations[5]	665	621	306	(170)	1,422
Net Earnings from Discontinued operations, net	49	46	32	36	163
Net Earnings/(Loss)	714	667	338	(134)	1,585
Earnings per Common Share[1]:					
Basic:					
Net Earnings/(Loss) from Continuing Operations[5]	$ 0.34	$ 0.32	$ 0.16	$ (0.09)	$ 0.73
Net Earnings from Discontinued Operations, net	0.02	0.02	0.01	0.02	0.08
Net Earnings/(Loss) per common share	$ 0.36	$ 0.34	$ 0.17	$ (0.07)	$ 0.81
Diluted[2][3][4]:					
Net Earnings/(Loss) from Continuing Operations[5]	$ 0.34	$ 0.32	$ 0.16	$ (0.09)	$ 0.73
Net Earnings from Discontinued Operations, net	0.02	0.02	0.01	0.02	0.08
Net Earnings/(Loss) per common share	$ 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

(1) Earnings per share for the quarters may not add to the amounts for the year, as each period is computed on a discrete basis.

(2) 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
2007	116	85	84	185	107
2006	165	147	146	174	164

(3) For the three months ended December 31, 2007 and 2006, as a result of the net loss, basic and diluted loss per share are equal.

(4) In 2007 and 2006, the 29 million weighted-average shares issuable, as well as $38 million and $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 anti-dilutive.

Note 24 SELECTED QUARTERLY FINANCIAL DATA (UNAUDITED) (Continued)

(5) The Company recorded the following items in 2007 and 2006 that affected the comparability of results:

2007:

Dollars in Millions	First Quarter	Second Quarter	Third Quarter	Fourth Quarter	Year
Productivity Transformation Initiative:					
Downsizing and streamlining of worldwide operations	$ —	$ —	$ —	$ 145	$ 145
Accelerated depreciation and asset impairment	—	—	—	110	110
Process standardization implementation costs	—	—	—	37	37
	—	—	—	292	292
Other:					
Litigation settlement	—	14	—	—	14
Insurance recovery	—	—	(11)	—	(11)
Product liability	—	—	5	10	15
Upfront and milestone payments and acquired in-process research and development	80	17	60	235	392
Auction rate securities impairment	—	—	—	275	275
Downsizing and streamlining of worldwide operations	37	7	—	—	44
Accelerated depreciation, asset impairment and contract termination	16	13	17	54	100
Gain on sale of properties and product assets	—	(26)	(247)	(9)	(282)
	133	25	(176)	857	839
Income taxes on items above	(40)	(5)	82	(70)	(33)
Change in estimate for taxes on a prior year item	(39)	—	—	—	(39)
(Increase)/Decrease to Net Earnings from Continuing Operations	$ 54	$ 20	$ (94)	$ 787	$ 767

2006:

	First Quarter	Second Quarter	Third Quarter	Fourth Quarter	Year
Litigation Matters:					
Pharmaceutical pricing and sales litigation	$ —	$ —	$ —	$ 353	$ 353
Product liability	—	—	11	—	11
Claim for damages	—	—	—	13	13
Commercial litigations	40	(14)	(40)	—	(14)
Insurance recovery	(21)	—	(9)	(7)	(37)
	19	(14)	(38)	359	326
Other:					
Debt retirement costs	—	—	—	220	220
Accelerated depreciation, asset impairment and contract termination	50	21	72	43	186
Upfront and milestone payments	18	—	17	35	70
Downsizing and streamlining of worldwide operations	1	3	2	53	59
Gain on sale of product asset	(200)	—	—	—	(200)
	(112)	10	53	710	661
Income taxes on items above	48	3	(5)	(196)	(150)
Minority interest, net of taxes	(13)	—	13	—	—
Change in estimate for taxes on prior year items	—	—	39	—	39
(Increase)/Decrease to Net Earnings from Continuing Operations	$ (77)	$ 13	$ 100	$ 514	$ 550

(6) All financial information reflects the Medical Imaging business as discontinued operations, see " – Note 5. Discontinued Operations and Assets Held for Sale."

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 sheets of Bristol-Myers Squibb Company and subsidiaries (the "Company") as of December 31, 2007 and 2006, and the related consolidated statements of earnings, comprehensive income and retained earnings, and cash flows for the years then ended. Our audits also included the financial statement schedule for the years ended December 31, 2007 and 2006 listed in the Index at Item 15. These financial statements and financial statement schedule are the responsibility of the Company's management. Our responsibility is to express an opinion on the financial statements and financial statement schedule based on our audits. The consolidated financial statements of the Company for the year ended December 31, 2005, before the effects of the retrospective adjustments for the discontinued operations of the Bristol-Myers Squibb Medical Imaging ("MI") business discussed in Note 5 to the consolidated financial statements, were audited by other auditors whose report, dated March 13, 2006, expressed an unqualified opinion on those statements.

We conducted our audits 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 audits provide a reasonable basis for our opinion.

In our opinion, such consolidated financial statements present fairly, in all material respects, the financial position of the Company as of December 31, 2007 and 2006, and the results of their operations and their cash flows for the years then ended, in conformity with accounting principles generally accepted in the United States of America. Also, in our opinion, such financial statement schedule for the years ended December 31, 2007 and 2006, when considered in relation to the basic consolidated financial statements taken as a whole, presents fairly, in all material respects, the information set forth therein.

We have also audited the retrospective adjustments to the 2005 consolidated financial statements for the operations of MI which were discontinued in 2007, as discussed in Note 5 to the consolidated financial statements. Our procedures included (1) obtaining the Company's underlying accounting analysis prepared by management of the retrospective adjustments for discontinued operations and comparing the retrospectively adjusted amounts per the 2005 consolidated financial statements to such analysis, (2) comparing previously reported amounts to the previously issued consolidated financial statements for such year, (3) testing the mathematical accuracy of the accounting analysis, and (4) comparing the adjustments to retrospectively adjust the consolidated financial statements for discontinued operations to the Company's supporting documentation. In our opinion, such retrospective adjustments are appropriate and have been properly applied. However, we were not engaged to audit, review or apply any procedures to the 2005 consolidated financial statements of the Company other than with respect to the retrospective adjustments and, accordingly, we do not express an opinion or any other form of assurance on the 2005 consolidated financial statements taken as a whole.

As discussed in Notes 1, 8, 17 and 21 to the consolidated financial statements, the Company adopted Financial Accounting Standards Board Interpretation ("FIN") No. 48, *Accounting for Uncertainty in Income Taxes – an interpretation of FASB Statement No. 109*, effective January 1, 2007, 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 Company's internal control over financial reporting as of December 31, 2007, 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 21, 2008 expressed an unqualified opinion on the Company's internal control over financial reporting.

/s/ Deloitte & Touche LLP

Deloitte & Touche LLP
Parsippany, New Jersey
February 21, 2008

Report of Independent Registered Public Accounting Firm

To the Board of Directors
and Stockholders of
Bristol–Myers Squibb Company:

In our opinion, the consolidated statements of earnings, comprehensive income and retained earnings, and cash flows for the year ended December 31, 2005, before the effects of the adjustments to retrospectively reflect the discontinued operations described in Note 5, present fairly, in all material respects, the results of operations and cash flows of Bristol–Myers Squibb Company and its subsidiaries for the year ended December 31, 2005, in conformity with accounting principles generally accepted in the United States of America (the 2005 consolidated financial statements before the effects of the adjustments discussed in Note 5 are not presented herein). In addition, in our opinion, the financial statement schedule for the year ended December 31, 2005, before the effects of the adjustments to retrospectively reflect the discontinued operations described in Note 1 to the financial statement schedule, presents fairly, in all material respects, the information set forth therein when read in conjunction with the related consolidated financial statements referred to above (the financial statement schedule for the year ended December 31, 2005 before the effects of the adjustments discussed in Note 1 to the financial statement schedule is not presented herein). These financial statements and financial statement schedule are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements and financial statement schedule based on our audit. We conducted our audit, before the effects of the adjustments described above, 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 audit provides a reasonable basis for our opinion.

We were not engaged to audit, review, or apply any procedures to the adjustments to retrospectively reflect the discontinued operations described in Note 5 to the financial statements and Note 1 to the financial statement schedule and accordingly, we do not express an opinion or any other form of assurance about whether such adjustments are appropriate and have been properly applied. Those adjustments were audited by other auditors.

/s/ PricewaterhouseCoopers LLP

PricewaterhouseCoopers LLP
Philadelphia, PA
March 13, 2006

Item 9. CHANGES IN AND DISAGREEMENTS WITH ACCOUNTANTS ON ACCOUNTING AND FINANCIAL DISCLOSURE.

None.

Item 9A. CONTROLS AND PROCEDURES.

Evaluation of Disclosure Controls and Procedures

As of December 31, 2007, 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, 2007, 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, 2007 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, 2007 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 Form 10–K and issued its report on the effectiveness of the Company's internal control over financial reporting as of December 31, 2007, 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, 2007 that have materially affected, or are reasonably likely to materially affect, the Company's internal control over financial reporting.

Item 9B. OTHER INFORMATION.

None.

Report of Independent Registered Public Accounting Firm

To the Board of Directors and Stockholders of
Bristol-Myers Squibb Company

We have audited the internal control over financial reporting of Bristol-Myers Squibb Company and subsidiaries (the "Company") as of December 31, 2007, 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 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, assessing the risk that a material weakness exists, testing and evaluating the design and operating effectiveness of internal control based on the assessed risk, and performing such other procedures as we considered necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinion.

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, the Company maintained, in all material respects, effective internal control over financial reporting as of December 31, 2007, 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 and financial statement schedule as of and for the year ended December 31, 2007 of the Company and our report dated February 21, 2008 expressed an unqualified opinion on those financial statements and financial statement schedule and included an explanatory paragraph regarding the Company's adoption of Financial Accounting Standards Board Interpretation ("FIN") No. 48, *Accounting for Uncertainty in Income Taxes – an interpretation of FASB Statement No. 109*, effective January 1, 2007.

/s/ Deloitte & Touche LLP

Deloitte & Touche LLP
Parsippany, New Jersey
February 21, 2008

PART III

Item 10. DIRECTORS AND EXECUTIVE OFFICERS OF THE REGISTRANT.

(a) Reference is made to the 2008 Proxy Statement to be filed on or about March 21, 2008 with respect to the Directors of the Registrant, which is incorporated herein by reference and made a part hereof in response to the information required by Item 10.

(b) The information required by Item 10 with respect to the Executive Officers of the Registrant has been included in Part IA of this Form 10–K in reliance on General Instruction G of Form 10–K and Instruction 3 to Item 401(b) of Regulation S–K.

Item 11. EXECUTIVE COMPENSATION.

Reference is made to the 2008 Proxy Statement to be filed on or about March 21, 2008 with respect to Executive Compensation, which is incorporated herein by reference and made a part hereof in response to the information required by Item 11.

Item 12. SECURITY OWNERSHIP OF CERTAIN BENEFICIAL OWNERS AND MANAGEMENT AND RELATED STOCKHOLDER MATTERS.

Reference is made to the 2008 Proxy Statement to be filed on or about March 21, 2008 with respect to the security ownership of certain beneficial owners and management, which is incorporated herein by reference and made a part hereof in response to the information required by Item 12.

Item 13. CERTAIN RELATIONSHIPS AND RELATED TRANSACTIONS.

Reference is made to the 2008 Proxy Statement to be filed on or about March 21, 2008 with respect to certain relationships and related transactions, which is incorporated herein by reference and made a part hereof in response to the information required by Item 13.

Item 14. AUDITOR FEES.

Reference is made to the 2008 Proxy Statement to be filed on or about March 21, 2008 with respect to auditor fees, which is incorporated herein by reference and made a part hereof in response to the information required by Item 14.

PART IV

Item 15. EXHIBITS, FINANCIAL STATEMENT SCHEDULE, AND REPORTS ON FORM 8-K.

(a)

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All other schedules not included with this additional financial data are omitted because they are not applicable or the required information is included in the financial statements or notes thereto.

3. Exhibit Index

The Exhibits listed below are identified by numbers corresponding to the Exhibit Table of Item 601 of Regulation S-K. The Exhibits designated by two asterisks (**) are management contracts or compensatory plans or arrangements required to be filed pursuant to Item 15. An asterisk (*) in the Page column indicates that the Exhibit has been previously filed with the Commission and is incorporated herein by reference. Unless otherwise indicated, all Exhibits are part of Commission File Number 1-1136.

Exhibit No.	Description	Page No.
3a.	Amended and Restated Certificate of Incorporation of Bristol-Myers Squibb Company (incorporated herein by reference to Exhibit 3a to the Form 10-Q for the quarterly period ended June 30, 2005).	*
3b.	Bylaws of Bristol-Myers Squibb Company, as amended as of February 11, 2008 (incorporated herein by reference to Exhibit 3.1 to Form 8-K dated February 11, 2008 and filed on February 15, 2008).	*
4a.	Letter of Agreement dated March 28, 1984 (incorporated herein by reference to Exhibit 4 to Form 10-K for the fiscal year ended December 31, 1983).	*
4b.	Indenture, dated as of June 1, 1993, between Bristol-Myers Squibb Company and JPMorgan Chase Bank (as successor trustee to The Chase Manhattan Bank (National Association)) (incorporated herein by reference to Exhibit 4.1 to the Form 8-K dated May 27, 1993, and filed on June 3, 1993).	*
4c.	Form of 7.15% Debenture due 2023 of Bristol-Myers Squibb Company (incorporated herein by reference to Exhibit 4.2 to the Form 8-K dated May 27, 1993, and filed on June 3, 1993).	*
4d.	Form of 6.80% Debenture due 2026 of Bristol-Myers Squibb Company (incorporated herein by reference to Exhibit 4e to the Form 10-K for the fiscal year ended December 31, 1996).	*
4e.	Form of 6.875% Debenture due 2097 of Bristol-Myers Squibb Company (incorporated herein by reference to Exhibit 4f to the Form 10-Q for the quarterly period ended September 30, 1997).	*
4f.	Third Supplemental Indenture, dated August 18, 2003, between Bristol-Myers Squibb Company and JPMorgan Chase Bank, as Trustee, to the indenture dated June 1, 1993 (incorporated herein by reference to Exhibit 4k to the Form 10-Q for the quarterly period ended September 30, 2003).	*
4g.	Form of 4.00% Senior Note due 2008 (incorporated herein by reference to Exhibit 4n to the Form 10-Q for the quarterly period ended September 30, 2003).	*
4h.	Form of 5.25% Senior Note due 2013 (incorporated herein by reference to Exhibit 4o to the Form 10-Q for the quarterly period ended September 30, 2003).	*
4i.	Indenture, dated October 1, 2003, between Bristol-Myers Squibb Company, as Issuer, and JPMorgan Chase Bank, as Trustee (incorporated herein by reference to Exhibit 4q to the Form 10-Q for the quarterly period ended September 30, 2003).	*
4j.	Form of Floating Rate Convertible Senior Debenture due 2023 (incorporated herein by reference to Exhibit 4s to the Form 10-Q for the quarterly period ended September 30, 2003).	*
4k.	Specimen Certificate of Common Stock (incorporated herein by reference to Exhibit 4s to the Form 10-K for the fiscal year ended December 31, 2003).	*

4l.	Specimen Certificate of Convertible Preferred Stock (incorporated herein by reference to Exhibit 4s to the Form 10–K for the fiscal year ended December 31, 2003).	*
4m.	Form of Fourth Supplemental Indenture between Bristol–Myers Squibb Company and The Bank of New York, as Trustee, to the indenture dated June 1, 1993 (incorporated herein by reference to Exhibit 4r the Form 8–K dated November 20, 2006 and filed November 27, 2006).	*
4n.	Form of 5.875% Notes due 2036 (incorporated herein by reference to Exhibit 4s the Form 8–K dated November 20, 2006 and filed November 27, 2006).	*
4o.	Form of 4.375% Notes due 2016 (incorporated herein by reference to Exhibit 4t the Form 8–K dated November 20, 2006 and filed November 27, 2006).	*
4p.	Form of 4.625% Notes due 2021 (incorporated herein by reference to Exhibit 4u the Form 8–K dated November 20, 2006 and filed November 27, 2006).	*
10a.	$2,000,000,000 Five Year Competitive Advance and Revolving Credit Facility Agreement dated as of December 21, 2006 among Bristol–Myers Squibb Company, the borrowing subsidiaries, the lenders named in the agreement, Bank of America, N.A. as syndication agent, and JPMorgan Chase Bank and Citicorp North America, Inc., as administrative agents (incorporated herein by reference to Exhibit 10.1 to the Form 8–K dated December 21, 2006 and filed December 27, 2006).	*
10b.	SEC Consent Order (incorporated herein by reference to Exhibit 10s to the Form 10–Q for the quarterly period ended September 30, 2004).	*
10c.	General Contract of Indemnity dated August 17, 2006 between Bristol–Myers Squibb Company and Travelers Casualty and Surety Company of America (incorporated herein by reference to Exhibit 10bb to the Form 8–K dated August 31, 2006 and filed September 5, 2006).	*
10d.	Registered Pledge and Master Security Agreement dated August 17, 2006 between Bristol–Myers Squibb Company and Travelers Casualty and Surety Company of America (incorporated herein by reference to Exhibit 10cc to the Form 8–K dated August 31, 2006 and filed September 5, 2006).	*
10e.	Control Agreement dated August 18, 2006 among Bristol–Myers Squibb Company, Travelers Casualty and Surety Company of America and Smith Barney Inc. (incorporated herein by reference to Exhibit 10dd to the Form 8–K dated August 31, 2006 and filed September 5, 2006).	*
10f.	Letter Agreement dated August 18, 2006 between Bristol–Myers Squibb Company and Travelers Casualty and Surety Company of America (incorporated herein by reference to Exhibit 10ee to the Form 8–K dated August 31, 2006 and filed September 5, 2006).	*
**10g.	Bristol–Myers Squibb Company 1997 Stock Incentive Plan, effective as of May 6, 1997 and as amended effective July 17, 2002 (incorporated herein by reference to Exhibit 10a to the Form 10–Q for the quarterly period ended June 30, 2002).	*
**10h.	Bristol–Myers Squibb Company 2002 Stock Incentive Plan, effective as of May 7, 2002 and as amended effective January 23, 2007 (incorporated herein by reference to Exhibit 10b to the Form 10–K for the fiscal year ended December 31, 2006).	*
**10i.	Bristol–Myers Squibb Company 2007 Stock Aware and Incentive Plan, effective as of May 1, 2007 (incorporated herein by reference to Exhibit B to the 2007 Proxy Statement dated March 22, 2007).	*
**10j.	Bristol–Myers Squibb Company TeamShare Stock Option Plan, as amended and restated effective September 10, 2002 (incorporated herein by reference to Exhibit 10c to the Form 10–K for the fiscal year ended December 31, 2002).	*
**10k.	Form of Non–Qualified Stock Option Agreement under the 2002 Stock Award and Incentive Plan (incorporated herein by reference to Exhibit 10s to the Form 10–K for the fiscal year ended December 31, 2005).	*

**10l.	Form of Non-Qualified Stock Option Agreement under the 2007 Stock Award and Incentive Plan (incorporated herein by reference to Exhibit 10s to the Form 10-Q for the quarterly period ended March 31, 2007).	*
**10m.	Form of Restricted Stock Award Agreement under the 2002 Stock Award and Incentive Plan (incorporated herein by reference to Exhibit 10t to the Form 10-K for the fiscal year ended December 31, 2005).	*
**10n.	Form of Performance Shares Agreement for the 2006-2008 Performance Cycle (incorporated herein by reference to Exhibit 10u to the Form 10-K for the fiscal year ended December 31, 2005).	*
**10o.	Form of Performance Shares Agreement for the 2007-2009 Performance Cycle (incorporated herein by reference to Exhibit 10.1 to the Form 10-Q for the quarterly period ended June 30, 2007).	*
**10p.	Form of Performance Shares Agreement for the 2008-2010 Performance Cycle (incorporated herein by reference to Exhibit 10.1 to the Form 10-Q for the quarterly period ended September 30, 2007).	*
**10q.	Form of Restricted Stock Units Agreement under the 2002 Stock Award and Incentive Plan (incorporated herein by reference to Exhibit 10v to the Form 10-K for the fiscal year ended December 31, 2006).	*
**10r.	Form of Restricted Stock Units Agreement under the 2007 Stock Award and Incentive Plan (incorporated herein by reference to Exhibit 10t to the Form 10-Q for the quarterly period ended March 31, 2007).	*
**10s.	Bristol-Myers Squibb Company Performance Incentive Plan, as amended (as adopted, incorporated herein by reference to Exhibit 2 to the Form 10-K for the fiscal year ended December 31, 1978; as amended as of January 8, 1990, incorporated herein by reference to Exhibit 19b to the Form 10-K for the fiscal year ended December 31, 1990; as amended on April 2, 1991, incorporated herein by reference to Exhibit 19b to the Form 10-K for the fiscal year ended December 31, 1991; as amended effective January 1, 1994, incorporated herein by reference to Exhibit 10d to the Form 10-K for the fiscal year ended December 31, 1993; and as amended effective January 1, 1994, incorporated herein by reference to Exhibit 10d to the Form 10-K for the fiscal year ended December 31, 1994).	*
**10t.	Bristol-Myers Squibb Company Executive Performance Incentive Plan (effective January 1, 1997 and incorporated herein by reference to Exhibit 10b to the Form 10-K for the fiscal year ended December 31, 1996).	*
**10u.	Bristol-Myers Squibb Company Executive Performance Incentive Plan (effective January 1, 2003 and incorporated herein by reference to Exhibit D to the 2003 Proxy Statement dated April 4, 2003).	*
**10v.	Bristol-Myers Squibb Company 2007 Senior Executive Performance Incentive Plan (effective May 1, 2007 and incorporated herein by reference to Exhibit C to the 2007 Proxy Statement dated March 22, 2007).	*
**10w.	Benefit Equalization Plan of Bristol-Myers Squibb Company and its Subsidiary or Affiliated Corporations Participating in the Bristol-Myers Squibb Company Retirement Income Plan or the Bristol-Myers Squibb Puerto Rico, Inc. Retirement Income Plan, as amended (as amended and restated as of January 1, 1993, as amended effective October 1, 1993, incorporated herein by reference to Exhibit 10e to the Form 10-K for the fiscal year ended December 31, 1993; and as amended effective February 1, 1995, incorporated herein by reference to Exhibit 10e to the Form 10-K for the fiscal year ended December 31, 1996).	*

**10x.	Benefit Equalization Plan of Bristol-Myers Squibb Company and its Subsidiary or Affiliated Corporations Participating in the Bristol-Myers Squibb Company Savings and Investment Program, as amended and restated effective as of January 1, 1996 (incorporated herein by reference to Exhibit 10h to the Form 10-K for the fiscal year ended December 31, 2001).	*
**10y.	Squibb Corporation Supplementary Pension Plan, as amended (as previously amended and restated, incorporated herein by reference to Exhibit 19g to the Form 10-K for the fiscal year ended December 31, 1991; as amended as of September 14, 1993, and incorporated herein by reference to Exhibit 10g to the Form 10-K for the fiscal year ended December 31, 1993).	*
**10z.	Senior Executive Severance Plan, effective as of April 26, 2007 (incorporated herein by reference to Exhibit 10.2 to the Form 8-K dated April 24, 2007 and filed on April 27, 2007).	*
**10aa.	Letter Agreement dated October 31, 2006 between James M. Cornelius and Bristol-Myers Squibb Company (incorporated herein by reference to Exhibit 10.1 to the Form 8-K dated October 31, 2006 and filed November 3, 2006).	*
**10bb.	Letter Agreement dated April 26, 2007 between James M. Cornelius and Bristol-Myers Squibb Company (incorporated herein by reference to Exhibit 10.1 to the Form 8-K dated April 24, 2007 and filed on April 27, 2007).	*
**10cc.	Aircraft Time Sharing Agreement dated as of July 31, 2007 between James M. Cornelius and Bristol-Myers Squibb Company (incorporated herein by reference to Exhibit 10.2 to the Form 10-Q for the quarterly period ended June 30, 2007).	*
**10dd.	Letter Agreement dated February 12, 2008 between James M. Cornelius and Bristol-Myers Squibb Company (incorporated herein by reference to Exhibit 10.1 to the Form 8-K dated February 11, 2008 and filed on February 15, 2008.	*
**10ee.	Letter Agreement effective September 20, 2005 and addendum effective October 31, 2005 between Lamberto Andreotti and the Company (incorporated herein by reference to Exhibit 10.2 to the Form 8-K dated December 5, 2006 and filed on December 11, 2006).	*
**10ff.	Form of Agreement entered into between the Registrant and each of the named executive officers and certain other executives effective January 1, 2008 (filed herewith).	E-10-1
**10gg.	Bristol-Myers Squibb Company Retirement Income Plan for Non-Employee Directors, as amended to March 5, 1996 (incorporated herein by reference to Exhibit 10k to the Form 10-K for the fiscal year ended December 31, 1996).	*
**10hh.	Bristol-Myers Squibb Company 1987 Deferred Compensation Plan for Non-Employee Directors, as amended to January 10, 2006 (incorporated herein by reference to Exhibit 10l to the Form 10-K for the fiscal year ended December 31, 2005).	*
**10ii.	Bristol-Myers Squibb Company Non-Employee Directors' Stock Option Plan, as amended (as approved by the Stockholders on May 1, 1990, incorporated herein by reference to Exhibit 28 to Registration Statement No. 33-38587 on Form S-8; as amended May 7, 1991, incorporated herein by reference to Exhibit 19c to the Form 10-K for the fiscal year ended December 31, 1991), as amended January 12, 1999 (incorporated herein by reference to Exhibit 10m to the Form 10-K for the fiscal year ended December 31, 1998).	*
**10jj.	Bristol-Myers Squibb Company Non-Employee Directors' Stock Option Plan, as amended (as approved by the Stockholders on May 2, 2000, incorporated herein by reference to Exhibit A to the 2000 Proxy Statement dated March 20, 2000.)	*
**10kk.	Squibb Corporation Deferral Plan for Fees of Outside Directors, as amended (as adopted, incorporated herein by reference to Exhibit 10e Squibb Corporation 1991 Form 10-K for the fiscal year ended December 31, 1987, File No. 1-5514; as amended effective December 31, 1991 incorporated herein by reference to Exhibit 10m to the Form 10-K for the fiscal year ended December 31, 1992).	*
**10ll.	Restricted Stock Units Agreement with James D. Robinson III, effective as of June 15, 2005 and as amended on July 13, 2005 (incorporated herein by reference to Exhibit 10x to the Form 10-Q for the quarterly period ended June 30, 2005).	*
**10mm.	Amendment to all of the Company's plans, agreements, legal documents and other writings, pursuant to action of the Board of Directors on October 3, 1989, to reflect the change of the Company's name to Bristol-Myers Squibb Company (incorporated herein by reference to Exhibit 10v to the Form 10-K for the fiscal year ended December 31, 1989).	*
12.	Statement re computation of ratios (filed herewith).	E-12-1
21.	Subsidiaries of the Registrant (filed herewith).	E-21-1
23a.	Consent of Deloitte & Touche LLP (filed herewith).	E-23-1
23b.	Consent of PricewaterhouseCoopers LLP (filed herewith)	E-23-2
31a.	Section 302 Certification Letter (filed herewith).	E-31-1
31b.	Section 302 Certification Letter (filed herewith).	E-31-2
32a.	Section 906 Certification Letter (filed herewith).	E-32-1
32b.	Section 906 Certification Letter (filed herewith).	E-32-2

* Indicates, in this Form 10-K, brand names of products, which are registered trademarks not owned by the Company or its subsidiaries. ERBITUX is a trademark of ImClone Systems Incorporated; AVAPRO/AVALIDE (known in the EU as APROVEL/KARVEA), ISCOVER and PLAVIX are trademarks of Sanofi-Aventis.; ABILIFY is a trademark of Otsuka Pharmaceutical Co., Ltd.; TRUVADA is a trademark of Gilead Sciences, Inc.; EMSAM is a trademark of Somerset Pharmaceuticals, Inc.; BUFFERIN, EXCEDRIN and GLEEVEC are trademarks of Novartis AG; ATRIPLA is a trademark of Bristol-Myers Squibb and Gilead Sciences, LLC; DOVONEX is a trademark of Leo Pharma A/S; NORVIR is a trademark of Abbott Laboratories.

SIGNATURES

Pursuant to the requirements of Section 13 or 15 (d) of the Securities Exchange Act of 1934, the Registrant has duly caused this Report to be signed on its behalf by the undersigned, thereunto duly authorized.

BRISTOL-MYERS SQUIBB COMPANY (Registrant)
By /s/ James M. Cornelius
James M. Cornelius
Chairman of the Board and Chief Executive Officer

Date: February 21, 2008

Pursuant to the requirements of the Securities Exchange Act of 1934, this Report has been signed below by the following persons on behalf of the Registrant and in the capacities and on the dates indicated.

Signature	Title	Date
/s/ James M. Cornelius (James M. Cornelius)	Chairman of the Board and Chief Executive Officer (Principal Executive Officer)	February 21, 2008
/s/ Andrew R.J. Bonfield (Andrew R.J. Bonfield)	Chief Financial Officer (Principal Financial Officer)	February 21, 2008
/S/ Joseph C. Caldarella (Joseph C. Caldarella)	Vice President and Controller (Principal Accounting Officer)	February 21, 2008
/s/ Lewis B. Campbell (Lewis B. Campbell)	Director	February 21, 2008
/s/ Louis J. Freeh (Louis J. Freeh)	Director	February 21, 2008
/s/ Laurie H. Glimcher, M.D. (Laurie H. Glimcher, M.D.)	Director	February 21, 2008
/s/ Michael Grobstein (Michael Grobstein)	Director	February 21, 2008
/s/ Leif Johansson (Leif Johansson)	Director	February 21, 2008
/s/ Alan J. Lacy (Alan J. Lacy)	Director	February 21, 2008
/s/ James D. Robinson III (James D. Robinson III)	Director	February 21, 2008
/s/ Vicki L. Sato, Ph.D. (Vicki L. Sato, Ph.D.)	Director	February 21, 2008
/s/ Togo D. West, Jr. (Togo D. West, Jr.)	Director	February 21, 2008
/s/ R. Sanders Williams, M.D. (R. Sanders Williams, M.D.)	Director	February 21, 2008

EXHIBIT INDEX

The Exhibits listed below are identified by numbers corresponding to the Exhibit Table of Item 601 of Regulation S-K. The Exhibits designated by two asterisks (**) are management contracts or compensatory plans or arrangements required to be filed pursuant to Item 15. An asterisk (*) in the Page column indicates that the Exhibit has been previously filed with the Commission and is incorporated herein by reference. Unless otherwise indicated, all Exhibits are part of Commission File Number 1-1136.

Exhibit No.	Description	Page No.
3a.	Amended and Restated Certificate of Incorporation of Bristol-Myers Squibb Company (incorporated herein by reference to Exhibit 3a to the Form 10-Q for the quarterly period ended June 30, 2005).	*
3b.	Bylaws of Bristol-Myers Squibb Company, as amended as of February 11, 2008 (incorporated herein by reference to Exhibit 3.1 to Form 8-K dated February 11, 2008 and filed on February 15, 2008).	*
4a.	Letter of Agreement dated March 28, 1984 (incorporated herein by reference to Exhibit 4 to Form 10-K for the fiscal year ended December 31, 1983).	*
4b.	Indenture, dated as of June 1, 1993, between Bristol-Myers Squibb Company and JPMorgan Chase Bank (as successor trustee to The Chase Manhattan Bank (National Association)) (incorporated herein by reference to Exhibit 4.1 to the Form 8-K dated May 27, 1993, and filed on June 3, 1993).	*
4c.	Form of 7.15% Debenture due 2023 of Bristol-Myers Squibb Company (incorporated herein by reference to Exhibit 4.2 to the Form 8-K dated May 27, 1993, and filed on June 3, 1993).	*
4d.	Form of 6.80% Debenture due 2026 of Bristol-Myers Squibb Company (incorporated herein by reference to Exhibit 4e to the Form 10-K for the fiscal year ended December 31, 1996).	*
4e.	Form of 6.875% Debenture due 2097 of Bristol-Myers Squibb Company (incorporated herein by reference to Exhibit 4f to the Form 10-Q for the quarterly period ended September 30, 1997).	*
4f.	Third Supplemental Indenture, dated August 18, 2003, between Bristol-Myers Squibb Company and JPMorgan Chase Bank, as Trustee, to the indenture dated June 1, 1993 (incorporated herein by reference to Exhibit 4k to the Form 10-Q for the quarterly period ended September 30, 2003).	*
4g.	Form of 4.00% Senior Note due 2008 (incorporated herein by reference to Exhibit 4n to the Form 10-Q for the quarterly period ended September 30, 2003).	*
4h.	Form of 5.25% Senior Note due 2013 (incorporated herein by reference to Exhibit 4o to the Form 10-Q for the quarterly period ended September 30, 2003).	*
4i.	Indenture, dated October 1, 2003, between Bristol-Myers Squibb Company, as Issuer, and JPMorgan Chase Bank, as Trustee (incorporated herein by reference to Exhibit 4q to the Form 10-Q for the quarterly period ended September 30, 2003).	*
4j.	Form of Floating Rate Convertible Senior Debenture due 2023 (incorporated herein by reference to Exhibit 4s to the Form 10-Q for the quarterly period ended September 30, 2003).	*
4k.	Specimen Certificate of Common Stock (incorporated herein by reference to Exhibit 4s to the Form 10-K for the fiscal year ended December 31, 2003).	*

4l.	Specimen Certificate of Convertible Preferred Stock (incorporated herein by reference to Exhibit 4s to the Form 10–K for the fiscal year ended December 31, 2003).	*
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4o.	Form of 4.375% Notes due 2016 (incorporated herein by reference to Exhibit 4t the Form 8–K dated November 20, 2006 and filed November 27, 2006).	*
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10b.	SEC Consent Order (incorporated herein by reference to Exhibit 10s to the Form 10–Q for the quarterly period ended September 30, 2004).	*
10c.	General Contract of Indemnity dated August 17, 2006 between Bristol–Myers Squibb Company and Travelers Casualty and Surety Company of America (incorporated herein by reference to Exhibit 10bb to the Form 8–K dated August 31, 2006 and filed September 5, 2006).	*
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10e.	Control Agreement dated August 18, 2006 among Bristol–Myers Squibb Company, Travelers Casualty and Surety Company of America and Smith Barney Inc. (incorporated herein by reference to Exhibit 10dd to the Form 8–K dated August 31, 2006 and filed September 5, 2006).	*
10f.	Letter Agreement dated August 18, 2006 between Bristol–Myers Squibb Company and Travelers Casualty and Surety Company of America (incorporated herein by reference to Exhibit 10ee to the Form 8–K dated August 31, 2006 and filed September 5, 2006).	*
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**10h.	Bristol–Myers Squibb Company 2002 Stock Incentive Plan, effective as of May 7, 2002 and as amended effective January 23, 2007 (incorporated herein by reference to Exhibit 10b to the Form 10–K for the fiscal year ended December 31, 2006).	*
**10i.	Bristol–Myers Squibb Company 2007 Stock Aware and Incentive Plan, effective as of May 1, 2007 (incorporated herein by reference to Exhibit B to the 2007 Proxy Statement dated March 22, 2007).	*
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**10m.	Form of Restricted Stock Award Agreement under the 2002 Stock Award and Incentive Plan (incorporated herein by reference to Exhibit 10t to the Form 10–K for the fiscal year ended December 31, 2005).	*
**10n.	Form of Performance Shares Agreement for the 2006–2008 Performance Cycle (incorporated herein by reference to Exhibit 10u to the Form 10–K for the fiscal year ended December 31, 2005).	*
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**10s.	Bristol–Myers Squibb Company Performance Incentive Plan, as amended (as adopted, incorporated herein by reference to Exhibit 2 to the Form 10–K for the fiscal year ended December 31, 1978; as amended as of January 8, 1990, incorporated herein by reference to Exhibit 19b to the Form 10–K for the fiscal year ended December 31, 1990; as amended on April 2, 1991, incorporated herein by reference to Exhibit 19b to the Form 10–K for the fiscal year ended December 31, 1991; as amended effective January 1, 1994, incorporated herein by reference to Exhibit 10d to the Form 10–K for the fiscal year ended December 31, 1993; and as amended effective January 1, 1994, incorporated herein by reference to Exhibit 10d to the Form 10–K for the fiscal year ended December 31, 1994).	*
**10t.	Bristol–Myers Squibb Company Executive Performance Incentive Plan (effective January 1, 1997 and incorporated herein by reference to Exhibit 10b to the Form 10–K for the fiscal year ended December 31, 1996).	*
**10u.	Bristol–Myers Squibb Company Executive Performance Incentive Plan (effective January 1, 2003 and incorporated herein by reference to Exhibit D to the 2003 Proxy Statement dated April 4, 2003).	*
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**10x.	Benefit Equalization Plan of Bristol-Myers Squibb Company and its Subsidiary or Affiliated Corporations Participating in the Bristol-Myers Squibb Company Savings and Investment Program, as amended and restated effective as of January 1, 1996 (incorporated herein by reference to Exhibit 10h to the Form 10-K for the fiscal year ended December 31, 2001).	*
**10y.	Squibb Corporation Supplementary Pension Plan, as amended (as previously amended and restated, incorporated herein by reference to Exhibit 19g to the Form 10-K for the fiscal year ended December 31, 1991; as amended as of September 14, 1993, and incorporated herein by reference to Exhibit 10g to the Form 10-K for the fiscal year ended December 31, 1993).	*
**10z.	Senior Executive Severance Plan, effective as of April 26, 2007 (incorporated herein by reference to Exhibit 10.2 to the Form 8-K dated April 24, 2007 and filed on April 27, 2007).	*
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31b.	Section 302 Certification Letter (filed herewith).	E-31-2
32a.	Section 906 Certification Letter (filed herewith).	E-32-1
32b.	Section 906 Certification Letter (filed herewith).	E-32-2

SCHEDULE II

BRISTOL-MYERS SQUIBB COMPANY
VALUATION AND QUALIFYING ACCOUNTS

Description Dollars in Millions	Balance at beginning of period	Provisions for bad debts, charge-backs & discounts	Bad debts written off/payments for charge-backs & discounts	Discontinued operations	Balance at end of period
Allowances for Charge-Backs, Discounts and Doubtful Accounts: [1]					
For the year ended December 31, 2007	$ 150	$ 951	$ (919)	$ (2)	$ 180
For the year ended December 31, 2006	207	956	(1,012)	(1)	150
For the year ended December 31, 2005	221	1,429	(1,442)	(1)	207

Description Dollars in Millions	Balance at beginning of period	Provisions for valuation allowance	Release of valuation allowance /other	Balance at end of period
Valuation Allowance on Deferred Tax Assets:				
For the year ended December 31, 2007	$ 625	$ 1,325	$ —	$ 1,950
For the year ended December 31, 2006	559	189	(123)	625
For the year ended December 31, 2005	507	55	(3)	559

(1) Amounts have been reclassified to give effect to discontinued operations. For further information on discontinued operations, see "Item 8. Financial Statements – Note 5. Discontinued Operations and Assets Held for Sale."

DUPONT E I DE NEMOURS & CO (DD)

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10-K

FORM 10-K
Filed on 02/19/2008 - Period: 12/31/2007
File Number 001-00815

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2007

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

Form 10-K

(Mark One)
☑ ANNUAL REPORT PURSUANT TO SECTION 13 or 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the fiscal year ended December 31, 2007
☐ TRANSITION REPORT PURSUANT TO SECTION 13 or 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

Commission file number 1-815

E. I. DU PONT DE NEMOURS AND COMPANY
(Exact name of registrant as specified in its charter)

Delaware	51-0014090
(State or Other Jurisdiction of Incorporation or Organization)	(I.R.S. Employer Identification No.)

1007 Market Street
Wilmington, Delaware 19898
(Address of principal executive offices)

Registrant's telephone number, including area code: 302-774-1000
Securities registered pursuant to Section 12(b) of the Act
(Each class is registered on the New York Stock Exchange, Inc.):

Title of Each Class
Common Stock ($.30 par value)
Preferred Stock (without par value-cumulative)
$4.50 Series
$3.50 Series

No securities are registered pursuant to Section 12(g) of the Act.

Indicate by check mark whether the registrant is a well-known seasoned issuer (as defined in Rule 405 of the Securities Act). Yes ☑ No ☐

Indicate by check mark whether the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act. Yes ☐ No ☑

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

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K. ☐

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

Large accelerated filer ☑	Accelerated filer ☐	Non-accelerated filer ☐ (Do not check if a smaller reporting company)	Smaller reporting company ☐

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

The aggregate market value of voting stock held by nonaffiliates of the registrant (excludes outstanding shares beneficially owned by directors and officers and treasury shares) as of June 30, 2007, was approximately $46.6 billion.

As of January 31, 2008, 899,346,000 shares (excludes 87,041,000 shares of treasury stock) of the company's common stock, $.30 par value, were outstanding.

Documents Incorporated by Reference
(Specific pages incorporated are indicated under the applicable Item herein):

	Incorporated By Reference In Part No.
The company's Proxy Statement in connection with the Annual Meeting of Stockholders to be held on April 30, 2008	III

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E. I. du Pont de Nemours and Company

Form 10-K

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The terms "DuPont" or the "company" as used herein refer to E. I. du Pont de Nemours and Company and its consolidated subsidiaries, or to E. I. du Pont de Nemours and Company, as the context may indicate.

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Note on Incorporation by Reference

Information pertaining to certain Items in Part III of this report is incorporated by reference to portions of the company's definitive 2008 Annual Meeting Proxy Statement to be filed within 120 days after the end of the year covered by this Annual Report on Form 10-K, pursuant to Regulation 14A (the Proxy).

ITEM 1. BUSINESS

DuPont was founded in 1802 and was incorporated in Delaware in 1915. DuPont is a world leader in science and technology in a range of disciplines, including biotechnology, electronics, materials science, safety and security and synthetic fibers. The company operates globally, manufacturing a wide range of products for distribution and sale to many different markets, including the transportation, safety and protection, construction, motor vehicle, agriculture, home furnishings, medical, electronics, communications, protective apparel and the nutrition and health markets. Total worldwide employment at December 31, 2007, was approximately 60,000 people.

The company is strategically aligned into five market- and technology-focused growth platforms consisting of Agriculture & Nutrition; Coatings & Color Technologies; Electronic & Communication Technologies; Performance Materials; and Safety & Protection. In addition to the five growth platforms, the company's reportable segments include Pharmaceuticals. The company includes embryonic businesses not included in the growth platforms, such as applied biosciences, and nonaligned businesses in Other.

Information describing the business of the company can be found on the indicated pages of this report:

Item	Page
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The company has operations in approximately 80 countries worldwide and about 60 percent of consolidated Net sales are made to customers outside the United States of America (U.S.). Subsidiaries and affiliates of DuPont conduct manufacturing, seed production, or selling activities and some are distributors of products manufactured by the company.

Sources of Supply
The company utilizes numerous firms as well as internal sources to supply a wide range of raw materials, energy, supplies, services and equipment. To ensure availability, the company maintains multiple sources for fuels and many raw materials, including hydrocarbon feedstocks. Large volume purchases are generally procured under competitively priced supply contracts.

A substantial portion of the production and sales in Performance Materials is dependent upon the availability of hydrocarbon and hydrocarbon derivative feedstocks. Current hydrocarbon feedstock requirements are met by purchases from major energy and petrochemical companies.

Within Agriculture & Nutrition, the company's wholly-owned subsidiary, Pioneer Hi-Bred International, Inc. (Pioneer), operates in the seed industry and has seed production facilities located throughout the world. Seed production is performed directly by the company or contracted with independent growers and conditioners. The company's ability to produce seeds primarily depends upon weather conditions, contract growers and the availability of preferred hybrids with desired traits.

Part I

Item 1. Business, *continued*

The major commodities, raw materials and supplies for the company's reportable segments in 2007 include the following:

Agriculture & Nutrition:
benzene and carbamic acid related intermediates; copper; insect control products; natural gas; soybeans; soy flake; soy lecithin; sulfonamides

Coatings & Color Technologies:
butyl acetate; chlorine; hexamethylenediamine based poly aliphatic isocyanates; industrial gases; pigments; resins; titanium ore

Electronic & Communication Technologies:
block co-polymers; chloroform; copper; fluorspar; hydrofluoric acid; hydroxylamine; oxydianiline; perchloroethylene; polyester film; precious metals; pyromellitic dianhydride

Performance Materials:
adipic acid; butadiene; butanediol; dimethyl terephthalate; ethane; ethylene glycol; fiberglass; hexamethylenediamine; methanol; natural gas; purified terephthalic acid

Safety & Protection:
alumina hydroxide; ammonia; benzene; high density polyethylene; isophthaloyl chloride; metaphenylenediamine; methyl methacrylate; natural gas; paraphenylenediamine; polyester fiber; propylene; terephthaloyl chloride; wood pulp

No commodities or raw materials are purchased for the Pharmaceutical segment. This segment's revenues arise from licensing arrangements for Cozaar® and Hyzaar® antihypertensive drugs, which are manufactured and distributed by Merck & Co. (Merck).

Since 1997, DuPont has contracted with Computer Sciences Corporation (CSC) and Accenture LLP (Accenture) to provide certain services for the company. CSC operates a majority of the company's global information systems and technology infrastructures and provides selected applications and software services. In December 2005, DuPont entered into a new contract with CSC to provide these services through December 2014. Accenture provides selected applications, software services and enterprise resource planning solutions designed to enhance the company's manufacturing, marketing, distribution and customer service. Accenture is contracted to provide these services through December 2008.

In November 2005, DuPont contracted with Convergys Corporation to provide the company with global human resources transactional services including employee development, workforce planning, compensation management, benefits administration and payroll. As of December 31, 2007, some of the services associated with this contract are in place and are operating. All services associated with this contract are scheduled to be operating in 2010. Convergys Corporation is contracted to provide services through 2018.

Backlog
The company does not consider backlog to be a significant indicator of the level of future sales activity. In general, the company does not manufacture its products against a backlog of orders. Production and inventory levels are based on the level of incoming orders as well as projections of future demand. Therefore, the company believes that backlog information is not material to understanding its overall business and should not be considered a reliable indicator of the company's ability to achieve any particular level of revenue or financial performance.

Intellectual Property
The company believes that its intellectual property estate provides it with an important competitive advantage. It has established a global network of attorneys, as well as branding, advertising and licensing professionals, to procure, maintain, protect, enhance and gain value from this estate.

Part I

Item 1. Business, *continued*

The company owns and is licensed under various patents, which expire from time to time, covering many products, processes and product uses. These patents protect many aspects of the company's significant research programs and the goods and services it sells. The actual protection afforded by these patents varies from country to country and depends upon the scope of coverage of each individual patent as well as the availability of legal remedies in each country. The company owns approximately 21,000 worldwide patents and approximately 16,000 worldwide patent applications. In 2007, the company was granted about 600 U.S. patents and about 1,500 international patents. Through an increase in research and development productivity, since 2000, the company's U.S. patent filings have more than doubled and the number of U.S. patents granted has increased more than 50 percent for DuPont's five growth platforms and embryonic businesses. The company's rights under its patents and licenses, as well as the products made and sold under them, are important to the company as a whole, and to varying degrees, important to each reportable segment. For a discussion of the importance of patents to Pharmaceuticals, see the segment discussion on page 34 of this report.

The environment in which Pioneer and the rest of the companies within the seed industry compete is increasingly affected by new patents, patent positions, patent lawsuits and the status of various intellectual property rights. Ownership of and access to intellectual property rights, particularly those relating to biotechnology and germplasm, are important to Pioneer and its competitors. No single patent owned by Pioneer or its competitors is essential to Pioneer's ability to compete. However, Pioneer will continue to address freedom to operate issues by enforcing its own intellectual property rights, challenging claims made by others and, where appropriate, obtaining licenses to important technologies on commercially reasonable terms. During 2007, Pioneer entered into a business agreement on corn herbicide tolerance and insect control trait technologies with Monsanto Company. Among other provisions, modifications were made to the existing corn license agreements; both parties agreed to exchange certain non-assert and other intellectual property rights; and both parties obtained rights to reference and access certain regulatory data and approvals in which the other has certain interests. See the Contractual Obligations table on page 39 and Note 11 to the Consolidated Financial Statements for more information.

The company has approximately 2,000 unique trademarks for its products and services and approximately 18,000 worldwide registrations and applications for these trademarks. Ownership rights in trademarks do not expire if the trademarks are continued in use and properly protected. The company has many trademarks that have significant recognition at the consumer retail level and/or business to business level. Significant trademarks at the consumer retail level include the DuPont Oval and DuPont™ (the "DuPont Brand Trademarks"); Pioneer® brand seeds; Teflon® fluoropolymers, films, fabric protectors, fibers and dispersions; Corian® surfaces; Kevlar® high strength material; and Tyvek® protective material. The company actively pursues licensing opportunities for selected trademarks at the retail level.

Seasonality
Sales of the company's products in Agriculture & Nutrition are affected by seasonal patterns. Agriculture & Nutrition's sales and earnings performance is strongest in the first half of the year. The segment generally operates at a loss during the third and fourth quarters of the year. As a result of the seasonal nature of its seed business, Agriculture & Nutrition's inventory is at its highest level at the end of the calendar year and is sold down in the first and second quarters. Trade receivables in Agriculture & Nutrition are at a low point at year-end and increase through the selling season to peak at the end of the second quarter.

In general, businesses in the remaining segments are not significantly affected by seasonal factors.

Marketing
With the exception of Pioneer® brand seeds and Solae® soy proteins, most products are marketed primarily through DuPont's sales force, although in some regions, more emphasis is placed on sales through distributors. Pioneer® brand products are promoted through multiple marketing channels in North America. In the corn and soybean markets of the U.S. Corn Belt, products are sold through a specialized force of independent sales representatives. In other North American markets, Pioneer® products are marketed through distributors and crop input retailers. Pioneer® products outside of North America are marketed through a network of subsidiaries, joint ventures and independent producer-distributors. Solae® isolated and functional soy proteins are marketed using a combination of outside distributors, joint ventures and direct sales.

Part I

Item 1. Business, *continued*

Major Customers
The company's sales are not materially dependent on a single customer or small group of customers. However, collectively, Coatings & Color Technologies and Performance Materials have several large customers, primarily in the automotive original equipment manufacturer (OEM) industry. The company has long-standing relationships with these customers and they are considered to be important to the segments' operating results.

Competition
The company competes on a variety of factors such as price, product quality and performance or specifications, continuity of supply, customer service and breadth of product line, depending on the characteristics of the particular market involved and the product or service provided.

Major competitors include diversified industrial companies principally based in the U.S., Western Europe, Japan, China and Korea. In the aggregate, these competitors offer a wide range of products from agricultural, commodity and specialty chemicals to plastics, fibers and advanced materials. The company also competes in certain markets with smaller, more specialized firms who offer a narrow range of products or converted products that functionally compete with the company's offerings.

Agriculture & Nutrition sells advanced plant genetics through Pioneer, principally for the global production of corn and soybeans and thus directly competes with other seed and plant biotechnology companies. Agriculture & Nutrition also provides food safety equipment and soy-based food ingredients in competition with other major grain and food processors.

Research and Development
The company conducts research in the U.S. at over 30 sites at either dedicated research facilities or manufacturing plants. The highest concentration of research is in the Wilmington, Delaware area at several large research centers. Among these, the Experimental Station laboratories engage in investigative and applied research, the Chestnut Run laboratories focus on applied research and the Stine-Haskell Research Center conducts agricultural product research and toxicological research to assure the safe manufacture, handling and use of products and raw materials.

Other major research locations in the U.S. include Marshall Lab in Philadelphia, Pennsylvania, and Mt. Clemens in Mt. Clemens, Michigan, both dedicated to coatings research; Pioneer research facilities in Johnston, Iowa; The Solae Company facilities in St. Louis, Missouri; polymer research facilities in Richmond, Virginia, and Parkersburg, West Virginia; and electronic technology research facilities in Research Triangle Park, North Carolina, Towanda, Pennsylvania, and Santa Barbara, California.

DuPont, reflecting the company's global interests, also operates more than 20 additional research and development facilities at locations outside the U.S., with major facilities located in Meyrin, Belgium; Wuppertal, Germany; Kingston, Canada; Utsunomiya, Japan; and Shanghai, China. A new research and development facility was opened in Taiwan in 2006 to better serve the integrated circuit market. Additionally, in 2007, the company announced that it plans to construct its first research and development center in India. The center, which is located in Hyderabad, is expected to be fully operational in early 2008.

The objectives of the company's research and development programs are to create new technologies, processes and business opportunities in relevant fields, as well as to improve existing products and processes. Each segment of the company funds research and development activities that support its business mission. Recently, the company has broadened its sustainability commitments beyond environmental footprint reduction to include market-driven targets for research and development investment. The company is expanding its offerings addressing safety, environment, energy and climate challenges in the global marketplace by developing and commercializing renewable, bio-based materials; advanced biofuels; energy-efficient technologies; enhanced safety and protection products; and alternative energy products and technologies. The goals are tied directly to business growth, specifically to the development of safer and environmentally improved products that enhance the environmental profile of its traditional businesses for DuPont's key global markets, including transportation, building and construction, agriculture and food and communications.

Part I

Item 1. Business, *continued*

The corporate research laboratories are responsible for conducting research programs aligned with corporate strategy as provided by the growth platforms. All research and development activities are administered by senior research and development management to ensure consistency with the business and corporate strategy. The future of the company is not dependent upon the outcome of any single research program.

Additional information with respect to research and development, including the amount incurred during each of the last three fiscal years, is included in Item 7, Management's Discussion and Analysis of Financial Condition and Results of Operations, on page 21 of this report.

Facility Security

DuPont recognizes that the security and safety of its operations are critical to its employees, neighbors and, indeed, to the future of the company. As such, the company has merged chemical site security into its safety core value where it serves as an integral part of its long standing safety culture. Physical security measures have been combined with process safety measures (including the use of inherently safer technology), administrative procedures and emergency response preparedness into an integrated security plan. The company has conducted vulnerability assessments at operating facilities in the U.S. and high priority sites worldwide and identified and implemented appropriate measures to protect these facilities from physical or cyber attacks. DuPont is partnering with carriers, including railroad, shipping and trucking companies, to secure chemicals in transit.

In April 2007, the Department of Homeland Security (DHS) issued an interim final rule (Rule) that establishes risk-based performance standards for the security of U.S. chemical facilities. Covered chemical facilities are required to prepare Security Vulnerability Assessments that identify facility security vulnerabilities and to develop and implement Site Security Plans that include measures satisfying the identified risk-based performance standards. The Rule contains associated provisions addressing inspections and audits, recordkeeping, and the protection of information that constitutes Chemical-terrorism Vulnerability Information. DHS can seek compliance through the issuance of Orders, including Orders Assessing Civil Penalty and Orders for the Cessation of Operations.

In November of 2007, DHS finalized the list of chemicals regulated by the Rule and required facilities that have those chemicals in specified quantities to register with DHS. Those facilities must provide information by which DHS will determine if and how the facility will be covered by the Rule's security requirements. DuPont's U.S. facilities have submitted this information and are awaiting DHS' determination of coverage. Once DHS has determined which DuPont facilities are covered, it will work with the company to establish security expectations specific to each facility. As a result, management will be able to better assess the Rule's impact on the company at that time. However, the company has already devoted substantial effort and resources in assessing security vulnerabilities and taking steps to reinforce security at its chemical manufacturing facilities. Management expects that these steps will fulfill most of the Rule's risk-based performance standards.

Environmental Matters

Information related to environmental matters is included in several areas of this report: (1) Environmental Proceedings on pages 11-12, (2) Management's Discussion and Analysis of Financial Condition and Results of Operations on pages 25 and 41- 44 and (3) Notes 1 and 19 to the Consolidated Financial Statements.

Available Information

The company is subject to the reporting requirements under the Securities Exchange Act of 1934. Consequently, the company is required to file reports and information with the Securities Exchange Commission (SEC), including reports on the following forms: annual report on Form 10-K, quarterly reports on Form 10-Q, current reports on Form 8-K, and amendments to those reports filed or furnished pursuant to Section 13(a) or 15(d) of the Securities Exchange Act of 1934.

The public may read and copy any materials the company files with the SEC at the SEC's Public Reference Room at 100 F Street, NE, Washington, DC 20549. The public may obtain information on the operation of the Public Reference Room by calling the SEC at 1-800-SEC-0330. The SEC also maintains an Internet site at

http://www.sec.gov that contains reports, proxy and information statements, and other information regarding issuers that file electronically with the SEC.

The company's annual report on Form 10-K, quarterly reports on Form 10-Q, current reports on Form 8-K and amendments to those reports are also accessible on the company's website at http://www.dupont.com by clicking on the tab labeled "Investor Center" and then on "SEC filings." These reports are made available, without charge, as soon as is reasonably practicable after the company files or furnishes them electronically with the Securities and Exchange Commission.

ITEM 1A. RISK FACTORS

The company's operations could be affected by various risks, many of which are beyond its control. Based on current information, the company believes that the following identifies the most significant risk factors that could affect its businesses. However, the risks and uncertainties the company faces are not limited to those discussed below. Additional risks and uncertainties not presently known to the company or that the company currently believes to be immaterial also could affect its businesses. Past financial performance may not be a reliable indicator of future performance and historical trends should not be used to anticipate results or trends in future periods.

Price increases for energy and raw materials could have a significant impact on the company's ability to sustain and grow earnings.
The company's manufacturing processes consume significant amounts of energy and raw materials, the costs of which are subject to worldwide supply and demand as well as other factors beyond the control of the company. Significant variations in the cost of energy, which primarily reflect market prices for oil and natural gas and raw materials affect the company's operating results from period to period. When possible, the company purchases raw materials through negotiated long-term contracts to minimize the impact of price fluctuations. Additionally, the company enters into over-the-counter and exchange traded derivative commodity instruments to hedge its exposure to price fluctuations on certain raw material purchases. The company has taken actions to offset the effects of higher energy and raw material costs through selling price increases, productivity improvements and cost reduction programs. Success in offsetting higher raw material costs with price increases is largely influenced by competitive and economic conditions and could vary significantly depending on the market served. If the company is not able to fully offset the effects of higher energy and raw material costs, it could have a significant impact on the company's financial results.

Failure to develop and market new products could impact the company's competitive position and have an adverse effect on the company's financial results.
The company's operating results are largely dependent on its ability to renew its pipeline of new products and services and to bring those products and services to market. This ability could be adversely affected by difficulties or delays in product development such as the inability to identify viable new products, successfully complete research and development, obtain relevant regulatory approvals, obtain intellectual property protection, or gain market acceptance of new products and services. Because of the lengthy development process, technological challenges and intense competition, there can be no assurance that any of the products the company is currently developing, or could begin to develop in the future, will achieve substantial commercial success. Sales of the company's new products could replace sales of some of its current products, offsetting the benefit of even a successful product introduction.

The company's results of operations could be adversely affected by litigation and other commitments and contingencies.
The company faces risks arising from various unasserted and asserted litigation matters, including, but not limited to, product liability claims, patent infringement claims and antitrust claims. The company has noted a nationwide trend in purported class actions against chemical manufacturers generally seeking relief such as medical monitoring, property damages, off-site remediation and punitive damages arising from alleged environmental torts without claiming present personal injuries. Various factors or developments can lead to changes in current estimates of liabilities such as a final adverse judgment, significant settlement or changes in applicable law. A future

adverse ruling or unfavorable development could result in future charges that could have a material adverse effect on the company. An adverse outcome in any one or more of these matters could be material to the company's financial results.

In the ordinary course of business, the company may make certain commitments, including representations, warranties and indemnities relating to current and past operations, including those related to divested businesses and issue guarantees of third party obligations. If the company were required to make payments as a result, they could exceed the amounts accrued, thereby adversely affecting the company's results of operations.

As a result of the company's current and past operations, including operations related to divested businesses, the company could incur significant environmental liabilities.
The company is subject to various laws and regulations around the world governing the environment, including the discharge of pollutants and the management and disposal of hazardous substances. As a result of its operations, including its past operations and operations of divested businesses, the company could incur substantial costs, including cleanup costs, third-party property damage or personal injury claims. The costs of complying with complex environmental laws and regulations, as well as internal voluntary programs, are significant and will continue to be so for the foreseeable future. The ultimate costs under environmental laws and the timing of these costs are difficult to predict. The company's accruals for such costs and liabilities may not be adequate because the estimates on which the accruals are based depend on a number of factors including the nature of the allegation, the complexity of the site, site geology, the nature and extent of contamination, the type of remedy, the outcome of discussions with regulatory agencies and other Potentially Responsible Parties (PRPs) at multi-party sites and the number and financial viability of other PRPs.

The company's ability to generate sales from genetically enhanced products, particularly seeds and other agricultural products, could be adversely affected by market acceptance, government policies, rules or regulations and competition.
The company is using biotechnology to create and improve products, particularly in its Agriculture & Nutrition segment. Demand for these products could be affected by market acceptance of genetically modified products as well as governmental policies, laws and regulations that affect the development, manufacture and distribution of products, including the testing and planting of seeds containing biotechnology traits and the import of crops grown from those seeds.

The company competes with major global companies that have strong intellectual property estates supporting the use of biotechnology to enhance products, particularly in the agricultural products and production markets. Speed in discovering and protecting new technologies and bringing products based on them to market is a significant competitive advantage. Failure to predict and respond effectively to this competition could cause the company's existing or candidate products to become less competitive, adversely affecting sales.

Changes in government policies and laws could adversely affect the company's financial results.
Sales outside the U.S. constitute more than half of the company's revenue. The company anticipates that international sales will continue to represent a substantial portion of its total sales and that continued growth and profitability will require further international expansion, particularly in emerging markets. The company's financial results could be affected by changes in trade, monetary and fiscal policies, laws and regulations, or other activities of U.S. and non-U.S. governments, agencies and similar organizations. These conditions include but are not limited to changes in a country's or region's economic or political conditions, trade regulations affecting production, pricing and marketing of products, local labor conditions and regulations, reduced protection of intellectual property rights in some countries, changes in the regulatory or legal environment, restrictions on currency exchange activities, burdensome taxes and tariffs and other trade barriers. International risks and uncertainties, including changing social and economic conditions as well as terrorism, political hostilities and war, could lead to reduced international sales and reduced profitability associated with such sales.

Economic factors, including inflation and fluctuations in currency exchange rates, interest rates and commodity prices could affect the company's financial results.
The company is exposed to fluctuations in currency exchange rates, interest rates and commodity prices. Because the company has significant international operations, there are a large number of currency transactions that result from international sales, purchases, investments and borrowings. The company actively manages currency exposures that are associated with monetary asset positions, committed currency purchases and sales and other assets and liabilities created in the normal course of business. Failure to successfully manage these risks could have an adverse impact on the company's financial position, results of operations and cash flows.

Business disruptions could seriously impact the company's future revenue and financial condition and increase costs and expenses.
Business disruptions, including supply disruptions, increasing costs for energy, temporary plant and/or power outages and information technology system and network disruptions, could seriously harm the company's operations as well as the operations of its customers and suppliers. Although it is impossible to predict the occurrences or consequences of any such events, they could result in reduced demand for the company's products, make it difficult or impossible for the company to deliver products to its customers or to receive raw materials from suppliers, and create delays and inefficiencies in the supply chain. The company actively manages the risks within its control that could cause business disruptions to mitigate any potential impact from business disruptions regardless of cause including acts of terrorism or war, and natural disasters. Despite these efforts, the impact from business disruptions could significantly increase the cost of doing business or otherwise adversely impact the company's financial performance.

Inability to protect and enforce the company's intellectual property rights could adversely affect the company's financial results.
Intellectual property rights are important to the company's business. The company endeavors to protect its intellectual property rights in jurisdictions in which its products are produced or used and in jurisdictions into which its products are imported. However, the company may be unable to obtain protection for its intellectual property in key jurisdictions. Additionally, the company has designed and implemented internal controls to restrict access to and distribution of its intellectual property, including confidential information and trade secrets. Despite these precautions, it is possible that unauthorized parties may access and use such property. When misappropriation is discovered, the company reports such situations to the appropriate governmental authorities for investigation and takes measures to mitigate any potential impact.

ITEM 1B. UNRESOLVED STAFF COMMENTS

None.

Part I

ITEM 2. PROPERTIES

The company's corporate headquarters are located in Wilmington, Delaware. The company's manufacturing, processing, marketing and research and development facilities, as well as regional purchasing offices and distribution centers are located throughout the world.

Information regarding research and development facilities is incorporated by reference to Item 1, Business–Research and Development. Additional information with respect to the company's property, plant and equipment and leases is contained in Notes 10, 19 and 24 to the Consolidated Financial Statements.

The company has investments in property, plant and equipment related to global manufacturing operations. Collectively there are over 300 sites in total. The more significant sites are listed by their applicable segment(s) as set forth below:

Agriculture & Nutrition

U.S.	Mobile, AL; Valdosta, GA; El Paso, IL; Gibson City, IL; Pryor, OK; Manati, Puerto Rico; Memphis, TN; LaPorte, TX
Asia Pacific	Toyko, Japan
Europe	Leper, Belgium; Aahrus, Denmark; Cerney, France and Asturias, Spain
Latin America	Camacari, Brazil; Esteio, Brazil; Lerma, Mexico

Coatings & Color Technologies

U.S.	Edgemoor, DE; Starke, FL; Mount Clemens, MI; Delisle, MS; New Johnsonville, TN; Houston, TX; Front Royal, VA
Asia Pacific	Kuan Yin, Taiwan
Europe	Mechelen, Belgium; Wuppertal, Germany
Latin America	Sao Paulo, Brazil; Altamira, Mexico

Electronic & Communication Technologies

U.S.	Hayward, CA; Santa Barbara, CA; Torrance, CA; Fort Madison, IA; Louisville, KY; Fayetteville, NC; Research Triangle Park, NC; Deepwater, NJ; Parlin, NJ; Buffalo, NY; Rochester, NY; Circleville, OH; Towanda, PA; Manati, Puerto Rico; Bayport, TX; Corpus Christi, TX; LaPorte, TX; Logan, UT; Parkersburg, WV
Asia Pacific	Changshu, China; Hsinchu, China; Shenzhen, China; Madurai, India; Chiba, Japan; Shimizu, Japan; Taoyuan, Taiwan; Tokai, Japan
Europe	Luxembourg; Mechelen, Belgium; Neu Isenburg, Germany; Dordrecht, Netherlands; Bristol, UK; East Kilbride, UK; Ruabon, UK

Performance Materials

U.S.	Newark, DE; LaPlace, LA; Fayetteville, NC; Deepwater, NJ; Circleville, OH; Charleston, SC; Florence, SC; Chattanooga, TN; Old Hickory, TN; Beaumont, TX; LaPorte, TX; Orange, TX; Victoria, TX; Hopewell, VA; Richmond, VA; Parkersburg, WV
Asia Pacific	Shenzen, China; Chiba, Japan; Gifu, Japan; Ibaraki, Japan; Utsunomiya, Japan; Ulsan, Korea; Singapore
Europe	Antwerp, Belgium; Mechelen, Belgium; Uentrop, Germany; Luxembourg; Dordrecht, Netherlands
Latin America	Berazategui, Argentina; Tlalnepantna, Mexico

Part I

Item 2. Properties, *continued*

Safety & Protection

U.S.	Red Lion, DE; Wurtland, KY; Burnside, LA; LaPlace, LA; Pascagoula, MS; Deepwater, NJ; Linden, NJ; Buffalo, NY; Niagara Falls, NY; Fort Hill, OH; Memphis, TN; Old Hickory, TN; Baytown, TX; Beaumont, TX; El Paso, TX; James River, VA; Richmond, VA; Belle, WV
Asia Pacific	Guangzhou, China; Ulsan, Korea
Europe	Villers-St. Paul, France; Luxembourg; Asturias, Spain; Sudbury, United Kingdom
Canada	Thetford Mines

The company's plants and equipment are well maintained and in good operating condition. Sales as a percent of capacity were over 80 percent in 2007, 2006 and 2005. Properties are primarily owned by the company; however, certain properties are leased. No title examination of the properties has been made for the purpose of this report and certain properties are shared with other tenants under long-term leases.

ITEM 3. LEGAL PROCEEDINGS

Litigation
Benlate®
Information related to this matter is included in Note 19 to the Consolidated Financial Statements under the heading Benlate®.

PFOA: Environmental and Litigation Proceedings
For purposes of this report, the term PFOA means collectively perfluorooctanoic acid and its salts, including the ammonium salt and does not distinguish between the two forms. Information related to this matter is included in Note 19 to the Consolidated Financial Statements under the heading PFOA.

Elastomers Antitrust Matters
Information related to this matter is included in Note 19 to the Consolidated Financial Statements under the heading Elastomers Antitrust Matters.

Environmental Proceedings
Acid Plants New Source Review Enforcement Action
In 2003, the U.S. Environmental Protection Agency (EPA) issued a "Notice of Violation and Finding of Violation" for the company's Fort Hill sulfuric acid plant in Ohio. The EPA conducted a review of capital projects at the plant over the past twenty years. Based on its review, the EPA believes that two of the projects triggered a requirement to meet the New Source Performance Standards for sulfuric acid plants and that the company should have sought a permit under the New Source Review requirements of the Clean Air Act (CAA). In July 2004, the EPA issued a Notice of Violation for the James River sulfuric acid plant in Virginia with similar allegations. The company's sulfuric acid plants in Louisiana and Kentucky use similar technology.

In July 2007 a Consent Decree was reached under which the company paid a total of $4,125,000 in civil penalties to the U.S. federal government, Louisiana, Ohio and Virginia. Under the Decree, DuPont must retrofit its Burnside plant in Louisiana by September 1, 2009 at an estimated cost of at least $66 million. In addition, by March 1, 2012, the other three plants must be retrofitted at an estimated total cost of at least $87 million or shut down.

Belle Spent Acid Plant New Source Review Notice of Violation
On August 2, 2007, the EPA issued a Notice and Finding of Violation to DuPont and Lucite International regarding the spent acid regeneration unit at the Belle Plant in South Charleston, West Virginia. DuPont sold the unit to Imperial Chemical Industries, Plc (ICI) in 1993, who sold it to Lucite in 1999. DuPont has operated the unit since it was built in 1964, including after the sale to ICI, through the present. The Notice alleges 5 projects in the time period 1988 to 1996 should have triggered the New Source Review or New Source Performance Standard requirements of CAA. If so, these would have required retrofit to "best available" technology. DuPont and Lucite are contesting the allegations. If the EPA declines to reconsider its findings it may bring an enforcement action in the courts

Item 3. Legal Proceedings, *continued*

seeking retrofit and penalties. Lucite has notified the company that it intends to seek indemnity from DuPont if this occurs.

Gibson City, Illinois
The EPA has alleged that The Solae Company violated the CAA's New Source Review Regulations and certain Prevention of Significant Deterioration requirements at its plant in Gibson City, Illinois. The Solae Company, a majority-owned venture with Bunge Limited, was formed in 2003. The EPA has proposed a settlement of this matter that would include sites located in Indiana, Ohio, Oklahoma and Tennessee, some of which are wholly owned by DuPont, in addition to the Gibson City site. The EPA's proposed settlement includes a penalty of $350,000 and Supplemental Environmental Projects involving expenditures of at least $500,000. The company and The Solae Company are negotiating with the EPA and U.S. Department of Justice (DOJ).

Pascagoula, Mississippi
In October 2002, the First Chemical Corporation (FCC) plant in Pascagoula, Mississippi experienced an explosion at one of its process units – the mononitrotoluene unit – Still Number 1 (MNT Still). The unit overheated, pressure built up in the column and a significant release occurred. No significant injuries occurred, nor was there any significant environmental harm as a result of the incident.

At the time of the October 2002 incident, FCC was not affiliated with DuPont; however, DuPont was in final negotiations for the purchase of ChemFirst, Inc., of which FCC was a subsidiary. After an extensive investigation of the incident by FCC and DuPont, DuPont completed the purchase in November 2002.

Two years after the incident, the EPA began an investigation under the CAA's "Prevention of Accidental Releases – General Duty of Care" provisions – CAA 112(r). Over the last three years, the EPA has requested significant documentation regarding the incident and the rebuild of the MNT Still. The EPA also requested, and FCC agreed to an independent third-party "process safety management" audit of the FCC facility, seeking information on pre-incident documents as well as the post-incident repair and replacement of the MNT Still.

The EPA has referred the matter to DOJ for enforcement action against FCC under the CAA. The EPA/DOJ and DuPont are currently engaged in settlement discussions to resolve the proposed CAA 112(r) enforcement action. Management cannot predict the outcome of these discussions at this time.

ITEM 4. SUBMISSION OF MATTERS TO A VOTE OF SECURITY HOLDERS

None.

Part I

Item 4. Submission of Matters to a Vote of Security Holders, *continued*

Executive Officers of the Registrant
The following is a list, as of February 18, 2008, of the company's executive officers:

	Age	Executive Officer Since
Chairman of the Board of Directors and Chief Executive Officer:		
Charles O. Holliday, Jr.	59	1992
Other Executive Officers:		
James C. Borel, Senior Vice President – Global Human Resources	52	2004
Thomas M. Connelly, Jr., Executive Vice President and Chief Innovation Officer	55	2000
Richard R. Goodmanson, Executive Vice President and Chief Operating Officer	60	1999
Jeffrey L. Keefer, Executive Vice President and Chief Financial Officer	55	2006
Ellen J. Kullman, Executive Vice President	52	2006
Stacey J. Mobley, Senior Vice President and Chief Administrative Officer and General Counsel	62	1992

The company's executive officers are elected or appointed for the ensuing year or for an indefinite term and until their successors are elected or appointed.

Charles O. Holliday, Jr. joined DuPont in 1970, and has advanced through various manufacturing and supervisory assignments in product planning and marketing. He is a former president, executive vice president, president and chairman–DuPont Asia Pacific. Mr. Holliday became an executive officer in 1992 when he was appointed senior vice president. He became Chief Executive Officer on February 1, 1998, and Chairman of the Board of Directors on January 1, 1999.

James C. Borel joined DuPont in 1978, and held a variety of product and sales management positions for Agricultural Products. In 1993, he transferred to Tokyo, Japan with Agricultural Products as regional manager, North Asia and was appointed regional director, Asia Pacific in 1994. In 1997, he was appointed regional director, North America and was appointed vice president and general manager–DuPont Crop Protection later that year. In January 2004, he was named to his current position, Senior Vice President–DuPont Global Human Resources.

Thomas M. Connelly, Jr. joined DuPont in 1977 as a research engineer. Since then, Mr. Connelly has served in various research and plant technical leadership roles, as well as product management and business director roles. Mr. Connelly served as vice president and general manager–DuPont Fluoroproducts from 1999 until September 2000, when he was named senior vice president and chief science and technology officer. In June 2006, Mr. Connelly was named Executive Vice President and Chief Innovation Officer.

Richard R. Goodmanson joined DuPont in 1999 as Executive Vice President and Chief Operating Officer. Prior to joining DuPont, Mr. Goodmanson was president and chief executive officer of America West Airlines from 1996 to 1999. He was senior vice president of operations for Frito–Lay Inc. from 1992 to 1996, and he was a principal at McKinsey & Company, Inc. from 1980 to 1992.

Jeffrey L. Keefer joined DuPont in 1976 as a financial analyst in corporate finance. In 1982, he accepted a field sales assignment and was appointed customer service manager in 1985. He advanced through various sales and management assignments and in February 1999 he was named vice president and general manager – DuPont

Part I

Item 4. Submission of Matters to a Vote of Security Holders, *continued*

Titanium Technologies. In January 2004, he was named group vice president – DuPont Performance Materials. In June 2006, he was named Executive Vice President – DuPont Finance and Chief Financial Officer.

Ellen J. Kullman joined DuPont in 1988 as marketing manager and progressed through various roles as global business director and was named vice president and general manager of White Pigment & Mineral Products in 1995. In 2000, Ms. Kullman was named group vice president and general manager of several businesses and new business development. She became group vice president–DuPont Safety & Protection in 2002. In June 2006, Ms. Kullman was named Executive Vice President and assumed leadership of Marketing & Sales along with Safety and Sustainability.

Stacey J. Mobley joined DuPont's legal department in 1972. He was named director of Federal Affairs in the company's Washington, D.C. office in 1983, and was promoted to vice president–Federal Affairs in 1986. He returned to the company's Wilmington, Delaware headquarters in March 1992 as vice president–Communications in External Affairs and was promoted to Senior Vice President in May 1992. He was named Chief Administrative Officer in May 1999 and General Counsel in November 1999.

Part II

ITEM 5. MARKET FOR REGISTRANT'S COMMON EQUITY, RELATED STOCKHOLDER MATTERS AND ISSUER PURCHASES OF EQUITY SECURITIES

Market for Registrant's Common Equity and Related Stockholder Matters
The company's common stock is listed on the New York Stock Exchange, Inc. (symbol DD) and certain non-U.S. exchanges. The number of record holders of common stock was 91,717 at December 31, 2007, and 91,405 at January 31, 2008.

Holders of the company's common stock are entitled to receive dividends when they are declared by the Board of Directors. While it is not a guarantee of future conduct, the company has continuously paid a quarterly dividend since the fourth quarter 1904. Dividends on common stock and preferred stock are usually declared in January, April, July and October. When dividends on common stock are declared, they are usually paid mid March, June, September and December. Preferred dividends are paid on or about the 25th of January, April, July and October. The Stock Transfer Agent and Registrar is Computershare Trust Company, N.A.

The company's quarterly high and low trading stock prices and dividends per common share for 2007 and 2006 are shown below.

	Market Prices		
	High	Low	Per Share Dividend Declared
2007			
Fourth Quarter	$ 50.42	$ 42.25	$ 0.41
Third Quarter	53.90	45.75	0.37
Second Quarter	53.25	48.44	0.37
First Quarter	53.67	47.58	0.37
2006			
Fourth Quarter	$ 49.68	$ 42.48	$ 0.37
Third Quarter	43.49	38.82	0.37
Second Quarter	45.75	39.53	0.37
First Quarter	43.50	38.52	0.37

Issuer Purchases of Equity Securities
There were no purchases of the company's common stock during the three months ended December 31, 2007.

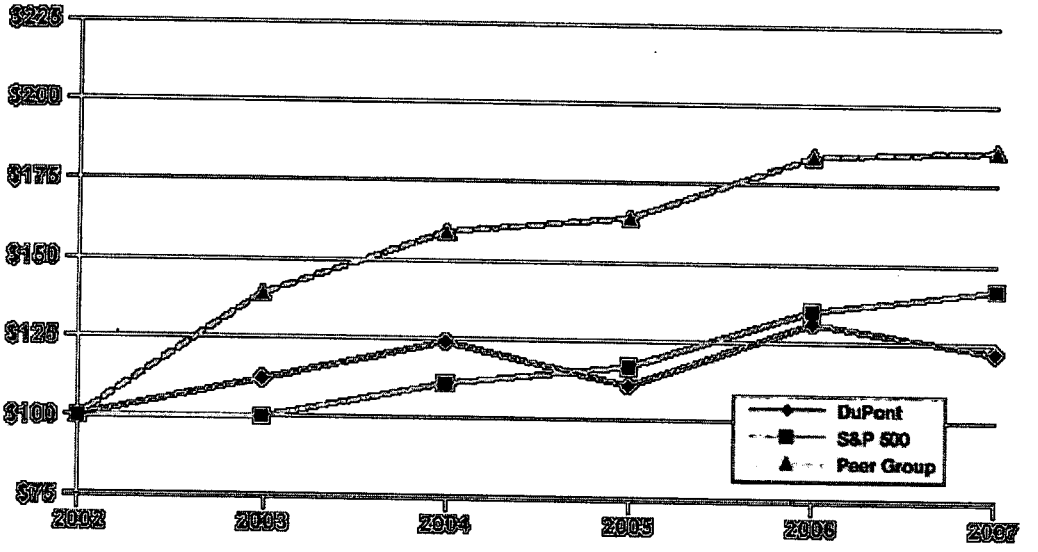
Part II

Item 5. Market for Registrant's Common Equity, Related Stockholder Matters and Issuer Purchases of Equity Securities, *continued*

Stock Performance Graph

The following graph presents the cumulative five-year total return for the company's common stock compared with the S&P 500 Stock Index and a self-constructed peer group of companies. The peer group companies for the year ended December 31, 2007 are Alcoa Inc.; BASF Corporation; The Dow Chemical Company; Eastman Kodak Company; Ford Motor Company; General Electric Company; Hewlett-Packard Company; Minnesota Mining and Manufacturing Company; Monsanto Company; Motorola, Inc.; PPG Industries, Inc.; Rohm and Haas Company; and United Technologies Corporation.

Stock Performance Graph



	12/31/2002	12/31/2003	12/31/2004	12/31/2005	12/31/2006	12/31/2007
DuPont	$ 100	$ 112	$ 124	$ 111	$ 131	$ 122
S&P 500	$ 100	$ 100	$ 111	$ 117	$ 135	$ 142
Peer Group	$ 100	$ 139	$ 159	$ 164	$ 184	$ 186

The graph assumes that the value of DuPont Common Stock, the S&P 500 Stock Index and the peer group of companies was each $100 on December 31, 2002 and that all dividends were reinvested. The peer group is weighted by market capitalization.

Part II

ITEM 6. SELECTED FINANCIAL DATA

(Dollars in millions, except per share)	2007	2006	2005	2004	2003
Summary of operations					
Net sales	$ 29,378	$ 27,421	$ 26,639	$ 27,340	$ 26,996
Income before income taxes and minority interests	$ 3,743	$ 3,329	$ 3,563	$ 1,442	$ 143
Provision for (benefit from) income taxes	$ 748	$ 196	$ 1,470	$ (329)	$ (930)
Income before cumulative effect of changes in accounting principles	$ 2,988	$ 3,148	$ 2,056	$ 1,780	$ 1,002
Net income	$ 2,988	$ 3,148	$ 2,056	$ 1,780	$ 973 [1]
Basic earnings per share of common stock					
Income before cumulative effect of changes in accounting principles	$ 3.25	$ 3.41	$ 2.08	$ 1.78	$ 1.00
Net income	$ 3.25	$ 3.41	$ 2.08	$ 1.78	$ 0.97 [1]
Diluted earnings per share of common stock					
Income before cumulative effect of changes in accounting principles	$ 3.22	$ 3.38	$ 2.07	$ 1.77	$ 0.99
Net income	$ 3.22	$ 3.38	$ 2.07	$ 1.77	$ 0.96 [1]
Financial position at year-end					
Working capital	$ 4,619	$ 4,930	$ 4,986	$ 7,272	$ 5,419
Total assets	$ 34,131	$ 31,777 [2]	$ 33,291	$ 35,632	$ 37,039
Borrowings and capital lease obligations					
Short-term	$ 1,370	$ 1,517	$ 1,397	$ 937 [3]	$ 6,017 [3]
Long-term	$ 5,955	$ 6,013	$ 6,783	$ 5,548	$ 4,462 [3]
Stockholders' equity	$ 11,136	$ 9,422 [2]	$ 8,962	$ 11,377	$ 9,781
General					
For the year					
Purchases of property, plant & equipment and investments in affiliates	$ 1,698	$ 1,563	$ 1,406	$ 1,298	$ 1,784
Depreciation	$ 1,158	$ 1,157	$ 1,128	$ 1,124	$ 1,355
Research and development (R&D) expense	$ 1,338	$ 1,302	$ 1,336	$ 1,333	$ 1,349
Average number of common shares outstanding (millions)					
Basic	917	921	982	998	997
Diluted	925	929	989	1,003	1,000
Dividends per common share	$ 1.52	$ 1.48	$ 1.46	$ 1.40	$ 1.40
At year-end					
Employees (thousands)	60	59	60	60	81
Closing stock price	$ 44.09	$ 48.71	$ 42.50	$ 49.05	$ 45.89
Common stockholders of record (thousands)	92	84	101	106	111

1 Includes a cumulative effect of a change in accounting principle charge of $29 million or $0.03 per share, basic and diluted, relating to the adoption of Statement of Financial Accounting Standards (SFAS) No. 143, "Accounting for Asset Retirement Obligations".

2 On December 31, 2006, 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)." Total assets and stockholders' equity were reduced by $2,159 million and $1,555 million, respectively, as a result of such adoption.

3 Includes borrowings and capital lease obligations classified as liabilities held for sale.

Part II

ITEM 7. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

CAUTIONARY STATEMENTS ABOUT FORWARD-LOOKING STATEMENTS

This report contains forward-looking statements which may be identified by their use of words like "plans," "expects," "will," "anticipates," "intends," "projects," "estimates" or other words of similar meaning. All statements that address expectations or projections about the future, including statements about the company's strategy for growth, product development, market position, expenditures and financial results are forward-looking statements.

Forward-looking statements are based on certain assumptions and expectations of future events. The company cannot guarantee that these assumptions and expectations are accurate or will be realized. For some of the important factors that could cause the company's actual results to differ materially from those projected in any such forward-looking statements see the Risk Factors discussion set forth under Part I, Item 1A beginning on page 7.

Overview

DuPont has been successfully executing its three growth strategies – *Putting Science to Work, Leveraging the Power of One DuPont and Going Where the Growth Is.* In 2007, approximately 1,200 new products were commercialized, approximately 2,000 new U.S. patent applications were filed and more than one third of 2007 sales were derived from products introduced in the last 5 years. The company again reduced fixed costs as a percent of Net sales. In 2007, over sixty percent of the company's sales were to customers outside of the United States. The company achieved 18 percent growth in the emerging markets of Europe, Asia Pacific and Latin America.

In January 2008, the company outlined goals and objectives beyond 2008 through 2010 in a five point plan. The company sees potential for double digit earnings growth driven by advances in several strategic areas:

New science for growing agriculture markets – With demand for protein rising rapidly, global food production will have to double between now and 2025 on virtually the same amount of land currently in production. As one of the world's largest producers of corn and soy seed and crop protection products, DuPont is bringing to market more efficient and cost-effective control systems for weeds, insects and fungus to boost farm productivity, quality and yield. The company anticipates that new products such as Optimum™ GAT™ traits and Rynaxypr™ insecticide, will provide significant growth.

Growing demand for Safety & Protection – People want to feel safer and more secure at home, on the job, in their cars – everywhere. The company's long experience and $6 billion base business in advanced materials such as Kevlar®, Nomex® and Tyvek® have resulted in a broad offering of products and services that address this growing global need. In 2007, the company announced a new $500 million Kevlar® brand fiber production facility in South Carolina, which came on the heels of capacity expansions for Nomex® flame-resistant fibers. In 2008, the company will continue to use its science and growth investments to take advantage of the opportunity it sees for attractive growth in its Safety & Protection segment.

Springboard position in emerging markets – The company's rapid top line growth in emerging markets is a key factor in counter-balancing softness in the North American automotive and U.S. housing markets. Business unit leaders in the Performance Materials, Coatings & Color Technologies and Electronic & Communication Technologies segments are succeeding in generating strong growth in the emerging markets of Asia Pacific, Central and Eastern Europe, and Latin America.

Extend cost productivity gains – DuPont continues to reduce fixed costs as a percent of Net sales. Cost savings projects have offset inflation in personnel costs and have provided funding for a large number of growth investments. DuPont is focused on continuing to generate cost productivity gains as a mechanism for funding growth.

Continue development of Applied Biosciences – Science and innovation are critical to the company's success. Ongoing development and commercialization of DuPont Applied Biosciences™ products will continue through at least 2010 with increasing intensity.

Part II

Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations, *continued*

Analysis of Operations

(Dollars in millions)	2007	2006	2005
NET SALES	$ 29,378	$ 27,421	$ 26,639

2007 versus 2006 Consolidated net sales for 2007 were $29.4 billion, up 7 percent. This growth was principally the result of an 11 percent increase in sales outside of the U.S., reflecting in part the benefit of a weaker U.S. dollar (USD), which added 3 percent to worldwide sales. Worldwide volumes and local selling prices each increased 2 percent. Sales in the U.S. increased 1 percent reflecting 3 percent higher selling prices, partially offset by 2 percent lower volume. The decrease in U.S. sales volume was primarily due to lower demand for the company's products related to housing and automotive production markets. Sales in Canada and Latin America increased 15 percent, primarily due to a 10 percent volume increase reflecting a substantial increase in sales of seed and crop protection products in South America.

The table below shows a regional breakdown of 2007 Consolidated net sales based on location of customers and percentage variances from prior year:

			Percent Change Due to:		
(Dollars in billions)	2007 Net Sales	Percent Change vs. 2006	Local Price	Currency Effect	Volume
Worldwide	$ 29.4	7	2	3	2
United States	11.3	1	3	–	(2)
Europe	8.8	12	2	8	2
Asia Pacific	5.2	8	2	2	4
Canada & Latin America	4.1	15	2	3	10

2006 versus 2005 Consolidated net sales for 2006 were $27.4 billion, up 3 percent. The increase reflects 2 percent higher local selling prices and 2 percent higher net volume partially offset by a 1 percent reduction in worldwide sales attributable to the transfer of certain elastomers assets in 2005. Local selling prices increased across all regions and business segments. During 2006, significant volume increases in key growth regions, particularly Asia Pacific and Latin America, along with modest growth in Europe, more than offset lower U.S. volume. Volume declines in the U.S. are largely attributable to lower demand in housing and automotive production markets. These declines more than offset the recovery in the U.S. of titanium dioxide, industrial chemical and packaging polymer sales lost in 2005 as a result of business disruptions due to Hurricanes Katrina and Rita.

The table below shows a regional breakdown of 2006 Consolidated net sales based on location of customers and percentage variances from prior year:

			Percent Change Due to:			
(Dollars in billions)	2006 Net Sales	Percent Change vs. 2005	Local Price	Currency Effect	Volume	Other[1]
Worldwide	$ 27.4	3	2	–	2	(1)
United States	11.1	–	3	–	(1)	(2)
Europe	7.9	3	2	(1)	3	(1)
Asia Pacific	4.8	5	3	(2)	7	(3)
Canada & Latin America	3.6	10	2	3	5	–

1 Percentage change due to the absence in 2006 of sales from elastomers businesses transferred to Dow on June 30, 2005. Sales attributable to the transferred assets were $386 million in 2005.

Part II

Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations, *continued*

(Dollars in millions)	2007	2006	2005
OTHER INCOME, NET	$ 1,275	$ 1,561	$ 1,852

2007 versus 2006 Other income, net, decreased $286 million versus 2006. This reduction is primarily due to an impairment charge of $165 million to write down the company's investment in a polyester films joint venture, a decrease of $81 million in net pretax exchange gains, and a decrease in miscellaneous items of $239 offset by higher Cozaar®/Hyzaar® income of $136 million (see page 34 for Pharmaceuticals segment information and Note 2 to the Consolidated Financial Statements).

The decrease in miscellaneous items resulted from the absence of 2006 benefits of $90 million for the reversal of accrued interest related to the favorable settlement of certain prior-year tax contingencies and $76 million of insurance recoveries from its insurance carriers. Of the $76 million, $61 million related to costs, including outside counsel fees and expenses and settlements paid over the past twenty years as part of asbestos litigation matters. During this twenty year period, DuPont has been served with thousands of lawsuits alleging injury from exposure to asbestos on DuPont premises. Most of these claims have been disposed of through trial, dismissal or settlement. Management believes it is remote that the outcome of remaining or future asbestos litigation matters will have a material adverse effect on the company's consolidated financial position or liquidity. These asbestos related insurance recoveries were reflected in Cash provided by operating activities within the company's Consolidated Statements of Cash Flows. The remaining $15 million is part of a total recovery of $143 million relating to insurance recoveries associated with damages to the company's facilities suffered as a result of Hurricane Katrina in 2005. The majority of the Hurricane Katrina recovery was included in Cost of goods sold and other operating charges in the Consolidated Income Statements. No amounts were received from insurance carriers for damages suffered by the company as a result of Hurricane Rita.

2006 versus 2005 Other income, net decreased $291 million versus 2005. This reduction is primarily due to a $407 million decrease in net pretax exchange gains (see page 46 for a discussion of the company's program to manage currency risk and Note 2 to the Consolidated Financial Statements). In 2006, the company recorded $76 million of insurance recoveries in Other income, net from its insurance carriers.

Additional information related to the company's Other income, net is included in Note 2 to the Consolidated Financial Statements.

(Dollars in millions)	2007	2006	2005
COST OF GOODS SOLD AND OTHER OPERATING CHARGES	$ 21,565	$ 20,440	$ 19,683
As a percent of Net sales	73%	75%	74%

2007 versus 2006 Cost of goods sold and other operating charges (COGS) for the year 2007 were $21.6 billion, versus $20.4 billion in 2006, an increase of 6 percent. COGS was 73 percent of net sales for 2007 versus 75 percent for the year 2006. The 2 percentage point reduction principally reflects the absence of 2006 charges for restructuring, the effects of the company's productivity initiatives and a current year benefit from the weaker U.S. dollar due to currency exchange rate changes which increased sales at a higher rate than the rate they increased COGS. Partly offsetting these factors were increases in raw material and finished product distribution costs, as well as the absence of a 2006 benefit of $128 million in insurance recoveries.

The 2006 restructuring programs included the elimination of approximately 3,200 positions and redeployment of about 400 employees in excess positions to the extent possible. The company recorded a net charge of $326 million in 2006 related to employee separation costs and asset impairment charges. This included $184 million to provide severance benefits for approximately 2,800 employees involved in manufacturing, marketing and sales, administrative and technical activities. Additional details related to these programs are contained in the individual segment reviews and in Note 4 to the Consolidated Financial Statements.

Part II

Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations, *continued*

Payments from operating cash flows to terminated employees as a result of the 2006 plans totaled $77 million during 2007 and $32 million during 2006. Annual pretax cost savings of about $125 million per year are associated with the Coatings & Color Technologies program, approximately $53 million of which is reflected in COGS. Cumulative savings of approximately 80 percent and 35 percent was realized in 2007 and 2006, respectively, with the remainder expected to be realized in 2008.

2006 versus 2005 COGS for the year 2006 was $20.4 billion, versus $19.7 billion in 2005, up 4 percent. COGS was 75 percent of sales in 2006 versus 74 percent in 2005. The 1 percentage point increase in COGS as a percent of sales principally reflects higher raw material costs not entirely covered by selling price increases and higher costs for restructuring plans discussed above.

In 2006, the company recorded a benefit to COGS for $128 million for insurance recoveries related to the property damage suffered as a result of Hurricane Katrina. In 2005, the company recorded charges of $160 million related to the clean-up and restoration of manufacturing operations, as well as the write-off of inventory and plant assets that were destroyed by Hurricanes Katrina and Rita. Hurricane related charges reduced segment earnings as follows: Coatings & Color Technologies – $116 million; Performance Materials – $17 million; and Safety & Protection – $27 million.

The company recorded a net charge of $326 million in 2006 related to employee separation costs and asset impairment charges as discussed above. In 2005, the company evaluated capital investment requirements at its Louisville, Kentucky facility and the declining demand for the neoprene products produced at the facility. As a result, the company has made plans to consolidate neoprene production at its upgraded facility in LaPlace, Louisiana. On December 31, 2007, the company initiated the shutdown, abatement and dismantlement process at the Louisville facility. A charge of $34 million was recorded in 2005 reflecting severance and related costs for approximately 275 employees, principally at the Louisville site. Additionally, a benefit of $13 million was recorded in 2005 to reflect changes in estimates related to employee separations that were implemented in earlier years.

(Dollars in millions)	2007	2006	2005
SELLING, GENERAL AND ADMINISTRATIVE EXPENSES	**$ 3,364**	$ 3,224	$ 3,223
As a percent of Net sales	**11%**	12%	12%

Selling, general and administrative (SG&A) expenses increased $140 million in 2007 as compared to 2006. The increase is primarily due to increased global commissions, and selling and marketing infrastructure investments in the Agriculture & Nutrition segment.

(Dollars in millions)	2007	2006	2005
RESEARCH AND DEVELOPMENT EXPENSE	**$ 1,338**	$ 1,302	$ 1,336
As a percent of Net sales	**5%**	5%	5%

Research and development expense (R&D) as a percent of sales remained constant over the three-year period. Higher R&D in 2007 for accelerated biotechnology trait research and development in the Agriculture & Nutrition segment was partially offset by a decrease in R&D in the Coatings & Color Technologies segment as a result of consolidating research facilities as a part of its 2006 business transformation plan. Expenditures in 2006 were consistent with spending by segment in 2005 and reflect concentration in expansion of seed traits, breeding advancement and product development within the Agriculture & Nutrition segment, as well as activities to support the other growth platforms.

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(Dollars in millions)	2007	2006	2005
INTEREST EXPENSE	$ 430	$ 460	$ 518

Interest expense decreased $30 million in 2007 compared to 2006 and $58 million in 2006 versus 2005. These decreases were primarily due to lower average borrowing levels and higher capitalized interest, partially offset by slightly higher average interest rates.

(Dollars in millions)	2007	2006	2005
SEPARATION ACTIVITIES – TEXTILES & INTERIORS	$ –	$ –	$ (62)

On April 30, 2004, the company sold a majority of the net assets of the then Textiles & Interiors segment (INVISTA) to subsidiaries of Koch Industries, Inc. (Koch). During 2005, the company sold its investments in three affiliated companies to Koch and its investment in a fourth affiliated company to its equity partner, resulting in a net benefit of $62 million. Although the transfer of these affiliates completed the sale to Koch, the company has significant continuing involvement with INVISTA as a result of long-term purchase and supply contracts and a long-term contract manufacturing agreement under which INVISTA manufactures and supplies certain products for the company. In January 2006, the company sold its interest in a Textiles & Interiors equity affiliate to its equity partner for proceeds of $14 million thereby completing the sale of all of the net assets of Textiles & Interiors. For more information related to the Textiles & Interiors separation, see Note 5 to the Consolidated Financial Statements.

(Dollars in millions)	2007	2006	2005
PROVISION FOR INCOME TAXES	$ 748	$ 196	$ 1,470
Effective income tax rate	20.0%	5.9%	41.3%

In 2007, the company recorded a tax provision of $748 million which included a benefit of $108 million related to tax settlements offset by net tax expense in other operating results (see Note 6 to the Consolidated Financial Statements.)

In 2006, the company recorded a tax provision of $196 million which included a benefit of $272 million related to tax settlements and a $186 million benefit for reversal of tax valuation allowances related to the net deferred tax assets of certain foreign subsidiaries due to the sustained improved business performance in these subsidiaries. These tax benefits were offset by net tax expense in other operating results (see Note 6 to the Consolidated Financial Statements).

In 2005, the company recorded a tax provision of $1,470 million which included $483 million of tax expense on exchange gains associated with the company's policy of hedging the foreign currency denominated monetary assets and liabilities of its operations and $292 million of tax expense related to the repatriation of $9.1 billion under The American Jobs Creation Act of 2004 (AJCA). AJCA created a temporary incentive for U.S. corporations to repatriate accumulated income earned abroad by providing an 85 percent dividends received deduction for certain dividends from controlled foreign corporations provided that repatriated cash from such accumulated earnings is reinvested in the U.S. pursuant to a domestic reinvestment plan.

The company's current estimate of the 2008 effective income tax rate is about 26 percent, excluding tax effects of exchange gains and losses which can not be reasonably estimated at this time. See Note 6 for additional detail on items that significantly impact the company's effective tax rates. In the past three years, these items have generally included a lower effective tax rate on international operations and tax settlements.

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(Dollars in millions)	2007	2006	2005
NET INCOME	$ 2,988	$ 3,148	$ 2,056

2007 versus 2006 Net income for 2007 decreased 5 percent versus 2006, primarily due to the higher effective tax rate, as well as the decrease in Other income. These decreases were partially offset by a 7 percent increase in Net sales, the absence of the restructuring charges taken in 2006 and a favorable foreign currency exchange impact.

2006 versus 2005 Net income for 2006 increased 53 percent versus 2005, reflecting higher selling prices, higher sales volumes, lower fixed costs and an increase in Other income, net, partly offset by higher raw material costs. Selling prices increased year over year in each quarter of 2006 and were higher for each platform and for each region for the full year. Net income for 2006 also included benefits from tax settlements, reversals of tax valuation allowances and insurance recoveries. These benefits were partly offset by charges for restructuring and asset impairments. 2005 results included significant hurricane related charges as well as tax expenses associated with the repatriation of cash under AJCA.

Corporate Outlook
The company's current 2008 earnings outlook is a range of $3.35 to $3.55 per share based on the expectation of continued revenue growth in emerging markets and earnings growth across all of the growth platforms. New product acceleration, mix enrichment, pricing discipline and continued cost and capital productivity gains across the company are expected to be additional contributing factors. The company's 2008 outlook is positive; however, it is moderated by continued weakness in U.S. housing and North American automotive markets and continued escalation of energy, ingredient and transportation costs.

Accounting Standards Issued Not Yet Adopted
In September 2006, the Financial Accounting Standards Board (FASB) issued Statement of Financial Accounting Standards (SFAS) No. 157, "Fair Value Measurements," (SFAS 157) which addresses how companies should measure fair value when required for recognition or disclosure purposes under GAAP. The standard's provisions will be applied to existing accounting measurements and related disclosures that are based on fair value. SFAS 157 does not require any new fair value measurements. The standard applies a common definition of fair value to be used throughout GAAP, with emphasis on fair value as a "market based" measurement versus an entity-specific measurement, and establishes a hierarchy of fair value measurement methods. The disclosure requirements are expanded to include the extent to which companies use fair value measurements, the methods and assumptions used to measure fair value and the effect of fair value measurements on earnings. SFAS 157 is effective for fiscal years beginning after November 15, 2007. The new standard's provisions applicable to the company will be applied prospectively beginning January 1, 2008. The FASB, on February 12, 2008, issued FASB Staff Position (FSP) FAS 157-2. This FSP permits a delay in the effective date of SFAS 157 to fiscal years beginning after November 15, 2008, for nonfinancial assets and nonfinancial liabilities, except for items that are recognized or disclosed at fair value in the financial statements on a recurring basis (at least annually). The delay is intended to allow the Board and constituents additional time to consider the effect of various implementation issues that have arisen, or that may arise, from the application of SFAS 157. On February 14, 2008, the FASB issued FSP FAS 157-1 to exclude SFAS 13, Accounting for Leases, and its related interpretive accounting pronouncements from the scope of SFAS 157. Management expects that adoption of SFAS 157 will not have a material effect on the company's financial position, liquidity or results of operations.

In December 2007, the FASB issued Statement of Financial Accounting Standards No. 141 (revised 2007) "Business Combinations" (SFAS 141R) which replaces FASB Statement No. 141. SFAS 141R addresses the recognition and measurement of identifiable assets acquired, liabilities assumed, and non-controlling interests in business combinations. SFAS 141R also requires disclosure that enables users of the financial statements to better evaluate the nature and financial effect of business combinations. SFAS 141R applies prospectively to business combinations for which the acquisition date is on or after the beginning of the first annual reporting period beginning on or after December 15, 2008. SFAS 141R will be adopted by the company on January 1, 2009. The company is currently evaluating the impact of adoption on its Consolidated Financial Statements.

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In December 2007, the FASB issued Statement of Financial Accounting Standards No. 160, "Noncontrolling Interests in Consolidated Financial Statements – an amendment of Accounting Research Bulletin No. 51" (SFAS 160) which changes the accounting and reporting for minority interests and for the deconsolidation of a subsidiary. It also clarifies that a third-party, non-controlling interest in a consolidated subsidiary is an ownership interest in the consolidated entity that should be reported as equity in the consolidated financial statements. SFAS 160 also requires disclosure that clearly identifies and distinguishes between the interests of the parent and the interests of the non-controlling owners. SFAS 160 is effective for fiscal years beginning after December 15, 2008. SFAS 160 will be adopted by the company on January 1, 2009. The company is currently evaluating the impact of adoption on its Consolidated Financial Statements.

Critical Accounting Estimates

The company's significant accounting policies are more fully described in Note 1 to the Consolidated Financial Statements. Management believes that the application of these policies on a consistent basis enables the company to provide the users of the financial statements with useful and reliable information about the company's operating results and financial condition.

The preparation of the Consolidated Financial Statements in conformity with GAAP requires management to make estimates and assumptions that affect the reported amounts, including, but not limited to, receivable and inventory valuations, impairment of tangible and intangible assets, long-term employee benefit obligations, income taxes, restructuring liabilities, environmental matters and litigation. Management's estimates are based on historical experience, facts and circumstances available at the time and various other assumptions that are believed to be reasonable. The company reviews these matters and reflects changes in estimates as appropriate. Management believes that the following represents some of the more critical judgment areas in the application of the company's accounting policies which could have a material effect on the company's financial position, liquidity or results of operations.

Long-term Employee Benefits

Accounting for employee benefit plans involves numerous assumptions and estimates. Discount rate and expected return on plan assets are two critical assumptions in measuring the cost and benefit obligation of the company's pension and other long-term employee benefit plans. Management reviews these two key assumptions annually as of December 31st. These and other assumptions are updated periodically to reflect the actual experience and expectations on a plan specific basis as appropriate. As permitted by GAAP, actual results that differ from the assumptions are accumulated on a plan by plan basis and to the extent that such differences exceed 10 percent of the greater of the plan obligations or the applicable plan assets, the excess is amortized over the average remaining working life of current employees.

About 80 percent of the company's benefit obligation for pensions and essentially all of the company's other long-term employee benefit obligations are attributable to the benefit plans in the U.S. The company utilizes published long-term high quality bond indices to determine the discount rate at the balance sheet date. Where commonly available, the company considers indices of various durations to reflect the timing of future benefit payments.

Within the U.S., the company establishes strategic asset allocation percentage targets and appropriate benchmarks for significant asset classes with the aim of achieving a prudent balance between return and risk. Strategic asset allocations in other countries are selected in accordance with the laws and practices of those countries. Where appropriate, asset-liability studies are also taken into consideration. The long-term expected return on plan assets in the U.S. is based upon historical real returns (net of inflation) for the asset classes covered by the investment policy and projections of inflation over the long-term period during which benefits are payable to plan participants.

In determining annual expense for the principal U.S. pension plan, the company uses a market-related value of assets rather than their fair value. Accordingly, there may be a lag in recognition of changes in market valuation. As a result, changes in the fair market value of assets are not immediately reflected in the company's calculation of net

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pension cost. The following table shows the market-related value and fair market value of plan assets for the principal U.S. pension plan:

(Dollars in billions)	2007	2006
Market-related value of assets	$ 19.3	$ 17.5
Fair market value of plan assets	$ 19.1	$ 18.3

For plans other than the principal U.S. pension plan, pension expense is typically determined using the fair value of assets. The fair value of assets in all pension plans was $22.6 billion at December 31, 2007, and the related projected benefit obligations were $22.2 billion. In addition, obligations under the company's unfunded other long-term employee benefit plans were $3.8 billion at December 31, 2007.

The following table highlights the potential impact on the company's pretax earnings due to changes in certain key assumptions with respect to the company's pension and other long-term employee benefit plans, based on assets and liabilities at December 31, 2007:

(Dollars in millions)	1/2 Percentage Point Increase	1/2 Percentage Point Decrease
Discount Rate	$ 10	$ (3)
Expected rate of return on plan pension assets	110	(110)

Additional information with respect to pension and other long-term employee benefits expenses, liabilities and assumptions is discussed under "Long-Term Employee Benefits" beginning on page 40.

Environmental Matters

DuPont accrues for remediation activities when it is probable that a liability has been incurred and a reasonable estimate of the liability can be made. The company's estimates are based on a number of factors, including the complexity of the geology, the nature and extent of contamination, the type of remedy, the outcome of discussions with regulatory agencies and other Potentially Responsible Parties (PRPs) at multiparty sites and the number of and financial viability of other PRPs. The company has recorded a liability of $357 million on the Consolidated Balance Sheet as of December 31, 2007; these accrued liabilities exclude claims against third parties and are not discounted.

Considerable uncertainty exists with respect to environmental remediation costs and, under adverse changes in circumstances, the potential liability may range up to two to three times the amount accrued. Much of this liability results from the Comprehensive Environmental Response, Compensation and Liability Act (CERCLA, often referred to as the Superfund), the Resource Conservation and Recovery Act (RCRA) and similar state laws. These laws require the company to undertake certain investigative and remedial activities at sites where the company conducts or once conducted operations or at sites where company-generated waste was disposed. The accrual also includes a number of sites identified by the company for which it is probable that environmental remediation will be required, but which are not currently the subject of CERCLA, RCRA or state enforcement activities. Federal and state authorities may seek fines and penalties for violation of the various laws and governmental regulations and could, among other things, impose liability on the company for cleaning up the damage resulting from company-generated waste disposal. Over the next two decades, the company could incur significant costs under both CERCLA and RCRA.

Remediation activities vary substantially in duration and cost from site to site. These activities and their associated costs, depend on the mix of unique site characteristics, evolving remediation technologies, diverse regulatory agencies and enforcement policies, as well as the presence or absence of PRPs. Therefore, it is difficult to develop precise estimates of future site remediation costs.

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Legal Contingencies
The company's results of operations could be affected by significant litigation adverse to the company, including product liability claims, patent infringement claims and antitrust claims. The company records accruals for legal matters when the information available indicates that it is probable that a liability has been incurred and the amount of the loss can be reasonably estimated. Management makes adjustments to these accruals to reflect the impact and status of negotiations, settlements, rulings, advice of counsel and other information and events that may pertain to a particular matter. Predicting the outcome of claims and lawsuits and estimating related costs and exposure involves substantial uncertainties that could cause actual costs to vary materially from estimates. In making determinations of likely outcomes of litigation matters, management considers many factors. These factors include, but are not limited to, the nature of specific claims including unasserted claims, the company's experience with similar types of claims, the jurisdiction in which the matter is filed, input from outside legal counsel, the likelihood of resolving the matter through alternative dispute resolution mechanisms and the matter's current status. Considerable judgment is required in determining whether to establish a litigation accrual when an adverse judgment is rendered against the company in a court proceeding. In such situations, the company will not recognize a loss if, based upon a thorough review of all relevant facts and information, management believes that it is probable that the pending judgment will be successfully overturned on appeal. A detailed discussion of significant litigation matters is contained in Note 19 to the Consolidated Financial Statements.

Income Taxes
The breadth of the company's operations and the global complexity of tax regulations require assessments of uncertainties and judgments in estimating the ultimate taxes the company will pay. The final taxes paid are dependent upon many factors, including negotiations with taxing authorities in various jurisdictions, outcomes of tax litigation and resolution of disputes arising from federal, state and international tax audits. The resolution of these uncertainties may result in adjustments to the company's tax assets and tax liabilities. It is reasonably possible that changes from future completed tax examinations could be significant when compared to the company's global unrecognized tax benefits, however due to the uncertainty regarding the timing of completion of these audits and the possible outcomes, a current estimate of the range of increase or decrease that may occur within the next twelve months cannot be made.

Deferred income taxes result from differences between the financial and tax basis 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. Significant judgment is required in evaluating the need for and magnitude of appropriate valuation allowances against deferred tax assets. The realization of these assets is dependent on generating future taxable income, as well as successful implementation of various tax planning strategies. For example, changes in facts and circumstances that alter the probability that the company will realize deferred tax assets could result in recording a valuation allowance, thereby reducing the deferred tax asset and generating a deferred tax expense in the relevant period. In some situations these changes could be material.

At December 31, 2007, the company had a net deferred tax asset balance of $4,750 million, net of valuation allowance of $1,424 million. Realization of these assets is expected to occur over an extended period of time. As a result, changes in tax laws, assumptions with respect to future taxable income and tax planning strategies could result in adjustments to these assets.

Valuation of Assets
Assessment of the potential impairment of property, plant and equipment, goodwill, other purchased intangible assets and investments in affiliates is an integral part of the company's normal ongoing review of operations. Testing for potential impairment of long-lived assets is significantly dependent on numerous assumptions and reflects management's best estimates at a particular point in time. The dynamic economic environments in which the company's businesses operate and key economic and business assumptions with respect to projected selling prices, market growth and inflation rates, can significantly affect the outcome of impairment tests. Estimates based on these assumptions may differ significantly from actual results. Changes in factors and assumptions used in assessing potential impairments can have a significant impact on the existence and magnitude of impairments, as

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well as the time in which such impairments are recognized. Future changes in the environment and the economic outlook for the assets being evaluated could also result in additional impairment charges. Information with respect to the company's significant accounting policies on long-lived assets is included in Note 1 to the Consolidated Financial Statements.

Segment Reviews
Segment sales include transfers. Segment pretax operating income (PTOI) is defined as operating income before income taxes, minority interests, exchange gains (losses), corporate expenses and net interest. A reconciliation of segment sales to consolidated Net sales and segment PTOI to Income before income taxes and minority interests for 2007, 2006 and 2005 is included in Note 25 to the Consolidated Financial Statements.

Effective January 1, 2007, the company changed the alignment of certain businesses within Agriculture & Nutrition, Performance Materials and Other. These changes were made to better align the businesses with the particular growth platform that management believes will provide more opportunity for synergy and technology development in future periods. The 2006 and 2005 segment information below has been reclassified to reflect the 2007 organizational structure.

AGRICULTURE & NUTRITION

	Segment Sales *(Dollars in billions)*	PTOI *(Dollars in millions)*
2007	**$ 6.8**	**$ 894**
2006	$ 6.0	$ 604
2005	$ 6.1	$ 875

Agriculture & Nutrition leverages the company's technology, customer relationships and industry knowledge to improve the quantity, quality and safety of the global food supply. Land available for worldwide agricultural production is increasingly limited. Therefore, increases in production will need to be achieved principally through improving crop yields and productivity rather than through increases in planted acreage. Agriculture & Nutrition delivers a broad portfolio of products and services that are specifically targeted to achieve gains in crop yields and productivity, including Pioneer® brand seed products and well-established brands of insecticides, fungicides and herbicides. The segment operates across the food value chain from inputs for producing agriculture products to global production and distribution of soy-based food ingredients to food quality diagnostic testing equipment. Research and development focuses on leveraging technology to increase grower productivity and enhance the value of grains and soy through improved seed traits, superior germplasm and the effective use of insecticides, herbicides and fungicides.

Agriculture & Nutrition includes the company's wholly owned subsidiary, Pioneer Hi-Bred International, Inc. (Pioneer), which is also the world's leading seed brand and a world leader in improving crop yields with hybrid and varietal seeds that improve grower yields and provide insect protection and herbicide tolerance. The principal products of Pioneer are hybrid seed corn and soybean seed. Sales of Pioneer® brand seeds increased 19 percent in 2007 with gains in corn seed sales globally, partially offset by lower North American soybean seed sales on a decline in North American planted acreage. In 2007, farmers in North America continued to demonstrate a preference for corn hybrids containing biotechnology traits and Pioneer had a limited supply of these products. As a result, corn market share in North America is at 30 percent. Pioneer will have increased supply of leading products containing biotechnology traits in 2008 and expects to maintain its present market share. In international operations, Pioneer increased market share in key segments supported by strong product performance. Pioneer benefited from the global launch of approximately 25 new soybean varieties and 130 new Pioneer® brand corn hybrids that include new combinations of corn borer, corn rootworm and weed management traits highlighted by the expansion of the Herculex®[1] family of traits.

[1] Registered Trademark of Dow AgroSciences LLC

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During the third quarter 2007, Pioneer entered into a business agreement on corn herbicide tolerance and insect control trait technologies with Monsanto Company. Among other provisions, modifications were made to the existing corn license agreements; both parties agreed to exchange certain non-assert and other intellectual property rights; and both parties obtained rights to reference and access certain regulatory data and approval in which the other party has certain interests. Refer to Note 11 to the Consolidated Financial Statements for further description of this agreement.

Agriculture & Nutrition also serves the global production agriculture industry with crop protection products in the grain and specialty crop sectors, forestry and vegetation management. Principal crop protection products are herbicides, fungicides, insect control products and plant growth regulators. The segment continued to expand its presence in fruit and vegetable specialty markets and continues to expand product offerings in the professional pest control market. Additionally, the segment operates within the specialty food ingredients market, including soy proteins and lecithins through its majority-owned venture with Bunge Limited, The Solae Company.

In 2006, the segment launched a restructuring plan to increase investment in plant genetics, biotechnology and other growth opportunities while consolidating manufacturing assets, technology centers and marketing strategies in its nutrition and crop protection businesses. The segment recorded a charge of $122 million in the fourth quarter 2006 for employee separations and asset impairments associated with this investment and streamlining plan. The plan includes the closure of manufacturing units and the elimination of approximately 1,500 positions. Operating costs savings of approximately $100 million per year will be reinvested into the seed business (see Note 4 to the Consolidated Financial Statements). During 2007, operating costs savings of $40 million were realized, which partially offset the growth investment in the seed business.

2007 versus 2006 Sales of $6.8 billion were 14 percent higher reflecting 9 percent higher USD selling prices and a 5 percent increase in volume. Higher USD selling prices reflected a richer mix of corn and soybean seed, and crop protection herbicides and fungicides. Volume increases were driven by corn seed sales in North America, herbicides in Europe and fungicides in Latin America, partially offset by a decrease in the sale of soybean seed on lower planting acreage in North America.

2007 PTOI was $894 million versus $604 million in 2006. 2006 PTOI included a $122 million restructuring charge. In addition, 2007 PTOI benefited from sales volume and price gains, partially offset by higher production costs across most of the segment and the growth investment in the seed business.

2006 versus 2005 Sales of $6.0 billion were 1 percent lower reflecting slightly lower USD selling prices and volumes. Lower selling prices reflected declines in the crop protection market partially offset by prices for a richer mix in corn and soybean seed. Volume declines were driven by lower corn seed sales in North America, specialty products in India and herbicide sales in North America and Europe, partially offset by increases in the sale of soybean seed. 2006 included some earlier than anticipated seed sales for the 2007 planting season in Europe.

2006 PTOI was $604 million versus $875 million in 2005. The decline in 2006 PTOI reflected the charge of $122 million described above. In addition, 2006 PTOI reflected the sales decline and higher production costs across most of the segment, slightly offset by income related to technology transfers, licensing agreements and asset sales.

Outlook In 2008, the segment anticipates continued PTOI growth through increased Pioneer corn value offerings, including stacked traits and seed treatments in the U.S. and Canada. Pioneer will build on their North American product offerings with the addition of approximately 30 new soybean varieties and 60 new Pioneer® brand corn hybrids. In international operations, Pioneer expects continued market share gains supported by strong product performance. Pioneer also expects continued market share gains in key soybean markets including the U.S., Canada and Brazil. The segment's introduction of new crop protection products is projected to drive volume gains, particularly in Europe and Latin America, and higher benefits from the 2006 restructuring program are expected to be realized. Higher production and raw material costs and continued growth investments in research, sales and marketing will be moderating factors.

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COATINGS & COLOR TECHNOLOGIES

	Segment Sales *(Dollars in billions)*	PTOI *(Dollars in millions)*
2007	$ 6.6	$ 840
2006	$ 6.3	$ 817
2005	$ 6.1	$ 536

Coatings & Color Technologies is one of the world's leading automotive coatings suppliers and the world's largest manufacturer of titanium dioxide white pigments. Products offered include high performance liquid and powder coatings for automotive OEMs, the automotive aftermarket and general industrial applications, such as coatings for heavy equipment, pipes and appliances and electrical insulation. The company markets its refinish products using the DuPont™, Standox®, Spies Hecker® and Nason® brand names. Standox® and Spies Hecker® are focused on the high-end automotive aftermarkets, while Nason® is primarily focused on economy coating applications. The segment's broad line of DuPont™ Ti-Pure® titanium dioxide products, in both slurry and powder form, serve the coatings, plastic and paper industries.

The segment's titanium tetrachloride business has moved from a startup business to an established, growing venture, shipping product globally. By mid-2008, the business plans to complete construction and begin operation of a $30 million titanium tetrachloride facility at its titanium dioxide plant in Tennessee.

The key markets in which Coatings & Color Technologies operates continued to grow in 2007, with more significant growth in Europe and Asia Pacific. Global demand for titanium dioxide white pigment was strong in 2007 with global market volumes up about 5 percent from 2006.

Sales for refinish products increased in all regions. The OEM market realized growth in Latin America and Asia Pacific, partially offsetting declines in the U.S. and Canada. This reflects the lower 2007 North American builds of automobiles and light trucks. Powder coatings sales increased in all regions, more significantly in Asia Pacific, U.S. and Europe. Worldwide sales in electrical insulation and metal coatings markets continued to improve.

2007 versus 2006 Sales of $6.6 billion were up 5 percent, reflecting about 4 percent higher USD selling prices for the segment, as well as a 1 percent increase in volume. USD selling prices were higher across a majority of the segment's products. The increase in volume was primarily attributable to the sales of titanium dioxide, particularly in Europe and Asia Pacific. This increase was partially offset by declines in volume for products sold to automotive OEM producers, primarily in North America and Europe. Volumes for sales of refinish products were relatively flat as compared to 2006.

PTOI in 2007 of $840 million increased from $817 million in 2006. The PTOI improvement was primarily the result of higher revenue driven by higher USD selling prices and benefits realized from the 2006 restructuring program, partially offset by higher raw material and transportation costs. PTOI in 2006 included a net charge of $132 million for restructuring and $30 million primarily for accelerated depreciation related to the transformation plan that was initiated in the first quarter 2006 (see Note 4 to the Consolidated Financial Statements). These charges were partially offset by $142 million in insurance proceeds, primarily related to the hurricane damages incurred in 2005.

2006 versus 2005 Sales of $6.3 billion were up 4 percent, reflecting about 2 percent higher USD selling prices for the segment. An additional 2 percent increase from volume was primarily realized in the pigments business, reflecting strong global demand as well as the first quarter startup of the DeLisle, Mississippi plant following Hurricane Katrina. Higher selling prices reflected concerted efforts within the segment to increase prices for the majority of its products as part of its efforts to offset the impact of higher raw material costs and the impact of lower global OEM automotive volumes.

PTOI in 2006 of $817 million increased from $536 million in 2005. Lower fixed costs in both years and higher volumes in pigments contributed to the improved 2006 earnings. PTOI in 2006 included a net charge of $132 million for restructuring and $30 million primarily for accelerated depreciation. 2006 PTOI also included $142 million in insurance proceeds, primarily related to the hurricane damages suffered in 2005. 2005 PTOI included charges of

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$116 million related to the clean-up and restoration of manufacturing operations, as well as the write-off of inventory and plant assets that were destroyed by hurricanes.

Outlook Sales in 2008 are expected to increase modestly, reflecting emerging market growth and pricing actions. Industry demand for titanium dioxide is expected to moderate in 2008, in line with more moderate global economic growth of about 2 percent. Competitive conditions in the global coatings industry will continue to provide a challenging operating environment in 2008. Modest growth is expected for refinish markets in mature economies while strong growth is expected to continue in emerging markets. Profitability of coatings sold to automotive OEM producers is highly dependent upon volume at specific plants the company services. Global automotive industry builds in 2008 are expected to be slightly higher than 2007 with moderate growth in Asia Pacific and Latin America, partially offset by slightly lower levels in North America. Significant segment PTOI growth is expected based upon sales growth and cost productivity gains.

ELECTRONIC & COMMUNICATION TECHNOLOGIES

	Segment Sales *(Dollars in billions)*	PTOI *(Dollars in millions)*
2007	$ 3.8	$ 594
2006	$ 3.6	$ 577
2005	$ 3.4	$ 558

Electronic & Communication Technologies provides a broad range of advanced materials for the electronics industry, flexographic printing and color communication systems and a wide range of fluoropolymer and fluorochemical products. The segment also continues to pursue development activities related to displays and alternative energy.

In the electronics industry, DuPont is a leading supplier of electronic and advanced display materials. The company offers a broad portfolio of ceramic, flexible and rigid organic circuit materials; materials for semiconductor fabrication and packaging; and a wide range of products for advanced displays. The segment's products enable increased functionality and lower costs for electronic and communications devices.

Electronic & Communication Technologies is the market leader in flexographic printing and black pigmented ink serving the packaging and commercial printing industries. Its offerings include DuPont™ Cyrel® and Cyrel® *FAST™* flexographic printing systems. DuPont is the world's leading supplier of solvent-free thermal flexographic platemaking technologies, with a broad array of patented products and equipment.

The segment also includes a portfolio of industrial and specialty fluorochemicals and fluoropolymers that are sold into the refrigeration, insulation, aerosol propellants, fire extinguishants, telecommunications, aerospace, automotive, electronics, chemical processing and housewares industries.

Electronic & Communication Technologies leverages DuPont's strong materials and technology base to target growth opportunities in electronics, fluoropolymers, fluorochemicals, packaging graphics, ink-jet and photovoltaic materials. In semiconductor fabrication, packaging and interconnect, the segment is extending and broadening its portfolio of materials to address critical needs in the industry, e.g., chemical mechanical planarization for semiconductor manufacture, flex circuitry and embedded passives enabling miniaturization. In the rapidly growing market for flat panel displays, the segment continues to be a leading materials supplier for plasma displays. In addition, the segment is developing new innovative technologies for liquid crystal displays, such as thermal color filters and display films, while continuing to invest in developing materials technologies for organic light-emitting diode (OLED) displays and field emission displays. In fluoropolymers and fluorochemicals, the segment continues to pursue product renewal innovations such as next generation refrigerants, while broadening the scope of applications into high growth areas such as photovoltaics. In packaging graphics, products such as Cyrel® *FAST™* have rapidly grown, solidifying the segment's market leadership position. Also, DuPont is maintaining its leadership position in black pigmented inks for ink-jet applications.

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2007 versus 2006 Sales of $3.8 billion were up 6 percent versus 2006, reflecting 5 percent volume growth and 1 percent higher USD selling prices. The volume growth was primarily due to increased demand for fluoroproducts and packaging graphics. Sales growth was strongest outside the U.S.

PTOI in 2007 was $594 million, an increase of 3 percent compared to 2006. This increase reflects 5 percent sales volume growth, as well as the benefit of $53 million related to a gain on a land sale and inventory valuation adjustments. These increases were partially offset by higher ingredient and transportation costs, as well as increased fixed cost from growth initiatives.

2006 versus 2005 Sales of $3.6 billion increased about 5 percent over 2005, reflecting 2 percent higher USD prices coupled with a 3 percent improvement in volume. Price improvements reflect higher metals prices primarily for microcircuit materials. Higher volumes reflect increased demand for fluoroproducts and electronic materials. Sales growth was strongest outside the U.S. PTOI in 2006 was $577 million versus $558 million in 2005. Earnings growth in 2006 resulted from improved volume, modest pricing improvement and continued productivity gains. 2005 PTOI included a gain of $48 million on the sale of the company's remaining interest in DuPont Photomasks, Inc.

Outlook For 2008, moderate sales growth is expected with gains in electronic materials, fluoropolymers, and packaging graphics. The segment's PTOI is expected to reflect moderate sales growth for 2008 versus 2007, modestly offset by investments in new applications, emerging markets and technologies. This segment manufactures products that could be affected by uncertainties associated with PFOA matters. See the discussion on page 44 under the subheading PFOA.

PERFORMANCE MATERIALS

	Segment Sales *(Dollars in billions)*	PTOI *(Dollars in millions)*
2007	**$ 6.6**	**$ 626**
2006	$ 6.2	$ 559
2005	$ 6.1	$ 515

Performance Materials provides productive, higher performance polymer materials, systems and solutions to improve the uniqueness, functionality and profitability of their customers' offerings. Performance Materials delivers a broad polymer-based materials product portfolio, including thermoplastic and thermoset engineering polymers that are primarily used by customers to fabricate components for mechanical and electrical systems, as well as specialized resins and films used in packaging and industrial applications, sealants and adhesives, sporting goods and interlayers for laminated safety glass. Key brands include DuPont™ Zytel® nylon resins, Delrin® acetal resins, Hytrel® polyester thermoplastic elastomer resins, Tynex® filaments, Surlyn® resins, SentryGlas® Plus and Butacite® laminate interlayers, Mylar® and Melinex® polyester films, Kalrez® perfluoroelastomer and Viton® fluoroelastomers.

The key markets served by the segment include the automotive OEM and associated after-market industries, as well as electrical, electronics, packaging, construction and consumer durable goods.

The segment's core competencies are polymer science and applications development focusing on substituting traditional materials with new materials that offer performance, durability, aesthetics and weight reduction advantages. Other areas of focus include new applications and processing materials into innovative parts and systems. A recent example of this core innovation capability is the introduction of Sorona® and Hytrel® resins based on renewable resources which have the performance attributes of high performance engineering resins but are based on plant feedstock.

In 2007, certain businesses were realigned to the Performance Materials segment from the Agriculture & Nutrition segment. As a result of reclassifying the 2006 segment information to reflect the 2007 organizational structure, Performance Materials results in 2006 reflect a $72 million restructuring charge related to businesses that were originally included in the 2006 Agriculture & Nutrition restructuring plan (see Note 4 to the Consolidated Financial Statements).

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On June 30, 2005, DuPont completed a transaction with Dow related to DuPont Dow Elastomers LLC (DDE), a 50/50 joint venture. Dow acquired from DDE certain assets related to the Engage®, Nordel® and Tyrin® businesses. Upon the completion of this transaction, the remaining elastomers business became a wholly owned subsidiary of DuPont and was renamed DuPont Performance Elastomers, LLC. In response to a long-term declining demand for the polychloroprene products and the anticipated capital investment requirements at the Louisville, Kentucky facility, the company is consolidating production at its upgraded LaPlace, Louisiana facility. On December 31, 2007, the company initiated the shutdown, abatement and dismantlement process at the Louisville facility. In 2005, the company recorded a restructuring charge of $34 million, reflecting severance and related costs for approximately 275 employees. Cash payouts of $25 million are largely expected to be paid in 2008. Annual cost reductions related to ceasing neoprene production at Louisville and consolidating production at LaPlace are expected to offset reduced revenue related to declining demand.

2007 versus 2006 Sales of $6.6 billion were 7 percent higher than 2006 reflecting 8 percent higher USD selling prices, partly offset by 1 percent lower volume. Sales volume declines reflect the impact of ingredients shortages, temporary operating unit shutdowns and softness in North America, principally in the automotive markets, partly offset by volume improvements in Latin America, Europe and Asia.

2007 PTOI increased 12 percent to $626. 2007 PTOI included an impairment charge of $165 million to write down the company's investment in a polyester films joint venture. The impairment resulted from several factors, including adverse changes in market conditions and the rapid rise in oil-related raw material costs, which have had a negative impact on the profitability on the venture's operations in North America and Europe. PTOI in 2006 included a $72 restructuring charge. Improvement in 2007 PTOI was driven by improved pricing, which reflected both the offset of the ingredient cost increases seen during the year and improved product sales mix, and positive currency benefits, offset in part by the weaker volume. The segment is involved in the elastomers antitrust matters and recorded a net $20 charge in 2007 related to these matters (see Note 19 to the Consolidated Financial Statements).

2006 versus 2005 Sales of $6.2 billion were 2 percent higher than 2005 reflecting 3 percent higher USD selling prices, partly offset by 1 percent decline in volume. Sales volume reflects the year over year impact of the businesses transferred to Dow at June 30, 2005. Excluding from 2005 the sales related to assets transferred to Dow ($386 million), sales volumes were up reflecting stronger business environment in Asia and Europe and the recovery from the segment's business interruption due to the 2005 hurricanes.

PTOI in 2006 was $559 million compared to $515 million in 2005. 2006 PTOI included the $72 million restructuring charge. 2005 PTOI included a $17 million hurricane charge, $47 million in operating income related to certain DDE assets sold, a $25 million gain on sale of these DDE assets and a charge of $34 million related to the planned consolidation of the company's neoprene operations at its LaPlace, Louisiana facility.

Outlook Global automotive industry builds in 2008 are expected to be slightly higher than 2007 with moderate growth in Asia Pacific and Latin America, partially offset by slightly lower levels in North America. However, the half year pattern is expected to be the reverse of 2007 with higher production in the second half of 2008. Global packaging market growth is expected to remain at current levels. The residential construction market in North America is expected to continue to be weak through 2008, but it is anticipated that the electrical and electronics markets will continue to improve. The 2008 outlook also assumes a second half softening from a weak petrochemical cycle. Revenue growth is expected to continue through volume growth and higher USD selling prices in 2008. PTOI is expected to increase, benefitting from higher revenue, price increases, improved fixed cost performance and customer-driven innovations for products and processes. The level of earnings improvements in 2008 will depend on offsetting the continued high intermediate feedstock costs with price increases and further productivity gains.

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SAFETY & PROTECTION

	Segment Sales *(Dollars in billions)*	PTOI *(Dollars in millions)*
2007	**$ 5.6**	**$ 1,199**
2006	$ 5.5	$ 1,080
2005	$ 5.1	$ 994

Safety & Protection satisfies the growing global needs of businesses, governments and consumers for solutions that make life safer, healthier and more secure. By uniting market-driven science with the strength of highly regarded brands such as Kevlar®, Tyvek® and Nomex®, Safety & Protection has built a unique presence in the marketplace since its inception in 2002.

The segment's businesses serve customers in diverse markets that include construction, transportation, communications, industrial chemicals, oil and gas, electric utilities, automotive, manufacturing, defense, homeland security and safety consulting.

In addition to serving its existing customer base, Safety & Protection is investing in the future by expanding into emerging markets. Over the past two years the segment has achieved strong double-digit growth in Greater China, India, Eastern Europe and Latin America. Safety & Protection is focusing its efforts globally on four major value propositions where it has a distinct competitive advantage: protecting lives, safe and durable buildings, protecting critical processes and protecting the environment.

DuPont™ Kevlar® and Nomex® hold strong positions in the life protection markets due to continued demand for body armor and personal protective gear for the military, law enforcement personnel, firefighters and other first responders, as well as for workers in the oil and gas industry and in emerging regions. Global demand for products that prevent disease and improve productivity in the food, health care and industrial markets continue to create growth opportunities for the segment's clean and disinfect offerings. Additionally, the surfaces protection businesses continue to offer new products that meet demand for sustainable solutions.

In 2007, DuPont announced a $500 million investment at its Cooper River site near Charleston, SC, to significantly expand production of DuPont™ Kevlar® brand fiber for industrial and military uses as well as investments in related polymer production. The company also announced a multi-product, multi-region expansion plan to increase worldwide capacity of DuPont™ Nomex®. The company expects to invest more than $100 million in the three-part expansion plan for Nomex®; the first phase was completed in 2007.

Safety & Protection continues to strengthen and enhance the building envelope and building interiors with offerings that improve comfort, energy efficiency, air quality and protection from the elements. In 2007, the business introduced 40 new products globally, including new Corian® surfaces and the metalized Tyvek® product family. The business is also taking advantage of substantial growth opportunities in China, India and Eastern Europe while focusing even more on commercial construction and remodeling markets.

Through its consulting services businesses, Safety & Protection continued to help organizations worldwide reduce workplace injuries and fatalities while improving operating costs, productivity and quality. DuPont is a leader in the safety consulting field, selling training products, as well as consulting services. Additionally, Safety & Protection is dedicated to clean air, clean fuel, and clean water with offerings that help reduce sulfur and other emissions, formulate cleaner fuels, or dispose of liquid waste. Its goal is to help maintain business continuity and environmental compliance for companies in the refining and petrochemical industries, as well as for government entities.

2007 versus 2006 Sales of $5.6 billion were 3 percent higher than last year, due to higher USD selling prices across all businesses within the platform. Sales volumes remained relatively flat as higher sales of Kevlar® and Nomex® were offset by decreased sales of products for U.S. residential construction markets.

PTOI in 2007 was $1,199 million, an increase of 11 percent over the prior year. The increased earnings were primarily due to higher sales of Kevlar® and Nomex®. 2006 PTOI included a $47 million asset impairment charge related to an industrial chemical asset held for sale, partially offset by a $33 million benefit from insurance proceeds.

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2006 versus 2005 Sales of $5.5 billion were up 7 percent due to 5 percent higher USD prices and 2 percent higher volumes. All businesses in the platform grew sales year over year with the strongest growth in chemical solutions and aramids. Segment sales experienced slower U.S. growth as a result of shifts in demand for construction, but were offset by higher sales growth in other regions, especially emerging regions.

PTOI in 2006 was $1,080 million, up 9 percent from $994 million in the prior year. The increase in PTOI reflects pricing gains and tight fixed cost control. 2006 PTOI included a $47 million asset impairment charge related to an industrial chemical asset held for sale, partially offset by a $33 million benefit from insurance proceeds.

Outlook Safety & Protection will continue to drive growth in its product lines globally with the strength of its brands. U.S. and global demand for Kevlar® and Nomex® is expected to remain strong. The personal protection, medical packaging and medical fabrics market segments are expected to grow during the year. Volume declines in the U.S. residential construction market will continue, but are expected to be mitigated by continued growth, in commercial, remodel and non-U.S. construction markets. Overall, continued revenue growth and moderate earnings growth in 2008 is expected based on continued market penetration, the introduction of new products and technologies and continued investment in its growth initiatives.

PHARMACEUTICALS

	Segment Sales *(Dollars in billions)*	PTOI *(Dollars in millions)*
2007	$ –	$ 949
2006	$ –	$ 819
2005	$ –	$ 751

On October 1, 2001, DuPont Pharmaceuticals was sold to the Bristol-Myers Squibb Company. DuPont retained its interest in Cozaar® (losartan potassium) and Hyzaar® (losartan potassium with hydrochlorothiazide). These drugs were discovered by DuPont and developed in collaboration with Merck and are used in the treatment of hypertension. The U.S. patents covering the compounds, pharmaceutical formulation and use for the treatment of hypertension, including approval for pediatric use, will expire in 2010. DuPont has exclusively licensed worldwide marketing and manufacturing rights for Cozaar® and Hyzaar® to Merck. Pharmaceuticals receives royalties and net proceeds as outlined below. Merck is responsible for manufacturing, marketing and selling Cozaar® and Hyzaar®.

Pharmaceuticals' Cozaar®/Hyzaar® income is the sum of two parts derived from a royalty on worldwide contract Net sales linked to the exclusivity term in a particular country, and a share of the profits from North American sales and certain markets in Europe, regardless of exclusivity term. Patents and exclusivity have already started to expire and the U.S. exclusivity for Cozaar® ends in April 2010. The worldwide agreement terminates when the following conditions are met: (i) the Canadian exclusivity ends in 2013, and (ii) North American sales fall below a certain level. Therefore, absent any major changes in the markets, the company expects its income to take its first significant step-down in 2010, and from that year on, continue to step-down each year to zero when the contract ends, which is expected to be after 2013. The company cannot predict the magnitude of the earnings step-down in each year. In general, management expects a traditional sales and earnings decline for a drug going off patent in the pharmaceutical industry.

Outlook DuPont and Merck continue to support Cozaar® and Hyzaar® with clinical studies designed to identify additional therapeutic benefits for patients with hypertension and co-morbid conditions. The company expects the ongoing Cozaar®/Hyzaar® collaboration to continue to be an important contributor to earnings until the U.S. patents expire in 2010. Thereafter, earnings are expected to decline significantly as outlined above.

OTHER

The company includes embryonic businesses not included in the growth platforms, such as applied biosciences and nonaligned businesses in Other. Applied biosciences is focused on the development of biotechnology solutions using biology, chemistry, materials science and engineering in an integrated fashion to serve our customers. Specific growth projects across the company globally are consolidated within applied biosciences to capitalize on the market

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opportunities and technology needs in this high-growth industry, including crop-based products and technologies, the biorefinery initiative with the U.S. Department of Energy and the development of advanced biofuels technologies through a collaboration with BP p.l.c. The first advanced biofuels product from this partnership will be biobutanol.

DuPont partnered with Tate & Lyle PLC to produce 1,3-propanediol (Bio-PDO™) using a proprietary fermentation and purification process based on corn sugar. Bio-PDO™ is the key building block for DuPont™ Sorona® polymer and DuPont™ Cerenol™ polyols, two new families of renewably sourced products. It is also being marketed for use as an ingredient in nearly a dozen direct applications ranging from industrial to personal care uses. The first commercial-scale plant to manufacture Bio-PDO™ began production in November 2006, marking the beginning of commercial availability of the company's bio-based pipeline.

A life cycle assessment of the production of nylon-6 polymer versus the production of renewably sourced Sorona® with Bio-PDO™ shows significant environmental benefits. The Sorona® process uses 30 percent less energy than nylon-6 manufacturing. Greenhouse gas emissions from the Sorona® operations are 63 percent lower than nylon-6 manufacturing including bio-based content stored in the product.

Nonaligned businesses include activities and costs associated with Benlate® fungicide and other discontinued businesses and, since January 2005, activities related to the remaining assets of Textiles & Interiors. In 2005, the company completed the transfer of three equity affiliates to Koch and sold its interest in another equity affiliate. In January 2006, the company completed the sale of its interest in an equity affiliate to its equity partner for proceeds of $14 million thereby completing the sale of all the net assets of Textiles & Interiors.

In the aggregate, sales in Other for 2007, 2006 and 2005 represent less than 1 percent of total segment sales.

PTOI in 2007 was a loss of $224 million compared to a loss of $173 million in 2006. The 29 percent increase in the pretax loss was primarily due to higher inventory, freight and business development costs. PTOI in 2007 included litigation charges for former businesses of $69 million. PTOI in 2006 included a charge of $27 million to write down certain specialty resins manufacturing assets to estimated fair value.

PTOI in 2006 was a loss of $173 million compared to a loss of $90 million in 2005. The losses in 2006 are reflective of the concentration of activities in applied biosciences and include the $27 million charge to write down certain specialty resins manufacturing assets to estimated fair value. PTOI in 2005 included a net gain of $62 million related to the disposition of equity affiliates, primarily associated with the Textiles & Interiors separation.

Liquidity & Capital Resources

Management believes that the company's ability to generate cash and access the capital markets will be adequate to meet anticipated future cash requirements to fund working capital, capital spending, dividend payments and other cash needs for the foreseeable future. The company's liquidity needs can be met through a variety of sources, including: Cash provided by operating activities, Cash and cash equivalents, Marketable securities, commercial paper, syndicated credit lines, bilateral credit lines, equity and long-term debt markets and asset sales. The company's current strong financial position, liquidity and credit ratings provide excellent access to the capital markets.

Pursuant to its cash discipline policy, the company seeks first to maintain a strong balance sheet and second, to return excess cash to shareholders unless the opportunity to invest for growth is compelling. Cash and cash equivalents and Marketable securities balances of $1.4 billion as of December 31, 2007, provide primary liquidity to support all short-term obligations. In the unlikely event that the company would not be able to meet its short-term liquidity needs, the company has access to approximately $4.3 billion in credit lines with several major financial institutions. These credit lines are primarily multi-year facilities.

The company continually reviews its debt portfolio for appropriateness and occasionally may rebalance it to ensure adequate liquidity and an optimum maturity debt schedule.

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The company's long term and short term credit ratings have not changed over the last three year ends and are as follows:

	Long term	Short term	Outlook
Standard & Poor	A	A-1	Stable
Moody's Investor Services	A2	P-1	Negative
Fitch Ratings	A	F1	Stable

(Dollars in millions)	2007	2006	2005
Cash provided by operating activities	$ 4,290	$ 3,736	$ 2,542

The company's Cash provided by operating activities was $4.3 billion in 2007, a $554 million increase from the $3.7 billion generated in 2006. The increase is primarily due to higher earnings after adjusting for noncash items. Net income for 2006 included noncash tax benefits totaling $615 million (see Note 6 to the Consolidated Financial Statements.) While the change in net working capital was essentially flat year over year, the company did realize productivity gains in inventory days supply and days payable outstanding. However, days sales outstanding slightly increased.

The company's Cash provided by operating activities was $3.7 billion in 2006, a $1.2 billion increase from the $2.5 billion generated in 2005. The increase is primarily due to higher net income in 2006 and a reduction in contributions made to pension plans, partially offset by the timing of tax payments. Working capital productivity measures of days sales outstanding and inventory days supply were essentially flat in 2006 versus 2005, while days payable outstanding slightly decreased.

(Dollars in millions)	2007	2006	2005
Cash used for investing activities	$ (1,750)	$ (1,345)	$ (602)

In 2007, Cash used for investing activities totaled $1.8 billion compared to $1.3 billion used in 2006. The $405 million increase was mainly due to the settlement of forward exchange contracts and a slight increase in capital spending, partially offset by higher proceeds from sales of assets. Due to the impact of a weakening USD, the settlement of forward exchange contracts issued to hedge the company's net exposure, by currency, related to monetary assets and liabilities resulted in the payment of $285 million in 2007 versus the receipt of $45 million in 2006. The forward exchange contract settlements were largely offset by the revaluation of the items being hedged, which are reflected in the appropriate categories in the Consolidated Statements of Cash Flows.

In 2006, Cash used for investing activities totaled $1.3 billion compared to $602 million used in 2005. The increase reflects higher purchases of property, plant and equipment and lower proceeds from the sale of assets. In addition, due to the impacts of a weakening USD, the settlement of forward exchange contracts issued to hedge the company's net exposure, by currency, related to monetary assets and liabilities resulted in the receipt of $45 million in 2006 versus the receipt of $653 million in 2005. These settlements were largely offset by revaluation of the items being hedged, which are reflected in the appropriate categories in the Consolidated Statements of Cash Flows.

Purchases of property, plant and equipment totaled $1.6 billion, $1.5 billion and $1.3 billion in 2007, 2006 and 2005, respectively. The company expects 2008 purchases of plant, property and equipment to be higher than 2007 levels. This incremental spending is primarily based on the company's previously announced investments in Kevlar®, Nomex® and titanium dioxide.

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(Dollars in millions)	2007	2006	2005
Cash used for financing activities	$ (3,069)	$ (2,323)	$ (2,851)

The $746 million increase in Cash used for financing activities in 2007 compared to 2006 was primarily due to the company's share repurchase activity, partially offset by the increase in proceeds from stock options exercised. The $528 million decrease in Cash used for financing activities in 2006 compared to 2005 was primarily due to the company's borrowings and share repurchase activity.

Total debt at December 31, 2007 was $7.3 billion, a $205 million decrease from December 31, 2006. This decrease was primarily due to the repayment of borrowings related to the 2005 AJCA cash repatriation program, partially offset by the issuance of $750 million in 5 year notes in December 2007.

Total debt at December 31, 2006 was $7.5 billion, a $650 million decrease from December 31, 2005. This decrease was primarily due to the repayment of borrowings related to the 2005 AJCA cash repatriation program, partially offset by the issuance of $1 billion in 10 and 30 year notes in December 2006.

Dividends paid to common and preferred shareholders were $1.4 billion in 2007, 2006 and 2005. Dividends per share of common stock were $1.52, $1.48 and $1.46 in 2007, 2006 and 2005, respectively. The common dividend declared in the first quarter 2008 was the company's 414th consecutive dividend since the company's first dividend in the fourth quarter 1904.

The company's Board of Directors authorized a $2 billion share buyback plan in June 2001. During 2005, the company purchased and retired 9.9 million shares at a total cost of $505 million. During 2007 and 2006, there were no purchases of stock under this program. As of December 31, 2007, the company has purchased 20.5 million shares at a total cost of $962 million. Management has not established a timeline for the buyback of the remaining shares of stock under this plan.

In October 2005, the Board of Directors authorized a $5 billion share buyback plan. In October 2005, the company repurchased 75.7 million shares of its common stock under an accelerated share repurchase agreement and paid $3.0 billion for the repurchase. Upon the conclusion of the agreement in 2006, the company paid $180 million in cash to Goldman, Sachs & Co. to settle the agreement. Additionally, in 2006, the company made open market purchases of its shares for $100 million. In 2007, the company purchased 34.7 million shares for $1.7 billion, thereby, completing this program. See Note 20 to the Consolidated Financial Statements for a reconciliation of shares activity.

Cash, Cash Equivalents and Marketable Securities
Cash and cash equivalents and Marketable securities totaled $1.4 billion at December 31, 2007 and $1.9 billion at December 31, 2006 and 2005. The $457 million decrease from 2006 to 2007 is primarily due to the company's share repurchase activity, as well as cash used to meet other business requirements.

Off-Balance Sheet Arrangements
Certain Guarantee Contracts
Indemnifications
The company has indemnified respective parties against certain liabilities that may arise in connection with acquisitions and divestitures and related business activities prior to the completion of the transactions. The terms of these indemnifications, which typically pertain to environmental, tax and product liabilities, are generally indefinite. In addition, the company indemnifies its duly elected or appointed directors and officers to the fullest extent permitted by Delaware law, against liabilities incurred as a result of their activities for the company, such as adverse judgments relating to litigation matters. If the indemnified party were to incur a liability or have a liability increase as a result of a successful claim, pursuant to the terms of the indemnification, the company would be required to reimburse the indemnified party. The maximum amount of potential future payments is generally indeterminable. The carrying amounts recorded for all indemnifications as of December 31, 2007 and 2006 were $101 million and $105 million, respectively. Although it is reasonably possible that future payments may exceed

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amounts accrued, due to the nature of indemnified items, it is not possible to make a reasonable estimate of the maximum potential loss or range of loss. No assets are held as collateral and no specific recourse provisions exist.

In connection with the sale of INVISTA, the company indemnified the purchasers, subsidiaries of Koch, against certain liabilities primarily related to taxes, legal and environmental matters and other representations and warranties under the Purchase and Sale Agreement. Koch has presented claims under these indemnities which the companies are discussing; however, DuPont disagrees with Koch's presentation. The estimated fair value of the indemnity obligations under the Purchase and Sale Agreement is $70 million and is included in the indemnifications balance of $101 million at December 31, 2007. The fair value was based on management's best estimate of the value expected to be required to issue the indemnifications in a standalone, arm's length transaction with an unrelated party and, where appropriate, by the utilization of probability weighted discounted net cash flow models. The company does not believe that these indemnities will have a material impact on the future liquidity of the company (see Note 19 to the Consolidated Financial Statements.)

Obligations for Equity Affiliates and Others

The company has directly guaranteed various debt obligations under agreements with third parties related to equity affiliates, customers, suppliers and other affiliated and unaffiliated companies. At December 31, 2007, the company had directly guaranteed $583 million of such obligations, plus $121 million relating to guarantees of obligations for divested subsidiaries and affiliates. This represents the maximum potential amount of future (undiscounted) payments that the company could be required to make under the guarantees. The company would be required to perform on these guarantees in the event of default by the guaranteed party. At December 31, 2007, a current liability of $135 million had been recorded for these obligations, principally related to obligations of the company's polyester films joint venture which are guaranteed by the company. No additional material loss is anticipated by reason of such agreements and guarantees.

Existing guarantees for customers, suppliers and other unaffiliated companies arose as part of contractual agreements. Existing guarantees for equity affiliates and other affiliated companies arose for liquidity needs in normal operations. In certain cases, the company has recourse to assets held as collateral as well as personal guarantees from customers and suppliers.

The company has guaranteed certain obligations and liabilities related to divested subsidiaries including Conoco and its subsidiaries and affiliates and Consolidation Coal Sales Company. The Restructuring, Transfer and Separation Agreement between DuPont and Conoco requires Conoco to use its best efforts to have Conoco, or any of its subsidiaries, substitute for DuPont. Conoco and Consolidation Coal Sales Company have indemnified the company for any liabilities the company may incur pursuant to these guarantees. No material loss is anticipated by reason of such agreements and guarantees. At December 31, 2007, the company had no liabilities recorded for these obligations.

Additional information with respect to the company's guarantees is included in Note 19 to the Consolidated Financial Statements. Historically, the company has not had to make significant payments to satisfy guarantee obligations; however, the company believes it has the financial resources to satisfy these guarantees.

Master Operating Leases

At December 31, 2007, the company has one master operating lease program relating to miscellaneous short-lived equipment valued at approximately $119 million. Lease payments for these assets totaled $59 million in 2007, $58 million in 2006 and $51 million in 2005, and were reported as operating expenses in the Consolidated Income Statements. The leases under this program are considered operating leases and accordingly the related assets and liabilities are not recorded on the Consolidated Balance Sheets. Furthermore, the lease payments associated with this program vary based on one month LIBOR. The company may terminate the program at any time by purchasing the assets. Should the company decide neither to renew the leases nor to exercise its purchase option, it must pay the owner a residual value guarantee amount, which may be recovered from a sale of the property to a third party. Residual value guarantees totaled $104 million at December 31, 2007.

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Contractual Obligations

Information related to the company's significant contractual obligations is summarized in the following table:

(Dollars in millions)	Total at December 31, 2007	Payments Due In 2008	2009 – 2010	2011 – 2012	2013 and beyond
Long-term and short-term debt [1]	$ 5,966	$ 21	$ 2,437	$ 414	$ 3,094
Expected cumulative cash requirements for interest payments through maturity	2,497	320	474	359	1,344
Capital leases [1]	13	3	4	1	5
Operating leases	1,020	328	324	209	159
Purchase obligations [2]					
Information technology infrastructure & services	123	68	36	14	5
Raw material obligations	685	260	208	120	97
Utility obligations	438	140	106	75	117
INVISTA-related obligations [3]	821	351	199	183	88
Human resource services	327	18	38	91	180
Other [4]	23	22	–	–	1
Total purchase obligations	2,417	859	587	483	488
Other liabilities [1,5]					
Workers' compensation	75	13	38	12	12
Asset retirement obligations	62	9	26	13	14
Environmental remediation	357	84	114	69	90
Legal settlements	70	38	26	6	–
License agreement [6]	703	110	180	179	234
Other [7]	119	21	25	15	58
Total other long-term liabilities	1,386	275	409	294	408
Contractual tax obligations [8]	80	80	–	–	–
Total contractual obligations	$ 13,379	$ 1,886	$ 4,235	$ 1,760	$ 5,498

1 Included in the Consolidated Financial Statements.

2 Represents enforceable and legally binding agreements in excess of $1 million to purchase goods or services that specify fixed or minimum quantities; fixed, minimum or variable price provisions; and the approximate timing of the agreement.

3 Includes raw material supply obligations of $744 million and contract manufacturing obligations of $77 million.

4 Primarily represents obligations associated with distribution, health care/benefit administration, research and development and other professional and consulting contracts.

5 Pension and other postretirement benefit obligations have been excluded from the table as they are discussed below within Long-Term Employee Benefits.

6 Represents remaining expected payments under a license agreement between Pioneer Hi-Bred International, Inc. and Monsanto Company. See Note 11 to the Consolidated Financial Statements.

7 Primarily represents employee-related benefits other than pensions and other postretirement benefits.

8 Due to uncertainty regarding the completion of tax audits and possible outcomes, the remaining estimate of obligations related to unrecognized tax benefits cannot be made. See Note 6 to the Consolidated Financial Statements for additional detail.

The company expects to meet its contractual obligations through its normal sources of liquidity and believes it has the financial resources to satisfy these contractual obligations should unforeseen circumstances arise.

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Long-Term Employee Benefits

The company has various obligations to its employees and retirees. The company maintains retirement-related programs in many countries that have a long-term impact on the company's earnings and cash flows. These plans are typically defined benefit pension plans, as well as medical, dental and life insurance benefits for pensioners and survivors and disability and life insurance protection for employees. Approximately 80 percent of the company's worldwide benefit obligation for pensions and essentially all of the company's worldwide other long-term employee benefit obligations are attributable to the U.S. benefit plans. Pension coverage for employees of the company's non-U.S. consolidated subsidiaries is provided, to the extent deemed appropriate, through separate plans. The company regularly explores alternative solutions to meet its global pension obligations in the most cost effective manner possible as demographics, life expectancy and country-specific pension funding rules change. Where permitted by applicable law, the company reserves the right to change, modify or discontinue its plans that provide pension, medical, dental, life insurance and disability benefits.

Benefits under defined benefit pension plans are based primarily on years of service and employees' pay near retirement. Pension benefits are paid primarily from trust funds established to comply with applicable laws and regulations. Unless required by law, the company does not make contributions that are in excess of tax deductible limits. The actuarial assumptions and procedures utilized are reviewed periodically by the plans' actuaries to provide reasonable assurance that there will be adequate funds for the payment of benefits. By law, no contributions are currently required to be made to the principal U.S. pension plan in 2008 and no contributions are currently anticipated. Contributions beyond 2008 are not determinable since the amount of any contribution is heavily dependent on the future economic environment and investment returns on pension trust assets. U.S. pension benefits that exceed federal limitations are covered by separate unfunded plans and these benefits are paid to pensioners and survivors from operating cash flows.

Funding for each pension plan is governed by the rules of the sovereign country in which it operates. Thus, there is not necessarily a direct correlation between pension funding and pension expense. In general, however, improvements in plans funded status tends to moderate subsequent funding needs. In 2007, the company contributed $277 million to its pension plans. The company anticipates that it will make approximately $250 million in contributions in 2008 to pension plans other than the principal U.S. pension plan.

The Pension Protection Act of 2006 (the "Act") was signed into law in the U.S. in August 2006. The Act introduces new funding requirements for single-employer defined benefit pension plans, provides guidelines for measuring pension plan assets and pension obligations for funding purposes, introduces benefit limitations for certain underfunded plans and raises tax deduction limits for contributions to retirement plans. The new funding requirements are generally effective for plan years beginning after December 31, 2007. The company does not anticipate that the Act will have a material impact on its required contributions.

In August 2006, the company announced major changes to its principal U.S. pension plan and principal defined contribution plan. As part of this announcement, the defined contribution benefits for most U.S. employees are in transition. Effective January 1, 2007, for employees hired on that date or thereafter, and effective January 1, 2008, for active employees on the rolls as of December 31, 2006, the company will make a contribution of 100 percent of the first 6 percent of the employee's contribution election. Additionally, the company will contribute 3 percent of each eligible employee's compensation regardless of the employee's contribution election. The definition of eligible compensation has also been expanded to be similar to the definition of eligible compensation in the U.S. pension plan. Covered full service employees on the rolls as of December 31, 2006 will also accrue additional benefits in the pension plan, but the annual rate of pension accrual will be about one-third of the previous rate. In addition, company-paid postretirement survivor benefits for these employees will not continue to grow after December 31, 2007. Covered employees hired in the U.S. after December 31, 2006 will not participate in the pension plan.

As a result of the amendment to the principal U.S. pension plan, the company was required to remeasure its pension expense for the remainder of 2006, reflecting plan assets and benefit obligations as of the remeasurement date. As a result of better than expected return on plan assets and a higher discount rate of 6 percent as of the remeasurement date, pretax pension expense decreased by $72 million for 2006. For 2007, the plan amendment resulted in a reduction in pension expense of about $40 million. For 2008, the plan amendment is expected to result in a net

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Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations, *continued*

reduction of approximately $40 million in combined pension and defined contribution plans expense. This estimate is composed of a reduction in pension expense of about $190 million, partially offset by an increase in defined contribution plan expense of approximately $150 million. Actual cash contributions for the savings plan will increase less than $130 million in 2008. Additional information related to these changes in the plans noted above is included in Note 21 to the Consolidated Financial Statements.

On December 31, 2006, the company adopted SFAS 158 and recorded a $1,555 million after-tax charge to stockholder's equity primarily due to reclassifying unrecognized actuarial losses and prior service costs related to the pension plans.

Medical, dental, life insurance and disability plans are unfunded and the cost of the approved claims is paid from operating cash flows. Pretax cash requirements to cover actual net claims costs and related administrative expenses were $315 million, $335 million and $408 million for 2007, 2006 and 2005, respectively. This amount is expected to be about $315 million in 2008. Changes in cash requirements reflect the net impact of higher per capita health care costs, demographic changes and changes in participant premiums, co-pays and deductibles.

The company's income can be significantly affected by pension and defined contribution benefits as well as retiree medical, dental and life insurance benefits. The following table summarizes the extent to which the company's income over each of the last 3 years was affected by pretax charges and credits related to long-term employee benefits.

(Dollars in millions)	2007	2006	2005
Defined benefit pension charges	$ (54)	$ 191	$ 432
Company contributions to defined contribution plans	99	86	81
Other long-term employee benefit charges	192	155	237
Net amount	$ 237	$ 432	$ 750

The above charges for pension and other long-term employee benefits are determined as of the beginning of each year. The decrease in pension expense in 2007 reflects favorable returns on pension assets, plan amendments and changes in demographics and discount rates. The increase in 2007 other long-term employee benefit charges principally reflects changes in demographics, discount rates and higher than expected health care costs. The decrease in pension expense in 2006 reflects favorable returns on pension assets, plan amendments and changes in discount rates. The decrease in 2006 other long-term employee benefit charges principally reflects the favorable medical trends in 2005 and refinements in estimates to reflect the anticipated commencement of the Medicare prescription drug program.

The company's key assumptions used in calculating its pension and other long-term employee benefits are the expected return on plan assets, the rate of compensation increases and the discount rate (see Note 21 to the Consolidated Financial Statements). For 2008, lower than anticipated medical trends, the net impact of the U.S. retirement plan amendments, changes in demographics and discount rates, and the expiration of a prior service cost amortization credit in 2007 are expected to result in a reduction in pension and other long-term employee benefit pretax expenses of about $170 million.

Environmental Matters

DuPont operates global manufacturing, product handling and distribution facilities that are subject to a broad array of environmental laws and regulations. Company policy requires that all operations fully meet or exceed legal and regulatory requirements. In addition, DuPont implements voluntary programs to reduce air emissions, eliminate the generation of hazardous waste, decrease the volume of waste water discharges, increase the efficiency of energy use and reduce the generation of persistent, bioaccumulative and toxic materials. The costs to comply with complex environmental laws and regulations, as well as internal voluntary programs and goals, are significant and will continue for the foreseeable future. While these costs may increase in the future, they are not expected to have a material impact on the company's financial position, liquidity or results of operations.

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Pretax environmental expenses charged to current operations totaled $576 million in 2007 compared with $521 million in 2006 and $468 million in 2005. These expenses include the remediation accruals discussed below; operating, maintenance and depreciation costs for solid waste, air and water pollution control facilities and the costs of environmental research activities. While expenses related to the costs of environmental research activities are not a significant component of the company's overall environmental expenses, the company expects these costs to become proportionally greater as the company increases its participation in businesses for which environmental assessments are required during product development. The largest of the environmental expenses in 2007 was $113 million for the operation of water pollution control facilities and $131 million for solid waste management. About 78 percent of total annual environmental expenses resulted from operations in the U.S.

In 2007, DuPont spent approximately $110 million on environmental capital projects either required by law or necessary to meet the company's internal environmental goals. The company currently estimates expenditures for environmental-related capital projects to be approximately $150 million in 2008. In the U.S., significant capital expenditures are expected to be required over the next decade for treatment, storage and disposal facilities for solid and hazardous waste and for compliance with the Clean Air Act (CAA). Until all CAA regulatory requirements are established and known, considerable uncertainty will remain regarding future estimates for capital expenditures. Total CAA capital costs over the next two years are currently estimated to range from $40 million to $70 million.

The goal of the Toxic Substances Control Act (TSCA) is to prevent unreasonable risks of injury to health or the environment associated with the manufacture, processing, distribution in commerce, use, or disposal of chemical substances. Under TSCA, the EPA has established reporting, record-keeping, testing and control-related requirements for new and existing chemicals. In 1998, the EPA challenged the U.S. chemical industry to voluntarily conduct screening level health and environmental effects testing on nearly 3,000 high production volume (HPV) chemicals or to make equivalent information publicly available. An HPV chemical is a chemical listed on the 1990 Inventory Update Rule with annual U.S. cumulative production and imports of one million pounds or more. The company expects to complete its commitments regarding the HPV chemicals it volunteered to sponsor within the next two to three years.

In December 2006, the European Union adopted a new regulatory framework concerning the Registration, Evaluation and Authorization of Chemicals. This regulatory framework known as REACH entered into force on June 1, 2007. One of its main objectives is the protection of human health and the environment. REACH requires manufacturers and importers to gather information on the properties of their substances that meet certain volume or toxicological criteria and register the information in a central database to be maintained by a Chemical Agency in Finland. The Regulation also calls for the progressive substitution of the most dangerous chemicals when suitable alternatives have been identified. Pre-registration will occur between June 1, 2008 and November 30, 2008; complete registrations containing extensive data on the characteristics of the chemical will be required in 2010 if production usage or tonnage exceeds 1,000 metric tons per year; 2013 if it is between 100 and 1,000 metric tons per year; and 2018 if it is 100 metric tons per year or less. By June 1, 2013, the Commission will review whether substances with endocrine disruptive properties should be authorized if safer alternatives exist. By June 1, 2019, the Commission will determine whether to extend the duty to warn from substances of very high concern to those that could be dangerous or unpleasant. Management does not expect that the costs to comply with REACH will be material to its operations and consolidated financial position.

DuPont believes that climate change is an important global issue that will present numerous risks and opportunities to business and society at large. Since the early 1990s when DuPont began taking action to reduce greenhouse gas emissions, the company has achieved major global reductions in emissions. Voluntary emissions reductions implemented by DuPont and other companies are valuable but alone will not be sufficient to effectively address a problem of this scale. The Kyoto Protocol to the United Nations Framework Convention on Climate Change entered into force in February 2005 and, while not ratified by the U.S., has spurred policy action by many other countries and regions around the world including the European Union. Considerable international attention is now focused on development of a post-2012 international policy framework to guide international action to address climate change when the Kyoto Protocol expires in 2012. Proposed and existing legislative efforts to control or limit greenhouse gas emissions could affect the company's energy source and supply choices as well as increase the cost of energy and raw materials derived from fossil fuels. However, the successful negotiation and implementation of sensible national,

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regional, and international climate change policies could provide the business community with greater certainty for the regulatory future, help guide investment decisions, and drive growth in demand for low-carbon and energy-efficient products, technologies, and services.

The company actively manages the potential risks that climate change could present, including those associated with the company's physical assets, as well as with regulatory and economic issues. DuPont looks for opportunities to make its overall portfolio less energy intensive, and energy use is one factor that is weighed when investments or divestitures are considered. DuPont is committed to continuing to bring to market more products and services to meet new and expanded demands of a low-carbon economy.

DuPont has discovered that very low levels of dioxins (parts per trillion to low parts per billion) and related compounds are inadvertently generated during its titanium dioxide pigment production process. Over 99 percent of the dioxin generated at DuPont's production plants becomes associated with process solid wastes that are disposed in controlled landfills where public exposure is negligible. A multi-year research and process engineering development program has culminated in capital projects and other process modifications intended to reduce dioxin generation by at least 90 percent. The last of these projects and process modifications were completed during 2007. As of December 31, 2007, the company's operations had results verifying the capability to reduce dioxin generation by 90 percent.

Remediation Expenditures

The RCRA extensively regulates and requires permits for the treatment, storage and disposal of hazardous waste. RCRA requires that permitted facilities undertake an assessment of environmental contamination at the facility. If conditions warrant, companies may be required to remediate contamination caused by prior operations. In contrast to CERCLA, the costs of the RCRA corrective action program are typically borne solely by the company. The company anticipates that significant ongoing expenditures for RCRA remediation activities may be required over the next two decades. Annual expenditures for the near term, however, are not expected to vary significantly from the range of such expenditures experienced in the past few years. Longer term, expenditures are subject to considerable uncertainty and may fluctuate significantly. The company's expenditures associated with RCRA and similar remediation activities were approximately $47 million, $44 million and $49 million in 2007, 2006 and 2005, respectively.

From time to time, the company receives requests for information or notices of potential liability from the EPA and state environmental agencies alleging that the company is a PRP under CERCLA or similar state statutes. CERCLA is often referred to as the Superfund and requires companies to undertake certain investigative and research activities at sites where it conducts or once conducted operations or where company generated waste has been disposed. The company has also, on occasion, been engaged in cost recovery litigation initiated by those agencies or by private parties. These requests, notices and lawsuits assert potential liability for remediation costs at various sites that typically are not company owned, but allegedly contain wastes attributable to the company's past operations.

As of December 31, 2007, the company had been notified of potential liability under CERCLA or state laws at 383 sites around the U.S., with active remediation under way at 139 of these sites. In addition, the company has resolved its liability at 161 sites, either by completing remedial actions with other PRPs or by participating in "de minimis buyouts" with other PRPs whose waste, like the company's, represented only a small fraction of the total waste present at a site. The company received notice of potential liability at six new sites during 2007 compared with six similar notices in 2006 and eight in 2005. The company's expenditures associated with CERCLA and similar state remediation activities were approximately $20 million, $19 million and $27 million in 2007, 2006 and 2005, respectively.

For nearly all Superfund sites, the company's potential liability will be significantly less than the total site remediation costs because the percentage of waste attributable to the company versus that attributable to all other PRPs is relatively low. Other PRPs at sites, where the company is a party, typically have the financial strength to meet their obligations and, where they do not, or where PRPs cannot be located, the company's own share of liability has not materially increased. There are relatively few sites where the company is a major participant and the cost to the

company of remediation at those sites and at all CERCLA sites in the aggregate, is not expected to have a material impact on the financial position, liquidity or results of operations of the company.

Total expenditures for previously accrued remediation activities under CERCLA, RCRA and similar state laws were $68 million, $64 million and $79 million in 2007, 2006 and 2005, respectively.

Remediation Accruals
At December 31, 2007, the Consolidated Balance Sheets included an accrued liability of $357 million compared to $349 million at December 31, 2006. Considerable uncertainty exists with respect to environmental remediation costs and, under adverse changes in circumstances, potential liability may range up to two to three times the amount accrued as of December 31, 2007. Of the $357 million accrued liability, approximately 10 percent was reserved for non-U.S. facilities. Approximately 65 percent of the reserve balance was attributable to RCRA and similar remediation liabilities, while about 25 percent was attributable to CERCLA liabilities. Remediation accruals of $76 million, $71 million and $64 million were added to the reserve in 2007, 2006 and 2005, respectively.

PFOA
DuPont manufactures fluoropolymer resins and dispersions as well as fluorotelomers, marketing many of them under the Teflon® and Zonyl® brands. The fluoropolymer resins and dispersions businesses are part of the Electronic & Communication Technologies segment; the fluorotelomers business is part of the Safety & Protection segment.

Fluoropolymer resins and dispersions are high-performance materials with many end uses including architectural fabrics, telecommunications and electronic wiring insulation, automotive fuel systems, computer chip processing equipment, weather-resistant/breathable apparel and non-stick cookware. Fluorotelomers are used to make soil, stain and grease repellants for paper, apparel, upholstery and carpets as well as firefighting foams and coatings.

A form of PFOA (collectively, perfluorooctanoic acid and its salts, including the ammonium salt) is used as a processing agent to manufacture fluoropolymer resins and dispersions. For over 50 years, DuPont purchased its PFOA needs from a third party, but beginning in the fall of 2002, it began producing PFOA to support the manufacture of fluoropolymer resins and dispersions. PFOA is not used in the manufacture of fluorotelomers; however, it is an unintended by-product present at trace levels in some fluorotelomer-based products.

DuPont Performance Elastomers, LLC (DPE) uses PFOA in the manufacture of raw materials to manufacture Kalrez® perfluoroelastomer parts. PFOA is also used in the manufacture of some fluoroelastomers marketed by DPE under the Viton® trademark. The wholly owned subsidiary is a part of the Performance Materials segment.

PFOA is bio-persistent and has been detected at very low levels in the blood of the general population. As a result, the EPA initiated a process to enhance its understanding of the sources of PFOA in the environment and the pathways through which human exposure to PFOA is occurring. In 2003, the EPA issued a preliminary risk assessment on PFOA that focuses on the exposure of the U.S. general population to PFOA and possible health effects, including developmental toxicity concerns. On January 12, 2005, the EPA issued a draft risk assessment on PFOA. The draft stated that cancer data for PFOA may be best described as "suggestive evidence of carcinogenicity, but not sufficient to assess human carcinogenic potential" under the EPA's Guidelines for Carcinogen Risk Assessment. Under the Guidelines, the descriptor "suggestive" is typically applied to agents if animal testing finds any evidence that exposure causes tumors in one species of animal.

The EPA requested that the Science Advisory Board (SAB) review and comment on the scientific soundness of this assessment. On May 31, 2006, the SAB released its report setting forth the view, based on laboratory studies in rats, that the human carcinogenic potential of PFOA is more consistent with the EPA's descriptor of "likely to be carcinogenic" as defined in the Guidelines for Carcinogen Risk Assessment. However, in its report the SAB indicated that additional data should be considered before the EPA finalizes its risk assessment of PFOA. Under the Guidelines the "likely" descriptor is typically applied to agents that have tested positive in more than one species, sex, strain, site or exposure route with or without evidence of carcinogenicity in humans. The EPA has acknowledged that it will consider additional data, including new research and testing, and has indicated that another SAB review will be sought after the EPA makes its risk assessment. DuPont disputes the cancer classification recommended in the

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SAB report. The EPA has stated that it is premature to draw any conclusions on the potential risks, including cancer, from PFOA until the additional data are integrated into the risk assessment. Although the EPA has stated that there remains considerable scientific uncertainty regarding potential risks associated with PFOA, it also stated that it does not believe that there is any reason for consumers to stop using any products because of concerns about PFOA.

DuPont respects the EPA's position raising questions about exposure routes and the potential toxicity of PFOA and DuPont and other companies have outlined plans to continue research, emission reduction and product stewardship activities to help address the EPA's questions. In January 2006, DuPont pledged its commitment to the EPA's 2010/15 PFOA Stewardship Program. The EPA program asks participants (1) to commit to achieve, no later than 2010, a 95 percent reduction in both facility emissions and product content levels of PFOA, PFOA precursors and related higher homologue chemicals and (2) to commit to working toward the elimination of PFOA, PFOA precursors and related higher homologue chemicals from emissions and products by no later than 2015. In October 2007, (for the year 2006), DuPont reported to the EPA that it had achieved an almost 98 percent reduction of PFOA emissions in U.S. manufacturing facilities. About a 95 percent reduction was achieved in global manufacturing emissions, meeting the EPA 2010 objective well ahead of the timeline. DuPont will work individually and with others in the industry to inform EPA's regulatory counterparts in the European Union, Canada, China and Japan about these activities and PFOA in general, including emissions reductions from DuPont's facilities, reformulation of the company's fluoropolymer dispersions and new manufacturing processes for fluorotelomers products.

In February 2007, DuPont announced its commitment to eliminate the need to make, use or buy PFOA by 2015. DuPont has discovered technology that should enable the elimination of PFOA use in fluoropolymer production. Commercial scale quantities of some fluoropolymer products have been made without PFOA and customers were notified in the fourth quarter 2007 that these products will be available for testing in their processes in 2008. Also, DuPont is developing the next generation of fluorotelomer products and already introduced two of them in the fourth quarter 2007.

In the meantime, DuPont has developed Echelon[tm] technology that can reduce the PFOA content in fluoropolymer dispersions by 97 percent. The company has already converted 90 percent of its product line by volume to manufacturing processes based on Echelon[tm]. DuPont also has successfully commercialized a new, patented manufacturing process to remove greater than 97 percent of trace by-product levels of PFOA, its homologues and direct precursors from its fluorotelomer products. The new products are being marketed as LX Platform[tm] products.

In November 2006, DuPont entered into an Order on Consent under the Safe Drinking Water Act (SDWA) with the EPA establishing a precautionary interim screening level for PFOA of 0.5 part per billion (ppb) in drinking water sources in the area around the Washington Works site located in Parkersburg, West Virginia. DuPont is required under the agreement to offer to install water treatment systems or an EPA-approved alternative if PFOA levels are detected at or above 0.5 ppb.

In February 2007, the New Jersey Department of Environmental Protection (NJDEP) identified a preliminary drinking-water guidance level for PFOA of 0.04 ppb as part of the first phase of an ongoing process to establish a state drinking-water standard. While the NJDEP will continue sampling and evaluation of data from all sources, it has not recommended a change in consumption patterns.

While occupational exposure to PFOA has been associated with small increases in some lipids (e.g. cholesterol), it is not known whether these are causal associations. These associations were not observed in a community study. Based on health and toxicological studies, DuPont believes the weight of evidence indicates that PFOA exposure does not pose a health risk to the general public. To date, there are no human health effects known to be caused by PFOA, although study of the chemical continues.

Currently, there are no regulatory actions pending that would prohibit the production or use of PFOA. However, because there continues to be regulatory interest, there can be no assurance that the EPA or any other regulatory entity will not choose to regulate or prohibit the production or use of PFOA in the future. Products currently manufactured by the company representing approximately $1 billion of 2007 revenues could be affected by any such regulation or prohibition. DuPont has established reserves in connection with certain PFOA environmental and litigation matters (see Note 19 to the Consolidated Financial Statements).

Part II

ITEM 7A. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

Financial Instruments

Derivatives and Other Hedging Instruments

Under procedures and controls established by the company's Financial Risk Management Framework, the company enters into contractual arrangements (derivatives) in the ordinary course of business to hedge its exposure to foreign currency, interest rate and commodity price risks. The counterparties to these contractual arrangements are major financial institutions, petrochemical and petroleum companies and exchanges.

The company hedges foreign currency denominated monetary assets and liabilities, certain business-specific foreign currency exposures and certain energy feedstock purchases. In addition, the company enters into exchange traded agricultural commodity derivatives to hedge exposures relevant to agricultural feedstock purchases.

Concentration of Credit Risk

Financial instruments that potentially subject the company to significant concentrations of credit risk consist principally of cash, investments, accounts receivable and derivatives.

As part of the company's risk management processes, it continuously evaluates the relative credit standing of all of the financial institutions that service DuPont and monitors actual exposures versus established limits. The company has not sustained credit losses from instruments held at financial institutions.

The company maintains cash and cash equivalents, short- and long-term investments, derivatives and certain other financial instruments with various financial institutions. These financial institutions are generally highly rated and geographically dispersed and the company has a policy to limit the dollar amount of credit exposure with any one institution.

The company's sales are not materially dependent on a single customer or small group of customers. As of December 31, 2007, no one individual customer balance represented more than 5 percent of the company's total outstanding receivables balance. Credit risk associated with its receivables balance is representative of the geographic, industry and customer diversity associated with the company's global businesses.

The company also maintains strong credit controls in evaluating and granting customer credit. As a result, it may require that customers provide some type of financial guarantee in certain circumstances. Length of terms for customer credit varies by industry and region.

Foreign Currency Risk

The company's objective in managing exposure to foreign currency fluctuations is to reduce earnings volatility associated with foreign currency rate changes. Accordingly, the company enters into various contracts that change in value as foreign exchange rates change to protect the value of its existing foreign currency-denominated assets, liabilities and commitments.

The company routinely uses forward exchange contracts to offset its net exposures, by currency, related to the foreign currency-denominated monetary assets and liabilities of its operations. The primary business objective of this hedging program is to maintain an approximately balanced position in foreign currencies so that exchange gains and losses resulting from exchange rate changes, net of related tax effects, are minimized.

The following table summarizes the impacts of this program on the company's results of operations for the years ended December 31, 2007, 2006 and 2005.

(Dollars in millions)	2007	2006	2005
Pretax exchange (loss)/gain	$ (85)	$ (4)	$ 445
Tax (expense)/benefit	54	(26)	(483)
After-tax loss	$ (31)	$ (30)	$ (38)

This table includes the company's pro rata share of its equity affiliates' exchange gains and losses and corresponding gains and losses on forward exchange contracts.

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Item 7A. Quantitative and Qualitative Disclosures About Market Risk *continued*

From time to time, the company will enter into forward exchange contracts to establish with certainty the USD amount of future firm commitments denominated in a foreign currency. Decisions regarding whether or not to hedge a given commitment are made on a case-by-case basis, taking into consideration the amount and duration of the exposure, market volatility and economic trends. Forward exchange contracts are also used, from time to time, to manage near-term foreign currency cash requirements and to place foreign currency deposits and marketable securities investments.

Interest Rate Risk
The company uses interest rate swaps to manage the interest rate mix of the total debt portfolio and related overall cost of borrowing.

Interest rate swaps involve the exchange of fixed for floating rate interest payments to effectively convert fixed rate debt into floating rate debt based on USD LIBOR. Interest rate swaps allow the company to maintain a target range of floating rate debt.

Commodity Price Risk
The company enters into over-the-counter and exchange-traded derivative commodity instruments to hedge its exposure to price fluctuations on certain raw material purchases.

A portion of energy feedstock purchases are hedged to reduce price volatility using fixed price swaps and options. Hedged feedstock purchases include natural gas and ethane.

The company contracts with independent growers to produce finished seed inventory. Under these contracts, growers are compensated with bushel equivalents that are marketed to the company for the market price of grain for a period of time following harvest. Derivative instruments, such as commodity futures that have a high correlation to the underlying commodity, are used to hedge the commodity price risk involved in compensating growers.

The company utilizes agricultural commodity futures to manage the price volatility of soybean meal. These derivative instruments have a high correlation to the underlying commodity exposure and are deemed effective in offsetting soybean meal feedstock price risk.

Additional details on these and other financial instruments are set forth in Note 23 to the Consolidated Financial Statements.

Sensitivity Analysis
The following table illustrates the fair values of outstanding derivative contracts at December 31, 2007 and 2006, and the effect on fair values of a hypothetical adverse change in the market prices or rates that existed at December 31, 2007 and 2006. The sensitivity for interest rate swaps is based on a one percent change in the market interest rate. Foreign currency, agricultural and energy derivative sensitivities are based on a 10 percent change in market rates.

	Fair Value Asset/ (Liability)		Fair Value Sensitivity	
(Dollars in millions)	2007	2006	2007	2006
Interest rate swaps	$ 19	$ (24)	$ (26)	$ (42)
Foreign currency contracts	20	(5)	(536)	(322)
Agricultural feedstocks	31	27	5	(1)
Energy feedstocks	–	(2)	–	(1)

Since the company's risk management programs are highly effective, the potential loss in value for each risk management portfolio described above would be largely offset by changes in the value of the underlying exposure.

ITEM 8. FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA

The financial statements and supplementary data required by this Item are included herein, commencing on page F-1 of this report.

Part II

ITEM 9. CHANGES IN AND DISAGREEMENTS WITH ACCOUNTANTS ON ACCOUNTING AND FINANCIAL DISCLOSURE

None.

ITEM 9A. CONTROLS AND PROCEDURES

The company maintains a system of disclosure controls and procedures for financial reporting to give reasonable assurance that information required to be disclosed in the company's reports submitted under the Securities Exchange Act of 1934 (Exchange Act) is recorded, processed, summarized and reported within the time periods specified in the rules and forms of the SEC. These controls and procedures also give reasonable assurance that information required to be disclosed in such reports is accumulated and communicated to management to allow timely decisions regarding required disclosures.

As of December 31, 2007, the company's Chief Executive Officer (CEO) and Chief Financial Officer (CFO), together with management, conducted an evaluation of the effectiveness of the company's disclosure controls and procedures pursuant to Rules 13a–15(e) and 15d–15(e) of the Exchange Act. Based on that evaluation, the CEO and CFO concluded that these disclosure controls and procedures are effective.

There has been no change in the company's internal control over financial reporting that occurred during the fourth quarter 2007 that has materially affected the company's internal control over financial reporting. The company has completed its evaluation of its internal controls and has concluded that the company's system of internal controls was effective as of December 31, 2007 (see page F–2).

The company continues to take appropriate steps to enhance the reliability of its internal control over financial reporting. Management has identified areas for improvement and discussed them with the company's Audit Committee and independent registered public accounting firm.

ITEM 9B. OTHER INFORMATION

None.

Part III

ITEM 10. DIRECTORS, EXECUTIVE OFFICERS AND CORPORATE GOVERNANCE

Information with respect to this Item is incorporated herein by reference to the Proxy. Information related to directors is included within the section entitled, "Election of Directors." The company has not made any material changes to the procedures by which security holders may recommend nominees to its Board of Directors since these procedures were communicated in the company's 2007 Proxy Statement for the Annual Meeting of Stockholders held on April 25, 2007. Information related to the Audit Committee is incorporated herein by reference to the Proxy and is included within the sections entitled "Committees of the Board" and "Committee Membership." Information regarding executive officers is contained in the Proxy section entitled "Section 16(a) Beneficial Ownership Reporting Compliance" and in Part I, Item 4 of this report.

The company has adopted a Code of Ethics for its CEO, CFO and Controller that may be accessed from the company's website at www.dupont.com by clicking on Investor Center and then Corporate Governance. Any amendments to, or waiver from, any provision of the code will be posted on the company's website at the above address.

ITEM 11. EXECUTIVE COMPENSATION

Information with respect to this Item is incorporated herein by reference to the Proxy and is included in the sections "Compensation Discussion and Analysis," "Summary Compensation Table," " Grants of Plan–Based Awards," "Outstanding Equity Awards," "Option Exercises and Stock Vested," "Retirement Plan Benefits," "Nonqualified Deferred Compensation," "Employment Agreements," and "Directors' Compensation." Information related to the Compensation Committee is included within the sections entitled "Compensation Committee Interlocks and Insider Participation" and "Compensation Committee Report."

ITEM 12. SECURITY OWNERSHIP OF CERTAIN BENEFICIAL OWNERS AND MANAGEMENT AND RELATED STOCKHOLDER MATTERS

Information with respect to Beneficial Owners is incorporated herein by reference to the Proxy and is included in the section entitled "Ownership of Company Stock."

Securities authorized for issuance under equity compensation plans as of December 31, 2007
(Shares and option amounts in thousands)

Plan Category	Number of Securities to be Issued Upon Exercise of Outstanding Options, Warrants and Rights	Weighted–Average Warrants and Rights Exercise Price of Outstanding Options, Warrants and Rights [2]	Number of Securities Remaining Available for Future Issuance Under Equity Compensation Plans [3]
Equity compensation plans approved by security holders	68,839[1]	$ 47.15	59,933
Equity compensation plans not approved by security holders [4]	11,600	$ 43.97	–
Total	80,239	$ 46.65	59,933

1 Includes stock–settled time–vested and performance–based restricted stock units granted and stock units deferred under the company's Equity and Incentive Plan, Stock Performance Plan, Variable Compensation Plan and the Stock Accumulation and Deferred Compensation Plan for Directors. Performance–based restricted stock units reflect the maximum number of shares to be awarded at the conclusion of the performance cycle (200% of the original grant). The actual award payouts can range from zero to 200 percent of the original grant.

2 Represents the weighted–average exercise price of the outstanding stock options only; the outstanding stock–settled time–vested and performance–based restricted stock units and deferred stock units are not included in this calculation.

3 Reflects shares available pursuant to the issuance of stock options, restricted stock, restricted stock units or other stock–based awards under the Equity and Incentive Plan approved by the shareholders on April 25, 2007 (see Note 22 to the Company's Consolidated Financial Statements). The maximum number of shares of stock reserved for the grant or settlement of awards under the Equity and Incentive Plan (the "Share Limit") shall be 60,000,000 and shall be subject to adjustment as provided therein; provided that each share in excess of 20,000,000 issued under the Equity and Incentive Plan pursuant to any award settled in stock, other than a stock option or stock appreciation right, shall be counted against the foregoing Share Limit as four shares for every one share actually issued in connection with such award. (For example, if 22,000,000 shares of restricted stock are granted under the Equity and Incentive Plan, 28,000,000 shall be charged against the Share Limit in connection with that award.)

4 Includes options totaling 10,434 granted under the company's 2002 Corporate Sharing Program (see Note 22 to the Consolidated Financial Statements) and 100 options with an exercise price of $46.50 granted to a consultant. Also includes 1,066 options from the conversion of DuPont Canada options to DuPont options in connection with the company's acquisition of the minority interest in DuPont Canada.

Part III

ITEM 13. CERTAIN RELATIONSHIPS AND RELATED TRANSACTIONS AND DIRECTOR INDEPENDENCE

Information with respect to the company's policy and procedures for the review, approval or ratification of transactions with related persons is incorporated by reference herein to the Proxy and is included in the section entitled "Review and Approval of Transactions with Related Persons." Information with respect to director independence is incorporated by reference herein to the Proxy and is included in the sections entitled "DuPont Board of Directors: Corporate Governance Guidelines," "Guidelines for Determining the Independence of DuPont Directors," "Committees of the Board" and "Committee Membership."

ITEM 14. PRINCIPAL ACCOUNTING FEES AND SERVICES

Information with respect to this Item is incorporated herein by reference to the Proxy and is included in the sections entitled "Ratification of Independent Registered Public Accounting Firm" and "Appendix A."

Part IV

ITEM 15. EXHIBITS AND FINANCIAL STATEMENT SCHEDULES

(a) Financial Statements, Financial Statement Schedules and Exhibits:

1. Financial Statements (See the Index to the Consolidated Financial Statements on page F–1 of this report).

2. Financial Statement Schedules

Schedule II – Valuation and Qualifying Accounts
(Dollars in millions)

Description	Balance at Beginning of Period	Charged to Costs and Expenses	Deductions	Balance at End of Period
For the Year Ended December 31, 2007				
Allowance for Doubtful Receivables	$ 233	$ 66	$ 38	$ 261
Total Allowances Deducted from Assets	$ 233	$ 66	$ 38	$ 261
For the Year Ended December 31, 2006				
Allowance for Doubtful Receivables	$ 205	$ 58	$ 30	$ 233
Total Allowances Deducted from Assets	$ 205	$ 58	$ 30	$ 233
For the Year Ended December 31, 2005				
Allowance for Doubtful Receivables	$ 199	$ 60	$ 54	$ 205
Total Allowances Deducted from Assets	$ 199	$ 60	$ 54	$ 205

The following should be read in conjunction with the previously referenced Consolidated Financial Statements:

Financial Statement Schedules listed under SEC rules but not included in this report are omitted because they are not applicable or the required information is shown in the Consolidated Financial Statements or notes thereto incorporated by reference.

Condensed financial information of the parent company is omitted because restricted net assets of consolidated subsidiaries do not exceed 25 percent of consolidated net assets. Footnote disclosure of restrictions on the ability of subsidiaries and affiliates to transfer funds is omitted because the restricted net assets of subsidiaries combined with the company's equity in the undistributed earnings of affiliated companies does not exceed 25 percent of consolidated net assets at December 31, 2007.

Separate financial statements of affiliated companies accounted for by the equity method are omitted because no such affiliate individually constitutes a 20 percent significant subsidiary.

3. Exhibits

Part IV

Item 15. Exhibits and Financial Statement Schedules, *continued*

The following list of exhibits includes both exhibits submitted with this Form 10-K as filed with the SEC and those incorporated by reference to other filings:

Exhibit Number	Description
3.1	Company's Restated Certificate of Incorporation.
3.2	Company's Bylaws, as last revised January 1, 1999 (incorporated by reference to Exhibit 3.2 to the company's Annual Report on Form 10-K for the year ended December 31, 2003).
4	The company agrees to provide the Commission, on request, copies of instruments defining the rights of holders of long-term debt of the company and its subsidiaries.
10.1*	The DuPont Stock Accumulation and Deferred Compensation Plan for Directors, as last amended effective April 25, 2007 (incorporated by reference to Exhibit 10.1 to the company's Quarterly Report on Form 10-Q for the period ended June 30, 2007).
10.2*	Terms and conditions of time-vested restricted stock units granted in 2007 to non-employee directors under the company's Stock Accumulation and Deferred Compensation Plan, as amended, or Equity and Incentive Plan (incorporated by reference to Exhibit 10.3 to the company's Quarterly Report on Form 10-Q for the period ended March 31, 2007).
10.3*	Company's Supplemental Retirement Income Plan, as last amended effective June 4, 1996 (incorporated by reference to Exhibit 10.3 to the company's Annual Report on Form 10-K for the year ended December 31, 2006).
10.4*	Company's Pension Restoration Plan, as restated effective July 17, 2006 (incorporated by reference to Exhibit 99.1 to the company's Current Report on Form 8-K filed on July 20, 2006).
10.5*	Company's Rules for Lump Sum Payments adopted July 17, 2006 (incorporated by reference to Exhibit 99.2 to the company's Current Report on Form 8-K filed on July 20, 2006).
10.6*	Company's Stock Performance Plan, as last amended effective January 25, 2007 (incorporated by reference to Exhibit 10.7 to the company's Quarterly Report on Form 10-Q for the period ended March 31, 2007).
10.7*	Company's Equity and Incentive Plan as approved by the company's shareholders on April 25, 2007 (incorporated by reference to pages C1-C13 of the company's Annual Meeting Proxy Statement dated March 19, 2007).
10.8*	Terms and conditions, as last amended effective January 1, 2007, of performance-based restricted stock units granted in 2005 under the company's Stock Performance Plan (incorporated by reference to Exhibit 10.8 to the company's Quarterly Report on Form 10-Q for the period ended March 31, 2007).
10.9*	Terms and conditions, as last amended effective January 1, 2007, of performance-based restricted stock units granted in 2006 under the company's Stock Performance Plan (incorporated by reference to Exhibit 10.9 to the company's Quarterly Report on Form 10-Q for the period ended March 31, 2007).
10.10*	Terms and conditions of stock appreciation rights granted in 2007 under the company's Stock Performance Plan or Equity and Incentive Plan (incorporated by reference to Exhibit 10.10 to the company's Quarterly Report on Form 10-Q for the period ended March 31, 2007).
10.11*	Terms and conditions of stock options granted in 2007 under the company's Stock Performance Plan or Equity and Incentive Plan (incorporated by reference to Exhibit 10.11 to the company's Quarterly Report on Form 10-Q for the period ended March 31, 2007).
10.12*	Terms and conditions of performance-based restricted stock units granted in 2007 under the company's Stock Performance Plan or Equity and Incentive Plan (incorporated by reference to Exhibit 10.12 to the company's Quarterly Report on Form 10-Q for the period ended March 31, 2007).
10.13*	Terms and conditions of time-vested restricted stock units granted in 2007 under the company's Stock Performance Plan or Equity and Incentive Plan (incorporated by reference to Exhibit 10.13 to the company's Quarterly Report on Form 10-Q for the period ended March 31, 2007).
10.14*	Company's Variable Compensation Plan, as last amended effective April 30, 1997 (incorporated by reference to Exhibit 10.15 to the company's Quarterly Report on Form 10-Q for the period ended June 30, 2007).

Part IV

Item 15. Exhibits and Financial Statement Schedules, *continued*

10.15*	Company's Salary Deferral & Savings Restoration Plan, as last amended effective January 1, 2007 (incorporated by reference to Exhibit 10.11 to the company's Annual Report on Form 10-K for the period ended December 31, 2006).
10.16*	Company's Retirement Savings Restoration Plan adopted effective January 1, 2007 (incorporated by reference to Exhibit 10.12 to the company's Annual Report on Form 10-K for the period ended December 31, 2006).
10.17*	Company's Retirement Income Plan for Directors, as last amended August 1995.
10.18*	Letter Agreement and Employee Agreement, dated as of July 30, 2004, as amended, between the company and R.R. Goodmanson (incorporated by reference to Exhibit 10.8 to the company's Quarterly Report on Form 10-Q for the period ended June 30, 2004).
10.19	Company's Bicentennial Corporate Sharing Plan, adopted by the Board of Directors on December 12, 2001 and effective January 9, 2002 (incorporated by reference to Exhibit 10.19 to the company's Quarterly Report on Form 10-Q for the quarter ended September 30, 2007).
10.20	Purchase Agreement by and among the company as Seller and the other Sellers Identified Therein and KED Fiber Ltd. and KED Fiber LLC as Buyers, dated as of November 16, 2003 (incorporated by reference to Exhibit 10.12 to the company's Annual Report on Form 10-K for the year ended December 31, 2003). The company agrees to furnish supplementally a copy of any omitted schedule to the Commission upon request.
10.21	Amendment to the Purchase Agreement dated December 23, 2003, by and among the company as Seller and the Other Sellers Identified Therein and KED Fiber Ltd. and KED Fiber LLC as buyers (incorporated by reference to Exhibit 10.13 to the company's Quarterly Report on Form 10-Q for the period ended March 31, 2004). The company agrees to furnish supplementally a copy of any omitted schedule to the commission upon request.
10.22	Amendment to the Purchase Agreement dated April 7, 2004, by and among the company as Seller and the Other Sellers Identified Therein and KED Fiber Ltd. and KED Fiber LLC as buyers (incorporated by reference to Exhibit 10.14 to the company's Quarterly Report on Form 10-Q for the period ended March 31, 2004). The company agrees to furnish supplementally a copy of any omitted schedule to the Commission upon request.
10.23	Amendment to the Purchase Agreement dated April 22, 2004, by and among the company as Seller and the Other Sellers Identified Therein and KED Fiber Ltd. and KED Fiber LLC as buyers (incorporated by reference to Exhibit 10.15 to the company's Quarterly Report on Form 10-Q for the period ended June 30, 2004). The company agrees to furnish supplementally a copy of any omitted schedule to the Commission upon request.
12	Computation of the Ratio of Earnings to Fixed Charges.
21	Subsidiaries of the Registrant.
23	Consent of Independent Registered Public Accounting Firm.
31.1	Rule 13a-14(a)/15d-14(a) Certification of the company's Principal Executive Officer.
31.2	Rule 13a-14(a)/15d-14(a) Certification of the company's Principal Financial Officer.
32.1	Section 1350 Certification of the company's Principal Executive Officer. The information contained in this Exhibit shall not be deemed filed with the Securities and Exchange Commission nor incorporated by reference in any registration statement filed by the registrant under the Securities Act of 1933, as amended.
32.2	Section 1350 Certification of the company's Principal Financial Officer. The information contained in this Exhibit shall not be deemed filed with the Securities and Exchange Commission nor incorporated by reference in any registration statement filed by the registrant under the Securities Act of 1933, as amended.

* Management contract or compensatory plan or arrangement required to be filed as an exhibit to this Form 10-K.

Signatures

Pursuant to the requirements of Section 13 of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

Date February 18, 2008

E. I. DU PONT DE NEMOURS AND COMPANY

By: /s/ J. L. KEEFER
J. L. Keefer
Executive Vice President and Chief Financial Officer
(Principal Financial and Accounting Officer)

Pursuant to the requirements of the Securities Exchange Act of 1934, this report has been signed below by the following persons on behalf of the registrant in the capacities and on the dates indicated:

Signature	Title(s)	Date
/s/ C. O. Holliday, Jr. C. O. Holliday, Jr.	Chairman of the Board and Chief Executive Officer and Director (Principal Executive Officer)	February 18, 2008
/s/ R. A. Brown R. A. Brown	Director	February 18, 2008
/s/ R. H. Brown R. H. Brown	Director	February 18, 2008
/s/ B. P. Collomb B. P. Collomb	Director	February 18, 2008
/s/ C. J. Crawford C. J. Crawford	Director	February 18, 2008
/s/ J. T. Dillon J. T. Dillon	Director	February 18, 2008
/s/ E. I. du Pont, II E. I. du Pont, II	Director	February 18, 2008
/s/ M. A. Hewson M. A. Hewson	Director	February 18, 2008
/s/ L. D. Juliber L. D. Juliber	Director	February 18, 2008
/s/ M. Naitoh M. Naitoh	Director	February 18, 2008
/s/ S. O'Keefe S. O'Keefe	Director	February 18, 2008
/s/ W. K. Reilly W. K. Reilly	Director	February 18, 2008

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E.I. du Pont de Nemours and Company

Index to the Consolidated Financial Statements

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Management's Reports on Responsibility for Financial Statements and Internal Control over Financial Reporting

Management's Report on Responsibility for Financial Statements
Management is responsible for the Consolidated Financial Statements and the other financial information contained in this Annual Report on Form 10–K. The financial statements have been prepared in accordance with generally accepted accounting principles in the United States of America (GAAP) and are considered by management to present fairly the company's financial position, results of operations and cash flows. The financial statements include some amounts that are based on management's best estimates and judgments. The financial statements have been audited by the company's independent registered public accounting firm, PricewaterhouseCoopers LLP. The purpose of their audit is to express an opinion as to whether the Consolidated Financial Statements included in this Annual Report on Form 10–K present fairly, in all material respects, the company's financial position, results of operations and cash flows. Their report is presented on the following page.

Management's Report on Internal Control over Financial Reporting
Management is responsible for establishing and maintaining an adequate system of internal control over financial reporting as defined in Rules 13a–15(f) and 15d–15(f) under the Securities Exchange Act of 1934. The company's internal control over financial reporting is a process designed 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. The company's internal control over financial reporting includes those policies and procedures that:

i. pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the company;

ii. 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 authorization of management and directors of the company; and

iii. provide reasonable assurance regarding prevention or timely detection of unauthorized acquisitions, use or disposition of the company's assets that could have a material effect on the financial statements. Internal control over financial reporting has certain inherent limitations which may not prevent or detect misstatements. In addition, changes in conditions and business practices may cause variation in the effectiveness of internal controls.

Management assessed the effectiveness of the company's internal control over financial reporting as of December 31, 2007, based on criteria set forth by the Committee of Sponsoring Organizations of the Treadway Commission (COSO) in *Internal Control–Integrated Framework*. Based on its assessment and those criteria, management concluded that the company maintained effective internal control over financial reporting as of December 31, 2007.

PricewaterhouseCoopers LLP, an independent registered public accounting firm, has issued an audit report on the effectiveness of the company's internal control over financial reporting as of December 31, 2007, which is presented on the following page.

Charles O. Holliday, Jr.
Chairman of the Board and
Chief Executive Officer

February 18, 2008

Jeffrey L. Keefer
Executive Vice President
and Chief Financial Officer

Report of Independent Registered Public Accounting Firm

To the Stockholders and the Board of Directors of
E. I. du Pont de Nemours and Company:

In our opinion, the accompanying consolidated balance sheets and the related consolidated statements of income, stockholders' equity and cash flows present fairly, in all material respects, the financial position of E. I. du Pont de Nemours and Company and its subsidiaries at December 31, 2007 and December 31, 2006, and the results of their operations and their cash flows for each of the three years in the period ended December 31, 2007 in conformity with accounting principles generally accepted in the United States of America. In addition, in our opinion, the financial statement schedule listed in the index appearing under Item 15(a) (2) presents fairly, in all material respects, the information set forth therein when read in conjunction with the related consolidated financial statements. Also in our opinion, the Company maintained, in all material respects, effective internal control over financial reporting as of December 31, 2007, based on criteria established in *Internal Control – Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO). The Company's management is responsible for these financial statements and financial statement schedule, for maintaining effective internal control over financial reporting and for its assessment of the effectiveness of internal control over financial reporting, included in "Management's Reports on Responsibility for Financial Statements and Internal Control over Financial Reporting" appearing on page F–2. Our responsibility is to express opinions on these financial statements and financial statement schedule and on the Company's internal control over financial reporting based on our integrated audits. We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audits to obtain reasonable assurance about whether the financial statements are free of material misstatement and whether effective internal control over financial reporting was maintained in all material respects. Our audits of the financial statements included 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. Our audit of internal control over financial reporting included obtaining an understanding of internal control over financial reporting, assessing the risk that a material weakness exists, and testing and evaluating the design and operating effectiveness of internal control based on the assessed risk. Our audits also included performing such other procedures as we considered necessary in the circumstances. We believe our audits provide a reasonable basis for our opinions.

As discussed in Note 1 to the consolidated financial statements, the company changed the manner in which it accounts for uncertainty in incomes taxes in 2007.

A company's internal control over financial reporting is a process designed 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 (i) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the company; (ii) 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 (iii) 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 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.

PricewaterhouseCoopers LLP

PricewaterhouseCoopers LLP
Philadelphia, Pennsylvania
February 18, 2008

E. I. du Pont de Nemours and Company

Consolidated Financial Statements

CONSOLIDATED INCOME STATEMENTS
(Dollars in millions, except per share)

For The Year Ended December 31,	2007	2006	2005
Net sales	$ 29,378	$ 27,421	$ 26,639
Other income, net	1,275	1,561	1,852
Total	30,653	28,982	28,491
Cost of goods sold and other operating charges	21,565	20,440	19,683
Selling, general and administrative expenses	3,364	3,224	3,223
Amortization of intangible assets	213	227	230
Research and development expense	1,338	1,302	1,336
Interest expense	430	460	518
Separation activities – Textiles & Interiors	–	–	(62)
Total	26,910	25,653	24,928
Income before income taxes and minority interests	3,743	3,329	3,563
Provision for income taxes	748	196	1,470
Minority interests in earnings (losses) of consolidated subsidiaries	7	(15)	37
Net income	$ 2,988	$ 3,148	$ 2,056
Basic earnings per share of common stock	$ 3.25	$ 3.41	$ 2.08
Diluted earnings per share of common stock	$ 3.22	$ 3.38	$ 2.07

See Notes to the Consolidated Financial Statements beginning on page F-8.

E. I. du Pont de Nemours and Company

Consolidated Financial Statements

CONSOLIDATED BALANCE SHEETS
(Dollars in millions, except per share)

December 31,	2007	2006
Assets		
Current assets		
Cash and cash equivalents	$ 1,305	$ 1,814
Marketable securities	131	79
Accounts and notes receivable, net	5,683	5,198
Inventories	5,278	4,941
Prepaid expenses	199	182
Income taxes	564	656
Total current assets	13,160	12,870
Property, plant and equipment	26,593	25,719
Less: Accumulated depreciation	15,733	15,221
Net property, plant and equipment	10,860	10,498
Goodwill	2,074	2,108
Other intangible assets	2,856	2,479
Investment in affiliates	818	803
Other assets	4,363	3,019
Total	$ 34,131	$ 31,777
Liabilities and Stockholders' Equity		
Current liabilities		
Accounts payable	$ 3,172	$ 2,711
Short-term borrowings and capital lease obligations	1,370	1,517
Income taxes	176	178
Other accrued liabilities	3,823	3,534
Total current liabilities	8,541	7,940
Long-term borrowings and capital lease obligations	5,955	6,013
Other liabilities	7,255	7,692
Deferred income taxes	802	269
Total liabilities	22,553	21,914
Minority interests	442	441
Commitments and contingent liabilities		
Stockholders' equity		
Preferred stock, without par value-cumulative; 23,000,000 shares authorized; issued at December 31, 2007 and 2006:		
$4.50 Series – 1,673,000 shares (callable at $120)	167	167
$3.50 Series – 700,000 shares (callable at $102)	70	70
Common stock, $.30 par value; 1,800,000,000 shares authorized; issued at December 31, 2007 – 986,330,000; 2006 – 1,009,109,000	296	303
Additional paid-in capital	8,179	7,797
Reinvested earnings	9,945	9,679
Accumulated other comprehensive loss	(794)	(1,867)
Common stock held in treasury, at cost (Shares: December 31, 2007 and 2006 – 87,041,000)	(6,727)	(6,727)
Total stockholders' equity	11,136	9,422
Total	$ 34,131	$ 31,777

See Notes to the Consolidated Financial Statements beginning on page F-8.

E. I. du Pont de Nemours and Company

Consolidated Financial Statements

CONSOLIDATED STATEMENTS OF STOCKHOLDERS' EQUITY
(Dollars in millions, except per share)

	Preferred Stock	Common Stock	Additional Paid in Capital	Reinvested Earnings	Accumulated Other Comprehensive Loss	Treasury Stock	Total Stockholders' Equity	Comprehensive Income
2005								
Balance January 1, 2005	$ 237	$ 324	$ 7,784	$ 10,182	$ (423)	$ (6,727)	$ 11,377	
Net income				2,056			2,056	$ 2,056
Cumulative effect from initial application of planned major maintenance change, net of tax of $27				52			52	
Cumulative translation adjustment					(109)		(109)	(109)
Net revaluation and clearance of cash flow hedges to earnings					(2)		(2)	(2)
Minimum pension liability					27		27	27
Net unrealized loss on securities					(11)		(11)	(11)
Total comprehensive income								$ 1,961
Common dividends ($1.46 per share)				(1,429)			(1,429)	
Preferred dividends				(10)			(10)	
Common stock								
Issued – compensation plans		3	538				541	
Repurchased						(3,530)	(3,530)	
Retired		(25)	(644)	(2,861)		3,530	-	
Balance December 31, 2005	$ 237	$ 302	$ 7,678	$ 7,990	$ (518)	$ (6,727)	$ 8,962	
2006								
Net income				3,148			3,148	$ 3,148
Cumulative translation adjustment					77		77	77
Net revaluation and clearance of cash flow hedges to earnings					15		15	15
Minimum pension liability					106		106	106
Net unrealized gain on securities					8		8	8
Total comprehensive income								$ 3,354
Common dividends ($1.48 per share)				(1,368)			(1,368)	
Preferred dividends				(10)			(10)	
Common stock								
Issued – compensation plans		2	317				319	
Repurchased			(180)			(100)	(280)	
Retired		(1)	(18)	(81)		100	-	
Adjustment to initially apply defined benefit plan standard, net of tax of $1,043 and minority interest of $8					(1,555)		(1,555)	
Balance December 31, 2006	$ 237	$ 303	$ 7,797	$ 9,679	$ (1,867)	$ (6,727)	$ 9,422	
2007								
Net income				2,988			2,988	$ 2,988
Cumulative translation adjustment					94		94	94
Net revaluation and clearance of cash flow hedges to earnings					24		24	24
Pension benefit plans					640		640	640
Other benefit plans					310		310	310
Net unrealized gain on securities					5		5	5
Total comprehensive income								$ 4,061
Common dividends ($1.52 per share)				(1,399)			(1,399)	
Preferred dividends				(10)			(10)	
Common stock								
Issued – compensation plans		3	638				641	
Repurchased						(1,695)	(1,695)	
Retired		(10)	(256)	(1,429)		1,695	-	
Adjustment to initially apply uncertainty in income taxes standard				116			116	
Balance December 31, 2007	$ 237	$ 296	$ 8,179	$ 9,945	$ (794)	$ (6,727)	$ 11,136	

See Notes to the Consolidated Financial Statements beginning on page F-8.

E. I. du Pont de Nemours and Company

Consolidated Financial Statements

CONSOLIDATED STATEMENTS OF CASH FLOWS
(Dollars in millions)

For The Year Ended December 31,	2007	2006	2005
Operating activities			
Net income	$ 2,988	$ 3,148	$ 2,056
Adjustments to reconcile net income to cash provided by operating activities:			
Depreciation	1,158	1,157	1,128
Amortization of intangible assets	213	227	230
Deferred tax (benefit)/expense	(1)	(615)	109
Other noncash charges and credits – net	365	288	44
Separation activities – Textiles & Interiors	–	–	(62)
Contributions to pension plans	(277)	(280)	(1,253)
(Increase) decrease in operating assets:			
Accounts and notes receivable	(214)	(194)	(74)
Inventories and other operating assets	(267)	(61)	6
Increase (decrease) in operating liabilities:			
Accounts payable and other operating liabilities	470	335	(633)
Accrued interest and income taxes	(145)	(269)	991
Cash provided by operating activities	4,290	3,736	2,542
Investing activities			
Purchases of property, plant and equipment	(1,585)	(1,532)	(1,340)
Investments in affiliates	(113)	(31)	(66)
Payments for businesses – net of cash acquired	(13)	(60)	(206)
Proceeds from sale of assets – net of cash sold	251	148	312
Net (increase) decrease in short-term financial instruments	(39)	37	36
Forward exchange contract settlements	(285)	45	653
Other investing activities – net	34	48	9
Cash used for investing activities	(1,750)	(1,345)	(602)
Financing activities			
Dividends paid to stockholders	(1,409)	(1,378)	(1,439)
Net increase (decrease) in short-term (less than 90 days) borrowings	1,117	(263)	(494)
Long-term and other borrowings:			
Receipts	1,998	2,611	4,311
Payments	(3,458)	(3,139)	(2,045)
Repurchase of common stock	(1,695)	(280)	(3,530)
Proceeds from exercise of stock options	445	148	359
Other financing activities – net	(67)	(22)	(13)
Cash used for financing activities	(3,069)	(2,323)	(2,851)
Effect of exchange rate changes on cash	20	10	(722)
Increase (decrease) in cash and cash equivalents	(509)	78	(1,633)
Cash and cash equivalents at beginning of year	1,814	1,736	3,369
Cash and cash equivalents at end of year	$ 1,305	$ 1,814	$ 1,736
Supplemental cash flow information:			
Cash paid during the year for			
Interest, net of amounts capitalized	$ 527	$ 295	$ 479
Taxes	795	899	355

See Notes to the Consolidated Financial Statements beginning on page F-8.

E. I. du Pont de Nemours and Company
Notes to the Consolidated Financial Statements
(Dollars in millions, except per share)

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

DuPont follows generally accepted accounting principles in the United States of America (GAAP). The significant accounting policies described below, together with the other notes that follow, are an integral part of the Consolidated Financial Statements.

Preparation of Financial Statements
The preparation of financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

Accounting Changes
Effective January 1, 2007, the company adopted Financial Accounting Standards Board (FASB) Interpretation No. 48, "Accounting for Uncertainty in Income Taxes" (FIN 48). FIN 48 clarifies the application of SFAS 109, "Accounting for Income Taxes," (SFAS 109) by defining criteria that an individual income tax position must meet for any part of the benefit of that position to be recognized in an enterprise's financial statements and provides guidance on measurement, derecognition, classification, accounting for interest and penalties, accounting in interim periods, disclosure, and transition. Upon adoption, the company recorded a $116 reduction in the previously accrued liabilities and a corresponding $116 increase in Reinvested earnings at January 1, 2007 (see Note 6).

Basis of Consolidation
The Consolidated Financial Statements include the accounts of the company, subsidiaries in which a controlling interest is maintained and variable interest entities (VIE) for which DuPont is the primary beneficiary. For those consolidated subsidiaries in which the company's ownership is less than 100 percent, the outside stockholders' interests are shown as Minority interests. Investments in affiliates over which the company has significant influence but not a controlling interest are carried on the equity basis. This includes majority-owned entities for which the company does not consolidate because a minority investor holds substantive participating rights. Investments in affiliates over which the company does not have significant influence are accounted for by the cost method. Gains or losses arising from issuances by an affiliate or a subsidiary of its own stock are recorded as nonoperating items.

Revenue Recognition
The company recognizes revenue when the earnings process is complete. The company's revenues are from the sale of a wide range of products to a diversified base of customers around the world. Revenue for product sales is recognized upon delivery, when title and risk of loss have been transferred, collectibility is reasonably assured and pricing is fixed or determinable. Substantially all product sales are sold FOB (free on board) shipping point or, with respect to non-U.S. customers, an equivalent basis. Accruals are made for sales returns and other allowances based on the company's experience. The company accounts for cash sales incentives as a reduction in sales and noncash sales incentives as a charge to cost of goods sold or selling expense, depending on the nature of the incentive. Amounts billed to customers for shipping and handling fees are included in Net sales and costs incurred by the company for the delivery of goods are classified as Cost of goods sold and other operating charges in the Consolidated Income Statements. Taxes on revenue-producing transactions are excluded from Net sales.

The company periodically enters into prepayment contracts with customers in the Agriculture & Nutrition segment and receives advance payments for product to be delivered in future periods. These advance payments are recorded as deferred revenue and are included in Other accrued liabilities on the Consolidated Balance Sheets. Revenue associated with advance payments is recognized as shipments are made and title, ownership and risk of loss pass to the customer.

Licensing and royalty income is recognized in accordance with agreed upon terms, when performance obligations are satisfied, the amount is fixed or determinable and collectibility is reasonably assured.

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Cash and Cash Equivalents
Cash equivalents represent investments with maturities of three months or less from time of purchase. They are carried at cost plus accrued interest, which approximates fair value because of the short-term maturity of these instruments.

Investments in Securities
Marketable securities represent investments in fixed and floating rate financial instruments with maturities of twelve months or less from time of purchase. They are classified as held-to-maturity and recorded at amortized cost.

Other assets include long-term investments in securities, which comprise investments for which market values are not readily available (cost investments) and available-for-sale securities that are reported at fair value (see Note 13).

Inventories
The majority of the company's inventories are valued at cost, as determined by the last-in, first-out (LIFO) method; in the aggregate, such valuations are not in excess of market. Seed inventories are valued at the lower of cost, as determined by the first-in, first-out (FIFO) method, or market.

Elements of cost in inventories include raw materials, direct labor and manufacturing overhead. Stores and supplies are valued at cost or market, whichever is lower; cost is generally determined by the average cost method.

Property, Plant and Equipment
Property, plant and equipment (PP&E) is carried at cost and is depreciated using the straight-line method. PP&E placed in service prior to 1995 is depreciated under the sum-of-the-years' digits method or other substantially similar methods. Substantially all equipment and buildings are depreciated over useful lives ranging from 15 to 25 years. Capitalizable costs associated with computer software for internal use are amortized on a straight-line basis over 5 to 7 years. When assets are surrendered, retired, sold or otherwise disposed of, their gross carrying values and related accumulated depreciation are removed from the accounts and included in determining gain or loss on such disposals.

Maintenance and repairs are charged to operations; replacements and improvements are capitalized.

Goodwill and Other Intangible Assets
Goodwill and indefinite-lived intangible assets are tested for impairment at least annually; however, these tests are performed more frequently when events or changes in circumstances indicate the carrying value may not be recoverable. The company's fair value methodology is based on quoted market prices, if available. If quoted market prices are not available, an estimate of fair market value is made based on prices of similar assets or other valuation methodologies including present value techniques. Impairment losses are included in Cost of goods sold and other operating charges.

Definite-lived intangible assets, such as purchased and licensed technology, patents and customer lists are amortized over their estimated useful lives, generally for periods ranging from 5 to 20 years. The company continually evaluates the reasonableness of the useful lives of these assets. Once these assets are fully amortized, they are removed from the Consolidated Balance Sheets.

Impairment of Long-Lived Assets
The company evaluates the carrying value of long-lived assets to be held and used when events or changes in circumstances indicate the carrying value may not be recoverable. The carrying value of a long-lived asset is considered impaired when the total projected undiscounted cash flows from such asset are separately identifiable and are less than its carrying value. In that event, a loss is recognized based on the amount by which the carrying value exceeds the fair market value of the long-lived asset. The company's fair value methodology is based on quoted market prices, if available. If quoted market prices are not available, an estimate of fair market value is made based on prices of similar assets or other valuation methodologies including present value techniques. Long-lived assets to be disposed of other than by sale are classified as held for use until their disposal. Long-lived assets to be

disposed by sale are classified as held for sale and are reported at the lower of carrying amount or fair market value less cost to sell and depreciation is discontinued.

Research and Development
Research and development costs are expensed as incurred.

Environmental
Accruals for environmental matters are recorded in operating expenses when it is probable that a liability has been incurred and the amount of the liability can be reasonably estimated. Accrued liabilities do not include claims against third parties and are not discounted.

Costs related to environmental remediation are charged to expense. Other environmental costs are also charged to expense unless they increase the value of the property or reduce or prevent contamination from future operations, in which case, they are capitalized.

Asset Retirement Obligations
The company records asset retirement obligations at fair value at the time the liability is incurred. Accretion expense is recognized as an operating expense using the credit-adjusted risk-free interest rate in effect when the liability was recognized. The associated asset retirement obligations are capitalized as part of the carrying amount of the long-lived asset and depreciated over the estimated remaining useful life of the asset, generally for periods ranging from 1 to 20 years.

Litigation
The company accrues for liabilities related to litigation matters when the information available indicates that it is probable that a liability has been incurred and the amount of the liability can be reasonably estimated. Legal costs such as outside counsel fees and expenses are charged to expense in the period incurred.

Insurance/Self-Insurance
The company self-insures certain risks where permitted by law or regulation, including workers' compensation, vehicle liability and employee related benefits. Liabilities associated with these risks are estimated in part by considering historical claims experience, demographic factors and other actuarial assumptions. For other risks, the company uses a combination of insurance and self-insurance, reflecting comprehensive reviews of relevant risks.

Income Taxes
The provision for income taxes is 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. Provision has been made for income taxes on unremitted earnings of subsidiaries and affiliates, except for subsidiaries in which earnings are deemed to be permanently invested. Investment tax credits or grants are accounted for in the period earned (the flow-through method). Interest accrued related to unrecognized tax benefits is included in miscellaneous income and expenses-net, under Other income, net. Income tax related penalties are included in the provision for income taxes. It is reasonably possible that changes from future completed tax examinations could be significant when compared to the company's global unrecognized tax benefits, however due to the uncertainty regarding the timing of completion of these audits and the possible outcomes, a current estimate of the range of increase or decrease that may occur within the next twelve months cannot be made.

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Notes to the Consolidated Financial Statements (continued)
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Foreign Currency Translation
The U.S. dollar (USD) is the functional currency of most of the company's worldwide operations. For subsidiaries where the USD is the functional currency, all foreign currency asset and liability amounts are remeasured into USD at end-of-period exchange rates, except for inventories, prepaid expenses, property, plant and equipment, goodwill and other intangible assets, which are remeasured at historical rates. Foreign currency income and expenses are remeasured at average exchange rates in effect during the year, except for expenses related to balance sheet amounts remeasured at historical exchange rates. Exchange gains and losses arising from remeasurement of foreign currency-denominated monetary assets and liabilities are included in income in the period in which they occur.

For subsidiaries where the local currency is the functional currency, assets and liabilities denominated in local currencies are translated into USD, at end-of-period exchange rates and the resultant translation adjustments are reported, net of their related tax effects, as a component of Accumulated other comprehensive income (loss) in stockholders' equity. Assets and liabilities denominated in other than the local currency are remeasured into the local currency prior to translation into USD and the resultant exchange gains or losses are included in income in the period in which they occur. Income and expenses are translated into USD at average exchange rates in effect during the period.

Variable Interest Entities (VIEs)
The company consolidates VIEs where DuPont is considered the primary beneficiary. At December 31, 2007, the assets, liabilities and operations of these entities are not material to the Consolidated Financial Statements of the company.

The company is also involved with other entities that are VIEs for which the company is not currently the primary beneficiary. Future events may require these VIEs to be consolidated if the company becomes the primary beneficiary. At December 31, 2007, the assets and liabilities of the other VIEs are immaterial to the Consolidated Financial Statements of the company. The company's share of the net income (loss) of these VIEs is included in Other income, net, in the Consolidated Income Statements and is not material.

Hedging and Trading Activities
Derivative instruments are reported on the Consolidated Balance Sheets at their fair values. For derivative instruments designated as fair value hedges, changes in the fair values of the derivative instruments will generally be offset on the income statement by changes in the fair value of the hedged items. For derivative instruments designated as cash flow hedges, the effective portion of any hedge is reported in Accumulated other comprehensive income (loss) until it is cleared to earnings during the same period in which the hedged item affects earnings. The ineffective portion of all hedges is recognized in current period earnings. Changes in the fair values of derivative instruments that are not designated as hedges are recorded in current period earnings.

In the event that a derivative designated as a hedge of a firm commitment or an anticipated transaction is terminated prior to the maturation of the hedged transaction, gains or losses realized at termination are deferred and included in the measurement of the hedged transaction. If a hedged transaction matures, or is sold, extinguished, or terminated prior to the maturity of a derivative designated as a hedge of such transaction, gains or losses associated with the derivative through the date the transaction matured are included in the measurement of the hedged transaction and the derivative is reclassified as for trading purposes. Derivatives designated as a hedge of an anticipated transaction are reclassified as for trading purposes if the anticipated transaction is no longer likely to occur.

Cash flows from derivative instruments accounted for as either fair value hedges or cash flow hedges are reported in the same category as the cash flows from the items being hedged. Cash flows from all other derivative instruments are generally reported as investing activities in the Consolidated Statements of Cash Flows. See Note 23 for additional discussion regarding the company's objectives and strategies for derivative instruments.

Reclassifications
Certain reclassifications of prior years' data have been made to conform to 2007 classifications.

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Notes to the Consolidated Financial Statements (continued)
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Accounting Standards Issued Not Yet Adopted

In September 2006, the FASB issued Statement of Financial Accounting Standards No. 157, "Fair Value Measurements," (SFAS 157) which addresses how companies should measure fair value when required for recognition or disclosure purposes under GAAP. The standard's provisions will be applied to existing accounting measurements and related disclosures that are based on fair value. SFAS 157 does not require any new fair value measurements. The standard applies a common definition of fair value to be used throughout GAAP, with emphasis on fair value as a "market-based" measurement versus an entity-specific measurement and establishes a hierarchy of fair value measurement methods. The disclosure requirements are expanded to include the extent to which companies use fair value measurements, the methods and assumptions used to measure fair value and the effect of fair value measurements on earnings. SFAS 157 is effective for fiscal years beginning after November 15, 2007. The new standard's provisions applicable to the company will be applied prospectively beginning January 1, 2008. The FASB, on February 12, 2008, issued FASB Staff Position (FSP) FAS 157-2. This FSP permits a delay in the effective date of SFAS 157 to fiscal years beginning after November 15, 2008, for nonfinancial assets and nonfinancial liabilities, except for items that are recognized or disclosed at fair value in the financial statements on a recurring basis (at least annually). The delay is intended to allow the Board and constituents additional time to consider the effect of various implementation issues that have arisen, or that may arise, from the application of SFAS 157. On February 14, 2008, the FASB issued FSP FAS 157-1 to exclude SFAS 13, Accounting for Leases, and its related interpretive accounting pronouncements from the scope of SFAS 157. Management expects that the adoption of SFAS 157 will not have a material effect on the company's financial position, liquidity or results of operations.

In December 2007, the FASB issued Statement of Financial Accounting Standards No. 141 (revised 2007) "Business Combinations" (SFAS 141R) which replaces FASB Statement No. 141. SFAS 141R addresses the recognition and measurement of identifiable assets acquired, liabilities assumed, and non-controlling interests in business combinations. SFAS 141R also requires disclosure that enables users of the financial statements to better evaluate the nature and financial effect of business combinations. SFAS 141R applies prospectively to business combinations for which the acquisition date is on or after the beginning of the first annual reporting period beginning on or after December 15, 2008. SFAS 141R will be adopted by the company on January 1, 2009. The company is currently evaluating the impact of adoption on its Consolidated Financial Statements.

In December 2007, the FASB issued Statement of Financial Accounting Standards No. 160, "Noncontrolling Interests in Consolidated Financial Statements – an amendment of Accounting Research Bulletin No. 51" (SFAS 160) which changes the accounting and reporting for minority interests and for the deconsolidation of a subsidiary. It also clarifies that a third-party, non-controlling interest in a consolidated subsidiary is an ownership interest in the consolidated entity that should be reported as equity in the consolidated financial statements. SFAS 160 also requires disclosure that clearly identifies and distinguishes between the interests of the parent and the interests of the non-controlling owners. SFAS 160 is effective for fiscal years beginning after December 15, 2008. SFAS 160 will be adopted by the company on January 1, 2009. The company is currently evaluating the impact of adoption on its Consolidated Financial Statements.

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Notes to the Consolidated Financial Statements (continued)
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2. OTHER INCOME, NET

	2007	2006	2005
Cozaar®/Hyzaar® licensing income	$ 951	$ 815	$ 747
Royalty income	125	120	130
Interest income	154	129	227
Equity in (losses) earnings of affiliates (Note 12)	(130)	50	108
Net gains on sales of assets	126	78	82
Net exchange (losses) gains [1]	(65)	16	423
Miscellaneous income and expenses – net [2]	114	353	135
	$ 1,275	$ 1,561	$ 1,852

1 The company routinely uses forward exchange contracts to offset its net exposures, by currency, related to the foreign currency- denominated monetary assets and liabilities of its operations. The objective of this program is to maintain an approximately balanced position in foreign currencies in order to minimize, on an after-tax basis, the effects of exchange rate changes. The net pretax exchange gains and losses are largely offset by the associated tax impact.

2 Miscellaneous income and expenses – net, principally includes insurance recoveries, litigation settlements, interest items, and other miscellaneous items.

3. INTEREST EXPENSE

	2007	2006	2005
Interest incurred	$ 475	$ 497	$ 541
Interest capitalized	(45)	(37)	(23)
	$ 430	$ 460	$ 518

4. RESTRUCTURING ACTIVITIES

2007 Activities
During 2007, the company did not institute any significant restructuring programs. In 2007, employee separation payments, net of exchange impact, of $77 associated with 2006 restructuring activities were made. At December 31, 2007, total liabilities relating to prior year restructuring activities were $82 including $70 associated with the plans initiated in 2006.

2006 Activities
During 2006, the company initiated restructuring actions within its Agriculture & Nutrition and Coatings & Color Technologies segments to improve the company's global competitiveness. As a result, a net charge of $326 was recorded in Cost of goods sold and other operating charges for employee separation and asset write-downs. Further details are discussed below.

Agriculture & Nutrition
During the fourth quarter 2006, the Agriculture & Nutrition platform launched plans to re-deploy capital and resources within various segments of the business. The plans included the closing or streamlining of manufacturing units at about twelve sites and the reduction of approximately 1,500 positions globally. Restructuring charges resulting from the plans totaled $194, $72 of which are reflected within Performance Materials segment results following the realignment of certain businesses in 2007. The global program included $64 for severance payments and $130 principally for asset impairments, primarily related to definite-lived intangible assets whose remaining useful lives were reduced, abandoned technology and other non-personnel charges. At December 31, 2007, 1,054 employees were separated from the company and 118 were redeployed. Essentially all employees are expected to be separated from the company by 2009. Cash payments related to these separations were approximately $25 in 2007 and $4 in 2006.

Coatings & Color Technologies
A business transformation plan was instituted during the first quarter 2006 within the Coatings & Color Technologies segment to better serve the company's customers and improve profitability. The plan included the elimination of approximately 1,700 positions. Restructuring charges resulting from the plan totaled $135, including $123 related to severance payments primarily in Europe and the U.S. for approximately 1,300 employees involved in manufacturing, marketing, administrative and technical activities. In connection with this program, a $12 charge was also recorded related to exit costs of non-strategic assets. As of December 31, 2007, essentially all positions identified as a part of the company's 2006 program have been separated from the company. This consisted of 1,200 separations and 450 individuals redeployed. Cash payments related to these separations were approximately $52 in 2007 and $28 in 2006.

Account balances and activity for the 2006 restructuring programs are summarized below:

	Write-down of Assets	Employee Separation Costs	Total
Net charges to income in 2006	$ 142	$ 184	$ 326
Charges to accounts			
Employee separation payments	–	(32)	(32)
Asset write-offs	(142)	–	(142)
Balance at December 31, 2006	$ –	$ 152	$ 152
Employee separation payments	–	(77)	(77)
Net charges (credits) to income	5	(5)	–
Asset write-offs	(5)	–	(5)
Balance at December 31, 2007	$ –	$ 70	$ 70

2005 Activities
During 2005, the company did not institute any significant restructuring programs. In 2005, employee separation payments of $133 associated with prior year programs were made.

5. SEPARATION ACTIVITIES-TEXTILES & INTERIORS

On April 30, 2004, the company sold a majority of the net assets of Textiles & Interiors, referred to as INVISTA, to Koch, Inc. (Koch). During 2005, the company sold its investments in three affiliated companies with a book value of $84 to Koch and its investment in a fourth affiliated company to its equity partner. In January 2006, the company completed the sale of its interest in the last equity affiliate to its equity partner for proceeds of $14 thereby completing the sale of all of the net assets of Textiles & Interiors.

In 2005, the company recorded a net benefit of $62 resulting from divestiture activities. The company's transfer of its interest in the affiliates to Koch resulted in a gain of $35. The sale of two of these affiliates had been delayed until the company received approval from its equity partners. The company also recorded a gain of $29 in 2005 related to the sale of the company's investment in another equity affiliate and $2 of other charges associated with the separation. Net cash proceeds from these transactions totaled $135. Additionally, in 2005, the company received $40 of cash proceeds related to a 2004 sale of an equity affiliate to its partner.

The company indemnified Koch against certain liabilities primarily related to taxes, legal matters, environmental matters and representations and warranties. See Note 19 for additional information.

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6. PROVISION FOR INCOME TAXES

	2007	2006	2005
Current tax expense (benefit):			
U.S. federal	$ 357	$ 505	$ 699
U.S. state and local	13	(1)	13
International	379	307	649
	749	811	1,361
Deferred tax expense (benefit):			
U.S. federal	63	(297)	204
U.S. state and local	(24)	(18)	(13)
International	(40)	(300)	(82)
	(1)	(615)	109
Provision for income taxes	$ 748	$ 196	$ 1,470
Stockholders' equity:			
Stock compensation [1]	(25)	(2)	(40)
Net revaluation and clearance of cash flow hedges to earnings [2]	15	9	(1)
Net unrealized (losses) gains on securities [2]	2	3	(6)
Minimum pension liability [2]	–	248	(20)
Pension benefits			
Net losses [3]	383	(1,048)	–
Prior service cost [3]	5	(51)	–
Other benefits			
Net losses [3]	223	(391)	–
Net prior service benefit [3]	(55)	447	–
	$ 1,296	$ (589)	$ 1,403

1 Represents Deferred tax benefits for certain stock compensation amounts that are deductible for income tax purposes but do not affect Net income.

2 Represents Deferred tax charges (benefits) recorded as a component of Accumulated other comprehensive loss in Stockholders' equity. See Note 20.

3 On December 31, 2006, the company adopted prospectively SFAS 158 and as required, the company included in the ending balance of Accumulated other comprehensive loss, taxes associated with the gains and losses and prior service costs and credits, that pursuant to SFAS No. 87 and 106 prior to amendment by SFAS 158 had not been recognized as components of net periodic benefit cost.

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Deferred income taxes result from temporary differences between the financial and tax basis of the company's assets and liabilities. The tax effects of temporary differences and tax loss/tax credit carryforwards/backs included in the deferred income tax provision are as follows:

	2007	2006	2005
Depreciation	$ (6)	$ (12)	$ (3)
Accrued employee benefits	30	(125)	405
Other accrued expenses	9	(329)	31
Inventories	(7)	(52)	(46)
Unrealized exchange (loss) gain	(38)	(62)	41
Investment in subsidiaries and affiliates	(18)	7	(7)
Amortization of intangibles	(18)	(14)	(45)
Other temporary differences	29	92	71
Tax loss/tax credit carryforwards/backs	(22)	65	(230)
Valuation allowance – net	40	(185)	(108)
	$ (1)	$ (615)	$ 109

The significant components of deferred tax assets and liabilities at December 31, 2007 and 2006, are as follows:

	2007		2006	
	Asset	Liability	Asset	Liability
Depreciation	$ –	$ 1,392	$ –	$ 1,380
Accrued employee benefits	1,469	196	2,302	137
Other accrued expenses	1,225	656	934	489
Inventories	238	121	169	49
Unrealized exchange gains	81	–	43	–
Tax loss/tax credit carryforwards/backs	2,830	–	2,602	–
Investment in subsidiaries and affiliates	38	338	31	337
Amortization of intangibles	92	643	75	661
Other	201	128	348	206
	$ 6,174	$ 3,474	$ 6,504	$ 3,259
Valuation allowance	(1,424)		(1,467)	
	$ 4,750		$ 5,037	

Current deferred tax assets of $564 and $656 at December 31, 2007 and 2006, respectively, are included in the caption Income taxes within Current assets of the Consolidated Balance Sheets. In addition, Deferred tax assets of $1,523 and $1,430 are included in Other assets at December 31, 2007 and 2006, respectively. See Note 13. Deferred tax liabilities of $9 and $39 at December 31, 2007 and 2006, respectively, are included in the caption Income taxes within Current liabilities of the Consolidated Balance Sheets.

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An analysis of the company's effective income tax rate (EITR) follows:

	2007	2006	2005
Statutory U.S. federal income tax rate	35.0%	35.0%	35.0%
Exchange gains/losses [1]	(0.9)	0.6	9.4
Domestic operations	(3.2)	0.1	(1.4)
Lower effective tax rates on international operations-net	(7.5)	(12.4)	(6.8)
Tax settlements	(3.4)	(10.4)	(1.4)
Lower effective tax rate on export sales	–	(0.8)	(1.0)
The American Jobs Creation Act of 2004 (AJCA) [2]	–	(0.6)	8.2
Valuation Allowance Release	–	(5.6)	(0.7)
	20.0%	5.9%	41.3%

1 Principally reflects the benefit of non-taxable exchange gains resulting from remeasurement of foreign currency denominated monetary assets and liabilities. Further information about the company's foreign currency hedging program is included in Note 23 under the heading Currency Risk.

2 Reflects the tax impact associated with the repatriation of $9.1 billion under the AJCA.

Income before income taxes and minority interests shown below is based on the location of the corporate unit to which such earnings are attributable. However, since such earnings are often subject to taxation in more than one country, coupled with the impact of exchange gains/losses, the income tax provision shown above as United States or international does not correspond to the earnings shown in the following table:

	2007	2006	2005
United States (including exports)	$ 1,652	$ 1,947	$ 2,795
International	$ 2,091	1,382	768
	$ 3,743	$ 3,329	$ 3,563

Under the tax laws of various jurisdictions in which the company operates, deductions or credits that cannot be fully utilized for tax purposes during the current year may be carried forward or back, subject to statutory limitations, to reduce taxable income or taxes payable in future or prior years. At December 31, 2007, the tax effect of such carryforwards/backs, net of valuation allowance approximated $1,415. Of this amount, $1,206 has no expiration date, $20 expires after 2007 but before the end of 2012 and $189 expires after 2012.

At December 31, 2007, unremitted earnings of subsidiaries outside the United States totaling $9,644 were deemed to be permanently reinvested. No deferred tax liability has been recognized with regard to the remittance of such earnings. It is not practical to estimate the income tax liability that might be incurred if such earnings were remitted to the United States.

Each year the company files hundreds of income tax returns in the various national, state and local income taxing jurisdictions in which it operates. These tax returns are subject to examination and possible challenge by the taxing authorities. Positions challenged by the taxing authorities may be settled or appealed by the company. As a result, there is an uncertainty in income taxes recognized in the company's financial statements in accordance with SFAS No. 109, "Accounting for Income Taxes" (SFAS 109). In 2006, the FASB issued FIN 48, which clarifies the application of SFAS 109 by defining criteria that an individual income tax position must meet for any part of the benefit of that position to be recognized in an enterprise's financial statements and provides guidance on measurement, derecognition, classification, accounting for interest and penalties, accounting in interim periods, disclosure, and transition.

In accordance with the transition provisions, the company adopted FIN 48 effective January 1, 2007. This resulted in a $116 reduction in the previously accrued liabilities and a corresponding $116 increase in Reinvested earnings at January 1, 2007. In accordance with FIN 48, the total amount of global unrecognized tax benefits at December 31, 2007 was $825. Of the $825 of unrecognized tax benefits, $443 relates to tax positions, which if recognized would

reduce tax expense. The total gross accrued interest and penalty during 2007 in the Consolidated Income Statement was $25 and the total gross accrued interest and penalties at December 31, 2007 was $114. The company and/or its subsidiaries files income tax returns in the United States of America (U.S.) federal jurisdiction, and various states and non-U.S. jurisdictions. With few exceptions, the company is no longer subject to U.S. federal, state and local, or non-U.S. income tax examinations by tax authorities for years before 1999. It is reasonably possible that changes to the company's global unrecognized tax benefits could be significant, however due to the uncertainty regarding the timing of completion of audits and possible outcomes, a current estimate of the range of increases or decreases that may occur within the next twelve months can not be made. A reconciliation of the beginning and ending amounts of unrecognized tax benefits is as follows:

Total Unrecognized Tax Benefits as of 1/1/2007	$ 1,070
Gross amounts of decreases in unrecognized tax benefits as a result of tax positions taken during the prior period	(173)
Gross amounts of increases in unrecognized tax benefits as a result of tax positions taken during the prior period	34
Gross amounts of increases in unrecognized tax benefits as a result of tax positions taken during the current period	77
Amount of decreases in the unrecognized tax benefits relating to settlements with taxing authorities	(209)
Reduction to unrecognized tax benefits as a result of a lapse of the applicable statue of limitations	(16)
Exchange gain/(loss)	42
Total Unrecognized Tax Benefits as of 12/31/2007	$ 825
Total unrecognized tax benefits that, if recognized, would impact the effective tax rate	$ 443
Total amount of interest and penalties recognized in the Consolidated Income Statement	$ 25
Total amount of interest and penalties recognized in the Consolidated Balance Sheet	$ 114

7. EARNINGS PER SHARE OF COMMON STOCK

Set forth below is a reconciliation of the numerator and denominator for basic and diluted earnings per share calculations for the periods indicated:

	2007	2006	2005
Numerator:			
Net income	$ 2,988	$ 3,148	$ 2,056
Preferred dividends	(10)	(10)	(10)
Net income available to common stockholders	$ 2,978	$ 3,138	$ 2,046
Denominator:			
Weighted-average number of common shares outstanding – Basic	917,132,000	921,474,000	982,193,000
Dilutive effect of the company's employee compensation plans and accelerated share repurchase agreement	8,270,000	7,127,000	6,761,000
Weighted average number of common shares outstanding – Diluted	925,402,000	928,601,000	988,954,000

The weighted-average number of common shares outstanding in 2007 and 2006 declined as a result of the company's repurchase and retirement of its common stock in connection with its $5 billion share buyback plan, which was authorized by the Board of Directors in October 2005. See Note 20 for further information.

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The following average number of stock options are antidilutive and therefore, are not included in the diluted earnings per share calculation:

	2007	2006	2005
Average number of stock options	23,252,000	63,294,000	52,958,000

The 40 million decrease in the average number of stock options that were antidilutive in 2007 compared to 2006 was primarily due to the increase in the company's average stock price. Additionally, there were 12.8 million stock options that expired unexercised and were cancelled in January 2007, which were included in the average number of stock options that were antidilutive in 2006.

8. ACCOUNTS AND NOTES RECEIVABLE

December 31,	2007	2006
Accounts receivable–trade–net of allowances of $261 in 2007 and $233 in 2006	$ 4,649	$ 4,335
Other	1,034	863
	$ 5,683	$ 5,198

Accounts and notes receivable are carried at amounts that approximate fair value and include amounts due from equity affiliates of $27 for 2007, and $58 for 2006.

9. INVENTORIES

December 31,	2007	2006
Finished products	$ 3,043	$ 3,075
Semifinished products	1,865	1,616
Raw materials, stores and supplies	1,000	804
	5,908	5,495
Adjustment of inventories to a LIFO basis	(630)	(554)
	$ 5,278	$ 4,941

Inventory values, before LIFO adjustment, are generally determined by the average cost method, which approximates current cost. Inventories, excluding seeds and stores and supplies, are valued under the LIFO method and comprised 80 percent of consolidated inventories before LIFO adjustment for the periods ended December 31, 2007 and 2006. Seed inventories of $1,369 and $1,115 at December 31, 2007 and 2006, respectively, were valued under the FIFO method. Stores and supplies inventories of $259 and $281 at December 31, 2007 and 2006, respectively, were valued under the average cost method.

10. PROPERTY, PLANT AND EQUIPMENT

December 31,	2007	2006
Buildings	$ 4,111	$ 4,081
Equipment	20,537	20,058
Land	426	417
Construction	1,519	1,163
	$ 26,593	$ 25,719

Property, plant and equipment includes gross assets acquired under capital leases of $55 and $61 at December 31, 2007 and 2006, respectively. Related amounts included in accumulated depreciation were $33 at December 31, 2007 and 2006.

11. GOODWILL AND OTHER INTANGIBLE ASSETS

Goodwill
The following table summarizes changes in the carrying amount of Goodwill for the year ended December 31, 2007, by reportable segment:

	Balance as of December 31, 2007	Goodwill Adjustments and Acquisitions	Balance as of December 31, 2006
Agriculture & Nutrition	$ 461	$ (1)	$ 462
Coatings & Color Technologies	821	–	821
Electronic & Communication Technologies	177	2	175
Performance Materials	422	(37)	459
Safety & Protection	182	2	180
Other	11	–	11
Total	$ 2,074	$ (34)	$ 2,108

Changes in Goodwill in 2007 resulted from purchase accounting refinements and other acquisitions and divestitures. In 2007, the company performed its annual impairment tests for goodwill and determined that no goodwill impairments existed.

Other Intangible Assets
The following table summarizes the gross carrying amounts and accumulated amortization of other intangible assets by major class:

	December 31, 2007			December 31, 2006		
	Gross	Accumulated Amortization	Net	Gross	Accumulated Amortization	Net
Intangible assets subject to amortization (Definite-lived)						
Purchased and licensed technology	$ 2,410	$ (1,142)	$ 1,268	$ 2,099	$ (1,253)	$ 846
Patents	155	(56)	99	141	(46)	95
Trademarks	53	(17)	36	53	(14)	39
Other [1]	536	(237)	299	536	(192)	344
	3,154	(1,452)	1,702	2,829	(1,505)	1,324
Intangible assets not subject to amortization (Indefinite-lived)						
Trademarks/tradenames	179	–	179	180	–	180
Pioneer germplasm [2]	975	–	975	975	–	975
	1,154	–	1,154	1,155	–	1,155
	$ 4,308	$ (1,452)	$ 2,856	$ 3,984	$ (1,505)	$ 2,479

1 Primarily consists of sales and grower networks, customer lists, marketing and manufacturing alliances and noncompetition agreements.

2 Pioneer germplasm is the pool of genetic source material and body of knowledge gained from the development and delivery stage of plant breeding. The company recognized germplasm as an intangible asset upon the acquisition of Pioneer. This intangible asset is expected to contribute to cash flows beyond the foreseeable future and there are no legal, regulatory, contractual, or other factors which limit its useful life. Prior to the adoption of SFAS No. 142, "Goodwill and Other Intangible Assets," the company amortized germplasm on a straight-line basis over a period of forty years, the maximum period previously allowed under generally accepted accounting principles.

During 2007, the company's wholly-owned subsidiary, Pioneer Hi-Bred International, Inc. (Pioneer) entered into a business agreement on corn herbicide tolerance and insect control trait technologies with Monsanto Company. Among other provisions, modifications were made to the existing corn license agreements; both parties agreed to exchange certain non-assert and other intellectual property rights; and both parties obtained rights to reference and access certain regulatory data and approvals in which the other has certain interests.

The YieldGard® MON810 Corn license agreement has been modified to provide Pioneer with more favorable royalty terms and broader rights to certain regulatory data and approvals for use in developing products stacked with YieldGard® MON810 Corn. As part of the agreement, Monsanto receives broader rights and access to certain Herculex® Insect Control trait regulatory data and approvals for use in developing products stacked with Herculex® Insect Control traits.

The agreement also modified the existing Roundup Ready® Corn 2 license to provide for specified annual royalty payments from 2008 through 2015 versus the per unit royalty arrangement in place for the same period. As a result of the change from a per unit royalty payment to specified annual royalty payments, the company recorded an intangible asset for licensed technology and an associated liability with a net present value of $573 in the year ended December 31, 2007. The intangible asset is subject to amortization, which will be reported in Cost of goods sold and other operating charges, over the life of the related contract. Interest expense associated with the liability will be reported in Cost of goods sold and other operating charges. Cumulative cash payments will be approximately $725 over this eight-year period.

The aggregate pretax amortization expense for definite-lived intangible assets was $213 for 2007, $227 for 2006, and $230 for 2005. The estimated aggregate pretax amortization expense for 2008, 2009, 2010, 2011 and 2012 is $280, $290, $275, $260 and $210, respectively, including amounts that will be reported in Cost of goods sold and other operating charges.

12. SUMMARIZED FINANCIAL INFORMATION FOR AFFILIATED COMPANIES

Summarized combined financial information for affiliated companies for which the equity method of accounting is used (see Note 1) is shown on a 100 percent basis. The most significant of these affiliates at December 31, 2007, are DuPont Teijin Films, DuPont-Toray Company Ltd. and DuPont-Mitsui, all of which are owned 50 percent by the company. Dividends received from equity affiliates were $88 in 2007, $61 in 2006 and $107 in 2005.

Results of operations	**2007**	**2006**	**2005**
Net sales [1]	$ 3,414	$ 3,491	$ 3,789
Earnings before income taxes	171	205	333
Net income [2]	66	85	207
DuPont's equity in (losses) earnings of affiliates:			
Partnerships-pretax [3]	(19)	3	7
Corporate joint ventures-after tax	54	47	101
Write-down of investment [4]	(165)	-	-
	$ (130)	$ 50	$ 108

1 Includes sales to DuPont of $496 in 2007, $624 in 2006, and $631 in 2005.

2 Includes losses of $25 in 2005 in DuPont Photomasks, Inc., an equity affiliate in which DuPont had approximately a 20 percent ownership interest. DuPont sold its interest in DuPont Photomasks, Inc. in April 2005.

3 Income taxes are reflected in the company's provision for income tax.

4 Impairment charge of $165 to write down the company's investment in a polyester films joint venture in the Performance Materials segment. As a result, at December 31, 2007, DuPont ceased using the equity method of accounting for three legal entities within the joint venture.

Financial position at December 31,	2007	2006
Current assets	$ 1,345	$ 1,376
Noncurrent assets	1,325	1,752
Total assets	2,670	3,128
Short-term borrowings [1]	420	639
Other current liabilities	689	687
Long-term borrowings [1]	82	238
Other long-term liabilities	118	112
Total liabilities	1,309	1,676
DuPont's investment in affiliates (includes advances)	$ 818	$ 803

1 The company's pro rata interest in total borrowings was $246 in 2007 and $432 in 2006, of which $48 in 2007 and $300 in 2006 were guaranteed by the company. These amounts are included in the guarantees disclosed in Note 19.

13. OTHER ASSETS

December 31,	2007	2006
Employee benefits – pension (Note 21)	$ 2,187	$ 1,040
Long-term investments in securities	90	94
Deferred income taxes (Note 6)	1,523	1,430
Miscellaneous	563	455
	$ 4,363	$ 3,019

Included within Long-term investments in securities are securities for which market values are not readily available (cost investments) and securities classified as available-for-sale. The company's cost investments totaled $61 and $73 at December 31, 2007 and 2006, respectively. The company's available for sale securities totaled $29 and $21 at December 31, 2007 and 2006, respectively.

14. ACCOUNTS PAYABLE

December 31,	2007	2006
Trade payables	$ 2,610	$ 2,162
Payables to banks	113	166
Miscellaneous	449	383
	$ 3,172	$ 2,711

Trade payables includes $34 in 2007 and $47 for 2006 due to equity affiliates. Payables to banks represent checks issued on certain disbursement accounts but not presented to the banks for payment. The reported amounts shown above approximate fair value because of the short-term maturity of these obligations.

15. SHORT-TERM BORROWINGS AND CAPITAL LEASE OBLIGATIONS

December 31,	2007	2006
Commercial paper	$ 1,198	$ -
Other loans-various currencies	148	352
Long-term debt payable within one year	21	1,163
Capital lease obligations	3	2
	$ 1,370	$ 1,517

The estimated fair value of the company's short-term borrowings, including interest rate financial instruments, based on quoted market prices for the same or similar issues, or on current rates offered to the company for debt of the same remaining maturities, was $1,400 and $1,500 at December 31, 2007 and 2006, respectively.

Unused bank credit lines were approximately $4,300 and $3,500 at December 31, 2007 and 2006, respectively. These lines are available to support short-term liquidity needs and general corporate purposes including letters of credit. As of December 31, 2007, the company had outstanding letters of credit of $255 supporting commitments made in the ordinary course of business.

The weighted-average interest rate on short-term borrowings outstanding at December 31, 2007 and 2006 was 4.3 and 5.4 percent, respectively.

16. OTHER ACCRUED LIABILITIES

December 31,	2007	2006
Compensation and other employee-related costs	$ 905	$ 796
Deferred revenue	981	817
Employee benefits (Note 21)	427	487
Discounts and rebates	394	374
Miscellaneous	1,116	1,060
	$ 3,823	$ 3,534

Deferred revenue principally includes advance customer payments related to businesses within the Agriculture & Nutrition segment. Miscellaneous other accrued liabilities principally includes accrued plant and operating expenses, accrued litigation costs, employee separation costs in connection with the company's restructuring programs, the estimated fair value of certain guarantees and accrued environmental remediation costs.

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17. LONG-TERM BORROWINGS AND CAPITAL LEASE OBLIGATIONS

December 31,	2007	2006
U.S. dollar:		
Industrial development bonds due 2026-2029 [1]	$ 50	$ 50
Medium-term notes due 2013-2048 [2]	457	454
6.75% notes due 2007 [3,4]	–	485
3.375% notes due 2007 [3,4]	–	395
5.75% notes due 2009	200	200
5.88% notes due 2009	404	408
6.88% notes due 2009 [4]	889	881
4.125% notes due 2010 [4]	914	884
4.75% notes due 2012	400	400
5.00% notes due 2013	748	–
4.875% notes due 2014	497	496
5.25% notes due 2016	598	598
6.50% debentures due 2028	298	298
5.60% notes due 2036	395	395
Other loans (average interest rate of 1.1 percent) [3]	24	30
Foreign currency denominated loans		
Euro loans (average interest rate of 4.7 percent) [3,5]	22	1,034
Other loans (various currencies) [3]	70	154
	5,966	7,162
Less short-term portion of long-term debt	21	1,163
	5,945	5,999
Capital lease obligations	10	14
Total	$ 5,955	$ 6,013

1 Average interest rates on industrial development bonds for December 31, 2007 and 2006, were 6.0 percent.

2 Average interest rates on medium-term notes at December 31, 2007 and 2006, were 5.1 percent and 5.3 percent, respectively.

3 Includes long-term debt due within one year.

4 The company has outstanding interest rate swap agreements with notional amounts totaling $1,150. Over the remaining terms of the notes and debentures, the company will receive fixed payments equivalent to the underlying debt and pay floating payments based on USD LIBOR. The fair value of the swaps was an asset of $19 at December 31, 2007 and a liability of $24 at December 31, 2006.

5 Subsidiary borrowings decreased in 2007 primarily due to the repayment of borrowings used to support the repatriation of foreign subsidiary earnings under AJCA.

Maturities of long-term borrowings are $1,522, $915, $14 and $400 for the years 2009, 2010, 2011 and 2012, respectively, and $3,094 thereafter.

The estimated fair value of the company's long-term borrowings, including interest rate financial instruments, based on quoted market prices for the same or similar issues or on current rates offered to the company for debt of the same remaining maturities, was $6,000 at December 31, 2007 and 2006.

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18. OTHER LIABILITIES

December 31,	2007	2006
Employee benefits		
Accrued other long-term benefit costs (Note 21)	$ 3,481	$ 4,045
Accrued pension benefit costs (Note 21)	1,663	1,844
Accrued environmental remediation costs	273	269
Miscellaneous	1,838	1,534
	$ 7,255	$ 7,692

Miscellaneous includes asset retirement obligations, litigation accruals, tax contingencies, royalty payables and certain obligations related to divested businesses.

19. COMMITMENTS AND CONTINGENT LIABILITIES

Guarantees

Product Warranty Liability

The company warrants that its products meet standard specifications. The company's product warranty liability as of December 31, 2007 and 2006 was $23 and $17, respectively. Estimates for warranty costs are based on historical claims experience.

Indemnifications

In connection with acquisitions and divestitures, the company has indemnified respective parties against certain liabilities that may arise in connection with these transactions and business activities prior to the completion of the transaction. The term of these indemnifications, which typically pertain to environmental, tax and product liabilities, is generally indefinite. In addition, the company indemnifies its duly elected or appointed directors and officers to the fullest extent permitted by Delaware law, against liabilities incurred as a result of their activities for the company, such as adverse judgments relating to litigation matters. If the indemnified party were to incur a liability or have a liability increase as a result of a successful claim, pursuant to the terms of the indemnification, the company would be required to reimburse the indemnified party. The maximum amount of potential future payments is generally unlimited. The carrying amounts recorded for all indemnifications as of December 31, 2007 and 2006 was $101 and $105, respectively. Although it is reasonably possible that future payments may exceed amounts accrued, due to the nature of indemnified items, it is not possible to make a reasonable estimate of the maximum potential loss or range of loss. No assets are held as collateral and no specific recourse provisions exist.

In connection with the sale of INVISTA, the company indemnified the purchasers, subsidiaries of Koch, against certain liabilities primarily related to taxes, legal and environmental matters and other representations and warranties under the Purchase and Sale Agreement. Koch has presented claims under these indemnities which the companies are discussing; however, DuPont disagrees with Koch's presentation. The estimated fair value of the indemnity obligations under the Purchase and Sale Agreement is $70 and is included in the indemnifications balance of $101 at December 31, 2007. The fair value was based on management's best estimate of the value expected to be required to issue the indemnifications in a standalone, arm's length transaction with an unrelated party and, where appropriate, by the utilization of probability weighted discounted net cash flow models. Under the Purchase and Sale Agreement, the company's total indemnification obligation for the majority of the representations and warranties can not exceed $1,400. The other indemnities are not subject to this limit.

Obligations for Equity Affiliates & Others

The company has directly guaranteed various debt obligations under agreements with third parties related to equity affiliates, customers, suppliers and other affiliated and unaffiliated companies. At December 31, 2007, the company had directly guaranteed $583 of such obligations, and $121 relating to guarantees of historical obligations for divested subsidiaries and affiliates. This represents the maximum potential amount of future (undiscounted) payments that the company could be required to make under the guarantees. The company would be required

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to perform on these guarantees in the event of default by the guaranteed party. At December 31, 2007, a liability of $135 had been recorded for these obligations, principally related to obligations of the company's polyester films joint venture which are guaranteed by the company. No additional material loss is anticipated by reason of such agreements and guarantees.

In certain cases, the company has recourse to assets held as collateral, as well as personal guarantees from customers and suppliers. Assuming liquidation, these assets are estimated to cover approximately 37 percent of the $261 of guaranteed obligations of customers and suppliers. Set forth below are the company's guaranteed obligations at December 31, 2007:

	Short-Term	Long-Term	Total
Obligations for customers, suppliers and other affiliated and unaffiliated companies [1,2]:			
Bank borrowings (terms up to 5 years)	$ 379	$ 132	$ 511
Revenue bonds (term 1 year)	1	–	1
Leases on equipment and facilities (terms of 1 to 2 years)	–	23	23
Obligations for equity affiliates [2]:			
Bank borrowings (terms up to 5 years)	15	28	43
Leases on equipment and facilities (terms of 1 to 3 years)	–	5	5
Total obligations for customers, suppliers, other affiliated and unaffiliated companies and equity affiliates	395	188	583
Obligations for divested subsidiaries and affiliates [3]:			
Conoco (terms of 1 to 19 years)	–	18	18
Consolidation Coal Sales Company (terms of 3 to 4 years)	–	103	103
Total obligations for divested subsidiaries and affiliates	–	121	121
	$ 395	$ 309	$ 704

1 Existing guarantees for customers, suppliers and other unaffiliated companies arose as part of contractual agreements.

2 Existing guarantees for equity affiliates and other affiliated companies arose for liquidity needs in normal operations.

3 The company has guaranteed certain obligations and liabilities related to divested subsidiaries, including Conoco and its subsidiaries and affiliates and Consolidation Coal Sales Company. The Restructuring, Transfer and Separation Agreement between DuPont and Conoco requires Conoco to use its best efforts to have Conoco, or any of its subsidiaries, substitute for DuPont. Conoco and Consolidation Coal Sales Company have indemnified the company for any liabilities the company may incur pursuant to these guarantees.

Operating Leases
The company uses various leased facilities and equipment in its operations. The terms for these leased assets vary depending on the lease agreement.

As of December 31, 2007, the company had one master operating lease program relating to short-lived equipment. In connection with this master operating lease program, the company had residual value guarantees in the amount of $104 at December 31, 2007. The guarantee amounts are tied to the unamortized lease values of the assets under the program and are due should the company decide neither to renew nor to exercise its purchase option. At December 31, 2007, the company had no liabilities recorded for these obligations. Any residual value guarantee amounts paid to the lessor may be recovered by the company from the sale of the assets to a third party.

Future minimum lease payments (including residual value guarantee amounts) under noncancelable operating leases are $328, $179, $145, $118 and $91 for the years 2008, 2009, 2010, 2011 and 2012 respectively, and $159 for subsequent years and are not reduced by noncancelable minimum sublease rentals due in the future in the amount of $12. Net rental expense under operating leases was $322 in 2007, $282 in 2006, and $265 in 2005.

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Asset Retirement Obligations
The company has recorded asset retirement obligations primarily associated with closure, reclamation and removal costs for mining operations related to the production of titanium dioxide in Coatings & Color Technologies. The company's asset retirement obligation liabilities were $62 at December 31, 2007 and 2006.

Litigation
Benlate®
In 1991, DuPont began receiving claims by growers that use of Benlate® 50 DF fungicide had caused crop damage. DuPont has since been served with thousands of lawsuits, most of which have been disposed of through trial, dismissal or settlement. The status of Benlate® cases is indicated in the table below:

	Number of Cases
Balance at January 1, 2005	93
Filed	–
Resolved	(30)
Balance at December 31, 2005	63
Filed	–
Resolved	(3)
Balance at December 31, 2006	60
Reinstated	2
Resolved	(48)
Balance at December 31, 2007	14

At December 31, 2007, there were nine cases pending in Florida state court, involving allegations that Benlate® caused crop damage. Plaintiffs appealed the court's 2006 dismissal of one of the nine cases for failure to prosecute. Two of the nine cases, involving twenty-seven Costa Rican fern growers, were tried during the second quarter of 2006 resulting in a $56 judgment against the company, which was reduced to $24 on DuPont's motion. At trial, the plaintiffs sought damages in the range of $270 to $400. The plaintiffs and DuPont have appealed the verdict. DuPont believes that the appeal will be resolved in its favor and, therefore, has not established a reserve relating to the judgment.

At December 31, 2007, there was one case pending in Florida and one in Hawaii in which the plaintiffs seek to reopen settlements with the company by alleging that it committed fraud and misconduct, as well as violations of federal and state racketeering laws. In October 2007, the appeals court entered an order precluding the judge from taking further action effectively dismissing the case pending in Florida. Plaintiffs are seeking a discretionary review by the Florida Supreme Court. In 2005, the case pending in Hawaii was settled in part for $1.2. In November 2007, the Hawaii Supreme Court affirmed the state court's dismissal of the remainder of the case. However, plaintiffs may seek review by the U.S. Supreme Court. During the second quarter 2007, the company settled five cases that were pending in Hawaii for $8.5. During the first quarter 2007, the dismissal of the sixteen reopener cases pending in Florida was affirmed and the cases were closed.

At September 30, 2007, there were two cases pending in Delaware state court, involving allegations that Benlate® caused birth defects to children exposed in utero. In the fourth quarter 2007, the court approved and finalized the settlement of $9 with the six plaintiffs in these two cases as well as twenty-six other claimants represented by the same attorney. DuPont paid the settlement in the fourth quarter 2007 although one parent has appealed the court's order approving the settlement in one of the cases. Therefore, at December 31, 2007, one of the cases was still pending.

At December 31, 2007, there were two shrimp cases in Florida pending against the company. These cases had been decided in DuPont's favor, but in September 2007, the judge granted plaintiffs' motion for new trial thus reinstating the cases. The company has appealed. The twenty-six other cases involving damage to shrimp pending against the

company in state court in Florida were settled for $2.5 during the second quarter 2007. Separately, plaintiffs filed a motion seeking sanctions for alleged discovery defaults in all twenty-eight of the cases. The court denied most of the sanctions sought by plaintiffs, but did impose on DuPont the reasonable and necessary attorney fees incurred by plaintiffs in moving for sanctions.

The company does not believe that Benlate® caused the damages alleged in each of these cases and denies the allegations of fraud and misconduct. The company continues to defend itself in ongoing matters. As of December 31, 2007, the company has incurred costs and expenses of approximately $2 billion associated with these matters. The company has recovered approximately $275 of its costs and expenses through insurance and does not expect additional insurance recoveries, if any, to be significant. At December 31, 2007, the company does not have any remaining accruals related to Benlate®.

PFOA

Environmental Actions Involving the Washington Works Site and Surrounding Area

In November 2006, DuPont entered into an Order on Consent under the Safe Drinking Water Act (SDWA) with the U.S. Environmental Protection Agency (EPA) establishing a precautionary interim screening level for PFOA (collectively, perfluorooctanoic acids and its salts, including the ammonium salt) of 0.5 parts per billion (ppb) in drinking water sources in the area around the DuPont Washington Works site located in Parkersburg, West Virginia. As part of the Order on Consent, DuPont conducted a two-part survey and performed sampling and analytical testing of certain public and private water systems in the area. DuPont is required under the agreement to offer to install water treatment systems or an EPA-approved alternative if PFOA levels are detected at or above 0.5 ppb. PFOA was detected at levels above 0.5 ppb in twenty-seven private water wells, so the company is providing alternative or treated water to these homes.

In late 2005 DuPont and the EPA entered into a Memorandum of Understanding (EPA MOU) that requires DuPont to monitor PFOA in the soil, air, water and biota around the Washington Works site. At December 31, 2007, DuPont has accruals of about $0.6 to fund its activities under the EPA MOU and Order on Consent.

EPA Administrative Complaints

In July and December 2004, the EPA filed administrative complaints against DuPont alleging that the company failed to comply with the technical reporting requirements of the Toxic Substances Control Act (TSCA) and the Resource Conservation and Recovery Act (RCRA) regarding PFOA. Under a 2005 agreement settling the matter, the company paid civil fines of $10.25 and will complete two Supplemental Environmental Projects at a total cost of $6.25.

Actions: Drinking Water

In August 2001, a class action, captioned Leach v. DuPont, was filed in West Virginia state court against DuPont and the Lubeck Public Service District. DuPont uses PFOA as a processing aid to manufacture fluoropolymer resins and dispersions at various sites around the world including its Washington Works plant in West Virginia. The complaint alleged that residents living near the Washington Works facility had suffered, or may suffer, deleterious health effects from exposure to PFOA in drinking water. The relief sought included damages for medical monitoring, diminution of property values and punitive damages plus injunctive relief to stop releases of PFOA. DuPont and attorneys for the class reached a settlement agreement in 2004 and as a result, the company established accruals of $108 in 2004. The agreement was approved by the Wood County Circuit Court on February 28, 2005 after a fairness hearing. The settlement binds a class of approximately 80,000 residents. As defined by the court, the class includes those individuals who have consumed, for at least one year, water containing 0.05 ppb or greater of PFOA from any of six designated public water sources or from sole source private wells.

In July 2005, the company paid the plaintiffs' attorneys' fees and expenses of $23 and made a payment of $70, which class counsel has designated to fund a community health project. The company is also funding a series of health studies by an independent science panel of experts in the communities exposed to PFOA to evaluate available scientific evidence on whether any probable link exists between exposure to PFOA and human disease. The independent science panel health studies are estimated to cost approximately $20, of which $5 was originally placed in an interest-bearing escrow account. At present, the expected timeframe to complete the studies is three to five years. In addition, the company is providing state-of-the art water treatment systems designed to reduce the level of

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PFOA in water to six area water districts, including the Little Hocking Water Association (LHWA), until the science panel determines that PFOA does not cause disease or until applicable water standards can be met without such treatment. The estimated cost of constructing, operating and maintaining these systems is about $20 of which $10 was originally placed in an interest-bearing escrow account. In the fourth quarter 2007, the water treatment system for the LHWA was brought online. At December 31, 2007, the reserve balance relating to the funding of the independent science panel health study and the water treatment systems was $21, including $6 in interest bearing escrow accounts.

The settlement resulted in the dismissal of all claims asserted in the lawsuit except for personal injury claims. If the independent science panel concludes that no probable link exists between exposure to PFOA and any diseases, then the settlement would also resolve personal injury claims. If it concludes that a probable link does exist between exposure to PFOA and any diseases, then DuPont would also fund up to $235 for a medical monitoring program to pay for such medical testing. In this event, plaintiffs would retain their right to pursue personal injury claims. All other claims in the lawsuit would remain dismissed by the settlement. DuPont believes that it is remote that the panel will find a probable link. Therefore, at December 31, 2007, the company had not established any accruals related to medical monitoring or personal injury claims. However, there can be no assurance as to what the independent science panel will conclude.

In June 2007, the LHWA notified DuPont that it intends to file suit under RCRA alleging "imminent and substantial endangerment to health and or the environment" based on detection of PFOA in its wells. DuPont denies any such endangerment exists and intends to vigorously defend itself if a lawsuit is filed.

In September 2007, LHWA refiled the suit it originally filed in Ohio state court and voluntarily dismissed in 2006. The suit claims that perfluorinated compounds, including PFOA, allegedly released from the Washington Works plant contaminated LHWA's well fields and underlying aquifer. LHWA's complaint seeks a variety of relief including compensatory and punitive damages, and an injunction requiring DuPont to provide a new "pristine" well field and the infrastructure to deliver it.

In the second quarter 2006, three purported class actions were filed alleging that drinking water had been contaminated by PFOA in excess of 0.05 ppb due to alleged releases from certain DuPont plants. One of these cases was filed in West Virginia state court on behalf of customers of the Parkersburg City Water District, but was removed on DuPont's motion to the U.S. District Court for the Southern District of West Virginia. The other two purported class actions were filed in New Jersey. One was filed in federal court on behalf of individuals who allegedly drank water contaminated by releases from DuPont's Chambers Works plant in Deepwater, New Jersey. The second was filed in state court on behalf of customers serviced primarily by the Pennsville Township Water Department and was removed to New Jersey federal district court on DuPont's motion. The New Jersey cases have been combined for purposes of discovery and the complaints have been amended to allege that drinking water had been contaminated by PFOA in excess of 0.04 ppb. The company intends to defend itself vigorously against these lawsuits alleging contamination of drinking water sources.

While DuPont believes that it is reasonably possible that it could incur losses related to PFOA matters in addition to those matters discussed above for which it has established accruals, a range of such losses, if any, cannot be reasonably estimated at this time.

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Consumer Products Class Actions

	Number of Cases
Balance at January 1, 2005	–
Filed	15
Resolved	–
Balance at December 31, 2005	15
Filed	7
Resolved	–
Balance at December 31, 2006	22
Filed	1
Resolved	–
Balance at December 31, 2007	23

As of December 31, 2007, twenty-three intrastate class actions have been filed on behalf of consumers who have purchased cookware with Teflon® non-stick coating in federal district courts against DuPont. The actions were filed on behalf of consumers in Colorado, Connecticut, Delaware, the District of Columbia, Florida, Illinois, Indiana, Iowa, Kentucky, Massachusetts, Michigan, Missouri, New Jersey, New Mexico, New York, Ohio, Oklahoma, Pennsylvania, South Carolina, Texas and West Virginia. Two of the 23 actions were filed in California. By order of the Judicial Panel on Multidistrict Litigation, all of these actions have been combined for coordinated and consolidated pre-trial proceedings in federal district court for the Southern District of Iowa. Under the court's latest case management order, a ruling on whether these cases can proceed as class actions is expected in 2008.

The actions allege that DuPont violated state laws by engaging in deceptive and unfair trade practices by failing "to disclose to consumers that products containing Teflon® were or are potentially harmful to consumers" and that DuPont has liability based on state law theories of negligence and strict liability. The actions allege that Teflon® contained or released harmful and dangerous substances; including a chemical (PFOA) alleged to have been determined to be "likely" to cause cancer in humans. The actions seek unspecified monetary damages for consumers who purchased cooking products containing Teflon®, as well as the creation of funds for medical monitoring and independent scientific research, attorneys' fees and other relief. In December 2005, a motion was filed by a single named plaintiff in the Superior Court for the Province of Quebec, Canada seeking authorization to institute a class action on behalf of all Quebec consumers who have purchased or used kitchen items, household appliances or food-packaging containing Teflon® or Zonyl® non-stick coatings. A ruling on this motion is expected from the Court in 2008. Damages are not quantified, but are alleged to include the cost of replacement products as well as one hundred dollars per class member as exemplary damages.

The company believes that the twenty-three class actions and the motion filed in Quebec are without merit and, therefore, believes it is remote that it will incur losses related to these actions. At December 31, 2007, the company had not established any accruals related to these matters.

Elastomers Antitrust Matters
Since 2002, the U.S., European Union (EU) and Canadian antitrust authorities have investigated the synthetic rubber markets for possible violations. These investigations included DuPont Dow Elastomers, LLC (DDE), as a result of its participation in the polychloroprene (PCP) and ethylene propylene diene monomer (EPDM) markets. DDE was a joint venture between The Dow Chemical Company (Dow) and DuPont.

In April 2004, DuPont and Dow entered into a series of agreements under which DuPont obtained complete control over directing DDE's response to these investigations and the related litigation and DuPont agreed to a disproportionate share of the venture's liabilities and costs related to these matters. Consequently, DuPont bears any potential liabilities and costs up to the initial $150. Dow is obligated to indemnify DuPont for up to $72.5 by paying 15 to 30 percent toward liabilities and costs in excess of $150. On June 30, 2005, DDE became a

wholly owned subsidiary of DuPont and was renamed DuPont Performance Elastomers LLC (DPE). In July 2007, DPE pled guilty to conspiring to fix prices and paid a fine of CDN $4, approximately $3.8 USD, resolving all criminal antitrust allegations against it related to PCP in Canada.

In late March 2007, the EU antitrust authorities issued a Statement of Objections that makes antitrust allegations regarding the PCP market against DPE, relating to the joint venture's activities, and DuPont, to which both have responded. In December 2007, the EU antitrust authorities issued their decision, including the imposition of fines against DPE, Dow and DuPont totaling EURO 59.25 (approximately $87 USD). The company will seek appellate review.

DDE resolved all criminal antitrust allegations against it related to PCP in the U.S. through a plea agreement with the DOJ in January 2005 which was approved by the court on March 29, 2005. The agreement requires the subsidiary to pay a fine of $84 which, at its election, is being paid in six equal, annual installments. The annual installment payments for 2005, 2006 and 2007 have been made. The agreement also requires the subsidiary to provide ongoing cooperation with the DOJ's investigation.

As a result of its April 2004 agreements with Dow, DuPont established accruals in 2004 of $268 and increased its accruals by $65 in the first quarter 2007. As a result of the EU decision in the fourth quarter 2007, the company reversed $44 of its accruals related to this matter. At December 31, 2007, the company has accruals of approximately $130 related to this matter and a receivable of $17 for the amount it expects to be reimbursed by Dow.

Spelter, West Virginia
In September 2006, a West Virginia state court certified a class action against DuPont that seeks relief including the provision of remediation services and property value diminution damages for 7,000 residential properties in the vicinity of a closed zinc smelter in Spelter, West Virginia. The action also seeks medical monitoring for an undetermined number of residents in the class area. The smelter was owned and operated by at least three companies between 1910 and 2001, including DuPont between 1928 and 1950. DuPont performed remedial measures at the request of the EPA in the late 1990's and in 2001 repurchased the site to facilitate and complete the remediation. The October 2007 trial was conducted in four phases: liability, medical monitoring, property and punitive damages. The jury found against DuPont in all four phases awarding $55.5 for property remediation and $196.2 in punitive damages. No specific amount was awarded in the medical monitoring phase although in post trial motions, plaintiffs estimate medical monitoring at $130. Also, in post trial motions, plaintiffs' attorneys seek legal fees equivalent to one-third of the total award plus $8 in expenses. The company believes it has a strong basis for appeal and will seek the right to appeal all four phases. As of December 31, 2007, the company had recorded accruals of $55, although given the uncertainties inherent in litigation, there can be no assurance as to the final outcome.

General
The company is subject to various lawsuits and claims arising out of the normal course of its business. These lawsuits and claims include actions based on alleged exposures to products, intellectual property and environmental matters and contract and antitrust claims. Management has noted a nationwide trend in purported class actions against chemical manufacturers generally seeking relief such as medical monitoring, property damages, off-site remediation and punitive damages arising from alleged environmental torts without claiming present personal injuries. Such cases may allege contamination from unregulated substances or remediated sites. Although it is not possible to predict the outcome of these various lawsuits and claims, management does not anticipate they will have a material adverse effect on the company's consolidated financial position or liquidity. However, the ultimate liabilities may be significant to results of operations in the period recognized. The company accrues for contingencies when the information available indicates that it is probable that a liability has been incurred and the amount of the liability can be reasonably estimated.

Environmental
The company is also subject to contingencies pursuant to environmental laws and regulations that in the future may require the company to take further action to correct the effects on the environment of prior disposal practices or releases of chemical or petroleum substances by the company or other parties. The company accrues for

environmental remediation activities consistent with the policy set forth in Note 1. Much of this liability results from the Comprehensive Environmental Response, Compensation and Liability Act (CERCLA, often referred to as Superfund), the Resource Conservation and Recovery Act (RCRA) and similar state laws. These laws require the company to undertake certain investigative and remedial activities at sites where the company conducts or once conducted operations or at sites where company-generated waste was disposed. The accrual also includes estimated costs related to a number of sites identified by the company for which it is probable that environmental remediation will be required, but which are not currently the subject of CERCLA, RCRA or state enforcement activities.

Remediation activities vary substantially in duration and cost from site to site. These activities, and their associated costs, depend on the mix of unique site characteristics, evolving remediation technologies, diverse regulatory agencies and enforcement policies, as well as the presence or absence of potentially responsible parties. At December 31, 2007 and 2006, the Consolidated Balance Sheet included a liability of $357 and $349, respectively, relating to these matters and, in management's opinion, is appropriate based on existing facts and circumstances. The average time frame, over which the accrued or presently unrecognized amounts may be paid, based on past history, is estimated to be 15–20 years. Considerable uncertainty exists with respect to these costs and, under adverse changes in circumstances, potential liability may range up to two to three times the amount accrued as of December 31, 2007.

Other
The company has various purchase commitments incident to the ordinary conduct of business. In the aggregate, such commitments are not at prices in excess of current market.

20. STOCKHOLDERS' EQUITY

The company's Board of Directors authorized a $2 billion share buyback plan in June 2001. During 2007 and 2006, there were no purchases of stock under this program. During 2005, the company purchased and retired 9.9 million shares at a total cost of $505. As of December 31, 2007, the company has purchased 20.5 million shares at a total cost of $962. Management has not established a timeline for the buyback of the remaining stock under this plan.

In addition to the plan described above, in October 2005 the Board of Directors authorized a $5 billion share buyback plan. The company entered into an accelerated share repurchase agreement with Goldman Sachs & Co. (Goldman Sachs) under which the company purchased and retired 75.7 million shares of DuPont's outstanding common stock from Goldman Sachs on October 27, 2005 at a price of $39.62 per share, with Goldman Sachs purchasing an equivalent number of shares in the open market over the following nine-month period.

On July 27, 2006, Goldman Sachs completed its purchase of 75.7 million shares of DuPont's common stock at a volume weighted average price (VWAP) of $41.99 per share. Upon the conclusion of the agreement in 2006, the company paid $180 in cash to Goldman Sachs to settle the agreement. The final settlement price was based upon the difference between the VWAP per share for the nine-month period, which ended July 27, 2006, and the purchase price of $39.62 per share. The amount paid to settle the contract was recorded as a reduction to Additional paid-in capital during the third quarter 2006. In addition, the company made open market purchases of its shares in the third quarter 2006 for $100 at an average price of $42.27 per share.

During 2007, the company paid $1.7 billion to purchase and immediately retire 34.7 million shares at an average price of $48.85 per share. As of December 31, 2007, the company has completed the $5 billion share buyback plan with the purchase and retirement of 112.8 million shares at an average price of $44.33 per share.

Common stock held in treasury is recorded at cost. When retired, the excess of the cost of treasury stock over its par value is allocated between Reinvested earnings and Additional paid-in capital.

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Set forth below is a reconciliation of common stock share activity for the three years ended December 31, 2007:

Shares of common stock	Issued	Held In Treasury
Balance January 1, 2005	1,081,382,000	(87,041,000)
Issued	10,934,000	–
Repurchased	–	(85,664,000)
Retired	(85,664,000)	85,664,000
Balance December 31, 2005	1,006,652,000	(87,041,000)
Issued	4,823,000	–
Repurchased	–	(2,366,000)
Retired	(2,366,000)	2,366,000
Balance December 31, 2006	1,009,109,000	(87,041,000)
Issued	11,916,000	–
Repurchased	–	(34,695,000)
Retired	(34,695,000)	34,695,000
Balance December 31, 2007	986,330,000	(87,041,000)

The pretax, tax and after-tax effects of the components of Other comprehensive income / (loss) are shown below:

	Pretax	Tax	After-tax
2007			
Cumulative translation adjustment	$ 94	$ –	$ 94
Net revaluation and clearance of cash flow hedges to earnings	39	(15)	24
Pension benefits (Note 21)	1,028	(388)	640
Other benefits (Note 21)	478	(168)	310
Net unrealized gains on securities	7	(2)	5
Other comprehensive income	$ 1,646	$ (573)	$ 1,073
2006			
Cumulative translation adjustment	$ 77	$ –	$ 77
Net revaluation and clearance of cash flow hedges to earnings	24	(9)	15
Minimum pension liability adjustment	160	(54)	106
Net unrealized gains on securities	11	(3)	8
Other comprehensive income	$ 272	$ (66)	$ 206
2005			
Cumulative translation adjustment	$ (109)	$ –	$ (109)
Net revaluation and clearance of cash flow hedges to earnings	(3)	1	(2)
Minimum pension liability adjustment	7	20	27
Net unrealized losses on securities	(17)	6	(11)
Other comprehensive loss	$ (122)	$ 27	$ (95)

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Balances of related after-tax components comprising Accumulated other comprehensive loss are summarized below:

December 31,	2007	2006	2005
Cumulative translation adjustment	$ 250	$ 156	$ 79
Net revaluation and clearance of cash flow hedges to earnings	41	17	2
Minimum pension liability adjustment	–	–	(594)
Net unrealized gains/(losses) on securities	8	3	(5)
Pension benefits			
Net gains/(losses)	(1,395)	(2,022)	–
Net prior service cost	(117)	(130)	–
Other benefits			
Net gains/(losses)	(307)	(720)	–
Net prior service benefit	726	829	–
	$ (794)	$ (1,867)	$ (518)

21. EMPLOYEE BENEFITS

The company offers various long-term benefits to its employees. Where permitted by applicable law, the company reserves the right to change, modify or discontinue the plans.

Defined Benefit Pensions
The company has both funded and unfunded noncontributory defined benefit pension plans covering substantially all U.S. employees. The benefits under these plans are based primarily on years of service and employees' pay near retirement. The company's funding policy is consistent with the funding requirements of federal laws and regulations.

Pension coverage for employees of the company's non-U.S. consolidated subsidiaries is provided, to the extent deemed appropriate, through separate plans. Obligations under such plans are funded by depositing funds with trustees, under insurance policies, or remain unfunded.

Other Long-term Employee Benefits
The parent company and certain subsidiaries provide medical, dental and life insurance benefits to pensioners and survivors, and disability and life insurance protection to employees. The associated plans for retiree benefits are unfunded and the cost of the approved claims is paid from company funds. Essentially all of the cost and liabilities for these retiree benefit plans are attributable to the U.S. parent company plans. The retiree medical plan is contributory with pensioners and survivors' contributions adjusted annually to achieve a 50/50 target sharing of cost increases between the company and pensioners and survivors. In addition, limits are applied to the company's portion of the retiree medical cost coverage.

Employee life insurance and disability benefit plans are insured in many countries. However, primarily in the U.S., such plans are generally self-insured or are fully experience-rated. Obligations and expenses for self-insured and fully experience-rated plans are reflected in the figures below.

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Summarized information on the company's pension and other long-term employee benefit plans is as follows:

	Pension Benefits		Other Benefits	
Obligations and Funded Status at December 31,	**2007**	**2006**	**2007**	**2006**
Change in benefit obligation				
Benefit obligation at beginning of year	$ 22,849	$ 22,935	$ 4,396	$ 4,224
Service cost	383	388	34	33
Interest cost	1,228	1,192	242	222
Plan participants' contributions	13	9	149	146
Actuarial loss (gain)	(728)	(244)	(565)	252
Benefits paid	(1,544)	(1,506)	(464)	(481)
Amendments	–	(1)	2	–
Net effects of acquisitions/divestitures	5	76	2	–
Benefit obligation at end of year	$ 22,206	$ 22,849	$ 3,796	$ 4,396
Change in plan assets				
Fair value of plan assets at beginning of year	$ 21,909	$ 19,792	$ –	$ –
Actual gain on plan assets	1,963	3,306	–	–
Employer contributions	277	280	315	335
Plan participants' contributions	13	9	149	146
Benefits paid	(1,544)	(1,506)	(464)	(481)
Net effects of acquisitions/divestitures	–	28	–	–
Fair value of plan assets at end of year	$ 22,618	$ 21,909	$ –	$ –
Funded status				
U.S. plans with plan assets	$ 2,061	$ 892	$ –	$ –
Non-U.S. plans with plan assets	(90)	(317)	–	–
All other plans	(1,559) [1]	(1,515) [1]	(3,796)	(4,396)
Total	$ 412	$ (940)	$ (3,796)	$ (4,396)
Amounts recognized in the Consolidated Balance Sheet consist of:				
Other assets (Note 13)	$ 2,187	$ 1,040	$ –	$ –
Other accrued liabilities (Note 16)	(112)	(136)	(315)	(351)
Other liabilities (Note 18)	(1,663)	(1,844)	(3,481)	(4,045)
Net amount recognized	$ 412	$ (940)	$ (3,796)	$ (4,396)

1 Includes pension plans maintained around the world where funding is not permissible or customary.

The pretax amounts recognized in Accumulated other comprehensive loss are summarized below:

	Pension Benefits		Other Benefits	
December 31,	**2007**	**2006**	**2007**	**2006**
Net loss	$ 2,060	$ 3,070	$ 475	$ 1,111
Prior service cost / (benefit)	162	181	(1,118)	(1,276)
	$ 2,222	$ 3,251	$ (643)	$ (165)

The accumulated benefit obligation for all pension plans was $20,404 and $20,880 at December 31, 2007, and 2006, respectively.

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Information for pension plans with projected benefit obligation in excess of plan assets	2007	2006
Projected benefit obligation	$ 3,183	$ 4,630
Accumulated benefit obligation	2,829	4,140
Fair value of plan assets	1,408	2,650

Information for pension plans with accumulated benefit obligations in excess of plan assets	2007	2006
Projected benefit obligation	$ 2,463	$ 4,018
Accumulated benefit obligation	2,256	3,691
Fair value of plan assets	737	2,113

Components of net periodic benefit cost (credit) and amounts recognized in other comprehensive income	Pension Benefits		
Net periodic benefit cost	2007	2006	2005
Service cost	$ 383	$ 388	$ 349
Interest cost	1,228	1,192	1,160
Expected return on plan assets	(1,800)	(1,648)	(1,416)
Amortization of loss	117	227	303
Amortization of prior service cost	18	29	37
Curtailment/settlement (gain) loss	–	3	(1)
Net periodic benefit cost	$ (54)	$ 191	$ 432
Changes in plan assets and benefit obligations recognized in other comprehensive income			
Net gain	(893)	–	–
Amortization of loss	(117)	–	–
Amortization of prior service cost	(18)	–	–
Total recognized in other comprehensive income	$ (1,028)	$ –	$ –
Total recognized in net periodic benefit cost and other comprehensive income	$ (1,082)	$ 191	$ 432

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Components of net periodic benefit cost (credit) and amounts recognized in other comprehensive income	Other Benefits 2007	2006	2005
Net periodic benefit cost			
Service cost	$ 34	$ 33	$ 33
Interest cost	242	222	269
Amortization of loss	72	56	90
Amortization of prior service benefit	(156)	(156)	(155)
Net periodic benefit cost	$ 192	$ 155	$ 237
Changes in plan assets and benefit obligations recognized in other comprehensive income			
Net gain	$ (564)	$ –	$ –
Amortization of loss	(72)	–	–
Prior service cost	2	–	–
Amortization of prior service benefit	156	–	–
Total recognized in other comprehensive income	$ (478)	$ –	$ –
Total recognized in net periodic benefit cost and other comprehensive income	$ (286)	$ 155	$ 237

The estimated pretax net loss and prior service cost for the defined benefit pension plans that will be amortized from Accumulated other comprehensive loss into net periodic benefit cost during 2008 are $57 and $18, respectively. The estimated pretax net loss and prior service credit for the other long-term employee benefit plans that will be amortized from Accumulated other comprehensive loss into net periodic benefit cost during 2008 are $32 and $(106), respectively.

Weighted-average assumptions used to determine benefit obligations at December 31,	Pension Benefits 2007	2006	Other Benefits 2007	2006
Discount rate	6.01%	5.56%	6.25%	5.75%
Rate of compensation increase	4.28%	4.32%	4.50%	4.50%

Weighted-average assumptions used to determine net periodic benefit cost for the years ended December 31,	Pension Benefits 2007	2006	Other Benefits 2007	2006
Discount rate	5.56%	5.43%	5.75%	5.50%
Expected return on plan assets	8.74%	8.74%	–	–
Rate of compensation increase	4.32%	4.31%	4.50%	4.50%

The discount rate and the rate of compensation increase used to determine the benefit obligation in the U.S. were 6.25 percent and 4.50 percent, respectively, for 2007, and 5.75 percent and 4.50 percent, respectively, for 2006. For determining U.S. plans' net periodic benefit costs, the discount rate, expected return on plan assets and the rate of compensation increase were 5.75 percent, 9.00 percent and 4.50 percent for 2007, and 5.50 percent, 9.00 percent and 4.50 percent for 2006. The discount rate for determining the principal U.S. pension plan's Net periodic benefit cost was increased to 6.00 percent as of August 31, 2006 due to remeasurement.

In August 2006, the company announced major changes to its principal U.S. pension plan. Effective January 1, 2008, covered full service employees on the rolls as of December 31, 2006 will continue to accrue benefits in the principal U.S. pension plan, but at a reduced rate of about one-third of its previous level. In addition, company-paid

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postretirement survivor benefits for these employees will not continue to grow after December 31, 2007. Covered employees hired after December 31, 2006 will not participate in the principal U.S. pension plan. As a result of this plan amendment, the company was required to remeasure its pension expense for the remainder of 2006, reflecting plan assets and benefit obligations as of the remeasurement date. Better than expected return on plan assets and a higher discount rate of 6.00 percent decreased pretax pension expense for 2006 by $72. For 2007, the plan amendment resulted in a reduction in pretax pension expense of about $40.

The company utilizes published long-term high quality corporate bond indices to determine the discount rate at measurement date. Where commonly available, the company considers indices of various durations to reflect the timing of future benefit payments.

The long-term rate of return on assets in the U.S. was selected from within the reasonable range of rates determined by (a) historical real returns (net of inflation) for the asset classes covered by the investment policy and (b) projections of inflation over the long-term period during which benefits are payable to plan participants. For non-U.S. plans, assumptions reflect economic assumptions applicable to each country.

Assumed health care cost trend rates at December 31,	**2007**	**2006**
Health care cost trend rate assumed for next year	9%	10%
Rate to which the cost trend rate is assumed to decline (the ultimate trend rate)	5%	5%
Year that the rate reaches the ultimate trend rate	2012	2012

Assumed health care cost trend rates have a modest effect on the amount reported for the health care plan. A one-percentage point change in assumed health care cost trend rates would have the following effects:

	1-Percentage Point Increase	**1-Percentage Point Decrease**
Effect on total of service and interest cost	$ 6	$ (4)
Effect on postretirement benefit obligation	83	(57)

Plan Assets
The strategic asset allocation targets of the company's pension plans as of December 31, 2007, and the weighted average asset allocation of these plans at December 31, 2007, and 2006, by asset category were as follows:

		Plan Assets at December 31,	
Asset Category	**Strategic Target**	**2007**	**2006**
Equity securities	57%	55%	57%
Debt securities	30%	30%	29%
Real estate	5%	5%	5%
Other *	8%	10%	9%
Total	100%	100%	100%

* Mainly private equity and private debt.

Essentially all pension plan assets in the U.S. are invested through a single master trust fund. The strategic asset allocation for this trust fund is selected by management, reflecting the results of comprehensive asset liability modeling. The general principles guiding investment of U.S. pension assets are those embodied in the Employee Retirement Income Security Act of 1974 (ERISA). These principles include discharging the company's investment responsibilities for the exclusive benefit of plan participants and in accordance with the "prudent expert" standard and other ERISA rules and regulations. The company establishes strategic asset allocation percentage targets and appropriate benchmarks for significant asset classes with the aim of achieving a prudent balance between return

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and risk. Strategic asset allocations in other countries are selected in accordance with the laws and practices of those countries. Where appropriate, asset liability studies are utilized in this process. U.S. plan assets and a significant portion of non-U.S. plan assets are managed by investment professionals employed by the company. The remaining assets are managed by professional investment firms unrelated to the company. The company's pension investment professionals have discretion to manage the assets within established asset allocation ranges approved by senior management of the company. Plans invest in securities from a variety of countries to take advantage of the investment opportunities that a global portfolio presents and to increase portfolio diversification. Additionally, pension trust funds are permitted to enter into certain contractual arrangements generally described as "derivatives." Derivatives are primarily used to reduce specific market risks, hedge currency and adjust portfolio duration and asset allocation in a cost-effective manner.

The company's pension plans directly held $440 (2 percent of total plan assets) and $486 (2 percent of total plan assets) of DuPont common stock at December 31, 2007 and 2006, respectively.

Cash Flow
Contributions
In 2007, the company contributed $277 to its pension plans. No contributions were required or made to the principal U.S. pension plan trust fund in 2007 and no contributions are required or expected to be made to this Plan in 2008. The company will continue to monitor asset values during the year. The Pension Protection Act of 2006 (the "Act") was signed into law in the U.S. in August 2006. The Act introduced new funding requirements for single-employer defined benefit pension plans, provided guidelines for measuring pension plan assets and pension obligations for funding purposes, introduced benefit limitations for certain underfunded plans and raised tax deduction limits for contributions to retirement plans. The new funding requirements are generally effective for plan years beginning after December 31, 2007. The company does not anticipate that the Act will have a material impact on its required contributions. The company expects to contribute approximately $250 in 2008 to its pension plans other than the principal U.S. pension plan and also expects to make cash payments of $315 in 2008 under its other long-term employee benefit plans.

In 2006, the company made contributions of $280 to its pension plans. No contributions were required or made to the principal U.S. pension plan trust fund in 2006. In 2005, the company made contributions of $1,253 to its pension plans, including a $1,000 contribution to its principal U.S. pension plan.

Estimated Future Benefit Payments
The following benefit payments, which reflect future service, as appropriate, are expected to be paid:

	Pension Benefits	Other Benefits
2008	$ 1,525	$ 315
2009	1,507	311
2010	1,493	306
2011	1,500	297
2012	1,500	292
Years 2013 – 2017	7,690	1,382

Defined Contribution Plan
The company sponsors several defined contribution plans, which cover substantially all U.S. employees. The most significant is The Savings and Investment Plan (the Plan). This Plan includes a non-leveraged Employee Stock Ownership Plan (ESOP). Employees are not required to participate in the ESOP and those who do are free to diversify out of the ESOP. The purpose of the Plan is to provide additional retirement savings benefits for employees and to provide employees an opportunity to become stockholders of the company. The Plan is a tax qualified contributory profit sharing plan, with cash or deferred arrangement and any eligible employee of the company may participate. The company contributed an amount equal to 50 percent of the first 6 percent of the employee's

contribution election. As part of the retirement plan changes in August 2006, the defined contribution benefits for most U.S. parent company employees are in transition. Effective January 1, 2007, for employees hired on that date or thereafter and effective January 1, 2008, for active employees as of December 31, 2006, the company will contribute 100 percent of the first 6 percent of the employee's contribution election and also contribute 3 percent of each eligible employee's eligible compensation regardless of the employee's contribution. In addition, the definition of eligible compensation has been expanded to be similar to the definition of eligible compensation in the pension plan.

The company's contributions to the U.S. parent company's defined contribution plans were $57, $52 and $51 for the years ended December 31, 2007, 2006 and 2005, respectively. The company's matching contributions vest immediately upon contribution. The 3 percent automatic company contribution also vests immediately for employees with at least three-years of service. In addition, the company made contributions of $42, $34 and $30 for the years ended December 31, 2007, 2006 and 2005, respectively, to other defined contribution plans. The company expects to contribute about $230 to its defined contribution plans in 2008.

22. COMPENSATION PLANS

Effective January 1, 2006, the company adopted SFAS 123R using the modified prospective application transition method. Because the company adopted the fair value recognition provisions of SFAS 123, as amended, prospectively on January 1, 2003, the adoption of SFAS 123R did not have a material impact on the company's financial position or results of operations. Prior to adoption of SFAS 123R, the nominal vesting approach was followed for all awards. Upon adoption of SFAS 123R on January 1, 2006, the company began expensing new stock-based compensation awards using a non-substantive approach, under which compensation costs are recognized over at least six months for awards granted to employees who are retirement eligible at the date of the grant or would become retirement eligible during the vesting period of the grant. Using the non-substantive vesting approach in lieu of the nominal vesting approach would not have had a material impact on the company's results of operations. Prior to the adoption of SFAS 123R, the company reported the tax benefit of stock option exercises as operating cash flows. Upon the adoption of SFAS 123R, tax benefits resulting from tax deductions in excess of compensation cost recognized for those options or restricted stock units are reported as financing cash flows.

The total stock-based compensation cost included in the Consolidated Income Statements was $144, $140 and $90 for 2007, 2006 and 2005, respectively. The income tax benefits related to stock-based compensation arrangements were $48, $46 and $27 for 2007, 2006 and 2005, respectively.

On April 25, 2007, the shareholders approved the DuPont Equity and Incentive Plan ("EIP"). The EIP consolidated several of the company's existing compensation plans (the Stock Performance Plan, Variable Compensation Plan, and equity awards of the Stock Accumulation and Deferred Compensation Plan for Directors) into one plan providing for equity-based and cash incentive awards to certain employees, directors and consultants. Currently, equity-based compensation awards consist of stock options, time-vested and performance-based restricted stock units, and stock appreciation rights.

Under the EIP, the maximum number of shares reserved for the grant or settlement of awards is 60 million shares, provided that each share in excess of 20 million that is issued with respect to any award that is not an option or stock appreciation right will be counted against the 60 million share limit as four shares. At December 31, 2007, approximately 60 million shares were authorized for future grants under the company's EIP. Awards or grants made in 2007, prior to shareholder approval of the EIP, were issued under the company's previously existing compensation plans. Awards outstanding under each of these plans have not been terminated. These awards remain outstanding and are administered under the terms of the applicable existing plan. No further awards will be made under the company's previously existing compensation plans.

The company's Compensation Committee determines the long-term incentive mix, including stock options, time-vested and performance-based restricted stock units and may authorize new grants annually.

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Notes to the Consolidated Financial Statements (continued)
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Stock Options
The purchase price of shares subject to option is equal to the market price of the company's stock on the date of grant. Prior to 2004, options expired 10 years from date of grant; however, beginning in 2004, options serially vest over a three-year period and carry a six-year option term. The plan allows retirement eligible employees to retain any granted awards upon retirement provided the employee has rendered at least six months of service following grant date.

For purposes of determining the fair value of stock options awards, the company uses the Black-Scholes option pricing model and the assumptions set forth in the table below. The weighted-average grant-date fair value of options granted in 2007, 2006 and 2005 was $9.47, $7.28 and $8.78, respectively.

	2007	2006	2005
Dividend yield	2.9%	3.8%	2.9%
Volatility	21.11%	25.02%	23.35%
Risk-free interest rate	4.7%	4.4%	3.7%
Expected life (years)	4.5	4.5	4.5

The company determines the dividend yield by dividing the current annual dividend on the company's stock by the option exercise price. A historical daily measurement of volatility is determined based on the expected life of the option granted. The risk free interest rate is determined by reference to the yield on an outstanding U.S. Treasury note with a term equal to the expected life of the option granted. Expected life is determined by reference to the company's historical experience.

Stock Option awards as of December 31, 2007, and changes during the year then ended were as follows:

	Number of Shares	Weighted Average Exercise Price (per share)	Weighted Average Remaining Contractual Term (years)	Aggregate Intrinsic Value (in thousands)
Outstanding, December 31, 2006	92,757	$ 46.76		
Granted	6,167	$ 51.01		
Exercised	(10,452)	$ 42.21		
Forfeited	(218)	$ 47.34		
Cancelled [1]	(13,717)	$ 52.70		
Outstanding, December 31, 2007 [2]	74,537	$ 46.66	3.25	$ 104,117
Exercisable, December 31, 2007	56,461	$ 45.27	3.11	$ 84,914

1 Includes 12.8 million options granted on January 29, 1997 that expired unexercised and were cancelled on January 28, 2007.

2 Includes 10.4 million options outstanding from the 2002 Corporate Sharing Program grants of 200 shares to all eligible employees at an option price of $44.50. These options are currently exercisable and expire 10 years from date of grant.

The aggregate intrinsic values in the table above represent the total pretax intrinsic value (the difference between the company's closing stock price on the last trading day of 2007 and the exercise price, multiplied by the number of in-the-money options) that would have been received by the option holders had all option holders exercised their in-the-money options at year end. The amount changes based on the fair market value of the company's stock. Total intrinsic value of options exercised for 2007, 2006 and 2005 were $96, $22 and $143, respectively. In 2007, the company realized a tax benefit of $32 from options exercised.

As of December 31, 2007, $25 of total unrecognized compensation cost related to stock options is expected to be recognized over a weighted-average period of 1.59 years.

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Time-vested and Performance-based Restricted Stock Units
In 2004, the company began issuing time-vested restricted stock units in addition to stock options. These restricted stock units serially vest over a three-year period. A retirement eligible employee retains any granted awards upon retirement provided the employee has rendered at least six months of service following the grant date. Additional restricted stock units are also granted from time to time to key senior management employees. These restricted stock units generally vest over periods ranging from two to five years.

The company also grants performance-based restricted stock units to senior leadership. Vesting occurs upon attainment of pre-established (i) corporate revenue growth relative to peer companies and (ii) return on invested capital objectives relative to peer companies (for periods prior to 2007) or attainment of internal absolute targets (for periods beginning in 2007). The actual award, delivered as DuPont common stock, can range from zero percent to 200 percent of the original grant. During 2007, there were 368,300 performance-based restricted stock units granted at a weighted average grant date fair value of $51.01. The fair value of time-vested and performance-based restricted stock units is based upon the market price of the underlying common stock as of the grant date.

Nonvested awards of time-vested and performance-based restricted stock units as of December 31, 2007 and 2006 are shown below. The weighted-average grant-date fair value of time-vested and performance-based restricted stock units granted during 2007, 2006, and 2005 was $51.00, $39.47, and $47.94, respectively. The table also includes restricted stock units for the Board of Directors that are settled in cash.

	Number of Shares	Weighted Average Grant Date Fair Value (per share)
Nonvested, December 31, 2006	3,478	$ 41.94
Granted	1,767	$ 51.00
Exercised	(1,234)	$ 42.71
Forfeited	(138)	$ 45.40
Nonvested, December 31, 2007	3,873	$ 45.67

As of December 31, 2007, there was $43 unrecognized stock-based compensation expense related to nonvested awards. That cost is expected to be recognized over a weighted-average period of 1.69 years. The total fair value of shares vested during 2007, 2006 and 2005 was $53, $23 and $15, respectively.

Other Cash-based Awards
Cash awards under the EIP plan may be granted to employees who have contributed most to the company's success, with consideration being given to the ability to succeed to more important managerial responsibility. Such awards were $163, $153 and $129 for 2007, 2006 and 2005, respectively. The amounts of the awards are dependent on company earnings and are subject to maximum limits as defined under the governing plans.

In addition, the company has other variable compensation plans under which cash awards may be granted. These plans include Pioneer's Annual Reward Program and the company's regional and local variable compensation plans. Such awards were $217, $178 and $159 for 2007, 2006 and 2005, respectively.

23. DERIVATIVES AND OTHER HEDGING INSTRUMENTS

Objectives and Strategies for Holding Derivative Instruments
Under procedures and controls established by the company's Financial Risk Management Framework, the company enters into contractual arrangements (derivatives) in the ordinary course of business to reduce its exposure to foreign currency, interest rate and commodity price risks. The framework has established a variety of approved derivative instruments to be utilized in each risk management program, as well as varying levels of exposure coverage and time horizons based on an assessment of risk factors related to each hedging program. Derivative instruments utilized during the period include forwards, options, futures and swaps. The company has not designated any nonderivatives as hedging instruments.

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The framework sets forth senior management's financial risk management philosophy and objectives through a Corporate Financial Risk Management Policy. In addition, the policy establishes oversight committees and risk management guidelines that authorize the use of specific derivative instruments and further establishes procedures for control and valuation, counterparty credit approval and routine monitoring and reporting. The counterparties to these contractual arrangements are major financial institutions and major commodity exchanges. The company is exposed to credit loss in the event of nonperformance by these counterparties. The company manages this exposure to credit loss through the aforementioned credit approvals, limits and monitoring procedures and, to the extent possible, by restricting the period over which unpaid balances are allowed to accumulate. The company does not anticipate nonperformance by counterparties to these contracts and no material loss would be expected from such nonperformance. Market and counterparty credit risks associated with these instruments are regularly reported to management.

The company hedges foreign currency denominated monetary assets and liabilities, certain business specific foreign currency exposures and certain energy feedstock purchases. In addition, the company enters into exchange traded agricultural commodity derivatives to hedge exposures relevant to agricultural feedstock purchases.

Fair Value Hedges
During the year ended December 31, 2007, the company maintained a number of interest rate swaps that involve the exchange of fixed for floating rate interest payments which allows the company to maintain a target range of floating rate debt. All interest rate swaps qualify for the shortcut method of hedge accounting, thus there is no ineffectiveness related to these hedges. Changes in the fair value of derivatives that hedge interest rate risk are recorded in Interest expense each period. The offsetting changes in the fair values of the related debt are also recorded in Interest expense. The company maintains no other fair value hedges.

Cash Flow Hedges
The company maintains a number of cash flow hedging programs to reduce risks related to commodity price risk. Commodity price risk management programs serve to reduce exposure to price fluctuations on purchases of inventory such as natural gas, ethane, corn, soybeans and soybean meal. While each risk management program has a different time maturity period, most programs currently do not extend beyond the next two-year period.

Hedges of inventory purchases are reported as a component of Cost of goods sold and other operating charges. Cash flow hedge results are reclassified into earnings during the same period in which the related exposure impacts earnings. Reclassifications are made sooner if it appears that a forecasted transaction will not materialize. Cash flow hedge ineffectiveness reported in earnings for 2007 was a pretax gain of $6. During 2007, there were no pretax gains (losses) excluded from the assessment of hedge effectiveness. The following table summarizes the effect of cash flow hedges on Accumulated other comprehensive loss for 2007:

	Pretax	Tax	After-tax
Beginning balance	$ 27	$ (10)	$ 17
Additions and revaluations of derivatives designated as cash flow hedges	69	(22)	47
Clearance of hedge results to earnings	(30)	7	(23)
Ending balance	$ 66	$ (25)	$ 41
Portion of ending balance expected to be reclassified into earnings over the next twelve months	$ 44	$ (16)	$ 28

Hedges of Net Investment in a Foreign Operation
During the year ended December 31, 2007, the company did not maintain any hedges of net investment in a foreign operation.

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Derivatives not Designated in Hedging Relationships
The company uses forward exchange contracts to reduce its net exposure, by currency, related to foreign currency-denominated monetary assets and liabilities. The netting of such exposures precludes the use of hedge accounting. However, the required revaluation of the forward contracts and the associated foreign currency-denominated monetary assets and liabilities results in a minimal earnings impact, after taxes. In addition, the company maintains a few small risk management programs for agricultural commodities that do not qualify for hedge accounting treatment.

Currency Risk
The company routinely uses forward exchange contracts to offset its net exposures, by currency, related to monetary assets and liabilities of its operations that are denominated in currencies other than the designated functional currency. The primary business objective is to maintain an approximately balanced position in foreign currencies so that exchange gains and losses resulting from exchange rate changes, net of related tax effects, are minimized.

From time to time, the company will enter into forward exchange contracts to establish with certainty the functional currency amount of future firm commitments denominated in another currency. Decisions regarding whether or not to hedge a given commitment are made on a case-by-case basis, taking into consideration the amount and duration of the exposure, market volatility and economic trends. Forward exchange contracts are also used to manage near-term foreign currency cash requirements and to place foreign currency deposits and marketable securities investments.

Interest Rate Risk
The company primarily uses interest rate swaps to manage the interest rate mix of the total debt portfolio and related overall cost of borrowing.

Interest rate swaps involve the exchange of fixed for floating rate interest payments that are fully integrated with underlying fixed-rate bonds or notes to effectively convert fixed rate debt into floating rate debt based on USD LIBOR.

At December 31, 2007, the company had entered into interest rate swap agreements with total notional amounts of approximately $1,150, whereby the company, over the remaining terms of the underlying notes, will receive a fixed rate payment equivalent to the fixed interest rate of the underlying note and pay a floating rate of interest that is based on USD LIBOR.

Interest rate swaps did not have a material effect on the company's overall cost of borrowing at December 31, 2007 and 2006. See Note 17 for additional descriptions of interest rate swaps.

Commodity Price Risk
The company enters into over-the-counter and exchange-traded derivative commodity instruments to hedge the commodity price risk associated with energy feedstock and agricultural commodity exposures.

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24. GEOGRAPHIC INFORMATION

	2007		2006		2005	
	Net Sales [1]	Net Property [2]	Net Sales [1]	Net Property [2]	Net Sales [1]	Net Property [2]
United States	$ 11,277	$ 7,698	$ 11,123	$ 7,479	$ 11,129	$ 7,333
Europe						
Belgium	$ 346	$ 166	$ 218	$ 175	$ 200	$ 144
Germany	2,045	319	1,826	319	2,040	359
France	1,039	121	992	120	986	124
Italy	864	27	832	26	799	26
Luxembourg	79	232	60	200	53	186
The Netherlands	187	275	213	283	192	287
Spain	466	183	455	161	457	189
United Kingdom	641	142	617	147	657	124
Other	3,162	289	2,708	277	2,312	251
Total Europe	$ 8,829	$ 1,754	$ 7,921	$ 1,708	$ 7,696	$ 1,690
Asia Pacific						
China/Hong Kong	$ 1,594	$ 270	$ 1,415	$ 209	$ 1,198	$ 175
India	424	21	345	16	287	18
Japan	1,187	105	1,103	114	1,107	110
Taiwan	427	128	447	116	391	112
Korea	551	80	569	78	563	63
Singapore	152	44	150	38	147	46
Other	842	44	730	46	822	45
Total Asia Pacific	$ 5,177	$ 692	$ 4,759	$ 617	$ 4,515	$ 569
Canada & Latin America						
Brazil	$ 1,485	$ 282	$ 1,191	$ 275	$ 1,055	$ 270
Canada	963	151	921	139	897	171
Mexico	801	211	810	205	698	198
Argentina	325	30	271	30	241	29
Other	521	42	425	45	408	49
Total Canada & Latin America	$ 4,095	$ 716	$ 3,618	$ 694	$ 3,299	$ 717
Total	$ 29,378	$ 10,860	$ 27,421	$ 10,498	$ 26,639	$ 10,309

1 Net sales are attributed to countries based on location of customer.

2 Includes property, plant and equipment less accumulated depreciation.

25. SEGMENT INFORMATION

The company has six reportable segments. Five of the segments constitute the company's growth platforms: Agriculture & Nutrition, Coatings & Color Technologies, Electronic & Communication Technologies, Performance Materials and Safety & Protection. The sixth segment, Pharmaceuticals, is limited to income from the company's interest in two drugs, Cozaar® and Hyzaar®.

Major products by segment include: Agriculture & Nutrition (hybrid seed corn and soybean seed, herbicides, fungicides, insecticides, value enhanced grains and soy protein); Coatings & Color Technologies (automotive finishes, industrial coatings and white pigments); Electronic & Communication Technologies (fluorochemicals, fluoropolymers, photopolymers and electronic materials); Performance Materials (engineering polymers, packaging and industrial polymers, films and elastomers); Safety & Protection (specialty and industrial chemicals, nonwovens, aramids and solid surfaces); and Pharmaceuticals (representing the company's interest in the collaboration relating to Cozaar®/Hyzaar® antihypertensive drugs, which is reported as Other income). The company operates globally in substantially all of its product lines.

In general, the accounting policies of the segments are the same as those described in the Summary of Significant Accounting Policies. Exceptions are noted as follows and are shown in the reconciliations below. Prior years' data have been reclassified to reflect the 2007 organizational structure. Segment sales include transfers. Products are transferred between segments on a basis intended to reflect, as nearly as practicable, the market value of the products. Segment pretax operating income (PTOI) is defined as operating income before income taxes, minority interests, exchange gains/(losses), corporate expenses, interest and the cumulative effect of changes in accounting principles. Segment net assets includes net working capital, net permanent investment and other noncurrent operating assets and liabilities of the segment. Affiliate net assets (pro rata share) excludes borrowing and other long-term liabilities. Depreciation and amortization includes depreciation on research and development facilities and amortization of other intangible assets, excluding write-down of assets which is discussed in Note 4. Expenditures for long-lived assets exclude investments in affiliates and include payments for Property, plant and equipment as part of business acquisitions.

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	Agriculture & Nutrition	Coatings & Color Technologies	Electronic & Communication Technologies	Performance Materials	Safety & Protection	Pharma-ceuticals	Other	Total
2007								
Segment sales	$ 6,842	$ 6,609	$ 3,797	$ 6,630	$ 5,641	$ -	$ 178	$ 29,697
Less transfers	-	(53)	(114)	(43)	(91)	-	(18)	(319)
Net sales	6,842	6,556	3,683	6,587	5,550	-	160	29,378
Pretax operating income (loss)	894	840	594	626	1,199	949	(224)	4,878
Depreciation and amortization	418	205	167	214	190	-	4	1,198
Equity in earnings of affiliates	3	1	36	(155)	22	-	(14)	(107)
Segment net assets	5,712	4,045	2,530	3,794	3,253	183	157	19,674
Affiliate net assets	157	12	314	421	91	32	52	1,079
Expenditures for long-lived assets	249	284	215	273	404	-	14	1,439
2006								
Segment sales	$ 6,008	$ 6,290	$ 3,573	$ 6,179	$ 5,496	$ -	$ 180	$ 27,726
Less transfers	-	(49)	(109)	(46)	(82)	-	(19)	(305)
Net sales	6,008	6,241	3,464	6,133	5,414	-	161	27,421
Pretax operating income (loss)	604	847	577	559	1,080	819	(173)	4,283
Depreciation and amortization	428	220	159	210	187	-	5	1,209
Equity in earnings of affiliates	(3)	-	48	10	20	-	(8)	67
Segment net assets	5,812	3,959	2,476	4,112	3,032	200	133	19,724
Affiliate net assets	51	10	293	713	87	40	55	1,249
Expenditures for long-lived assets	214	370	212	254	320	-	8	1,378
2005								
Segment sales	$ 6,090	$ 6,055	$ 3,408	$ 6,062	$ 5,144	$ -	$ 174	$ 26,933
Less transfers	-	(48)	(99)	(55)	(73)	-	(19)	(294)
Net sales	6,090	6,007	3,309	6,007	5,071	-	155	26,639
Pretax operating income (loss)	875	536	558	515	994	751	(90)	4,139
Depreciation and amortization	421	207	156	219	181	-	3	1,187
Equity in earnings of affiliates	(3)	1	39	26	18	-	11	92
Segment net assets	5,692	3,567	2,296	3,941	2,689	169	204	18,558
Affiliate net assets	41	5	275	754	80	43	72	1,270
Expenditures for long-lived assets	266	287	185	200	266	-	4	1,208

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Reconciliation to Consolidated Financial Statements

PTOI to income before income taxes and minority interests	2007	2006	2005
Total segment PTOI	$ 4,878	$ 4,283	$ 4,139
Net exchange (losses)/gains (includes affiliates)	(85)	(4)	445
Corporate expenses and interest	(1,050)	(950)	(1,021)
Income before income taxes and minority interests	$ 3,743	$ 3,329	$ 3,563

Segment net assets to total assets	2007	2006	2005
Total segment net assets	$ 19,674	$ 19,724	$ 18,558
Corporate assets [1]	6,649	5,874	8,142
Liabilities included in net assets	7,808	6,179	6,591
Total assets	$ 34,131	$ 31,777	$ 33,291

1 Pension assets are included in corporate assets. The balance at December 31, 2007 and 2006 reflected the adoption of SFAS 158.

Other items	Segment Totals	Adjustments	Consolidated Totals
2007			
Depreciation and amortization	$ 1,198	$ 173	$ 1,371
Equity in earnings of affiliates	(107)	(23)	(130)
Affiliate net assets	1,079	(261)	818
Expenditures for long-lived assets	1,439	146	1,585
2006			
Depreciation and amortization	$ 1,209	$ 175	$ 1,384
Equity in earnings of affiliates	67	(17)	50
Affiliate net assets	1,249	(446)	803
Expenditures for long-lived assets	1,378	154	1,532
2005			
Depreciation and amortization	$ 1,187	$ 171	$ 1,358
Equity in earnings of affiliates	92	16	108
Affiliate net assets	1,270	(426)	844
Expenditures for long-lived assets	1,208	132	1,340

Additional Segment Details
2007 included the following pretax benefits (charges):

Performance Materials [1, 2]	$ (185)
Other [3]	(40)
	$ (225)

1 Included a net $20 charge for existing litigation in connection with the elastomers antitrust matter. See Note 19 for more details.

2 Included a $165 impairment charge to write-down the carrying value of the company's investment in a polyester films joint venture.

3 Included a $40 charge for existing litigation relating to a former business. See Note 19 for more details.

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2006 includes the following pretax benefits (charges):

Agriculture & Nutrition [1, 2]	$ (115)
Coatings & Color Technologies [1, 3, 4]	10
Electronic & Communication Technologies [1]	10
Performance Materials [1, 2]	(60)
Safety & Protection [1, 3, 5]	(14)
	$ (169)

1 Included a benefit of $61 of insurance recoveries, net of fees, which related to asbestos litigation expenses incurred by the company in prior periods. Pretax amounts by segment for the insurance recoveries were: Agriculture & Nutrition – $7; Coatings & Color Technologies – $19; Electronic & Communication Technologies – $10; Performance Materials – $12; and Safety & Protection – $13.

2 Included a restructuring charge of $194 in the following segments: Agriculture & Nutrition – $122 and Performance Materials – $72. See Note 4 for more details.

3 Included insurance recoveries relating to the damage suffered from Hurricane Katrina in 2005. Pretax amounts by segment were: Coatings & Color Technologies – $123 and Safety & Protection – $20.

4 Included a net restructuring charge of $132 in the Coatings & Color Technologies segment. See Note 4 for more details.

5 Included an asset impairment charge of $47 associated with an underperforming industrial chemicals asset held for sale within the Safety & Protection segment.

2005 included the following pretax benefits (charges):

Coatings & Color Technologies [1]	$ (116)
Electronic & Communication Technologies [2]	48
Performance Materials [1]	(17)
Safety & Protection [1]	(27)
Other [3]	62
	$ (50)

1 Included charges of $160 for damaged facilities, inventory write-offs, clean-up costs and other costs related to the 2005 hurricanes, in the following segments: Coatings & Color Technologies – $116; Performance Materials – $17; and Safety & Protection – $27.

2 Included a $48 gain from the sale of the company's equity interest in DuPont Photomasks, Inc.

3 Reflects a net gain of $62 from the disposition of four equity affiliates associated with the separation of Textiles & Interiors, partly offset by other separation costs.

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26. QUARTERLY FINANCIAL DATA (UNAUDITED)

	For The Quarter Ended			
	March 31,	June 30,	September 30,	December 31,
2007				
Net Sales	$ 7,845	$ 7,875	$ 6,675	$ 6,983
Cost of goods sold and other expenses [1]	6,750	6,823	6,297	6,610
Income before income taxes and minority interests	1,312 [3]	1,308	630 [4]	493 [5]
Net income	945	972	526	545 [6]
Basic earnings per share of common stock [2]	1.02	1.05	0.57	0.60
Diluted earnings per share of common stock [2]	1.01	1.04	0.56	0.60
2006				
Net Sales	$ 7,394	$ 7,442	$ 6,309	$ 6,276
Cost of goods sold and other expenses [1]	6,500	6,464	5,895	6,334
Income before income taxes and minority interests	1,050 [7]	1,255	636 [10]	388 [11]
Net income	817 [8]	975 [9]	485	871 [12]
Basic earnings per share of common stock [2]	0.88	1.05	0.52	0.94
Diluted earnings per share of common stock [2]	0.88	1.04	0.52	0.94

1 Excludes interest expense and nonoperating items.

2 Earnings per share for the year may not equal the sum of quarterly earnings per share due to changes in average share calculations.

3 Included a net $52 charge for existing litigation in the Performance Materials segment in connection with the elastomers antitrust matter. See Note 19 for more details.

4 Included a $40 charge for existing litigation in Other relating to a former business. See Note 19 under the heading Spelter, West Virginia, for more details.

5 Included an impairment charge of $165 to write down the company's investment in a polyester films joint venture in the Performance Materials segment. This charge was partially offset by a net $32 benefit resulting from the reversal of certain litigation accruals in the Performance Materials segment established in prior periods for the elastomers antitrust matter (see Note 19 for more details) and a $6 benefit for the reversal of accrued interest associated with the favorable settlement of certain prior year tax contingencies.

6 Included a benefit of $108 for the reversal of income tax accruals associated with the favorable settlement of certain prior year tax contingencies.

7 Included a $135 restructuring charge in the Coatings & Color Technologies segment in connection with the company's plans to close and consolidate certain manufacturing and laboratory sites within this segment (see Note 4 for more details). This charge was partially offset by a $7 benefit for the reversal of accrued interest associated with the favorable settlement of certain prior year tax contingencies.

8 Included a benefit of $44 for the reversal of income tax accruals associated with the favorable settlement of certain prior year tax contingencies.

9 Included a benefit of $31 associated with an increase in the deferred tax assets of a European subsidiary for a tax basis investment loss recognized on the local tax return.

10 Included a $50 benefit resulting from initial insurance recoveries relating to the damage suffered from Hurricane Katrina in 2005.

11 Included a $122 charge for a restructuring program in the Agriculture & Nutrition segment, a $72 charge for a restructuring program in the Performance Materials segment and a $47 asset impairment charge in the Safety & Protection segment. These charges were partially offset by a $93 benefit resulting from insurance recoveries relating to the damage suffered from Hurricane Katrina in 2005, a benefit of $61 resulting from insurance recoveries, net of fees, which related to asbestos litigation expenses incurred by the company in prior periods and a $90 benefit for the reversal of accrued interest associated with the favorable settlement of certain prior year tax contingencies.

12 Included a benefit of $479 for reversals of income tax accruals associated with the favorable settlement of certain prior year tax contingencies and tax valuation allowances, as well as the finalization of taxes related to the company's repatriation of foreign earnings under the AJCA.

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Information for Investors

Corporate Headquarters
E. I. du Pont de Nemours and Company
1007 Market Street
Wilmington, DE 19898
Telephone: 302 774-1000
E-mail: **find.info@usa.dupont.com**

2008 Annual Meeting
The annual meeting of the shareholders will be held at 10:30 a.m., Wednesday, April 30, in The DuPont Theatre in the DuPont Building, 1007 Market Street, Wilmington, Delaware.

Stock Exchange Listings
DuPont common stock (Symbol DD) is listed on the New York Stock Exchange, Inc. (NYSE) and on certain foreign exchanges. Quarterly high and low market prices are shown in Item 5 of the Form 10-K. On May 25, 2007, the company certified to the NYSE that it is not aware of any violations of the NYSE's Corporate Governance listing standards. The company filed the required certifications under Section 302 of the Sarbanes-Oxley Act with its annual report for the year ended December 31, 2007, on Form 10-K.

DuPont preferred stock is listed on the New York Stock Exchange, Inc. (Symbol DDPrA for $3.50 series and Symbol DDPrB for $4.50 series).

Dividends
Holders of the company's common stock are entitled to receive dividends when they are declared by the Board of Directors. While it is not a guarantee of future conduct, the company has continuously paid a quarterly dividend since the fourth quarter 1904. Dividends on common stock and preferred stock are usually declared in January, April, July and October. When dividends on common stock are declared, they are usually paid mid March, June, September and December. Preferred dividends are paid on or about the 25th of January, April, July and October.

Shareholder Services
Inquiries from shareholders about stock accounts, transfers, certificates, dividends (including direct deposit and reinvestment), name or address changes and electronic receipt of proxy materials may be directed to DuPont's stock transfer agent:
Computershare Trust Company, N.A.
P.O. Box 43078
Providence, RI 02940-3078
or call: in the United States and Canada
888 983-8766 (toll-free)
other locations – 781 575-2724
for the hearing impaired –
TDD: 800 952-9245 (toll-free)
or visit Computershare's home page at
http://www.computershare.com

Independent Registered Public Accounting Firm
PricewaterhouseCoopers LLP
Two Commerce Square, Suite 1700
2001 Market Street
Philadelphia, PA 19103

Investor Relations
Institutional investors and other representatives of financial institutions should contact:
E. I. du Pont de Nemours and Company
DuPont Investor Relations
1007 Market Street-D-11018
Wilmington, DE 19898
or call 302 774-4994

Bondholder Relations
E. I. du Pont de Nemours and Company
DuPont Finance
1007 Market Street-D-8028
Wilmington, DE 19898
or call 302 774-8802

DuPont on the Internet
Financial results, news and other information about DuPont can be accessed from the company's website at **http://www.dupont.com**. This site includes important information on products and services, financial reports, news releases, environmental information and career opportunities. The company's periodic and current reports filed with the SEC are available on its website, free of charge, as soon as reasonably practicable after being filed.

Product Information / Referral
From the United States and Canada:
800 441-7515 (toll-free)
From other locations: 302 774-1000
E-mail: find.info@usa.dupont.com
On the Internet: http://www.dupont.com

Printed Reports Available to Shareholders
The following company reports may be obtained, without charge:
1. 2007 Annual Report to the Securities and Exchange Commission, filed on Form 10-K;
2. Proxy Statement for 2008 Annual Meeting of Stockholders; and
3. Quarterly reports to the Securities and Exchange Commission, filed on Form 10-Q

Requests should be addressed to:
DuPont Corporate Information Center
CRP705-GS38
P.O. Box 80705
Wilmington, DE 19880-0705
or call 302 774-5991
E-mail: find.info@usa.dupont.com

Services for Shareholders

Online Account Access
Registered shareholders may access their accounts and obtain online answers to stock transfer questions by signing up for Internet account access. Call toll-free 888 983-8766 (outside the United States and Canada, call 781 575-2724) to obtain by mail a temporary personal identification number and information on viewing your account over the Internet.

Dividend Reinvestment Plan
An automatic dividend reinvestment plan is available to all registered shareholders. Common or preferred dividends can be automatically reinvested in DuPont common stock. Participants also may add cash for the purchase of additional shares. A detailed account statement is mailed after each investment. Your account can also be viewed over the Internet if you have Online Account Access (see above). To enroll in the plan, please contact Computershare (listed above).

Online Delivery of Proxy Materials

Registered stockholders may request their proxy materials electronically in 2008 by visiting www.computershare.com/us/ecomms and holders of shares in the U.S. employee benefit plans may request their proxy materials electronically by visiting www.econsent.com/dd. Stockholders with brokerage accounts can determine if their brokers offer electronic delivery by visiting **www.icsdelivery.com.**

Direct Deposit of Dividends
Registered shareholders who would like their dividends directly deposited in a U.S. bank account should contact Computershare (listed above).

GENERAL ELECTRIC CO (GE)

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W3M
FAIRFIELD, CT 06828
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10-K

Filed on 02/20/2008 - Period: 12/31/2007
File Number 001-00035

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United States Securities and Exchange Commission

WASHINGTON, D.C. 20549

FORM 10–K

(Mark One)

☑ Annual Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934

For the fiscal year ended December 31, 2007

or

☐ Transition Report pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934

For the transition period from _____ to _____

Commission file number 1–35

General Electric Company

(Exact name of registrant as specified in charter)

New York		14–0689340
(State or other jurisdiction of incorporation or organization)		(I.R.S. Employer Identification No.)
3135 Easton Turnpike, Fairfield, CT	06828–0001	203/373–2211
(Address of principal executive offices)	(Zip Code)	(Telephone No.)

Securities Registered Pursuant to Section 12(b) of the Act:

Title of each class	Name of each exchange on which registered
Common stock, par value $0.06 per share	New York Stock Exchange Boston Stock Exchange

Securities Registered Pursuant to Section 12(g) of the Act:

(Title of class)

Indicate by check mark if the registrant is a well–known seasoned issuer, as defined in Rule 405 of the Securities Act. Yes ☑ No ☐

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act. Yes ☐ No ☑

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

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S–K is not contained herein, and will not be contained, to the best of registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10–K or any amendment to this Form 10–K. ☐

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non–accelerated filer, or a smaller reporting company. See definition of "large accelerated filer," "accelerated filer" and "smaller reporting company" in Rule 12b–2 of the Exchange Act. (Check one):

Large accelerated filer ☑
Non–accelerated filer ☐
Accelerated filer ☐
Smaller reporting company ☐

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

The aggregate market value of the outstanding common equity of the registrant as of the last business day of the registrant's most recently completed second fiscal quarter was $392.2 billion. Affiliates of the Company beneficially own, in the aggregate, less than one–tenth of one percent of such shares. There were 9,985,669,000 shares of voting common stock with a par value of $0.06 outstanding at February 1, 2008.

DOCUMENTS INCORPORATED BY REFERENCE

The Annual Report to Shareowners for the fiscal year ended December 31, 2007 is incorporated by reference in Parts I, II and III to the extent described therein. The definitive proxy statement relating to the registrant's Annual Meeting of Shareowners, to be held April 23, 2008, is incorporated by reference in Part III to the extent described therein.

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Part I

Item 1. Business

General

Unless otherwise indicated by the context, we use the terms "GE," "GECS" and "GE Capital" on the basis of consolidation described in note 1 to the consolidated financial statements on page 70 of the 2007 Annual Report to Shareowners of General Electric Company (the Company). The financial section of such Annual Report to Shareowners (pages 39 through 113 of that document) is described in Part IV Item 15(a)(1) and set forth in Exhibit 13 of this 10–K Report and is an integral part hereof. References in Parts I and II of this 10–K Report are to the page numbers of the 2007 Annual Report to Shareowners. Also, unless otherwise indicated by the context, "General Electric" means the parent company, General Electric Company.

General Electric's address is 1 River Road, Schenectady, NY 12345–6999; we also maintain executive offices at 3135 Easton Turnpike, Fairfield, CT 06828–0001.

We are one of the largest and most diversified technology, media, and financial services corporations in the world. With products and services ranging from aircraft engines, power generation, water processing, and security technology to medical imaging, business and consumer financing, media content and industrial products, we serve customers in more than 100 countries and employ more than 300,000 people worldwide. Since our incorporation in 1892, we have developed or acquired new technologies and services that have broadened considerably the scope of our activities.

In virtually all of our global business activities, we encounter aggressive and able competition. In many instances, the competitive climate is characterized by changing technology that requires continuing research and development, as well as customer commitments. With respect to manufacturing operations, we believe that, in general, we are one of the leading firms in most of the major industries in which we participate. The NBC Television Network is one of four major U.S. commercial broadcast television networks. We also compete in syndicated broadcast television programming, cable/satellite television programming activities and in the motion picture industry. The businesses in which GECS engages are subject to competition from various types of financial institutions, including commercial banks, thrifts, investment banks, broker–dealers, credit unions, leasing companies, consumer loan companies, independent finance companies and finance companies associated with manufacturers.

This document contains "forward–looking statements"– that is, statements related to future, not past, events. In this context, forward–looking statements often address our expected future business and financial performance, and often contain words such as "expect," "anticipate," "intend," "plan," "believe," "seek," or "will." Forward–looking statements by their nature address matters that are, to different degrees, uncertain. For us, particular uncertainties that could adversely or positively affect our future results include: the behavior of financial markets, including fluctuations in interest and exchange rates and commodity and equity prices; the commercial and consumer credit environment; the impact of regulation and regulatory, investigative and legal actions; strategic actions, including acquisitions and dispositions; future integration of acquired businesses; future financial performance of major industries which we serve, including, without limitation, the air and rail transportation, energy generation, media, real estate and healthcare industries; and numerous other matters of national, regional and global scale, including those of a political, economic, business and competitive nature. These uncertainties may cause our actual future results to be materially different than those expressed in our forward–looking statements. We do not undertake to update our forward–looking statements.

Our consolidated global revenues increased to $86.5 billion in 2007, compared with $70.8 billion in 2006 and $60.9 billion in 2005. For additional information about our geographic operations, see pages 51 and 52 of the 2007 Annual Report to Shareowners.

Operating Segments

Segment revenue and profit information is presented on page 47 of the 2007 Annual Report to Shareowners. Additional financial data and commentary on recent financial results for operating segments are provided on pages 46–51 of that report and in note 25 (pages 98 and 99) to the consolidated financial statements.

Operating businesses that are reported as segments include Infrastructure, Commercial Finance, GE Money, Healthcare, NBC Universal and Industrial. There is appropriate elimination of the net earnings of GECS and the effect of transactions between segments to arrive at total consolidated data. A summary description of each of our operating segments follows.

During the fourth quarter of 2007, we transferred the Equipment Services business from the Industrial segment to the Commercial Finance segment, where a portion of the business is reported in Capital Solutions. Prior period information has been reclassified to be consistent with the current organization.

We also continue our longstanding practice of providing supplemental information for certain businesses within the segments.

Infrastructure

Infrastructure (33.5%, 30.9% and 30.5% of consolidated revenues in 2007, 2006 and 2005, respectively) is one of the world's leading providers of essential technologies to developed, developing and emerging countries. Through products and services in aviation, energy, oil and gas, transportation, and water and process technologies, GE is helping to develop the infrastructure of countries all over the world. Infrastructure also provides aviation financing as well as energy and water investing, lending and leasing.

Our operations are located in North America, Europe, Asia and South America.

Aviation and Aviation Financial Services

Aviation produces, sells and services jet engines, turboprop and turbo shaft engines, and related replacement parts for use in military and commercial aircraft. Our military engines are used in a wide variety of aircraft including fighters, bombers, tankers, helicopters and surveillance aircraft, as well as marine applications, and our commercial engines power aircraft in all categories of range: short/medium, intermediate and long-range, as well as executive and regional aircraft. We also produce and market engines through CFM International, a company jointly owned by GE and Snecma, a subsidiary of SAFRAN of France, and the Engine Alliance, LLC, a company jointly owned by GE and the Pratt & Whitney division of United Technologies Corporation. New engines are also being designed and marketed in joint ventures with Rolls-Royce Group plc and Honda Aero, Inc., a division of Honda Motor Co., Ltd.

Infrastructure is party to collaboration agreements that share the financial results of certain aircraft and marine engine lines and their related aero-derivatives. Infrastructure collaboration agreements take the form of both joint ventures and revenue sharing programs.

- Joint ventures market and sell particular aircraft engine lines, but require negligible direct investment because the venture parties conduct essentially all of the development, production, assembly and aftermarket support activities. Under these agreements, Aviation supplies certain engine components and retains related intellectual property rights. The CFM56 engine line is the product of CFM International and the GP7000 engine line is the product of Engine Alliance, LLC.
- Revenue sharing programs are a standard form of cooperation for specific product programs in the aviation and aero-derivative industries. These businesses are controlled by Infrastructure, but counterparties have an agreed share of revenues as well as development and component production responsibilities. At December 31, 2007, such counterparty interests ranged from 3% to 49% of various programs; associated distributions are accounted for as costs of production.

On May 4, 2007, Aviation acquired Smiths Aerospace from Smiths Group plc for approximately $5.2 billion in cash. Smiths Aerospace is a $2.4 billion (sales) global aerospace systems and equipment company that provides airborne platform computing systems, power generation and distribution products, mechanical actuation products and landing gear, plus various engine components and a global customer services organization.

We provide maintenance, component repair and overhaul services (MRO), including sales of replacement parts, for many models of engines, including repair and overhaul of engines manufactured by competitors. These MRO services are often provided under long-term maintenance contracts.

The worldwide competition in aircraft jet engines and MRO (including parts sales) is intense. Both U.S. and export markets are important. Product development cycles are long and product quality and efficiency are critical to success. Research and development expenditures are important in this business, as are focused intellectual property strategies and protection of key aircraft engine design, manufacture, repair and product upgrade technologies. Our products and services are subject to a number of regulatory standards.

Potential sales for any engine are limited by, among other things, its technological lifetime, which may vary considerably depending upon the rate of advance in technology, the small number of potential customers and the limited number of relevant airframe applications. Aircraft engine orders tend to follow military and airline procurement cycles, although these cycles differ from each other.

Aviation Financial Services is a global commercial aviation financial services business that offers a broad range of financial products to airlines, aircraft operators, owners, lenders, investors and airport developers. Financial products include leases, aircraft purchasing and trading, loans, engine/spare parts financing, fleet planning and financial advisory services. We operate in a highly competitive environment. Our competitors include aircraft manufacturers, banks, financial institutions, and other finance and leasing companies. Competition is based on lease rates and terms, as well as aircraft delivery dates, condition and availability.

Energy and Energy Financial Services

Energy serves power generation, industrial, government and other customers worldwide with products and services related to energy production, distribution and management. We offer wind turbines as part of our renewable energy portfolio, which also includes solar technology. We also sell aircraft engine derivatives for use as industrial power sources. Gas turbines and generators are used principally in power plants for generation of electricity and for industrial cogeneration and mechanical drive applications. We are a leading provider of Integrated Gasification Combined Cycle (IGCC) technology design and development. IGCC systems convert coal and other hydrocarbons into synthetic gas that, after cleanup, is used as the primary fuel for gas turbines in combined-cycle systems. IGCC systems produce fewer air pollutants compared with traditional pulverized coal power plants. We sell steam turbines and generators to the electric utility industry and to private industrial customers for cogeneration applications. Nuclear reactors, fuel and support services for both new and installed boiling water reactors are offered through a joint ventures with Hitachi and Toshiba. We provide our customers with total solutions to meet their needs through a complete portfolio of aftermarket services, including equipment upgrades, long-term maintenance service agreements, repairs, equipment installation, monitoring and diagnostics, asset management and performance optimization tools, remote performance testing and Dry Low NOx (DLN) tuning. We continue to invest in advanced technology development that will provide more value to our customers and more efficient solutions that comply with today's strict environmental regulations.

Worldwide competition for power generation products and services is intense. Demand for power generation is global and, as a result, is sensitive to the economic and political environment of each country in which we do business. The balance of regional growth and demand side management are important factors to evaluate as we plan for future development.

Energy Financial Services offers structured equity, debt, leasing, partnership financing, project finance and broad-based commercial finance to the global energy and water industries and invests in operating assets in these industries. During 2007, we acquired a controlling interest in Regency Energy Partners LP, a midstream master limited partnership engaged in the gathering, processing, transporting and marketing of natural gas and gas liquids. We operate in a highly competitive environment. Our competitors include banks, financial institutions, energy and water companies, and other finance and leasing companies. Competition is primarily based on price, that is interest rates and fees, as well as deal structure and terms. As we compete globally, our success is sensitive to the economic and political environment of each country in which we do business.

Oil & Gas

Oil & Gas supplies technology–based equipment and services for the entire oil and gas industry – from drilling and completion to production, transportation, refining, processing, petrochemicals and plastics. We offer a wide range of surface and subsea drilling and production systems, equipment for floating production platforms, compressors, turbines, turboexpanders and industrial power generation equipment. As a global business, Oil & Gas supports the world's leading national and international oil companies with latest technology products and services that drive improvements in productivity, efficiency and environmental performance.

On February 23, 2007, Oil & Gas acquired Vetco Gray, one of the world's leading suppliers of drilling, completion and production equipment for onshore and subsea applications in oil and gas fields. The business supplies flow control valves (known as "Christmas trees"), control systems, wellheads, manifolds, risers and associated after–market services.

The global demand for oil and gas, coupled with a geographic imbalance between supply and demand, is promoting investment in the exploration, production, transportation and processing segments of the industry.

Transportation

Transportation provides technology solutions for customers in a variety of industries including railroad, transit, mining, oil and gas, power generation and marine. We serve customers in more than 100 countries.

Transportation manufactures high–horsepower diesel–electric locomotives, including the Evolution Series", the most technologically advanced and most fuel efficient locomotive, which meets or exceeds the U.S. Environmental Protection Agency's Tier II requirements. We also offer leading drive technology solutions to the mining, transit, marine and stationary, and drilling industries. Our motors operate in thousands of applications, from electrical drives systems for large haulage trucks used in the mining industry to transit cars and drilling rigs, and our engines are used for marine power as well as stationary power generation applications. We also provide gearing technology for critical applications such as wind turbines.

Transportation also provides a portfolio of services offerings, designed to improve fleet efficiency and reduce operating expenses, including repair services, locomotive enhancements, modernizations, and information–based services like remote monitoring and diagnostics. We provide train control products, railway management services, and signaling systems to increase service levels, optimize asset utilization, and streamline operations for railroad owners and operators. We deliver leading edge tools that improve asset availability and reliability, optimize network planning, and control network execution to plan.

Water

Water offers water treatment solutions for industrial and municipal water systems including the supply and related services of specialty chemicals, water purification systems, pumps, valves, filters and fluid handling equipment for improving the performance of water, wastewater and process systems, including mobile treatment systems and desalination processes. During 2006, we acquired ZENON Environmental Inc., a global leader in advanced membranes for water purification and wastewater treatment.

For information about orders and backlog, see page 48 of the 2007 Annual Report to Shareowners.

Commercial Finance

Commercial Finance (19.8%, 20.3% and 20.0% of consolidated revenues in 2007, 2006 and 2005, respectively) offers a broad range of financial services worldwide. We have particular mid-market expertise and offer loans, leases and other financial services to customers, including manufacturers, distributors and end-users for a variety of equipment and major capital assets. These assets include industrial-related facilities and equipment; commercial and residential real estate; vehicles; corporate aircraft; and equipment used in many industries, including the construction, manufacturing, transportation, telecommunications and healthcare industries.

During 2007, we made a number of acquisitions, the most significant of which were Trustreet Properties, Inc.; Diskont und Kredit AG and Disko Leasing GmbH (DISKO) and ASL Auto Service-Leasing GmbH (ASL), the leasing businesses of KG Allgemeine Leasing GmbH & Co.; and Sanyo Electric Credit Co., Ltd.

We operate in a highly competitive environment. Our competitors include commercial banks, investment banks, leasing companies, financing companies associated with manufacturers, and independent finance companies. Competition related to our lending and leasing operations is based on price, that is interest rates and fees, as well as deal structure and terms. Profitability is affected not only by broad economic conditions that affect customer credit quality and the availability and cost of capital, but also by successful management of credit risk, operating risk and market risks such as interest rate and currency exchange risks. Success requires high quality risk management systems, customer and industry specific knowledge, diversification, service and distribution channels, strong collateral and asset management knowledge, deal structuring expertise and the ability to reduce costs through technology and productivity.

Our headquarters are in Norwalk, Connecticut with offices throughout North America, South America, Europe, Australia and Asia.

Capital Solutions

Capital Solutions offers a broad range of financial services worldwide, and has particular mid-market expertise, offering loans, leases, inventory finance, transport solutions and other financial services to customers, including manufacturers, dealers and end-users for a variety of equipment and major capital assets. These assets include retail facilities; vehicles; corporate aircraft; and equipment used in many industries, including the construction, transportation, technology, and manufacturing industries.

Real Estate

Real Estate offers a comprehensive range of capital and investment solutions, including equity capital for acquisition or development, as well as fixed and floating rate mortgages for new acquisitions or re-capitalizations of commercial real estate worldwide. Our business finances, with both equity and loan structures, the acquisition, refinancing and renovation of office buildings, apartment buildings, retail facilities, parking facilities and industrial properties. Our typical real estate loans are intermediate term, may be either senior or subordinated, fixed or floating-rate, and are secured by existing income-producing commercial properties. Certain of our originations of low loan-to-value loans are conducted for term securitization within one year; certain of our equity investments, including properties we acquire for investment, are sold under favorable market conditions. We invest in, and provide restructuring financing for, portfolios of mortgage loans, limited partnerships and tax-exempt bonds.

In the normal course of our business operations, we sell certain real estate equity investments when it is economically advantageous for us to do so. However, as real estate values are affected by certain forces beyond our control (e.g., market fundamentals and demographic conditions), it is difficult to predict with certainty the level of future sales or sales prices. Rental income generally approximates operating expenses, which include depreciation and amortization.

GE Money

GE Money (14.5%, 13.0% and 12.5% of consolidated revenues in 2007, 2006 and 2005, respectively) is a leading provider of financial services to consumers and retailers in over 50 countries around the world. We offer a full range of innovative financial products to suit customers' needs. These products include private-label credit cards; personal loans; bank cards; auto loans and leases; mortgages; debt consolidation; home equity loans; corporate travel and purchasing cards; deposit and other savings products; small and medium enterprise lending; and credit insurance on a global basis. In September 2007, we committed to a plan to sell our Japanese personal loan business (Lake) and in December 2007, we sold our U.S. mortgage business (WMC).

In 2007, as part of our continued global expansion, we made a number of acquisitions, the most significant of which was a 33% stake in Bank of Ayudhya and private label credit card portfolios of Chevron and Lowe's.

Our operations are subject to a variety of bank and consumer protection regulations. Further, a number of countries have ceilings on rates chargeable to consumers in financial service transactions. We are subject to competition from various types of financial institutions including commercial banks, leasing companies, consumer loan companies, independent finance companies, manufacturers' captive finance companies, and insurance companies. Industry participants compete on the basis of price, servicing capability, promotional marketing, risk management, and cross selling. The markets in which we operate are also subject to the risks from fluctuations in retail sales, interest and currency exchange rates, and the consumer's capacity to repay debt.

Our headquarters are currently in Stamford, Connecticut and our operations are located in North America, South America, Europe, Australia and Asia. In February 2008, we announced that we will move our headquarters to London, England.

Healthcare

Healthcare (9.8%, 10.9% and 11.0% of consolidated revenues in 2007, 2006 and 2005, respectively) has expertise in medical imaging and information technologies, medical diagnostics, patient monitoring systems, disease research, drug discovery and biopharmaceutical manufacturing technologies. We are dedicated to predicting and detecting disease earlier, monitoring its progress and informing physicians, helping them to tailor individual treatment for individual patients. Healthcare manufactures, sells and services a wide range of medical equipment: diagnostic imaging systems including equipment for magnetic resonance (MR), computed tomography (CT), positron emission tomography (PET), nuclear and X-ray imaging. Clinical systems including patient monitoring, diagnostic cardiology, ultrasound, bone densitometry, anesthesiology and oxygen therapy, neonatal and critical care devices. Medical diagnostics and life sciences products include diagnostic imaging agents used in medical scanning procedures, protein separation products including chromatography purification systems used in the manufacturing of bio-pharmaceuticals, and high-throughput systems for applications in genomics, proteomics and bioassays. During 2006, we acquired IDX Systems Corporation, a leading healthcare information technology provider and Biacore International AB, a leading provider of systems for protein interaction analysis. We sell products and product services to hospitals, medical facilities, pharmaceutical and biotechnology companies and to the life science research market worldwide. Our product services include remote diagnostic and repair services for medical equipment manufactured by GE and by others, as well as computerized data management and customer productivity services.

We compete with a variety of U.S. and non-U.S. manufacturers and services operations. Technological competence and innovation, excellence in design, high product performance, quality of services and competitive pricing are among the key factors affecting competition for these products and services. Throughout the world, we play a critical role in delivering new technology to improve patient outcomes and productivity tools to help control healthcare costs.

Our products are subject to regulation by numerous government agencies, including the FDA, and various laws apply to claims submitted under Medicare, Medicaid or other federally-funded healthcare programs.

For information about orders and backlog, see page 50 of the 2007 Annual Report to Shareowners.

Our headquarters are in Chalfont St. Giles, United Kingdom and our operations are located in North America, Europe, Asia, Australia and South America.

NBC Universal

NBC Universal (8.9%, 10.7% and 10.8% of consolidated revenues in 2007, 2006 and 2005, respectively) is one of the world's leading media and entertainment companies in the development, production and marketing of entertainment, news and information to a global audience. Formed in 2004 through the combining of NBC and Vivendi Universal Entertainment, NBC Universal owns and operates a valuable portfolio of news and entertainment networks, a premier motion picture company, significant television production operations, a leading television stations group and world-renowned theme parks. NBC Universal is 80-percent owned by General Electric and 20-percent owned by Vivendi S.A. NBC Universal is principally engaged in the broadcast of network television services to affiliated television stations within the United States; the production and distribution of television programs and motion pictures; the operation, under licenses from the U.S. Federal Communications Commission (FCC), of television stations; the operation of several cable/satellite television networks around the world; the operation of theme parks; and investment and programming activities in digital media and the Internet. The NBC television network is one of four major U.S. commercial broadcast television networks and serves 230 affiliated stations within the United States. Telemundo is our U.S. Spanish-language broadcast television network. At December 31, 2007, we owned and operated 26 television stations. Broadcasting operations of the NBC television network, the Telemundo network and the company's owned stations are subject to FCC regulation. Our cable/satellite television network operations principally include USA Network, Bravo, CNBC, the SciFi Channel, MSNBC, Oxygen, the Sundance Channel, UniHD, Chiller, Sleuth, mun2 and news, information and entertainment channels across Europe, Asia and Latin America. We have exclusive U.S. television rights to the 2008, 2010 and 2012 Olympic Games, National Football League Sunday Night Football and the Super Bowl in 2009 and 2012.

NBC Universal is subject to a wide range of factors, which could adversely affect our operations. Our broadcast networks, cable television networks and television stations are subject to advertising patterns and changes in viewer taste and preference that can be unpredictable or unforeseen. In addition, future revenues in these properties are dependent upon our ability to obtain, renew or renegotiate long-term programming contracts, including event-based sports programming and contracts for the distribution of our programming to cable/satellite operators. Our television and motion pictures production and distribution businesses are affected by the timing and performance of releases in the theatrical, home entertainment and television markets. Technological advances like digital video recorders, Internet streaming and electronic sell-through offer entertainment options through new media, introducing uncertainty to our operations. Other technologies enable the unauthorized copying and distribution of our motion pictures and television programming, increasing the risk of piracy. We continue to devote substantial resources to protect our intellectual property against unauthorized use.

NBC Universal's headquarters are in New York, New York, with operations throughout North America, Europe, South America and Asia.

Industrial

Industrial (10.3%, 11.7% and 12.5% of consolidated revenues in 2007, 2006 and 2005, respectively) produces and sells products including consumer appliances, industrial equipment and related services. GE Supply, a network of electrical supply houses, was also in the Industrial segment until its sale in the third quarter of 2006. Advanced Materials, a manufacturer of silicone– and quartz–based materials, was also in the Industrial segment until its sale in the fourth quarter of 2006. Prior to the sale of our Plastics business in August 2007, we also manufactured and sold plastics and structured products. Plastics and Advanced Materials results are reported in discontinued operations for all periods presented.

Our operations are located in North America, Europe, Asia and South America.

Consumer & Industrial

Consumer & Industrial sells products that share several characteristics – competitive design, efficient manufacturing and effective distribution and service. Strong global competition rarely permits premium pricing, so cost control, including productivity, is key. Despite pricing pressures on many of our products, we also invest in the development of differentiated, premium products that are more profitable. While some Consumer & Industrial products are primarily directed to consumer applications (major appliances, for example), and some primarily to industrial applications (switchgear, for example), others are directed to both markets (lighting, for example).

We sell and service major home appliances including refrigerators, freezers, electric and gas ranges, cooktops, dishwashers, clothes washers and dryers, microwave ovens, room air conditioners, and residential water systems for filtration, softening and heating. Brands are Monogram®, GE Profile", GE® and Hotpoint®.

We manufacture certain products, and also source finished product and component parts from third–party global manufacturers. A large portion of our appliances sales are through a variety of retail outlets for replacement of installed units. Residential building contractors installing units in new construction are our second major U.S. channel. We offer the largest OEM service organization in the appliances industry, providing in–home repair, extended service plans and warranty administration. We also manufacture and sell a variety of lamp products for commercial, industrial and consumer markets, including full lines of incandescent, halogen, fluorescent, high–intensity discharge, light–emitting diode, automotive and miniature products.

Consumer & Industrial also provides integrated electrical equipment and systems used to distribute, protect and control energy and equipment. We manufacture and distribute electrical distribution and control products including transformers, meters, circuit breakers, panel boards and general purpose controls that are used to distribute and manage power in a variety of residential, commercial, consumer and industrial applications. In addition, we design and manufacture motors and control systems used in industrial applications primarily for oil and gas extraction and mining. We also provide customer–focused solutions centered on the delivery and control of electric power, and market a wide variety of commercial lighting systems.

The aggregate level of economic activity in markets for such products and services generally lags overall economic slowdowns as well as subsequent recoveries. In the United States, industrial markets are undergoing significant structural changes reflecting, among other factors, increased international competition and continued commodity cost pressures.

Enterprise Solutions

Enterprise Solutions offers protection and productivity solutions to some of the most pressing issues that industries face: safe facilities, plant automation, power control and sensing applications in the operating environment. From home to industry to national security, our technology covers the full spectrum of security solutions, including card access systems, high–tech video monitoring, intrusion and fire detection, real estate and property control, and explosives and narcotics detection. We design and manufacture equipment and systems that enable customers to monitor, protect, control and ensure the safety of their critical applications. These products include precision sensors for temperature, flow rate, pressure, humidity, gas, infrared and ultrasonic applications; high–quality handheld and portable field calibrators; equipment for detection of material defects; stand–alone measurement instrumentation; and systems that provide the end–to–end solutions necessary to validate or certify vital commercial and industrial processes. We deliver automation hardware and software designed to help users reduce costs, increase efficiency and enhance profitability through a diverse array of capabilities and products, including controllers, embedded systems, advanced software, motion control, computer numerical controls, operator interfaces, industrial computers, and lasers. We also provide products and services to protect and optimize assets such as generators, transmission lines and motors, to ensuring secure wireless data transmission and uninterruptible power.

Our products and services are sold to a diverse worldwide commercial and residential customer base in the transportation, industrial, pharmaceutical and healthcare markets. Our business environment is characterized by technological innovation and market growth. Our competitors include technology–driven suppliers of the same, as well as other functionally equivalent products and services.

Discontinued Operations

Discontinued operations comprised Lake; WMC; Plastics; Advanced Materials; GE Life, our U.K.–based life insurance operation; the property and casualty insurance and reinsurance businesses and the European life and health operations of GE Insurance Solutions Corporation (GE Insurance Solutions); and Genworth Financial, Inc. (Genworth), our formerly wholly–owned subsidiary that conducted most of our consumer insurance business, including life and mortgage insurance operations.

Geographic Data

Geographic data are reported in note 25 to the consolidated financial statements on page 98 and 99 of the 2007 Annual Report to Shareowners.

Additional financial data about our geographic operations is provided on page 51 and 52 of the 2007 Annual Report to Shareowners.

Orders Backlog

See pages 48, 50 and 62 of the 2007 Annual Report to Shareowners for information about our backlog of unfilled orders.

Research and Development

Total expenditures for research and development were $4,075 million, $3,480 million and $3,235 million in 2007, 2006 and 2005, respectively. Of these amounts, $3,009 million in 2007 was GE–funded ($2,790 million in 2006 and $2,551 million in 2005); and $1,066 million in 2007 was funded by customers ($690 million in 2006 and $684 million in 2005), principally the U.S. government. Infrastructure's Aviation business accounts for the largest share of GE's research and development expenditures with funding from both GE and customer funds. Healthcare and Infrastructure's Energy business also made significant expenditures funded primarily by GE.

Environmental Matters

Our operations, like operations of other companies engaged in similar businesses, involve the use, disposal and cleanup of substances regulated under environmental protection laws.

We are involved in a sizable number of remediation actions to clean up hazardous wastes as required by federal and state laws. Such statutes require that responsible parties fund remediation actions regardless of fault, legality of original disposal or ownership of a disposal site. Expenditures for site remediation actions amounted to approximately $0.2 billion in both 2007 and 2006. We presently expect that such remediation actions will require average annual expenditures in the range of $0.2 billion to $0.3 billion over the next two years.

The U.S. Environmental Protection Agency (EPA) ruled in February 2002 that approximately 150,000 pounds of polychlorinated biphenyls (PCBs) must be dredged from a 40–mile stretch of the upper Hudson River in New York state. On November 2, 2006, the U.S. District Court for the Northern District of New York approved a consent decree entered into between GE and the EPA that represents a comprehensive framework for implementation of the EPA's 2002 decision to dredge PCB–containing sediments in the upper Hudson River. The dredging will be performed in two phases with an intervening peer review of performance after phase 1. Under this consent decree, we have committed up to $0.1 billion to reimburse the EPA for its past and future project oversight costs and agreed to perform the first phase of dredging. We further committed that, subject to future agreement with the EPA about completion of dredging after completion of phase 1 and the peer review, we will be responsible for further costs, including costs of phase 2 dredging. Our Statement of Financial Position as of December 31, 2007 and 2006, included liabilities for the estimated costs of this remediation.

Employee Relations

At year–end 2007, General Electric Company and consolidated affiliates employed approximately 327,000 persons, of whom approximately 155,000 were employed in the United States. For further information about employees, see page 63 of the 2007 Annual Report to Shareowners.

Approximately 20,500 GE manufacturing and service employees in the United States are represented for collective bargaining purposes by a total of approximately 125 different union locals. A majority of such employees are represented by union locals that are affiliated with, and bargain in coordination with, the IUE–CWA, The Industrial Division of the Communication Workers of America, AFL–CIO, CLC. During 2007, General Electric Company negotiated four–year contracts with unions representing a substantial majority of the unionized employees in the United States. Most of these contracts will terminate in June 2011.

Approximately 3,500 staff employees (and a large number of freelance employees) in the United States are covered by about 160 labor agreements to which NBC Universal is a party. These agreements are with various labor unions, expire at various dates and are generally for a term ranging from three to five years.

Executive Officers

See Part III, Item 10 of this 10–K Report for information about Executive Officers of the Registrant.

Other

Because of the diversity of our products and services, as well as the wide geographic dispersion of our production facilities, we use numerous sources for the wide variety of raw materials needed for our operations. We have not been adversely affected by the inability to obtain raw materials.

We own, or hold licenses to use, numerous patents. New patents are continuously being obtained through our research and development activities as existing patents expire. Patented inventions are used both within the Company and are licensed to others, but no operating segment is substantially dependent on any single patent or group of related patents.

Agencies of the U.S. Government constitute our largest single customer. An analysis of sales of goods and services as a percentage of revenues follows:

	% of Consolidated Revenues			% of GE Revenues		
	2007	2006	2005	2007	2006	2005
Total sales to U.S. Government Agencies	2%	2%	3%	3%	3%	4%
Infrastructure segment defense–related sales	2	2	2	3	3	3

GE is a trademark and service mark of General Electric Company.

The Company's Internet address is www.ge.com. Our annual report on Form 10–K, quarterly reports on Form 10–Q, current reports on Form 8–K, and amendments to those reports are available, without charge, on our website, www.ge.com/en/company/investor/secfilings.htm, as soon as reasonably practicable after they are filed electronically with the SEC. Copies are also available, without charge, from GE Corporate Investor Communications, 3135 Easton Turnpike, Fairfield, CT 06828. Reports filed with the SEC may be viewed at www.sec.gov or obtained at the SEC Public Reference Room in Washington, D.C. Information regarding the operation of the Public Reference Room may be obtained by calling the SEC at 1–800–SEC–0330. References to our website addressed in this report are provided as a convenience and do not constitute, or should be viewed as, an incorporation by reference of the information contained on, or available through, the website. Therefore, such information should not be considered part of this report.

Item 1A. Risk Factors.

The following discussion of risk factors contains "forward-looking statements," as discussed in Item 1. These risk factors may be important to understanding any statement in this Annual Report on Form 10-K or elsewhere. The following information should be read in conjunction with Management's Discussion and Analysis (MD&A), and the consolidated financial statements and related notes incorporated by reference in this report.

Our businesses routinely encounter and address risks, some of which will cause our future results to be different -- sometimes materially different -- than we presently anticipate. Discussion about important operational risks that our businesses encounter can be found in the MD&A section of our 2007 Annual Report to Shareowners and in the business descriptions in Item 1. of this Form 10-K. Below, we have described certain important strategic risks. Our reactions to material future developments as well as our competitors' reactions to those developments will determine our future results.

Our global growth is subject to a number of economic and political risks

We conduct our operations in virtually every part of the world. Global economic developments affect businesses such as ours in many ways. Operations are subject to the effects of global competition. Our global business is affected by local economic environments, including inflation, recession and currency volatility. Political changes, some of which may be disruptive, can interfere with our supply chain, our customers and all of our activities in a particular location. While some of these risks can be hedged using derivatives or other financial instruments and some are insurable, such attempts to mitigate these risks are costly and not always successful.

Our credit ratings are important to our cost of capital

The major debt agencies routinely evaluate our debt and have given their highest debt ratings to us. This evaluation is based on a number of factors, which include financial strength as well as transparency with rating agencies and timeliness of financial reporting. One of our strategic objectives is to maintain our "Triple A" ratings as they serve to lower our borrowing costs and facilitate our access to a variety of lenders. Failure to maintain our Triple A debt ratings could adversely affect our cost of funds and related margins, liquidity, competitive position and access to capital markets.

The success of our business depends on achieving our objectives for strategic acquisitions and dispositions

With respect to acquisitions and mergers, we may not be able to identify suitable candidates at terms acceptable to us, or may not achieve expected returns and other benefits as a result of integration challenges, such as personnel and technology. We will continue to evaluate the potential disposition of assets and businesses that may no longer help us meet our objectives. When we decide to sell assets or a business, we may encounter difficulty in finding buyers or alternative exit strategies on acceptable terms in a timely manner, which could delay the accomplishment of our strategic objectives, or we may dispose of a business at a price or on terms, which are less than we had anticipated. In addition, there is a risk that we sell a business whose subsequent performance exceeds our expectations, in which case our decision would have potentially sacrificed enterprise value. Correspondingly, we may be too optimistic about a particular business's prospects, in which case we may be unable to find a buyer at a price acceptable to us and therefore may have potentially sacrificed enterprise value.

We are subject to a wide variety of laws and regulations

Our businesses are subject to regulation by U.S. federal and state laws and foreign laws, regulations and policies. Changes to laws or regulations may even require us to modify our business objectives if existing practices become more restricted, subject to escalating costs or prohibited outright. Particular risks include regulatory risks arising from local laws, such as laws that reduce the allowable lending rate or limit consumer borrowing, from local liquidity regulations that may increase the risks of not being able to retrieve assets, and changes to tax law that may affect our return on investments. For example, GE's effective tax rate is reduced because active business income earned and indefinitely reinvested outside the United States is taxed at less than the U.S. rate. A significant portion of this reduction depends upon a provision of U.S. tax law that defers the imposition of U.S. tax on certain active financial services income until that income is repatriated to the United States as a dividend. This provision is consistent with international tax norms and permits U.S. financial services companies to compete more effectively with foreign banks and other foreign financial institutions in global markets. This provision, which is scheduled to expire at the end of 2008, has been scheduled to expire on four previous occasions, and each time it has been extended by Congress. If this provision is not extended, the current U.S. tax imposed on active financial services income earned outside the United States would increase, making it more difficult for U.S. financial services companies to compete in global markets. Our businesses and the industries in which we operate are also at times being reviewed or investigated by regulators, which could lead to enforcement actions, fines and penalties or the assertion of private litigation claims and damages.

Changes in the real estate markets are highly uncertain

We provide financing for the acquisition, refinancing and renovation of various types of properties. We also consider opportunities to buy and sell properties which may result in significant outlays or proceeds of cash, either individually or in the aggregate. The profitability of real estate investments is largely dependent upon the specific geographic market in which they are located and the perceived value of that market at the time of sale. We may have difficulty optimizing that mix and such activity may vary significantly from one year to the next.

Item 1B. Unresolved Staff Comments.

Not applicable.

Item 2. Properties.

Manufacturing operations are carried out at approximately 300 manufacturing plants located in 40 states in the United States and Puerto Rico and at 261 manufacturing plants located in 40 other countries.

Item 3. Legal Proceedings.

As previously reported, in January 2005 the staff of the U.S. Securities and Exchange Commission (SEC) informed us that it had commenced an investigation and requested certain documents and information with respect to the use of hedge accounting for derivatives by us and GE Capital. In August 2005 the SEC staff advised us that the SEC had issued a formal order of investigation in the matter. The SEC staff has taken testimony in this matter and has requested information about other GE accounting policies and practices, including items related to revenue recognition.

In connection with the SEC's investigation, we are conducting an internal review of revenue recognition matters. Our review has been thorough and extensive, continuing for more than a year, and has been conducted using substantial internal and external resources. These resources have included extensive redeployment of our 430 person audit staff to focus on this review; substantial time and resources of our controllership and finance organizations and our internal legal organization; accounting and expert support from our auditor, KPMG; and extensive resources from outside legal counsel and accounting expertise, who have advised us and our audit committee. We have regularly reported results of the review to the SEC staff as conclusions have been reached and in cases where errors have been identified, we have publicly disclosed them in our filings with the SEC.

In a Form 8–K filed January 18, 2008, we reported that we had determined that we made an error in the manner in which we changed our accounting for profits on certain aftermarket spare parts. As we reported, under long–term product services agreements, we provide repair and maintenance for installed products, including spare parts. We recognize revenue and profits over the contract period in proportion to our contract costs. An element of our contract costs is the cost of spare parts. Before January 1, 2002, our Aviation business accounted for the profits on spare parts installed pursuant to long–term product service agreements either in its spare parts unit or in its revenue recognition model for commercial engines. Effective January 1, 2002, with the concurrence of KPMG, we changed our accounting for spare parts in two ways that largely offset: to exclude all spare parts from the model for engine sales and to include margin in long–term services agreements to the extent spare parts are associated with such agreements.

In making this change, we changed our estimate of the unperformed portions of long–term product services agreements to use our cost instead of catalogue list price. We have determined that because we did not also re–compute our pre–2002 spare parts costs on the same basis, we overestimated the percentage of completion of affected agreements and underestimated the related contract profit rates, an error that resulted in accelerating revenues and profits attributable to such agreements in 2002 and understating revenues and profits in some future periods. Similar adjustments in the accounting method for estimating the cost of spare parts installed pursuant to long–term services agreements were made by Aviation in 2003 with respect to spare parts manufactured by a joint venture partner and in our Energy business in 2006. We also reported that we had determined that for periods prior to 2004, we made an error in our application and description of appropriate revenue measurement principles in certain Infrastructure businesses. Our associated routines and controls failed to prevent or detect these errors.

We and our audit committee, with the assistance of the committee's independent counsel, have evaluated the circumstances surrounding and the effect on our previously reported financial statements of the items reported in our January 18, 2008 Form 8–K, and have determined that the adjustments relating to these items, both individually and together with the adjustments for the errors identified in our Form 10–Qs filed on July 27, 2007 and November 2, 2007, are not material to our financial statements and have determined that restatement of our prior period financial statements is not required. We have included the adjustments for these items in prior period financial information reported in this Form 10–K.

We also have considered these matters in context of our review of our internal control over financial reporting and have concluded that the internal control deficiencies implicated by the items identified above constitute significant deficiencies in our internal control over financial reporting, but do not (individually or in the aggregate with other identified deficiencies) constitute a material weakness in the Company's internal control.

We and our audit committee take these internal control matters very seriously and are committed to continuing to improve our internal control processes and procedures. In response to these matters, we and our audit committee have been actively engaged in the planning and implementation of remediation efforts to address the identified deficiencies in our internal controls with respect to our revenue recognition policies and procedures, and to enhance our overall control environment. We have already undertaken, and are continuing to implement, a number of remedial actions and internal control enhancements:

- Strengthening our expertise and technical controllership resources in corporate accounting and our internal audit staff devoted to complex accounting matters;
- Implementing improved procedures for our corporate accounting and internal audit staff for review of accounting for unusual transactions;
- Enhancing our operational controllership resources, structure and processes to oversee GE businesses to better ensure controllership policies are fully executed;
- Enhancing and clarifying our global accounting policies and procedures for revenue recognition and our related training programs and communication;
- Improving the processes and procedures around documentation of critical accounting areas and judgments and accounting changes, and enhancing communication of these matters to senior management and our audit committee;
- Continuing to stress leadership communication about integrity, accuracy and transparency; and
- Evaluating responsibility, where errors have occurred, with respect to the employees involved in the transactions related to such errors and making appropriate personnel determinations based on such evaluations.

We continue to cooperate with the ongoing SEC investigation and to discuss the investigation and issues arising in that investigation and our internal review with the SEC staff with a goal of completing our review and resolving these matters as soon as practicable. Our senior management and audit committee are monitoring the review closely with the assistance of outside counsel and accounting experts. We and our audit committee are committed to addressing issues that arise and to providing transparent disclosure to our investors concerning these matters.

The Antitrust Division of the Department of Justice (DOJ) and the SEC are continuing to conduct an industry–wide investigation of marketing and sales of guaranteed investment contracts, and other financial instruments, to municipalities. In connection with this investigation, two subsidiaries of GE Capital received subpoenas in 2006: GE Funding CMS (Trinity Funding Co.) received a subpoena from the DOJ requesting documents and GE Funding Capital Market Services, Inc. received a subpoena from the SEC that requests similar information about Trinity Funding Company, LLC. The Company is cooperating fully with the SEC and DOJ in this matter.

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10-K

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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549

Form 10–K

♦ ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d)
OF THE SECURITIES EXCHANGE ACT OF 1934
For the fiscal year ended December 31, 2007
OR
O TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d)
OF THE SECURITIES EXCHANGE ACT OF 1934
For the transition period from to
Commission file number 1–8974

Honeywell International Inc.

(Exact name of registrant as specified in its charter)

DELAWARE	22–2640650
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)
101 Columbia Road Morris Township, New Jersey	07962
(Address of principal executive offices)	(Zip Code)

Registrant's telephone number, including area code (973)455–2000
Securities registered pursuant to Section 12(b) of the Act:

Title of Each Class	Name of Each Exchange on Which Registered
Common Stock, par value $1 per share*	New York Stock Exchange Chicago Stock Exchange
Zero Coupon Serial Bonds due 2009	New York Stock Exchange
9 1/2% Debentures due June 1, 2016	New York Stock Exchange

* The common stock is also listed for trading on the London Stock Exchange.

Securities registered pursuant to Section 12(g) of the Act: None

Indicate by check mark if the Registrant is a well–known seasoned issuer, as defined in Rule 405 of the Securities Act. Yes _X_ No _

Indicate by check mark if the Registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Exchange Act. Yes _ No _X_

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

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S–K is not contained herein, and will not be contained, to the best of Registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10–K or any amendment to this Form 10–K. ♦

Indicate by check mark whether the Registrant is a large accelerated filer, an accelerated filer, a non–accelerated filer, or a smaller reporting company. See definition of "accelerated filer," "large accelerated filer," and "smaller reporting company" in Rule 12b–2 of the Exchange Act. (Check One):

Large accelerated filer ♦ Accelerated filer O Non–accelerated filer O Smaller reporting company O

Indicate by check mark whether the Registrant is a shell company (as defined in Rule 12b–2 of the Act). Yes _ No _X_

The aggregate market value of the voting stock held by nonaffiliates of the Registrant was approximately $42.1 billion at June 30, 2007.

There were 744,382,933 shares of Common Stock outstanding at January 31, 2008.

Documents Incorporated by Reference

Part III: Proxy Statement for Annual Meeting of Shareowners to be held April 28, 2008.

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PART I.

Item 1. Business

Honeywell International Inc. (Honeywell) is a diversified technology and manufacturing company, serving customers worldwide with aerospace products and services, control, sensing and security technologies for buildings, homes and industry, turbochargers, automotive products, specialty chemicals, electronic and advanced materials, and process technology for refining and petrochemicals. Honeywell was incorporated in Delaware in 1985.

We maintain an internet website at http://www.honeywell.com. Our Annual Report on Form 10–K, Quarterly Reports on Form 10–Q, Current Reports on Form 8–K and any amendments to those reports, are available free of charge on our website under the heading "Investor Relations" (see "SEC Filings & Reports") immediately after they are filed with, or furnished to, the Securities and Exchange Commission (SEC). In addition, in this Form 10–K, the Company incorporates by reference certain information from parts of its proxy statement for the 2008 Annual Meeting of Stockholders, which we expect to file with the SEC on or about March 13, 2008, and which will also be available free of charge on our website.

Information relating to corporate governance at Honeywell, including Honeywell's Code of Business Conduct, Corporate Governance Guidelines and Charters of the Committees of the Board of Directors are also available, free of charge, on our website under the heading "Investor Relations" (see "Corporate Governance"), or by writing to Honeywell, 101 Columbia Road, Morris Township, New Jersey 07962, c/o Vice President and Corporate Secretary. Honeywell's Code of Business Conduct applies to all Honeywell directors, officers (including the Chief Executive Officer, Chief Financial Officer and Controller) and employees.

The certifications of our Chief Executive Officer and Chief Financial Officer pursuant to Section 302 and Section 906 of the Sarbanes–Oxley Act of 2002 about the disclosure contained in this Annual Report on Form 10–K are included as Exhibits 31.1, 31.2, 32.1 and 32.2 to this Annual Report and are available free of charge on our website under the heading "Investor Relations" (see "SEC Filings & Reports"). Our Chief Executive Officer certified to the New York Stock Exchange (NYSE) on May 3, 2007, pursuant to Section 303A.12 of the NYSE's listing standards, that he was not aware of any violation by Honeywell of the NYSE's corporate governance listing standards as of that date.

Major Businesses

We globally manage our business operations through four businesses that are reported as operating segments: Aerospace, Automation and Control Solutions, Specialty Materials and Transportation Systems. Financial information related to our operating segments is included in Note 23 of Notes to Financial Statements in "Item 8. Financial Statements and Supplementary Data."

The major products/services, customers/uses and key competitors of each of our operating segments follows:

Aerospace

Our Aerospace segment is a leading global provider of integrated avionics, engines, systems and service solutions for aircraft manufacturers, airlines, business and general aviation, military, space and airport operations.

Product/Service Classes	Major Products/Services	Major Customers/Uses	Key Competitors
Turbine propulsion engines	TFE731 turbofan TFE1042 turbofan ATF3 turbofan F124 turbofan ALF502 turbofan LF507 turbofan CFE738 turbofan HTF 7000 turbofan T53, T55 turboshaft T800 turboshaft	Business, regional, general aviation and military trainer aircraft Commercial and military helicopters Military vehicles	United Technologies Rolls Royce/Allison Turbomeca Williams

Product/Service Classes	Major Products/Services	Major Customers/Uses	Key Competitors
Turbine propulsion engines (continued)	TF40B/50A HTS900 LT101–650/750/850 TPE 331 turboprop AGT1500 turboshaft Repair, overhaul and spare parts		
Auxiliary power units (APUs)	Airborne auxiliary power units Jet fuel starters Secondary power systems Ground power units Repair, overhaul and spare parts	Commercial, regional, business and military aircraft Ground power	United Technologies
Environmental control systems	Air management systems: Air conditioning Bleed air Cabin pressure control Air purification and treatment Gas Processing Heat Exchangers Turbo Systems Repair, overhaul and spare parts	Commercial, regional and general aviation aircraft Military aircraft Ground vehicles Spacecraft	Auxilec Barber Colman Dukes Eaton–Vickers General Electric Goodrich Liebherr Pacific Scientific Parker Hannifin TAT United Technologies
Electric power systems	Generators Power distribution & control Power conditioning Repair, overhaul and spare parts	Commercial, regional, business and military aircraft	General Electric Goodrich Safran United Technologies
Engine systems and accessories	Electronic and hydromechanical fuel controls Engine start systems Electronic engine controls Sensors Valves Electric and pneumatic power generation systems Thrust reverser actuation, pneumatic and electric	Commercial, regional and general aviation aircraft Military aircraft	BAE Controls Goodrich Parker Hannifin United Technologies
Aircraft hardware distribution	Fasteners, including nuts, bolts, rivets, clamps and pins Bearings, including ball, roller, spherical, needle and ceramic Electrical hardware, including connectors, components, lighting products, terminals, and wire and wiring accessories Seals, including seals, o–rings, gaskets and packings Value–added services, repair and overhaul < /font>kitting and point–of–use	Commercial, regional, business and military aviation aircraft	Anixter Arrow Pemco Avnet BE Aerospace (M&M Aerospace) Fairchild Direct Satair Wencor Wesco Aircraft

	replenishment		
Avionics systems	Flight safety systems: Enhanced Ground Proximity Warning Systems (EGPWS) Traffic Alert and Collision Avoidance Systems (TCAS) Windshear detection systems Flight data and cockpit voice recorders Weather radar	Commercial, business and general aviation aircraft Government aviation	BAE Boeing/Jeppesen Garmin General Electric Goodrich Kaiser L3 Lockheed Martin Northrop Grumman Rockwell Collins Thales Trimble/Terra Universal Avionics Universal Weather

Product/Service Classes	Major Products/Services	Major Customers/Uses	Key Competitors
Avionics systems (continued)	Communication, navigation and surveillance systems: Navigation & guidance systems Global positioning systems Satellite systems Integrated systems Flight management systems Cockpit display systems Data management and aircraft performance monitoring systems Aircraft information systems Network file servers Wireless network transceivers Weather information network Navigation database information Cabin management systems Vibration detection and monitoring Mission management systems Tactical data management systems		
Aircraft and Obstruction lighting	Inset lights Regulators Tower and obstruction lights Interior and exterior aircraft lighting	Commercial, regional, business, helicopter and military aviation aircraft (operators, OEMs, parts distributors and MRO service providers) General contractors (building and tower manufacturers), cell–phone companies	Bruce Hella/Goodrich LSI Luminator Siemens Whelen
Inertial sensor	Inertial sensor systems for guidance, stabilization, navigation and control Gyroscopes, accelerometers, inertial measurement units and thermal switches	Military and commercial vehicles Commercial spacecraft and launch vehicles Commercial, regional, business and military aircraft Transportation Missiles Munitions	Astronautics–Kearfott BAE Ball GEC General Electric L3 Com KVH Northrop Grumman Rockwell
Control products	Radar altimeters Pressure products Air data products Thermal switches Magnetic sensors	Military aircraft Missiles, UAVs Commercial applications	Ball Brothers BAE Druck Goodrich NavCom Northrop Grumman Rosemount Solarton
Space products and subsystems	Guidance subsystems Control subsystems Processing subsystems Radiation hardened electronics and integrated circuits GPS–based range safety systems	Commercial and military–spacecraft DoD FAA NASA	BAE Ithaco L3 Northrop Grumman Raytheon

Management and technical services	Maintenance/operation and provision of space systems, services and facilities Systems engineering and integration Information technology services Logistics and sustainment	U.S. government space (NASA) DoD (logistics and information services) FAA DoE Local governments Commercial space ground segment systems and services	Bechtel Boeing Computer Sciences Dyncorp ITT Lockheed Martin Raytheon SAIC The Washington Group United Space Alliance

Product/Service Classes	Major Products/Services	Major Customers/Uses	Key Competitors
Landing systems	Wheels and brakes Wheel and brake repair and overhaul services	Commercial airline, regional, business and military aircraft High performance commercial vehicles USAF, DoD, DoE Boeing, Airbus, Lockheed Martin	Dunlop Standard Aerospace Goodrich K&F Industries Messier–Bugatti NASCO

Automation and Control Solutions

Our Automation and Control Solutions segment is a leading global provider of environmental and combustion controls, sensing controls, security and life safety products and services and process automation and building solutions and services for homes, buildings and industrial facilities.

Environmental and combustion controls; sensing controls	Heating, ventilating and air conditioning controls and components for homes and buildings Indoor air quality products including zoning, air cleaners, humidification, heat and energy recovery ventilators Controls plus integrated electronic systems for burners, boilers and furnaces Consumer household products including humidifiers and thermostats Electrical devices and switches Water controls Sensors, measurement, control and industrial components	Original equipment manufacturers (OEMs) Distributors Contractors Retailers System integrators Commercial customers and homeowners served by the distributor, wholesaler, contractor, retail and utility channels Package and materials handling operations Appliance manufacturers Automotive companies Aviation companies Food and beverage processors Medical equipment Heat treat processors Computer and business equipment manufacturers	Bosch Cherry Danfoss Eaton Emerson Endress & Hauser Holmes Invensys Johnson Controls Motorola Schneider Siemens United Technologies Yamatake
Security and life safety products and services	Security products and systems Fire products and systems Access controls and closed circuit television Home health monitoring and nurse call systems Gas detection products and systems Emergency lighting Distribution Hand held imagers Mobile and wireless computers	OEMs Retailers Distributors Commercial customers and homeowners served by the distributor, wholesaler, contractor, retail and utility channels Health care organizations Security monitoring service providers	Bosch Draeger GE Intermec Technologoes Mine Safety Appliances Motorola Pelco Phillips Riken Keiki Siemens Tyco United Technologies
Process automation products and solutions	Advanced control software and industrial automation systems for control and monitoring of continuous, batch and hybrid operations Production management software Communications systems for Industrial Control equipment and systems Consulting, networking engineering and	Refining and petrochemical companies Chemical manufacturers Oil and gas producers Food and beverage processors Pharmaceutical companies Utilities Film and coated producers Pulp and paper industry Continuous web producers in the paper, plastics, metals, rubber,	ABB AspenTech Emerson Invensys Siemens Yokogawa

installation Terminal automation solutions Process control instrumentation Field instrumentation Analyti cal instrumentation Recorders Controllers Critical environment control solutions and services Aftermarket maintenance, repair and upgrade	non–wovens and printing industries Mining and mineral industries

Product/Service Classes	Major Products/Services	Major Customers/Uses	Key Competitors
Building solutions and services	HVAC and building control solutions and services Energy management solutions and services Security and asset management solutions and services Enterprise building integration solutions Building information services Airport lighting and systems, visual docking guidance systems	Building managers and owners Contractors, architects and developers Consulting engineers Security directors Plant managers Utilities Large global corporations Public school systems Universities Local governments Public housing agencies Airports	Ameresco GroupMac Ingersoll Rand Invensys Johnson Controls Local contractors and utilities Safegate Schneider Siemens Trane Thorn United Technologies

Specialty Materials

Our Specialty Materials segment is a global leader in providing customers with high–performance specialty materials, including fluorine products, specialty films and additives, advanced fibers and composites, intermediates, specialty chemicals, electronic materials and chemicals, and catalysts, adsorbents, equipment and technologies for the petrochemical and refining industries.

Resins & chemicals	Nylon polymer Caprolactam Ammonium sulfate Cyclohexanone Cyclophexanol (KA Oil)	Nylon for carpet fibers, engineered resins and packaging Fertilizer ingredients Specialty chemicals	BASF DSM
Hydrofluoric acid (HF)	Anhydrous and aqueous hydrofluoric acid	Fluorocarbons Steel Oil refining Chemical intermediates	Mexichem Flour Solvay
Fluorocarbons	Genetron® refrigerants, aerosol and insulation foam blowing agents Genesolv® solvents Oxyfume sterilant gases Ennovate 3000 blowing agent for refrigeration insulation	Refrigeration Air conditioning Polyurethane foam Precision cleaning Optical Appliances Hospitals Medical equipment manufacturers	Arkema Dupont Solvay–Solexis Ineos
Fluorine specialties	Sulfur hexafluoride (SF_6) Iodine pentafluoride (IF) Antimony pentafluoride (SbF_5)	Electric utilities Magnesium gear manufacturers	Air Products Asahi Glass Solvay–Solexis
Nuclear services	UF_6 conversion services	Nuclear fuel Electric utilities	Cameco Comurhex Rosatom
Research and fine chemicals	Oxime–based fine chemicals Fluoroaromatics High–purity solvents	Agrichemicals Biotech	Avecia Degussa DSM E. Merck Thermo Fisher Scientific Lonza Sigma–Aldrich
Performance chemicals Imaging chemicals Chemical processing sealants	HF derivatives Fluoroaromatics Catalysts Oxime–silanes	Diverse by product type	Atotech BASF DSM

Advanced fibers & composites	High modulus polyethylene fiber and shield composites Aramid shield composites	Bullet resistant vests, helmets and other armor applications Cut–resistant gloves Rope & cordage	DuPont DSM Teijin
Specialty films	Cast nylon film Bi–axially oriented nylon film Fluoropolymer film	Food and pharmaceutical packaging	American Biaxis CFP Daikin Kolon Unitika

Product/Service Classes	Major Products/Services	Major Customers/Uses	Key Competitors
Specialty additives	Polyethylene waxes Paraffin waxes and blends PVC lubricant systems Processing aids Luminescent pigments	Coatings and inks PVC pipe, siding & profiles Plastics Reflective coatings Safety & security applications	BASF Clariant Eastman
Electronic chemicals	Ultra high–purity HF Inorganic acids Hi–purity solvents	Semiconductors Photovoltaics	Air Products Arch E. Merck
Semiconductor materials and services	Interconnect–dielectrics Interconnect–metals Semiconductor packaging materials Advanced polymers Sapphire substrates Anti–reflective coatings Thermo–couples	Semiconductors Microelectronics Telecommunications	BASF Brewer Dow Corning Foxconn Japan Energy Kyocera Shinko
Catalysts, adsorbents and specialties	Catalysts Molecular sieves Adsorbents Customer catalyst manufacturing	Petroleum, refining, petrochemical, gas processing, and manufacturing industries	Akzo Nobel Axens BASF Davison Grace Haldor Shell/Criterion Sud Chemie
Process technology and equipment	Technology licensing and engineering design of process units and systems Engineered products Proprietary equipment Training and development of technical personnel	Petroleum refining, petrochemical, and gas processing	ABB Lummus Axens BP/Amoco Exxon–Mobil Haldor Koch Glitsch Linde AG Lynara Shaw Group Shell/SGS

Transportation Systems

Our Transportation Systems segment is one of the leading manufacturers of engine boosting systems for passenger cars and commercial vehicles, as well as a leading provider of automotive care and braking products.

Charge–air systems	Turbochargers for gasoline and diesel engines	Passenger car, truck and off–highway OEMs Engine manufacturers Aftermarket distributors and dealers	Borg–Warner Holset IHI MHI
Thermal systems	Exhaust gas coolers Charge–air coolers Aluminum radiators Aluminum cooling modules	Passenger car, truck and off–highway OEMs Engine manufacturers Aftermarket distributors and dealers	Behr Modine Valeo
Aftermarket filters, spark plugs, electronic components and car care products	Oil, air, fuel, transmission and coolant filters PCV valves Spark plugs Wire and cable Antifreeze/coolant Windshield washer fluids Waxes, washes and specialty cleaners	Automotive and heavy vehicle aftermarket channels, OEMs and Original Equipment Service Providers (OES) Auto supply retailers Specialty installers Mass merchandisers	AC Delco Bosch Champion Mann & Hummel NGK Peak/Old World Industries Purolator STP/ArmorAll Turtle Wax

			Zerex/Valvoline
Brake hard parts and other friction materials	Disc brake pads and shoes Drum brake linings Brake blocks Disc and drum brake components Brake hydraulic components Brake fluid Aircraft brake linings Railway linings	Automotive and heavy vehicle OEMs, OES, brake manufacturers and aftermarket channels Installers Railway and commercial/ military aircraft OEMs and brake manufacturers	Advics Akebono Federal–Mogul ITT Corp JBI Nisshinbo TMD Friction

Aerospace Sales

Our sales to aerospace customers were 35 percent of our total sales in each of 2007 and 2006 and 38 percent of our total sales in 2005, respectively. Our sales to commercial aerospace original equipment manufacturers were 10, 10 and 9 percent of our total sales in 2007, 2006 and 2005, respectively. In addition, our sales to commercial aftermarket customers of aerospace products and services were 11, 11 and 15 percent of our total sales in 2007, 2006 and 2005, respectively. Our Aerospace results of operations can be impacted by various industry and economic conditions. See "Item 1A. Risk Factors."

U.S. Government Sales

Sales to the U.S. Government (principally by our Aerospace segment), acting through its various departments and agencies and through prime contractors, amounted to $4,011, $3,688 and $3,719 million in 2007, 2006 and 2005, respectively, which included sales to the U.S. Department of Defense, as a prime contractor and subcontractor, of $3,192, $3,052 and $2,939 million in 2007, 2006 and 2005, respectively. U.S. defense spending increased in 2007 and is also expected to increase in 2008. We do not expect to be significantly affected by any proposed changes in 2008 federal spending due principally to the varied mix of the government programs which impact us (OEM production, engineering development programs, aftermarket spares and repairs and overhaul programs). Our contracts with the U.S. Government are subject to audits, investigations, and termination by the government. See "Item 1A. Risk Factors."

Backlog

Our total backlog at December 31, 2007 and 2006 was $12,303 and $10,674 million, respectively. We anticipate that approximately $9,155 million of the 2007 backlog will be filled in 2008. We believe that backlog is not necessarily a reliable indicator of our future sales because a substantial portion of the orders constituting this backlog may be canceled at the customer's option.

Competition

We are subject to active competition in substantially all product and service areas. Competition is expected to continue in all geographic regions. Competitive conditions vary widely among the thousands of products and services provided by us, and vary by country. Depending on the particular customer or market involved, our businesses compete on a variety of factors, such as price, quality, reliability, delivery, customer service, performance, applied technology, product innovation and product recognition. Brand identity, service to customers and quality are generally important competitive factors for our products and services, and there is considerable price competition. Other competitive factors for certain products include breadth of product line, research and development efforts and technical and managerial capability. While our competitive position varies among our products and services, we believe we are a significant competitor in each of our major product and service classes. However, a number of our products and services are sold in competition with those of a large number of other companies, some of which have substantial financial resources and significant technological capabilities. In addition, some of our products compete with the captive component divisions of original equipment manufacturers.

International Operations

We are engaged in manufacturing, sales, service and research and development mainly in the United States, Europe, Canada, Asia and Latin America. U.S. exports and foreign manufactured products are significant to our operations. U.S. exports comprised 10, 11 and 10 percent of our total sales in 2007, 2006 and 2005, respectively. Foreign manufactured products and services, mainly in Europe, were 39, 37 and 35 percent of our total sales in 2007, 2006 and 2005, respectively.

Approximately 18 percent of total 2007 sales of Aerospace–related products and services were exports of U.S. manufactured products and systems and performance of services such as aircraft repair and overhaul. Exports were principally made to Europe, Canada, Asia and Latin America. Foreign manufactured products and systems and performance of services comprised approximately 14

percent of total 2007 Aerospace sales. The principal manufacturing facilities outside the U.S. are in Europe, with less significant operations in Canada and Asia.

Approximately 2 percent of total 2007 sales of Automation and Control Solutions products were exports of U.S. manufactured products. Foreign manufactured products and performance of services accounted for 58 percent of total 2007 Automation and Control Solutions sales. The principal manufacturing facilities outside the U.S. are in Europe with less significant operations in Asia, Canada and Latin America.

Approximately 18 percent of total 2007 sales of Specialty Materials products and services were exports of U.S. manufactured products. Exports were principally made to Asia and Latin America. Foreign manufactured products and performance of services comprised 23 percent of total 2007 Specialty Materials sales. The principal manufacturing facilities outside the U.S. are in Europe, with less significant operations in Asia and Canada.

Exports of U.S. manufactured products comprised 1 percent of total 2007 sales of Transportation Systems products. Foreign manufactured products accounted for 70 percent of total 2007 sales of Transportation Systems. The principal manufacturing facilities outside the U.S. are in Europe, with less significant operations in Asia, Latin America and Canada.

Financial information including net sales and long–lived assets related to geographic areas is included in Note 24 of Notes to Financial Statements in "Item 8. Financial Statements and Supplementary Data". Information regarding the economic, political, regulatory and other risks associated with international operations is included in "Item 1A. Risk Factors."

Raw Materials

The principal raw materials used in our operations are generally readily available. We experienced no significant problems in the purchase of key raw materials and commodities in 2007. We are not dependent on any one supplier for a material amount of our raw materials, except related to phenol, a raw material used in our Specialty Materials segment. We purchase phenol under a supply agreement with one supplier. We have no reason to believe there is any material risk to this supply.

We are highly dependent on our suppliers and subcontractors in order to meet commitments to our customers. In addition, many major components and product equipment items are procured or subcontracted on a sole–source basis with a number of domestic and foreign companies. We maintain a qualification and performance surveillance process to control risk associated with such reliance on third parties. While we believe that sources of supply for raw materials and components are generally adequate, it is difficult to predict what effects shortages or price increases may have in the future.

The costs of certain key raw materials, including natural gas, benzene (the key component in phenol), ethylene and sulfur in our Specialty Materials' business, steel, nickel, other metals and ethylene glycol in our Transportation Systems business, and nickel, titanium and other metals in our Aerospace business, have been and are expected to remain at high price levels. In addition, in 2007 certain large long–term fixed supplier price agreements expired, primarily relating to components used by our Aerospace business, which in the aggregate, subjected us to higher volatility in certain component costs. We will continue to attempt to offset raw material cost increases with formula or long–term price agreements, price increases and hedging activities where feasible. We have no reason to believe a shortage of raw materials will cause any material adverse impact during 2008. See "Item 1A. Risk Factors" for further discussion.

Patents, Trademarks, Licenses and Distribution Rights

Our segments are not dependent upon any single patent or related group of patents, or any licenses or distribution rights. We own, or are licensed under, a large number of patents, patent applications and trademarks acquired over a period of many years, which relate to many of our products or improvements to those products and which are of importance to our business. From time to time, new patents and trademarks are obtained, and patent and trademark licenses and rights are acquired from others. We also have distribution rights of varying terms for a number of products and services produced by other companies. In our judgment, those rights are adequate for the conduct of our business. We believe that, in the aggregate, the rights under our patents, trademarks and licenses

are generally important to our operations, but we do not consider any patent, trademark or related group of patents, or any licensing or distribution rights related to a specific process or product, to be of material importance in relation to our total business. See "Item 1A. Risk Factors" for further discussion.

We have registered trademarks for a number of our products and services, including Honeywell, UOP, Prestone, FRAM, Autolite, Bendix, Jurid, Holts, Garrett, Ademco, Fire–Lite, Notifier, System Sensor, MK, Novar, Genetron, Enovate, Spectra, Aclar, Simoniz and Redex.

Research and Development

Our research activities are directed toward the discovery and development of new products, technologies and processes and the development of new uses for existing products. The Company has research and development activities in the U.S., Europe, India and China.

Research and development (R&D) expense totaled $1,459, $1,411 and $1,072 million in 2007, 2006 and 2005, respectively. The increase in R&D expense in 2007 compared to 2006 of 3 percent was mainly due to additional product, design and development costs in Automation and Control Solutions and increased expenditures on the development of turbocharging systems for new platforms. The increase in R&D expense in 2006 compared to 2005 of 32 percent was primarily due to the impact of additional R&D expense for UOP in Specialty Materials as well as product, design and development costs in Aerospace and Automation and Control Solutions. Customer–sponsored (principally the U.S. Government) R&D activities amounted to an additional $881, $777 and $694 million in 2007, 2006 and 2005, respectively.

Environment

We are subject to various federal, state, local and foreign government requirements regulating the discharge of materials into the environment or otherwise relating to the protection of the environment. It is our policy to comply with these requirements, and we believe that, as a general matter, our policies, practices and procedures are properly designed to prevent unreasonable risk of environmental damage, and of resulting financial liability, in connection with our business. Some risk of environmental damage is, however, inherent in some of our operations and products, as it is with other companies engaged in similar businesses.

We are and have been engaged in the handling, manufacture, use and disposal of many substances classified as hazardous or toxic by one or more regulatory agencies. We believe that, as a general matter, our policies, practices and procedures are properly designed to prevent unreasonable risk of environmental damage and personal injury, and that our handling, manufacture, use and disposal of these substances are in accord with environmental and safety laws and regulations. It is possible, however, that future knowledge or other developments, such as improved capability to detect substances in the environment or increasingly strict environmental laws and standards and enforcement policies, could bring into question our current or past handling, manufacture, use or disposal of these substances.

Among other environmental requirements, we are subject to the federal superfund and similar state and foreign laws and regulations, under which we have been designated as a potentially responsible party that may be liable for cleanup costs associated with current and former operating sites and various hazardous waste sites, some of which are on the U.S. Environmental Protection Agency's superfund priority list. Although, under some court interpretations of these laws, there is a possibility that a responsible party might have to bear more than its proportional share of the cleanup costs if it is unable to obtain appropriate contribution from other responsible parties, we have not had to bear significantly more than our proportional share in multi–party situations taken as a whole.

Further information, including the current status of significant environmental matters and the financial impact incurred for remediation of such environmental matters, if any, is included in "Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations," in Note 21 of Notes to Financial Statements in "Item 8. Financial Statements and Supplementary Data," and in "Item 1A. Risk Factors."

Employees

We have approximately 122,000 employees at December 31, 2007, of which approximately 57,000 were located in the United States.

Item 1A. Risk Factors

Cautionary Statement about Forward–Looking Statements

We have described many of the trends and other factors that drive our business and future results in "Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations", including the overview of the Company and each of our segments and the discussion of their respective economic and other factors and areas of focus for 2008. These sections and other parts of this report (including this Item 1A) contain "forward–looking statements" within the meaning of Section 21E of the Securities Exchange Act of 1934.

Forward–looking statements are those that address activities, events or developments that management intends, expects, projects, believes or anticipates will or may occur in the future. They are based on management's assumptions and assessments in light of past experience and trends, current conditions, expected future developments and other relevant factors. They are not guarantees of future performance, and actual results, developments and business decisions may differ significantly from those envisaged by our forward–looking statements. We do not undertake to update or revise any of our forward–looking statements. Our forward–looking statements are also subject to risks and uncertainties that can affect our performance in both the near–and long–term. These forward–looking statements should be considered in light of the information included in this Form 10–K, including, in particular, the factors discussed below.

Risk Factors

Our business, operating results, cash flows and financial condition are subject to various risks and uncertainties, including, without limitation, those set forth below, any one of which could cause our actual results to vary materially from recent results or from our anticipated future results.

Industry and economic conditions may adversely affect the market and operating conditions of our customers, which in turn can affect demand for our products and services and our results of operations.

The operating results of our segments are impacted by general industry and economic conditions that can cause changes in spending and capital investment patterns, demand for our products and services and the level of our manufacturing costs. The operating results of our Aerospace segment, which generated 35 percent of our consolidated revenues in 2007, are directly tied to cyclical industry and economic conditions, including global demand for air travel as reflected in new aircraft production and/or the retirement of older aircraft, global flying hours, and business and general aviation aircraft utilization rates, as well as supplier consolidation, factory transitions and capacity constraints, and the level and mix of U.S. Government appropriations for defense and space programs (as further discussed in other risk factors below). The challenging operating environment faced by the commercial airline industry is expected to continue and may be influenced by a wide variety of factors including aircraft fuel prices, labor issues, airline consolidation, airline insolvencies, terrorism and safety concerns as well as changes in regulations. Future terrorist actions or pandemic health issues could dramatically reduce both the demand for air travel and our Aerospace aftermarket sales and margins. The operating results of our Automation and Control Solutions (ACS) segment, which generated 36 percent of our consolidated revenues in 2007, are impacted by the level of global residential and commercial construction (including retrofits and upgrades), capital spending on building and process automation, industrial plant capacity utilization and expansion, and global economic growth rates. Specialty Materials' operating results, which generated 14 percent of our consolidated revenues in 2007, are impacted by global economic growth rates, and capacity utilization for chemical, industrial, refining and petrochemical plants. Transportation Systems' operating results, which generated 15 percent of our consolidated revenues in 2007, are impacted by global production and demand for automobiles and trucks equipped with turbochargers, regulatory changes regarding automobile and truck emissions and fuel economy, and consumer spending levels and patterns for automotive aftermarket and car care products. Each of the segments is impacted by volatility in raw material prices (as further described below) and non–material inflation.

Raw material price fluctuations and the ability of key suppliers to meet quality and delivery requirements can increase the cost of our products and services and impact our ability to meet commitments to customers.

The cost of raw materials is a key element in the cost of our products, particularly in our Specialty Materials (benzene (the key component in phenol), natural gas, ethylene and sulfur), Transportation Systems (nickel, steel, other metals and ethylene glycol) and Aerospace (nickel, titanium and other metals) segments. Our inability to offset material price inflation through increased prices to customers, formula or long–term fixed price contracts with suppliers, productivity actions or through commodity hedges could adversely affect our results of operations.

Our manufacturing operations are also highly dependent upon the delivery of materials (including raw materials) by outside suppliers and their assembly of major components and subsystems used in our products in a timely manner and in full compliance with purchase order terms and conditions, quality standards, and applicable laws and regulations. We also depend in limited instances on sole source suppliers. Our suppliers may fail to perform according to specifications as and when required and we may be unable to identify alternate suppliers or to otherwise mitigate the consequences of their non–performance. The supply chains for our businesses could also be disrupted by external events such as natural disasters, pandemic health issues, terrorist actions, labor disputes or governmental actions. Our inability to fill our supply needs would jeopardize our ability to fulfill obligations under commercial and government contracts, which could, in turn, result in reduced sales and profits, contract penalties or terminations, and damage to customer relationships.

Our future growth is largely dependent upon our ability to develop new technologies that achieve market acceptance with acceptable margins.

Our businesses operate in global markets that are characterized by rapidly changing technologies and evolving industry standards. Accordingly, our future growth rate depends upon a number of factors, including our ability to (i) identify emerging technological trends in our target end–markets, (ii) develop and maintain competitive products, (iii) enhance our products by adding innovative features that differentiate our products from those of our competitors, (iv) develop, manufacture and bring products to market quickly and cost–effectively, and (v) develop and retain individuals with the requisite expertise.

Our ability to develop new products based on technological innovation can affect our competitive position and requires the investment of significant resources. These development efforts divert resources from other potential investments in our businesses, and they may not lead to the development of new technologies or products on a timely basis or that meet the needs of our customers as fully as competitive offerings. In addition, the markets for our products may not develop or grow as we currently anticipate. The failure of our technologies or products to gain market acceptance due to more attractive offerings by our competitors could significantly reduce our revenues and adversely affect our competitive standing and prospects.

Protecting our intellectual property is critical to our innovation efforts. We own or are licensed under a large number of U.S. and non–U.S. patents and patent applications, trademarks and copyrights. Our intellectual property rights may be challenged, invalidated or infringed upon by third parties or we may be unable to maintain, renew or enter into new licenses of third party proprietary intellectual property on commercially reasonable terms. In some non–U.S. countries, laws affecting intellectual property are uncertain in their application, which can affect the scope or enforceability of our patents and other intellectual property rights. Any of these events or factors could diminish or cause us to lose the competitive advantages associated with our intellectual property, subject us to judgments, penalties and significant litigation costs, and/or temporarily or permanently disrupt our sales and marketing of the affected products or services.

An increasing percentage of our sales and operations is in non–U.S. jurisdictions and is subject to the economic, political, regulatory and other risks of international operations.

Our international operations, including U.S. exports, comprise a growing proportion of our operating results and our strategy calls for increasing sales to and operations in overseas markets, including developing markets such as China, India and the Middle East. In 2007, 49 percent of our total sales (including products manufactured in the U.S. and in international locations) were outside of the U.S. including 29 percent in Europe and 11 percent in Asia. Risks related to international operations include exchange control regulations, wage and price controls, employment regulations, foreign investment laws, import and trade restrictions (including embargoes), changes in regulations regarding transactions with state–owned enterprises, nationalization of private enterprises, government instability and our ability to hire and maintain qualified staff in these regions. The cost of compliance with increasingly complex and often conflicting regulations worldwide can also impair our flexibility in modifying product, marketing, pricing or other strategies for growing our businesses, as well as our ability to improve productivity and maintain acceptable operating margins.

As we continue to grow our businesses internationally, our operating results could be increasingly effected by the relative strength of the European and Asian economies and the impact of exchange rate fluctuations. We do have a policy to reduce the risk of volatility through hedging activities, but such activities bear a financial cost and may not always be available to us and may not be successful in eliminating such volatility.

We may be required to recognize impairment charges for our long–lived assets.

At December 31, 2007, the net carrying value of long–lived assets (property, plant and equipment, goodwill and other intangible assets) totaled approximately $15.7 billion. In accordance with generally accepted accounting principles, we periodically assess our long–lived assets to determine if they are impaired. Significant negative industry or economic trends, disruptions to our business, unexpected significant changes or planned changes in use of the assets, divestitures and market capitalization declines may result in impairments to goodwill and other long–lived assets. Future impairment charges could significantly affect our results of operations in the periods recognized. Impairment charges would also reduce our consolidated shareowners' equity and increase our debt–to–total–capitalization ratio, which could negatively impact our access to the public debt and equity markets.

A change in the level of U.S. Government defense and space funding or the mix of programs to which such funding is allocated could adversely impact sales of Aerospace's defense and space–related product and services.

Sales of our defense and space–related products and services are largely dependent upon government budgets, particularly the U.S. defense budget. Sales as a prime contractor and subcontractor to the U.S. Department of Defense comprised approximately 26 and 9 percent of Aerospace and total sales, respectively, for the year ended December 31, 2007. Although U.S. defense spending increased in 2007 and is expected to increase again in 2008, we cannot predict the extent to which funding for individual programs will be included, increased or reduced as part of the 2009 and subsequent budgets ultimately approved by Congress, or be included in the scope of separate supplemental appropriations. We also cannot predict the impact of potential changes in priorities due to military transformation and planning and/or the nature of war–related activity on existing, follow–on or replacement programs. A shift in defense or space spending to programs in which we do not participate and/or reductions in funding for or termination of existing programs could adversely impact our results of operations.

As a supplier of military and other equipment to the U.S. Government, we are subject to unusual risks, such as the right of the U.S. Government to terminate contracts for convenience and to conduct audits and investigations of our operations and performance.

In addition to normal business risks, companies like Honeywell that supply military and other equipment to the U.S. Government are subject to unusual risks, including dependence on

Congressional appropriations and administrative allotment of funds, changes in governmental procurement legislations and regulations and other policies that reflect military and political developments, significant changes in contract scheduling, complexity of designs and the rapidity with which they become obsolete, necessity for constant design improvements, intense competition for U.S. Government business necessitating increases in time and investment for design and development, difficulty of forecasting costs and schedules when bidding on developmental and highly sophisticated technical work, and other factors characteristic of the industry. Changes are customary over the life of U.S. Government contracts, particularly development contracts, and generally result in adjustments of contract prices.

Our contracts with the U.S. Government are subject to audits. Like many other government contractors, we have received audit reports that recommend downward price adjustments to certain contracts to comply with various government regulations. We have made adjustments and paid voluntary refunds in appropriate cases and may do so in the future.

U.S. Government contracts are subject to termination by the government, either for the convenience of the government or for our failure to perform under the applicable contract. In the case of a termination for convenience, we are typically entitled to reimbursement for our allowable costs incurred, plus termination costs and a reasonable profit. If a contract is terminated by the government for our failure to perform we could be liable for additional costs incurred by the government in acquiring undelivered goods or services from any other source and any other damages suffered by the government.

We are also subject to government investigations of business practices and compliance with government procurement regulations. If Honeywell or one of its businesses were charged with wrongdoing as a result of any such investigation or other government investigations (including violations of certain environmental or export laws), it could be suspended from bidding on or receiving awards of new government contracts, suspended from contract performance pending the completion of legal proceedings and/or have its export privileges suspended. The U.S. Government also reserves the right to debar a contractor from receiving new government contracts for fraudulent, criminal or other egregious misconduct. Debarment generally does not exceed three years.

Changes in legislation or government regulations or policies can have a significant impact on our results of operations.

The sales and margins of each of our segments are directly impacted by government regulations. Safety and performance regulations (including mandates of the Federal Aviation Administration and other similar international regulatory bodies requiring the installation of equipment on aircraft), product certification requirements and government procurement practices can impact Aerospace sales, research and development expenditures, operating costs and profitability. The demand for and cost of providing Automation and Control Solutions products, services and solutions can be impacted by fire, security, safety, health care, enviornmental and energy efficiency standards and regulations. Specialty Materials' results of operations can be affected by environmental (e.g. government regulation of fluorocarbons), safety and energy efficiency standards and regulations, while emissions and energy efficiency standards and regulations can impact the demand for turbochargers in our Transportation Systems segment.

Completed acquisitions may not perform as anticipated or be integrated as planned, and divestitures may not occur as planned.

We regularly review our portfolio of businesses and pursue growth through acquisitions and seek to divest non–core businesses. We may not be able to complete transactions on favorable terms, on a timely basis or at all. In addition, our results of operations and cash flows may be adversely impacted by (i) the failure of acquired businesses to meet or exceed expected returns, (ii) the discovery of unanticipated issues or liabilities, (iii) the failure to integrate acquired businesses into Honeywell on schedule and/or to achieve synergies in the planned amount or within the expected timeframe, and/or (iv) the inability to dispose of non–core assets and businesses on satisfactory terms and conditions and within the expected timeframe.

We cannot predict with certainty the outcome of litigation matters, government proceedings and other contingencies and uncertainties.

We are subject to a number of lawsuits, investigations and disputes (some of which involve substantial amounts claimed) arising out of the conduct of our business, including matters relating to commercial transactions, government contracts, product liability (including asbestos), prior acquisitions and divestitures, employment, employee benefits plans, intellectual property, import and export matters and environmental, health and safety matters. Resolution of these matters can be prolonged and costly, and the ultimate results or judgments are uncertain due to the inherent uncertainty in litigation and other proceedings. Moreover, our potential liabilities are subject to change over time due to new developments, changes in settlement strategy or the impact of evidentiary requirements, and we may be required to pay damage awards or settlements, or become subject to damage awards or settlements, that could have a material adverse effect on our results of operations, cash flows and financial condition. While we maintain insurance for certain risks, the amount of our insurance coverage may not be adequate to cover the total amount of all insured claims and liabilities. It also is not possible to obtain insurance to protect against all our operational risks and liabilities. The incurrence of significant liabilities for which there is no or insufficient insurance coverage could adversely affect our results of operations, cash flows, liquidity and financial condition.

Our operations and the prior operations of predecessor companies expose us to the risk of material environmental liabilities.

Mainly because of past operations and operations of predecessor companies, we are subject to potentially material liabilities related to the remediation of environmental hazards and to personal injuries or property damages that may be caused by hazardous substance releases and exposures. We have incurred remedial response and voluntary clean–up costs for site contamination and are a party to lawsuits and claims associated with environmental and safety matters, including past production of products containing toxic substances. Additional lawsuits, claims and costs involving environmental matters are likely to continue to arise in the future. We are subject to various federal, state, local and foreign government requirements regulating the discharge of materials into the environment or otherwise relating to the protection of the environment. These laws and regulations can impose substantial fines and criminal sanctions for violations, and require installation of costly equipment or operational changes to limit emissions and/or decrease the likelihood of accidental hazardous substance releases. We incur, and expect to continue to incur capital and operating costs to comply with these laws and regulations. In addition, changes in laws, regulations and enforcement of policies, the discovery of previously unknown contamination or new technology or information related to individual sites, or the imposition of new clean–up requirements or remedial techniques could require us to incur costs in the future that would have a negative effect on our financial condition or results of operations.

Our expenses include significant costs related to employee health and retiree health and income benefits.

With approximately 122,000 employees, including 57,000 in the U.S., our expenses relating to employee health and retiree health and income benefits are significant. In recent years, we have experienced significant increases in certain of these costs, largely as a result of economic factors beyond our control, in particular, ongoing increases in health care costs well in excess of the rate of inflation. Continued increasing health–care costs, and changes in other assumptions used to calculate retiree health and income benefit expenses, may affect our future profitability.

Additional tax expense or additional tax exposures could affect our future profitability

We are subject to income taxes in both the United States and various non–U.S. jurisdictions, and our domestic and international tax liabilities are dependent upon the distribution of income among these different jurisdictions. In 2007, our tax expense represented 26.4 percent of our income before tax, and includes estimates of additional tax which may be incurred for tax exposures and reflects various estimates and assumptions, including assessments of future earnings of the Company that

could effect the valuation of our deferred tax assets. Our future results could be adversely affected by changes in the effective tax rate as a result of a change in the mix of earnings in countries with differing statutory tax rates, changes in the overall profitability of the Company, changes in tax legislation, changes in the valuation of deferred tax assets and liabilities, and continuing assessments of our tax exposures.

Volatility of credit markets or macro–economic factors may increase our cost of financing

Changes in U.S. and global financial and equity markets, including market disruptions, limited liquidity and interest rate fluctuations, may increase the cost of financing. In addition, our borrowing costs can be affected by short and long–term ratings assigned by independent rating agencies. A decrease in these ratings could increase our cost of borrowing.

Item 1B. Unresolved Staff Comments

Not Applicable

Item 2. Properties

We have approximately 1,400 locations consisting of plants, research laboratories, sales offices and other facilities. Our headquarters and administrative complex is located at Morris Township, New Jersey. Our plants are generally located to serve large marketing areas and to provide accessibility to raw materials and labor pools. Our properties are generally maintained in good operating condition. Utilization of these plants may vary with sales to customers and other business conditions; however, no major operating facility is significantly idle. We own or lease warehouses, railroad cars, barges, automobiles, trucks, airplanes and materials handling and data processing equipment. We also lease space for administrative and sales staffs. Our properties and equipment are in good operating condition and are adequate for our present needs. We do not anticipate difficulty in renewing existing leases as they expire or in finding alternative facilities.

Our principal plants, which are owned in fee unless otherwise indicated, are as follows:

Aerospace

Anniston, AL (leased)
Glendale, AZ (leased)
Phoenix, AZ
Tempe, AZ
Tucson, AZ
Torrance, CA
Clearwater, FL
South Bend, IN
Olathe, KS
Minneapolis, MN
Plymouth, MN
Rocky Mount, NC
Albuquerque, NM
Urbana, OH
Greer, SC
Redmond, WA (leased)
Toronto, Canada
Raunheim, Germany
Singapore (leased)
Yeovil, UK (leased)

Automation and Control Solutions

Phoenix, AZ (leased)
San Diego, CA (leased)
Northford, CT
Freeport, IL
Golden Valley, MN
Skaneateles Falls, NY (leased)
Mosbach, Germany
Neuss, Germany
Schonaich, Germany
Chihuahua, Mexico
Juarez, Mexico (partially leased)
Tijuana, Mexico (leased)
Emmen, Netherlands
Newhouse, Scotland

Specialty Materials

Mobile, AL
Des Plaines, IL
Metropolis, IL
Baton Rouge, LA
Geismar, LA
Shreveport, LA
Pottsville, PA
Orange, TX
Chesterfield, VA
Colonial Heights, VA
Hopewell, VA
Spokane, WA
Seelze, Germany

Stratford, Canada
Shanghai, China
Conde, France

Transportation Systems

Thaon–Les–Vosges, France
Glinde, Germany
Waterford, Ireland

Atessa, Italy
Kodama, Japan
Ansan, Korea
(leased)
Mexicali, Mexico (partially leased)
Barcelona, Spain

Item 3. Legal Proceedings

We are subject to a number of lawsuits, investigations and claims (some of which involve substantial amounts) arising out of the conduct of our business. See a discussion of environmental, asbestos and other litigation matters in Note 21 of Notes to Financial Statements in "Item 8. Financial Statements and Supplementary Data."

Environmental Matters Involving Potential Monetary Sanctions in Excess of $100,000

Although we cannot predict the outcome of the matters described below, we believe that sufficient provisions have been made in our financial statements for these matters. We do not believe that the matters described below will have a material adverse effect on our consolidated financial position, results of operations or operating cash flows.

We have been engaged in discussions with the Louisiana Department of Environmental Quality (LADEQ) to resolve alleged civil environmental violations at our Baton Rouge and Geismar, Louisiana facilities that relate, in part, to a release of chlorine, a release of antimony pentachloride (which resulted in an employee fatality) and an employee exposure to hydrofluoric acid at the Baton Rouge facility that were the subject of a previously reported matter. A settlement has been reached with LADEQ under which Honeywell will pay a fine of $250,000 and perform certain additional Supplemental Environmental Projects for a total cost of approximately of $630,000. In December 2007, the United States EPA referred additional civil claims related to these incidents to the Department of Justice. At the Department of Justice's request, Honeywell has signed a tolling agreement while the parties discuss resolving these claims.

Honeywell is a defendant in a lawsuit filed by the Arizona Attorney General's office on behalf of the Arizona Department of Environmental Quality (ADEQ). The complaint alleges failure to make required disclosures, as well as unrelated environmental violations. ADEQ's most significant allegations have been dismissed with prejudice over the course of the proceedings. The state has voluntarily dismissed its remaining claims without prejudice pending consideration of an appeal of its previously dismissed claims.

In February 2007, ADEQ demanded penalties for alleged violations by Honeywell of the state's underground storage tank regulations at the aircraft engines plant in Phoenix, Arizona. ADEQ subsequently added claims relating to other alleged environmental violations at the aircraft engines plant and has made a demand to resolve all alleged violations which we are evaluating. Negotiations regarding the penalty are ongoing.

Honeywell received Notices of Violation from the Maricopa County Air Quality Department in July 2006 with respect to various air permitting compliance matters at one of its facilities located in Phoenix, Arizona. Honeywell believes it has taken appropriate corrective and preventive actions to address the concerns raised by the County.

Item 4. Submission of Matters to a Vote of Security Holders

Not Applicable.

Executive Officers of the Registrant

The executive officers of Honeywell, listed as follows, are elected annually by the Board of Directors. There are no family relationships among them.

Name, Age, Date First Elected an Executive Officer	Business Experience
David M. Cote (a), 55 2002	Chairman of the Board and Chief Executive Officer since July 2002. President and Chief Executive Officer from February 2002 to June 2002. Chairman of the Board, President and Chief Executive Officer of TRW (manufacturer of aerospace and automotive products) from August 2001 to February 2002.
Adriane M. Brown, 49 2005	President and Chief Executive Officer Transportation Systems since January 2005. Vice President and General Manager of Engine Systems & Accessories from September 2001 to December 2004.
Dr. Nance K. Dicciani, 60 2001	President and Chief Executive Officer Specialty Materials since November 2001.
Roger Fradin, 54 2004	President and Chief Executive Officer Automation and Control Solutions since January 2004. President of Automation and Control Products from June 2002 to December 2003. President and Chief Executive Officer of Security and Fire Solutions from February 2000 to May 2002.
Robert J. Gillette, 47 2001	President and Chief Executive Officer Aerospace since January 2005. President and Chief Executive Officer Transportation Systems from July 2001 to December 2004.
David J. Anderson, 58 2003	Senior Vice President and Chief Financial Officer since June 2003. Senior Vice President and Chief Financial Officer of ITT Industries (global manufacturing company) from December 1999 to June 2003.
Larry E. Kittelberger, 59 2001	Senior Vice President Technology and Operations since October 2006. Senior Vice President Administration and Chief Information Officer from August 2001 to October 2006.
Peter M. Kreindler, 62 1992	Senior Vice President and General Counsel since January 1992.
Mark R. James, 46 2007	Senior Vice President Human Resources and Communications since November 2007. Vice President of Human Resources and Communications for Aerospace from October 2004 to November 2007. Vice President of Human Resources for Aerospace Electronic Systems from March 2001 to October 2004.

(a) Also a Director.

Part II.

Item 5. Market for Registrant's Common Equity, Related Stockholder Matters and Issuer Purchases of Equity Securities

Market and dividend information for Honeywell's common stock is included in Note 26 of Notes to Financial Statements in "Item 8. Financial Statements and Supplementary Data."

The number of record holders of our common stock at December 31, 2007 was 69,767.

The following table summarizes Honeywell's purchases of its common stock, par value $1 per share, for the quarter ending December 31, 2007, under its previously reported $3 billion authorized share repurchase program. Honeywell purchased a total of 74,235,000 shares of common stock in 2007:

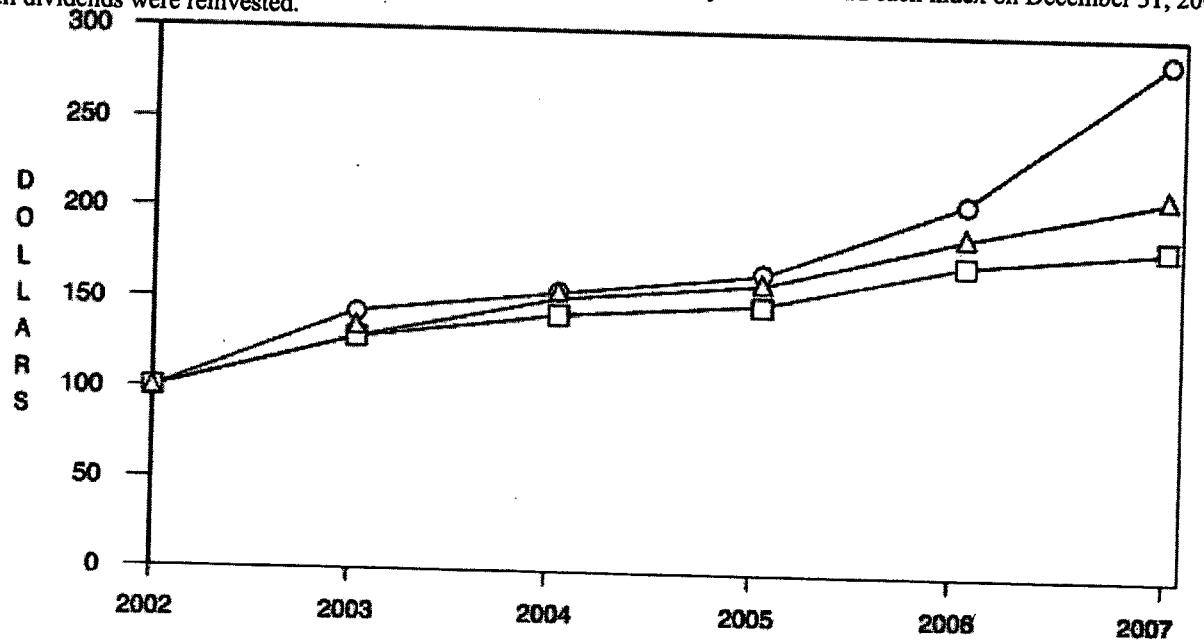
Issuer Purchases of Equity Securities

Period	(a) Total Number of Shares Purchased	(b) Average Price Paid per Share	(c) Total Number of Shares Purchased as Part of Publicly Announced Plans or Programs	(d) Approximate Dollar Value of Shares that May Yet be Purchased Under Plans or Programs (Dollars in millions)
November 2007	2,500,000	$ 59.58	2,500,000	$ 2,777
December 2007	1,000,000	$ 54.64	1,000,000	$ 2,723

Honeywell intends to repurchase outstanding shares from time to time in the open market using cash flow generated by operations. The amount and timing of repurchases may vary depending on market conditions and the level of other investing activities.

Performance Graph

The following graph compares the five–year cumulative total return on our Common Stock to the total returns on the Standard & Poor's 500 Stock Index and a composite of Standard & Poor's Aerospace and Defense and Industrial Conglomerates indices, on an equally weighted basis (the "Composite Index"). The selection and weighting of the Aerospace and Defense component of the Composite Index was deemed appropriate in light of the fact that Honeywell's Aerospace segment has accounted for, on average, approximately 50% of our aggregate segment profit over the past three completed fiscal years. The selection and weighting of the Industrial Conglomerates component of the Composite Index reflects the diverse and distinct range of non–aerospace businesses conducted by Honeywell and their contribution to our overall segment profits. The annual changes for the five–year period shown in the graph are based on the assumption that $100 had been invested in Honeywell stock and each index on December 31, 2002 and that all dividends were reinvested.



	Dec 2002	Dec 2003	Dec 2004	Dec 2005	Dec 2006	Dec 2007
Honeywell	100	143.25	155.01	166.71	207.00	286.99
S&P 500®	100	128.68	142.69	149.70	173.34	182.86
Composite Index	100	128.99	151.80	160.99	188.18	210.44

Item 6. Selected Financial Data

	Years Ended December 31,				
	2007	2006	2005	2004	2003
	(Dollars in millions, except per share amounts)				
Results of Operations					
Net sales	$ 34,589	$ 31,367	$ 27,652	$ 25,593	$ 23,095
Income (loss) from continuing operations	2,444	2,078	1,564	1,246	1,309
Per Common Share					
Earnings (loss) from continuing operations:					
Basic	3.20	2.53	1.85	1.45	1.52
Assuming dilution	3.16	2.51	1.84	1.45	1.52
Dividends	1.00	0.9075	0.825	0.75	0.75
Financial Position at Year-End					
Property, plant and equipment—net	4,985	4,797	4,658	4,331	4,295
Total assets	33,805	30,941	31,633	30,570	28,767
Short-term debt	2,238	1,154	2,024	1,204	199
Long-term debt	5,419	3,909	3,082	4,069	4,961
Total debt	7,657	5,063	5,106	5,273	5,160
Shareowners' equity(1)	9,222	9,720	10,762	10,777	10,289

(1) For the year ended December 31, 2006 shareowners' equity includes a reduction of $1,512 related to the adoption of SFAS No. 158, "Employers' Accounting for Defined Benefit Pension and Other Postretirement Plans".

Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations

The following Management's Discussion and Analysis of Financial Condition and Results of Operations ("MD&A") is intended to help the reader understand the results of operations and financial condition of Honeywell International Inc. ("Honeywell") for the three years ended December 31, 2007. All references to Notes relate to Notes to the Financial Statements in "Item 8—Financial Statements and Supplementary Data".

CONSOLIDATED RESULTS OF OPERATIONS

Net Sales

	2007	2006	2005
		(Dollars in millions)	
Net sales	$ 34,589	$ 31,367	$ 27,652
% change compared with prior year	10 %	13 %	

The change in net sales in 2007 and 2006 is attributable to the following:

	2007 Versus 2006	2006 Versus 2005
Price	1 %	1 %
Volume	6	6
Foreign Exchange	2	—
Acquisitions/Divestitures	1	6
	10 %	13 %

A discussion of net sales by segment can be found in the Review of Business Segments section of this MD&A.

Cost of Products and Services Sold

	2007	2006	2005
		(Dollars in millions)	
Cost of products and services sold	$ 26,300	$ 24,096	$ 21,524
Gross margin %	24.0 %	23.2 %	22.2 %

Gross margin increased by 0.8 of a percentage point in 2007 compared with 2006 primarily due to (i) higher margins in our Specialty Materials segment of 1.0 percentage point mainly due to the continued growth of UOP, (ii) higher margins in our Aerospace segment of 0.8 of a percentage point mainly resulting from sales volume growth, increased prices and productivity savings, and (iii) lower pension and other post retirement benefits expense of 0.3 of a percentage point, which were partially offset by lower margins in our Transportation Systems segment of 1.0 percentage point primarily attributable to lower Consumer Products Group ("CPG") sales volume and operational planning and production issues.

Gross margin increased by 1 percentage point in 2006 compared with 2005 due primarily to higher margins in our Specialty Materials segment following our acquisition of full ownership of UOP (1.3 percentage points), and lower pension and other postretirement benefits expense of 0.5 of a percentage point, partially offset by higher repositioning costs of 0.2 of a percentage point.

For further discussion of segment results, see "Review of Business Segments".

Selling, General and Administrative Expenses

	2007	2006	2005
		(Dollars in millions)	
Selling, general and administrative expenses	$ 4,565	$ 4,210	$ 3,707
Percent of sales	13.2 %	13.4 %	13.4 %

Selling general and administrative expenses (SG&A) as a percentage of sales decreased by 0.2 of a percentage point in 2007 compared with 2006. SG&A as a percentage of sales decreased in all of our segments primarily due to the benefits from cost savings initiatives and the positive impact of prior repositioning actions. A reduction of 0.1 of a percentage point from lower pension and other post retirement benefits expense was offset by higher repositioning costs.

SG&A as a percentage of sales was flat in 2006 compared with 2005 due primarily to a reduction in expenses in our Aerospace segment, which reflects the benefit of prior restructuring actions, offsetting higher expenses in Automation and Control Solutions (ACS) and Specialty Materials as a result of acquisitions. A reduction of repositioning and pension costs of 0.2 of a percentage point offset the 0.2 of a percentage point increase for expenses of $77 million relating to stock–based compensation expense following the adoption of FAS No. 123R (see Note 20 to the financial statements).

Other (Income)/Expense

	2007	2006	2005
		(Dollars in millions)	
Gain on sale of non–strategic businesses and assets	$ (19)	$ (30)	$ (36)
Equity (income)/loss of affiliated companies	(10)	(13)	(134)
Interest income	(81)	(94)	(84)
Foreign exchange	34	18	21
Other (net)	23	8	2
Total	$ (53)	$ (111)	$ (231)

Other income decreased by $58 million, or 52 percent in 2007 compared to 2006 primarily as a result of lower interest income due to interest received on a favorable tax settlement in 2006 and higher foreign exchange losses due to changes in exchange rates.

Other income decreased by $120 million, or 52 percent in 2006 compared to 2005 primarily due to a $121 million reduction in equity income of affiliated companies primarily related to UOP, following our acquisition of full ownership of UOP in November 2005.

Interest and Other Financial Charges

	2007	2006	2005
	(Dollars in millions)		
Interest and other financial charges	$ 456	$ 374	$ 356
% change compared with prior year	22 %	5 %	

Interest and other financial charges increased by 22 percent in 2007 compared to 2006 and 5 percent in 2006 compared with 2005, due to higher debt balances and higher borrowing costs.

Tax Expense

	2007	2006	2005
	(Dollars in millions)		
Tax expense	$ 877	$ 720	$ 732
Effective tax rate	26.4 %	25.7 %	31.9 %

The effective tax rate increased by 0.7 of a percentage point in 2007 compared with 2006 due principally to the expiration of the tax benefit on export sales, partially offset by a decrease in the overall state and foreign effective tax rate, an increase in the tax benefit for the domestic manufacturing deduction, and the favorable resolution of certain tax audits. The effective tax rate was lower than the statutory rate of 35 percent due in part to tax benefits derived from lower foreign taxes and benefits from tax planning strategies.

The effective tax rate decreased by 6.2 percentage points in 2006 compared with 2005, due principally to the absence of the 2005 one–time tax charge of $155 million for the repatriation of foreign earnings under the American Jobs Creation Act of 2004, offset, in part, by $64 million of tax benefits associated with the 2005 sale of our Industrial Wax business which had a higher tax basis than book basis. In addition, in 2006, there were benefits recognized from the favorable resolution of certain tax audits offset by a tax charge for an up–front licensing of certain in–process research and development. The effective tax rate was lower than the statutory rate of 35 percent due in part to tax benefits derived from export sales, lower foreign taxes, and benefits from tax planning strategies. See Note 6 to the financial statements for further information on taxes, including a detailed effective tax rate reconciliation.

In 2008, the effective tax rate could change based upon the Company's operating results and the outcome of tax positions taken regarding previously filed tax returns currently under audit by various Federal, State and foreign tax authorities, several of which may be finalized in the foreseeable future. The Company believes that it has adequate reserves for these matters, the outcome of which could materially impact the results of operations and operating cash flows in the period that they are resolved.

Income From Continuing Operations

	2007	2006	2005
	(Dollars in millions, except per share amounts)		
Income from continuing operations	$ 2,444	$ 2,078	$ 1,564
Earnings per share of common stock—assuming dilution	$ 3.16	$ 2.51	$ 1.84

The increase of $0.65 in earnings (diluted) per share from continuing operations in 2007 compared with 2006 primarily relates to an increase in segment profit (most significantly in Aerospace and Automation and Control Solutions), a reduction in the number of shares outstanding due to the previously announced stock repurchase program, and lower pension and other post retirement expense, partially offset by increased repositioning costs.

The increase of $0.67 in earnings (diluted) per share for continuing operations in 2006 compared with 2005 primarily relates to an increase in segment profit in Aerospace and Automation and Control Solutions and income generated from our acquisition of full ownership of UOP in Specialty Materials, reduced repositioning and pension costs and a reduction in the number of shares outstanding due to the previously announced stock repurchase program, offset by the impact of adopting FAS No. 123R ("Share–Based Payment") for stock–based compensation expense of $77 million in 2006. In addition, in 2005 there was a one–time tax charge of $155 million for the repatriation of foreign earnings under the American Jobs Creation Act of 2004, which decreased earnings and earnings per share in 2005.

For further discussion of segment results, see "Review of Business Segments".

Income From Discontinued Operations

Income from discontinued operations of $5 million, or $0.01 earnings per share (diluted) in 2006 relates to the operating results of the Indalex business which was sold in February 2006 to Sun Capital Partners, Inc.

BUSINESS OVERVIEW

This Business Overview provides a summary of Honeywell and its four reportable operating segments (Aerospace, Automation and Control Solutions, Specialty Materials and Transportation Systems), including their respective areas of focus for 2008 and the relevant economic and other factors impacting their results, and a discussion of each segment's results for the three years ended December 31, 2007. Each of these segments is comprised of various product and service classes that serve multiple end markets. See Note 23 to the financial statements for further information on our reportable segments and our definition of segment profit.

Economic and Other Factors

In addition to the factors listed below with respect to each of our operating segments, our consolidated operating results are principally driven by:

- Global economic growth rates (US, Europe and emerging regions);
- Overall sales mix, in particular the mix of Aerospace original equipment and aftermarket sales and the mix of Automation and Control Solutions products and services sales;
- The extent to which cost savings from productivity actions are able to offset or exceed the impact of material and non–material inflation;
- The impact of the pension discount rate on pension expense; and
- The impact of changes in foreign currency exchange rate, particularly the US dollar–Euro exchange rate.

Areas of Focus for 2008

The areas of focus for 2008, which are generally applicable to each of our operating segments, include:

- Driving profitable growth by building innovative products that address customer needs;
- Achieving sales growth, technological excellence and manufacturing capability through global expansion, especially focused on emerging regions in China, India and the Middle East;
- Continuing to grow through disciplined acquisition and rigorous integration processes;
- Proactively managing raw material cost increases with formula and long term fixed price agreements, price increases and hedging activities, where feasible;
- Driving free cash flow through increased net income and effective working capital management enabling continued investment in our businesses, strategic acquisitions, and enabling us to return value to shareholders through share repurchases and increased dividend payments;

- Utilizing our enablers Honeywell Operating System (HOS), Functional Transformation and Velocity Product Development (VPD)™ to standardize the way we work, increase quality and reduce the costs of product manufacturing, reduce costs and enhance the quality of our administrative functions and improve business operations through investments in systems and process improvements;

- Managing Corporate costs, including costs incurred for asbestos and environmental matters, pension and other post–retirement expenses and our tax expense; and

- Achieving productivity savings and price increases to offset inflation.

Review of Business Segments

	2007	2006	2005
		(Dollars in millions)	
Net Sales			
Aerospace	$ 12,236	$ 11,124	$ 10,496
Automation and Control Solutions	12,478	11,020	9,416
Specialty Materials	4,866	4,631	3,234
Transportation Systems	5,009	4,592	4,505
Corporate	—	—	1
	$ 34,589	$ 31,367	$ 27,652
Segment Profit			
Aerospace	$ 2,197	$ 1,892	$ 1,676
Automation and Control Solutions	1,405	1,223	1,065
Specialty Materials	658	568	257
Transportation Systems	583	574	557
Corporate	(189)	(177)	(173)
	$ 4,654	$ 4,080	$ 3,382

A reconciliation of segment profit to income from continuing operations before taxes follows:

	2007	2006	2005
		(Dollars in millions)	
Segment profit	$ 4,654	$ 4,080	$ 3,382
Other income (expense)	53	111	231
Interest and other financial charges	(456)	(374)	(356)
Stock option expense(1)	(65)	(77)	—
Pension and other postretirement benefits (expense)(1)	(322)	(459)	(561)
Repositioning and other charges(1)	(543)	(483)	(400)
Income from continuing operations before taxes	$ 3,321	$ 2,798	$ 2,296

(1) Amounts included in cost of products and services sold and selling, general and administrative expenses.

Aerospace

Overview

Aerospace is a leading global supplier of aircraft engines, avionics, and related products and services for aircraft manufacturers, airlines, aircraft operators, military services, and defense and space contractors. Our Aerospace products and services include auxiliary power units, propulsion engines, environmental control systems, engine controls, flight safety, communications, navigation, radar and surveillance systems, aircraft lighting, management and technical services, advanced systems and instruments, aircraft wheels and brakes and repair and overhaul services. Aerospace sells its products to original equipment (OE) manufacturers in the air transport, regional, business and general aviation aircraft segments, and provides spare parts and repair and maintenance services for the aftermarket

(principally to aircraft operators). The United States Government is also a major customer for our defense and space products.

Economic and Other Factors

Aerospace operating results are principally driven by:

- Global demand for air travel as reflected in new aircraft production, as well as the demand for spare parts and maintenance and repair services for aircraft currently in use;
- Aircraft production by commercial air transport, regional jet, business and general aviation OE manufacturers, as well as global flying hours and airline profitability; and
- Level and mix of U.S. Government appropriations for defense and space programs and military activity; and
- Availability and price volatility of raw materials such as titanium and other metals.

Results of Operations

	2007	2006	2005
	(Dollars in millions)		
Net sales	$ 12,236	$ 11,124	$ 10,496
% change compared with prior year	10 %	6 %	
Segment profit	$ 2,197	$ 1,892	$ 1,676
% change compared with prior year	16 %	13 %	

Aerospace sales by major customer end–markets were as follows:

	% of Aerospace Sales			% Change in Sales	
Customer End–Markets	2007	2006	2005	2007 Versus 2006	2006 Versus 2005
Commercial:					
Air transport and regional original equipment	16 %	16 %	15 %	10 %	14 %
Air transport and regional aftermarket	22	22	23	8	4
Business and general aviation original equipment	11	12	11	16	16
Business and general aviation aftermarket	10	10	10	16	1
Defense and Space	41	40	41	8	3
Total	100 %	100 %	100 %	10 %	6 %

Aerospace sales increased by 10 percent and 6 percent in 2007 and 2006, respectively. Details regarding the net increase in sales by customer end–markets for both 2007 and 2006 are as follows:

- Air transport and regional original equipment (OE) sales increased by 10 percent in 2007 and 14 percent in 2006 driven by increased deliveries to air transport customers primarily due to higher aircraft production rates at major OE manufacturers.
- Air transport and regional aftermarket sales increased by 8 percent in 2007 and 4 percent in 2006. The 2007 increase was a result of increased sales volume and price of spare parts and maintenance activity relating to the approximately 6 percent increase in global flying hours. The 2006 increase over 2005 was a result of increased sales of spare parts and maintenance activity relating to a more than 5 percent increase in global flying hours which more than offset the anticipated decline in the sales of upgrades and retrofits of avionics equipment to meet certain mandated regulatory standards.
- Business and general aviation OE sales increased by 16 percent in both 2007 and 2006 due to continued demand in the business jet end market as evidenced by an increase in new business jet deliveries, as well as the launch of new aircraft platforms in 2007 and high demand in the fractional ownership market in 2006. In both 2007 and 2006, sales to this end–market primarily

consisted of sales of Primus Epic integrated avionics systems and the TFE 731 and HTF 7000 engines.

- Business and general aviation aftermarket sales increased by 16 percent in 2007 and 1 percent in 2006. The 2007 increase was primarily due to increased revenue under maintenance service agreements and higher sales of spare parts. The 2006 increase over 2005 was primarily due to higher sales of spare parts and increased maintenance activity resulting in part from higher engine utilization, partially offset by lower sales of mandated upgrades and retrofits of avionics equipment required in 2005 to meet certain mandated regulatory standards.

- Defense and space sales increased by 8 percent in 2007 and 3 percent in 2006. The 2007 increase was primarily due to, higher sales of surface systems, a 2 percent positive impact of the acquisition of Dimensions International (a defense logistics business) and an increase in space sales, including engineering activity relating to the Orion (CEV) program. The 2006 increase over 2005 was primarily due to higher sales of surface systems and sales of spare parts for helicopters that offset lower volume of space sales due to delays in project funding.

Aerospace segment profit increased by 16 percent in 2007 compared to 2006 due primarily to sales volume growth, increased prices and productivity, partially offset by inflation.

Segment profit increased by 13 percent in 2006 compared with 2005 due primarily to sales volume growth, increased prices and productivity savings (including benefits from prior restructuring actions) that were partially offset by inflation and the impact of stronger OE sales that typically have lower margins than aftermarket sales.

2008 Areas of Focus

Aerospace's primary areas of focus for 2008 include:

- Continuing to grow the sales and profitability of the commercial aerospace aftermarket in the highly competitive and cost focused airline industry;

- Securing Honeywell product content on new aircraft platforms;

- Continuing to design equipment that enhances the safety, performance and durability of aerospace and defense equipment, while reducing weight and operating costs;

- Developing differentiated, affordable products and services for the defense and space end–market; and

- Delivering world–class customer service and enhancing the customer service experience.

Automation and Control Solutions (ACS)

Overview

ACS provides innovative solutions that make homes, buildings, industrial sites, airport facilities and infrastructure more efficient, safe and comfortable. Our ACS products and services include controls for heating, cooling, indoor air quality, ventilation, humidification, lighting and home automation; advanced software applications for home/building control and optimization; sensors, switches, control systems and instruments for measuring pressure, air flow, temperature and electrical current; security, fire and gas detection; access control; video surveillance; remote patient monitoring systems; products for automatic identification and data collection, installation, maintenance and upgrades of systems that keep buildings safe, comfortable and productive; and automation and control solutions for industrial plants, including advanced software and automation systems that integrate, control and monitor complex processes in many types of industrial settings.

Economic and Other Factors

ACS's operating results are principally driven by:

- The growth of global commercial construction (including retrofits and upgrades);

- Demand for residential security and environmental control retrofits and upgrades;

- Industrial production;
- U.S. and European economic conditions;
- Economic growth rates in emerging markets;
- The strength of capital spending on process (including petrochemical and refining) and building automation; and
- Changes to energy, fire, security, health care, safety and environmental concerns and regulations.

Results of Operations

	2007	2006	2005
		(Dollars in millions)	
Net sales	$ 12,478	$ 11,020	$ 9,416
% change compared with prior year	13 %	17 %	
Segment profit	$ 1,405	$ 1,223	$ 1,065
% change compared with prior year	15 %	15 %	

ACS sales increased by 13 percent in 2007 compared with 2006, including 4 percent favorable impact of foreign exchange and net growth from acquisitions and divestitures of 2 percent.

- Sales in our Products businesses grew by 11 percent, driven by (i) increased sales of security products primarily due to growth in intrusion products, European distribution sales and emerging markets, (ii) continued strong demand for life safety products and (iii) introduction of new environmental and combustion control products.
- Sales in our Solutions businesses increased by 17 percent with growth in all regions, driven by energy retrofit and refining services projects, global infrastructure expansion, continued growth in orders and conversion to sales from our order backlog, as well as the favorable impact of foreign exchange.

ACS sales increased by 17 percent in 2006 compared with 2005, including 7 percent net impact from acquisitions and divestitures.

- Sales grew by 19 percent in our Products businesses, due to 11 percent net impact from acquisitions and divestitures, as well as strong customer demand for new products in our security and life safety products and increased sales to customers in emerging markets for environmental, combustion, sensing and control products.
- Sales in our Solutions businesses increased by 14 percent driven by continued strong orders growth, strong conversion to sales from our order backlog and increased sales in emerging markets and strong revenue from energy projects and 3 percent net impact from acquisitions net of divestitures.
- Sales from acquisitions, net of divestitures, increased by 7 percent in 2006 compared with 2005, largely representing revenues in ACS products businesses relating to NOVAR (primarily environmental, combustion, building controls and life safety products) for the first quarter of 2006, Zellweger (gas detection) for the first two quarters of 2006 and revenues from our Gardiner Groupe (security distribution) and First Technology (gas detection) acquisitions in the last three quarters of 2006.

ACS segment profit increased by 15 percent in 2007 compared with 2006 principally due to increased Products and Solutions sales volume and productivity savings, partially offset by inflation. We continue to experience a change in mix resulting from stronger sales growth in our Solutions businesses that historically have lower margins than our Products businesses.

ACS segment profit increased by 15 percent in 2006 compared with 2005 due principally to increased sales volume and productivity savings (including net integration savings from our acquisitions) that more than offset continued inflation. Segment profit was also negatively impacted in 2006 by a contract loss experienced on a Building Solutions project, and by ERP implementation costs.

2008 Areas of Focus

ACS's primary areas of focus for 2008 include:

- Extending technology leadership: lowest total installed cost and integrated product solutions;
- Defending and extending our installed base through customer productivity and globalization;
- Sustaining strong brand recognition through our brand and channel management;
- Centralization and standardization of global software development capabilities;
- Acquisition execution and integration; and
- Continuing to establish emerging markets presence and capability.

Specialty Materials

Overview

Specialty Materials develops and manufactures high–purity, high–quality and high–performance chemicals and materials for applications in the automotive, healthcare, agricultural, packaging, carpet fibers, refrigeration, appliance, housing, semiconductor, wax and adhesives segments. Specialty Materials also provides process technology, products and services for the petroleum refining, petrochemical and other industries. Specialty Materials' product portfolio includes fluorocarbons, caprolactam, ammonium sulfate for fertilizer, specialty films, advanced fibers, customized research chemicals and intermediates, electronic materials and chemicals, catalysts, and adsorbents.

Economic and Other Factors

Specialty Materials operating results are principally driven by:

- Level of investment in refining and petrochemical capacity, utilization and/or expansion,
- Degree of pricing volatility in raw materials such as benzene (the key component in phenol), natural gas, ethylene and sulfur;
- Impact of environmental and energy efficiency regulations;
- Extent of change in order rates from global semiconductor customers;
- Global demand for non–ozone depleting Hydro fluorocarbons (HFC's); and
- Condition of the US residential housing industry.

Results of Operations

	2007	2006	2005
	(Dollars in millions)		
Net sales	$ 4,866	$ 4,631	$ 3,234
% change compared with prior year	5 %	43 %	
Segment profit	$ 658	$ 568	$ 257
% change compared with prior year	16 %	121 %	

Specialty Materials sales increased by 5 percent in 2007 compared to 2006 driven by (i) a 16 percent increase in UOP sales primarily as a result of higher volume in its projects business principally due to capacity expansion in the refining and petrochemical industries and (ii) a 4 percent increase in Specialty Products sales due in large part to increased sales of electronic chemicals and specialty additives and higher sales to customers in the health care industry. Partially offsetting these increases was a 6 percent decrease in Fluorine Products sales primarily due to lower refrigerant pricing and lower sales volume of foam blowing agents used in insulating material as a result of continued weakness in the U.S. housing market.

Specialty Materials sales increased by 43 percent in 2006 compared to 2005 due to organic sales growth of 7 percent and 36 percent growth due to our UOP acquisition, net of divestitures.

Organic growth was 7 percent in 2006 primarily due to higher volume and prices. Organic sales in our Fluorine Products business increased by 9 percent due to continued strong demand for non– ozone depleting HFC products, and organic growth in our Resins and Chemicals business was 4 percent, primarily due to price increases to recover increased raw material costs. Both of these businesses experienced lower sales growth in the fourth quarter of 2006 due to the slowdown in the US residential housing industry. Our Resins and Chemicals business was also negatively impacted by a partial facility outage in the second half of 2006. Specialty Products organic sales increased by 10 percent due to higher sales to our customers in the semiconductor industry and increased sales of our specialty additives and our advanced fiber body armor. In 2005, organic sales increased by 4 percent, largely as a result of higher prices of 7 percent primarily in our Resins and Chemicals and Fluorine businesses, offsetting lower volumes in Specialty Products businesses.

Sales from acquisitions, net of divestitures grew by 36 percent in 2006 compared to 2005. This was due to a 44 percent growth in sales from UOP, which was consolidated into the Specialty Materials segment following our acquisition of the remaining 50 percent interest in UOP in November 2005. Prior to that date, UOP results were included in other income. UOP sales have grown due to continued strength in the petrochemical and refining industries. This growth was offset by the loss of sales of 8 percent principally from the divestiture of our Industrial Wax and North American Nylon Fiber businesses.

Specialty Materials segment profit increased by 16 percent in 2007 compared with 2006 principally due to increased UOP and Specialty Products sales partially offset by the decline in Fluorine Products sales as a result of the factors discussed above. Additionally, the effects of increased pricing and productivity more than offset raw material and other cost inflation.

Specialty Materials segment profit increased by 121 percent in 2006 compared with 2005 due principally to the impact of the UOP acquisition, net of divestitures, and increased organic growth and productivity savings (net of the lost margin from the partial facility outage). Price increases (including benefits from formula based pricing contracts) offset the impact of continued inflation in raw material costs.

2008 Areas of Focus

Specialty Materials primary areas of focus for 2008 include:

- Improving plant operational performance;
- Increasing resources and market penetration in emerging regions;
- Developing new products that address energy efficiency, renewable energy sources, global warming and security regulations;
- Increasing product differentiation;
- Continued contract wins and development of new process technologies and products in the petrochemical and refining industries; and
- Achieving productivity savings and pricing actions to offset inflation.

Transportation Systems

Overview

Transportation Systems provides automotive products that improve the performance, efficiency, and appearance of cars, trucks, and other vehicles through state–of–the–art technologies, world class brands and global solutions to customers' needs. Transportation Systems' products include turbochargers and charge–air and thermal systems; car care products including anti–freeze (Prestone(R)), filters (Fram(R)), spark plugs (Autolite(R)), and cleaners, waxes and additives (Holts(R)); and brake hard parts and other friction materials (Bendix(R) and Jurid(R)). Transportation Systems sells its products to OE automotive and truck manufacturers (e.g., BMW, Caterpillar, Daimler, Renault, Ford, and Volkswagen), wholesalers and distributors and through the retail aftermarket.

Economic and Other Factors

Transportation Systems operating results are principally driven by:

- Global demand for automobile and truck production;
- Diesel penetration rates for new engine platforms;
- Global consumer preferences for boosted diesel passenger cars;
- Degree of volatility in raw material prices, including nickel and steel;
- Changes in consumer spending for automotive aftermarket and car care products; and
- Regulations mandating lower emissions and improved fuel economy.

Results of Operations

	2007	2006	2005
		(Dollars in millions)	
Net sales	$ 5,009	$ 4,592	$ 4,505
% change compared with prior year	9 %	2 %	
Segment profit	$ 583	$ 574	$ 557
% change compared with prior year	2 %	3 %	

Transportation Systems sales increased 9 percent in 2007 compared with 2006, primarily due to the 5 percent favorable impact of foreign exchange and increased Turbo Technologies sales volume.

- Turbo Technologies sales increased by 12 percent primarily due to the favorable impact of foreign exchange and strong sales to European light vehicle manufacturers, resulting from increased production and diesel penetration rates, as well as sales related to the launch of new turbo platforms by these customers, partially offset by lower sales to commercial vehicle engine manufacturers.
- Consumer Products Group ("CPG") sales increased by 4 percent primarily due to the favorable impact of foreign exchange and higher prices (primarily to pass through ethylene glycol cost increases). This higher pricing was offset by lower sales volume, primarily due to continued softness in the US automotive aftermarket.

Transportation Systems sales increased 2 percent in 2006 compared with 2005, primarily due to increased Turbo Technologies sales, offset by lower CPG sales.

- Turbo Technologies sales increased by 6 percent primarily due to new product introductions in Europe and Asia, a slight increase in diesel penetration in Europe and relatively flat sales in the U.S.
- CPG sales decreased by 4 percent as a result of reduced consumer spending in North America on automotive aftermarket products and our exit from the North America Friction Materials OE business.

Transportation System segment profit increased by 2 percent in 2007 compared with 2006 primarily due to increased productivity, increased prices and lower warranty expense partially offset by the impact of inflation (primarily relating to nickel components), investment in product development to support future Turbo platforms, costs associated with CPG product introductions and CPG operational planning and production issues.

Transportation Systems segment profit increased by 3 percent in 2006 compared with 2005 due primarily to increased Turbo Technologies volume and productivity savings including the benefits of prior year restructuring actions, which offset higher material and labor inflation and increased warranty expense.

2008 Areas of Focus

Transportation Systems primary areas of focus in 2008 include:

- Sustaining superior turbocharger technology through successful platform launches;

- Increasing global penetration and share of diesel and gasoline turbocharger OEM demand;
- Further global expansion and extension of established strong product brands in CPG; and
- Addressing CPG operational planning and production issues.

Repositioning and Other Charges

A summary of repositioning and other charges follows:

	Years Ended December 31,		
	2007	2006	2005
	(Dollars in millions)		
Severance	$ 186	$ 102	$ 248
Asset impairments	14	15	5
Exit costs	9	7	14
Reserve adjustments	(18)	(22)	(25)
Total net repositioning charge	191	102	242
Asbestos related litigation charges, net of insurance	100	126	10
Probable and reasonably estimable environmental liabilities	225	210	186
Business impairment charges	9	12	23
Arbitration award related to phenol supply agreement	—	(18)	(67)
Other	18	51	18
Total net repositioning and other charges	$ 543	$ 483	$ 412

The following table summarizes the pretax distribution of total net repositioning and other charges by income statement classification.

	Years Ended December 31,		
	2007	2006	2005
	(Dollars in millions)		
Cost of products and services sold	$ 495	$ 472	$ 357
Selling, general and administrative expenses	48	11	43
Other (income) expense	—	—	12
	$ 543	$ 483	$ 412

The following tables provide details of the pretax impact of total net repositioning and other charges by segment.

	Years Ended December 31,		
	2007	2006	2005
	(Dollars in millions)		
Aerospace			
Net repositioning charge	$ 37	$ 10	$ 96

	Years Ended December 31,		
	2007	2006	2005
	(Dollars in millions)		
Automation and Control Solutions			
Net repositioning charge	$ 127	$ 39	$ 84
Other	—	—	1
	$ 127	$ 39	$ 85

	Years Ended December 31,		
	2007	2006	2005
	(Dollars in millions)		
Specialty Materials			
Net repositioning charge	$ 5	$ 11	$ 14
Business impairment charges	9	12	23
Arbitration award related to phenol supply agreement	—	(18)	(67)
Other	—	—	(4)
	$ 14	$ 5	$ (34)

	Years Ended December 31,		
	2007	2006	2005
	(Dollars in millions)		
Transportation Systems			
Net repositioning charge	$ 19	$ 32	$ 49
Asbestos related litigation charges, net of insurance	100	261	31
Other	—	—	2
	$ 119	$ 293	$ 82

	Years Ended December 31,		
	2007	2006	2005
	(Dollars in millions)		
Corporate			
Net repositioning charge	$ 3	$ 10	$ (1)
Asbestos related litigation charges, net of insurance	—	(135)	(21)
Probable and reasonably estimable environmental liabilities	225	210	186
Other	18	51	19
	$ 246	$ 136	$ 183

In 2007, we recognized repositioning charges totaling $209 million primarily for severance costs related to workforce reductions of 3,408 manufacturing and administrative positions mainly in our Automation and Control Solutions and Aerospace segments. Also, $18 million of previously established accruals, primarily for severance at our Transportation Systems and Aerospace segments, were returned to income in 2007 due mainly to changes in the scope of previously announced severance programs and due to fewer employee separations than originally planned associated with prior severance programs.

In 2006, we recognized repositioning charges totaling $124 million primarily for severance costs related to workforce reductions of 2,253 manufacturing and administrative positions across all of our segments. Also, $22 million of previously established accruals, primarily for severance at our Aerospace, Transportation Systems and Specialty Materials segments, were returned to income in 2006 due mainly to changes in the scope of previously announced severance programs and due to fewer employee separations than originally planned associated with prior Aerospace severance actions.

In 2005, we recognized repositioning charges totaling $267 million primarily for severance costs related to workforce reductions of 5,269 maufacturing and administrative positions across all of our segments including the implementation of a new organizational structure in our Aerospace segment (substantially implemented in the third quarter of 2005) which reorganized our Aerospace businesses to better align with customer segments. Also, $25 million of previously established accruals, primarily for severance at our Corporate, Specialty Materials and Automation and Control Solutions segments were returned to income in 2005. The reversal of severance liabilities related to changes in the scope of previously announced severance programs, excise taxes related to an executive severance amount previously paid which were determined to no longer be payable, and severance amounts previously

paid to an outside service provider as part of an outsourcing arrangement which were refunded to Honeywell.

These repositioning actions are expected to generate incremental pretax savings of approximately $100 million in 2008 compared with 2007 principally from planned workforce reductions. Cash expenditures for severance and other exit costs necessary to execute our repositioning actions were $92, $142 and $171 million in 2007, 2006 and 2005, respectively. Such expenditures for severance and other exit costs have been funded principally through operating cash flows. Cash expenditures for severance and other exit costs necessary to execute the remaining actions will approximate $150 million in 2008 and will be funded through operating cash flows.

In 2007, we recognized a charge of $225 million for environmental liabilities deemed probable and reasonably estimable during the year. We recognized asbestos related litigation charges, net of insurance, of $100 million which are discussed in Note 21 to the financial statements. We recognized other charges of $18 million for a business sales tax related to a prior divestiture ($8 million) and for contemplated settlements of certain legal matters ($10 million). We also recognized impairment charges of $9 million related to the write–down of property, plant and equipment held for sale in our Specialty Materials segment.

In 2006, we recognized a charge of $210 million for environmental liabilities deemed probable and reasonably estimable during the year. We recognized asbestos related litigation charges, net of insurance, of $126 million which are discussed in Note 21 to the financial statements. We recognized other charges of $51 million related to our Corporate segment primarily for the settlement of a property damage claim litigation matter in Brunswick, GA and our entrance into a plea agreement related to an environmental matter at our Baton Rouge, LA. facility. We recognized impairment charges of $12 million related to the write–down of property, plant and equipment held for sale in our Specialty Materials segment. We also recognized a credit of $18 million in connection with an arbitration award for overcharges by a supplier of phenol to our Specialty Materials business for 2005 transactions.

In 2005, we recognized a charge of $186 million for environmental liabilities deemed probable and reasonably estimable during the year. We recognized asbestos related litigation charges, net of insurance, of $10 million which are discussed in Note 21 to the financial statements. We recognized a credit of $67 million in connection with an arbitration award for overcharges by a supplier of phenol to our Specialty Materials business from June 2003 through the end of 2004. We recognized impairment charges of $23 million related to the write–down of property, plant and equipment held and used in our Specialty Materials segment. We also recognized other charges of $18 million principally related to the modification of a lease agreement for the Corporate headquarters facility ($10 million) and for various legal settlements ($7 million).

LIQUIDITY AND CAPITAL RESOURCES

The Company continues to manage its businesses to maximize operating cash flows as the primary source of liquidity. In addition to our available cash and operating cash flows, additional sources of liquidity include committed credit lines, short–term debt from the commercial paper market, long–term borrowings, and access to the public debt and equity markets, as well as the ability to sell trade accounts receivables. We continue to balance our cash and financing uses through investment in our existing core businesses, acquisition activity, share repurchases and dividends.

Cash Flow Summary

Our cash flows from operating, investing and financing activities, as reflected in the Consolidated Statement of Cash Flows for the years ended December 31, 2007, 2006 and 2005 are summarized as follows:

	2007	2006	2005
	(Dollars in millions)		
Cash provided by (used for):			
Operating activities	$ 3,911	$ 3,211	$ 2,442
Investing activities	(1,782)	(614)	(2,010)
Financing activities	(1,574)	(2,649)	(2,716)
Effect of exchange rate changes on cash	50	42	(68)
Net increase/(decrease) in cash and cash equivalents	$ 605	$ (10)	$ (2,352)

Cash provided by operating activities increased by $700 million during 2007 compared with 2006 primarily due to increased earnings, an increase in accrued liabilities of $349 million (primarily compensation, benefits and other employee related accruals, as well as customer advances and deferred income), a $55 million decrease in repositioning payments partially offset by decreased deferred income tax expense of $118 million and increased working capital usage of $68 million (accounts and other receivables, inventory and accounts payable). Cash provided by operating activities increased by $769 million during 2006 compared to 2005 primarily due to increased earnings, lower cash payments for asbestos of $331 million, receipt of $100 million from the sale of an insurance receivable, an increase in customer advances and deferred income (net of acquisitions) of $115 million, and $93 million receipt of an arbitration award relating to Specialty Materials, partially offset by increased working capital usage (accounts and other receivables (net of tax receivables), inventory and accounts payable) of $263 million (including proceeds of $58 million from the sale of a long–term receivable), higher cash tax payments (net of tax receipts) of $236 million and higher pension and postretirement payments of $154 million.

Cash used for investing activities increased by $1,168 million during 2007 compared with 2006 due primarily to higher spending for acquisitions, and lower proceeds from sales of businesses. In 2007, cash paid for acquisitions, net of cash acquired was $1,150 million primarily for Dimensions International, Enraf Holding B.V., Hand Held Products, Inc, and Maxon Corporation, compared to $633 million in 2006, primarily for our acquisitions of First Technologies and Gardiner Groupe. Sale proceeds from divestitures was $51 million in the 2007, compared to $665 million in 2006 primarily due to the sale of Indalex in February 2006 for $425 million, First Technology Safety & Analysis business (FTSA) for $93 million in May 2006 and the sale of First Technology Automotive Business in December 2006 for $90 million. Cash used for investing activities decreased by $1,396 million during 2006 compared with 2005 due primarily to lower spending for acquisitions, partially offset by lower proceeds of $285 million from maturities of investment securities.

Cash used for financing activities decreased by $1,075 million during 2007 compared with 2006 primarily due to a $2,620 million increase in net proceeds from debt (including commercial paper and short term borrowings), a $306 million reduction in cash used for payment of debt assumed with acquisitions, and an increase in proceeds from issuance of common stock primarily related to stock option exercises of $207 million; partially offset by increases in repurchases of common stock of $2,090 million. Cash used for financing activities decreased by $67 million during 2006 compared 2005, primarily due to a reduction for payment of debt assumed with acquisition of $356 million,

increased net proceeds from debt of $258 million, and increased proceeds from issuance of common stock primarily related to stock option exercises of $229 million, offset by increase in repurchases of common stock of $763 million and increased dividend payments.

Liquidity

Each of our businesses is focused on implementing strategies to improve working capital turnover in 2008 to increase operating cash flows. Considering the current economic environment in which each of our businesses operate and our business plans and strategies, including our focus on growth, cost reduction and productivity initiatives, we believe that our cash balances and operating cash flows will remain our principal source of liquidity. In addition to our available cash and operating cash flows, additional sources of liquidity include committed credit lines, short term debt from the commercial paper markets, long–term borrowings, and access to the public debt and equity markets, as well as our ability to sell trade accounts receivables.

A source of liquidity is our ability to issue short–term debt in the commercial paper market. Commercial paper notes are sold at a discount and have a maturity of not more than 270 days from date of issuance. Borrowings under the commercial paper program are available for general corporate purposes as well as for financing potential acquisitions. There was $1,756 million of commercial paper outstanding at December 31, 2007.

Our ability to access the commercial paper market, and the related cost of these borrowings, is affected by the strength of our credit ratings and our $3.0 billion of committed bank revolving credit facilities (Revolving Credit Facilities). Our credit ratings are periodically reviewed by the major independent debt–rating agencies. In 2007, Standard and Poor's, Fitch's and Moody's Rating Services affirmed their corporate ratings on our long–term debt of A and A+ and A2 respectively, and short–term debt of A–1, F1 and P–1 respectively, and maintained Honeywell's ratings outlook as "stable".

In March 2007, the Company issued $400 million of 5.30% Senior Notes due 2017 and $600 million 5.70% Senior Notes due 2037 (collectively, the "Notes"). The Notes are senior unsecured and unsubordinated obligations of Honeywell and rank equally with all of Honeywell's existing and future senior unsecured debt and senior to all Honeywell's subordinated debt. The offering resulted in gross proceeds of $1 billion, offset by $12 million in discount and issuance costs. Proceeds from the Notes were used to repay commercial paper and debt.

In May 2007 Honeywell entered into a $2.8 billion Amended and Restated Five–Year Credit Agreement ("Credit Agreement") with a syndicate of banks. Commitments under the Credit Agreement can be increased pursuant to the terms of the Credit Agreement to an aggregated amount not to exceed $3.5 billion. This credit facility contains a $700 million sub–limit for the issuance of letters of credit. The Credit Agreement is maintained for general corporate purposes, including support for the issuance of commercial paper and replaces the previous $2.3 billion five year credit agreement dated April 27, 2006 ("Prior Agreement"). At December 31, 2007, there were no borrowings or letters of credit issued under the credit facility. The Credit Agreement does not restrict Honeywell's ability to pay dividends, nor does it contain financial covenants.

In July 2007, the Company issued $500 million Floating Rate Senior Notes due 2009 and $400 million 5.625% Senior Notes due 2012 (collectively, the "Senior Notes"). The Senior Notes are senior unsecured and unsubordinated obligations of Honeywell and rank equally with all of Honeywell's existing and future senior unsecured debt and senior to all Honeywell's subordinated debt. The offering resulted in gross proceeds of $900 million, offset by $3 million in discount and issuance costs. Proceeds from the Senior Notes were used to repay commercial paper.

We also have a current shelf registration statement filed with the Securities and Exchange Commission under which we may issue additional debt securities, common stock and preferred stock that may be offered in one or more offerings on terms to be determined at the time of the offering. Net proceeds of any offering would be used for general corporate purposes, including repayment of existing indebtedness, capital expenditures and acquisitions.

We also sell interests in designated pools of trade accounts receivables to third parties. The sold receivables were over–collateralized by $101 million at December 31, 2007 and we retain a

subordinated interest in the pool of receivables representing that over-collateralization as well as an undivided interest in the balance of the receivables pools. New receivables are sold under the agreement as previously sold receivables are collected. The retained interests in the receivables are reflected at the amounts expected to be collected by us, and such carrying value approximates the fair value of our retained interests. The sold receivables were $500 million at both December 31, 2007 and 2006.

In addition to our normal operating cash requirements, our principal future cash requirements will be to fund capital expenditures, debt repayments, dividends, employee benefit obligations, environmental remediation costs, asbestos claims, severance and exit costs related to repositioning actions, share repurchases and any strategic acquisitions.

Specifically, we expect our primary cash requirements in 2008 to be as follows:

- Capital expenditures—we expect to spend approximately $900 million for capital expenditures in 2008 primarily for growth, replacement, production capacity expansion, cost reduction and maintenance.

- Debt repayments—there are $418 million of scheduled long-term debt maturities in 2008. We expect to refinance substantially all of these maturities in the debt capital markets during 2008.

- Share repurchases—We intend to continue to repurchase outstanding shares from time to time in the open market principally using cash generated from operations. Under the Company's previously announced $3.0 billion share repurchase program, $2.7 billion remained available as of December 31, 2007 for additional share repurchases. The amount and timing of repurchases may vary depending on market conditions and the level of other investing activities.

- Dividends—we expect to pay approximately $800 million in dividends on our common stock in 2008, reflecting the 10 percent increase in the dividend rate announced by Honeywell's Board of Directors in December 2007.

- Asbestos claims—we expect our cash spending for asbestos claims and our cash receipts for related insurance recoveries to be approximately $244 and $44 million, respectively, in 2008. See Asbestos Matters in Note 21 to the financial statements for further discussion.

- Pension contributions—assuming that actual pension plan returns are consistent with our expected rate of return of 9 percent in 2008 and beyond and that interest rates remain constant, we would not be required to make any contributions to our U.S. pension plans to satisfy minimum statutory funding requirements for the foreseeable future. However, we expect to make voluntary contributions of approximately $40 million to our U.S. pension plans in 2008 for government contracting purposes. We also expect to make contributions to our non-U.S. plans of approximately $125 million in 2008. See Note 22 to the financial statements for further discussion of pension contributions.

- Repositioning actions—we expect that cash spending for severance and other exit costs necessary to execute the remaining repositioning actions will approximate $150 million in 2008.

- Environmental remediation costs—we expect to spend approximately $300 million in 2008 for remedial response and voluntary clean-up costs. See Environmental Matters in Note 21 to the financial statements for additional information.

We continuously assess the relative strength of each business in our portfolio as to strategic fit, market position, profit and cash flow contribution in order to upgrade our combined portfolio and identify business units that will most benefit from increased investment. We identify acquisition candidates that will further our strategic plan and strengthen our existing core businesses. We also identify businesses that do not fit into our long-term strategic plan based on their market position, relative profitability or growth potential. These businesses are considered for potential divestiture, restructuring or other repositioning actions subject to regulatory constraints. In 2007, we realized $51 million in cash proceeds from sales of non-strategic businesses.

Based on past performance and current expectations, we believe that our operating cash flows will be sufficient to meet our future cash needs. Our available cash, committed credit lines, access to the public debt and equity markets as well as our ability to sell trade accounts receivables, provide

additional sources of short–term and long–term liquidity to fund current operations, debt maturities, and future investment opportunities. Based on our current financial position and expected economic performance, we do not believe that our liquidity will be adversely impacted by an inability to access our sources of financing.

Contractual Obligations and Probable Liability Payments

Following is a summary of our significant contractual obligations and probable liability payments at December 31, 2007:

	Payments by Period				
	Total	2008	2009–2010	2011–2012	Thereafter
	(Dollars in millions)				
Long–term debt, including capitalized leases(1)	$ 5,837	$ 418	$ 2,145	$ 934	$ 2,340
Minimum operating lease payments	1,185	327	397	197	264
Purchase obligations(2)	2,357	913	690	401	353
Estimated environmental liability payments(3)	799	300	350	100	49
Asbestos related liability payments(4)	1,655	244	900	400	111
Asbestos insurance recoveries(5)	(1,136)	(44)	(88)	(88)	(916)
	$ 10,697	$ 2,158	$ 4,394	$ 1,944	$ 2,201

(1) Assumes all long–term debt is outstanding until scheduled maturity.

(2) Purchase obligations are entered into with various vendors in the normal course of business and are consistent with our expected requirements.

(3) The payment amounts in the table only reflect the environmental liabilities which are probable and reasonably estimable as of December 31, 2007. See Environmental Matters in Note 21 to the financial statements for additional information.

(4) These amounts are estimates of asbestos related cash payments for NARCO and Bendix based on our asbestos related liabilities which are probable and reasonably estimable as of December 31, 2007. NARCO estimated payments are based on the terms and conditions, including evidentiary requirements, specified in the definitive agreements or agreements in principle and pursuant to Trust Distribution Procedures. Bendix payments are based on our estimate of pending and future claims. Projecting future events is subject to many uncertainties that could cause asbestos liabilities to be higher or lower than those projected and recorded. See Asbestos Matters in Note 21 to the financial statements for additional information.

(5) These amounts represent probable insurance recoveries through 2018 based on our insurance recoveries that are deemed probable for asbestos related liabilities as of December 31, 2007. See Asbestos Matters in Note 21 to the financial statements for additional information.

The table excludes $666 million of uncertain tax positions. See Note 6 to the financial statements.

The table also excludes our pension and other postretirement benefits (OPEB) obligations. We made voluntary contributions of $42 and $68 million to our U.S. pension plans in 2007 and 2006, respectively. Future plan contributions are dependent upon actual plan asset returns and interest rates. Assuming that actual plan asset returns are consistent with our expected plan return of 9 percent in 2008 and beyond, and that interest rates remain constant, we would not be required to make any contributions to our U.S. pension plans to satisfy minimum statutory funding requirements for the foreseeable future. We expect to make voluntary contributions of approximately $40 million to our U.S. plans in 2008 for government contracting purposes. We expect to make contributions to our non–U.S. plans of approximately $125 million in 2008. Payments due under our OPEB plans are not required to be funded in advance, but are paid as medical costs are incurred by covered retiree populations, and are principally dependent upon the future cost of retiree medical benefits under our plans. We expect our OPEB payments to approximate $206 million in 2008 net of the benefit of approximately $15 million

from the Medicare prescription subsidy. See Note 22 to the financial statements for further discussion of our pension and OPEB plans.

Off–Balance Sheet Arrangements

Following is a summary of our off–balance sheet arrangements:

Guarantees—We have issued or are a party to the following direct and indirect guarantees at December 31, 2007:

	Maximum Potential Future Payments
	(Dollars in millions)
Operating lease residual values	$ 39
Other third parties' financing	4
Unconsolidated affiliates' financing	3
Customer financing	23
	$ 69

We do not expect that these guarantees will have a material adverse effect on our consolidated results of operations, financial position or liquidity.

In connection with the disposition of certain businesses and facilities we have indemnified the purchasers for the expected cost of remediation of environmental contamination, if any, existing on the date of disposition. Such expected costs are accrued when environmental assessments are made or remedial efforts are probable and the costs can be reasonably estimated.

Retained Interests in Factored Pools of Trade Accounts Receivables—As a source of liquidity, we sell interests in designated pools of trade accounts receivables to third parties. The sold receivables ($500 million at December 31, 2007) are over–collateralized and we retain a subordinated interest in the pool of receivables representing that over–collateralization as well as an undivided interest in the balance of the receivables pools. The over–collateralization provides credit support to the purchasers of the receivable interest by limiting their losses in the event that a portion of the receivables sold becomes uncollectible. At December 31, 2007, our retained subordinated and undivided interests at risk were $101 and $721 million, respectively. Based on the underlying credit quality of the receivables placed into the designated pools of receivables being sold, we do not expect that any losses related to our retained interests at risk will have a material adverse effect on our consolidated results of operations, financial position or liquidity.

Environmental Matters

We are subject to various federal, state, local and foreign government requirements relating to the protection of the environment. We believe that, as a general matter, our policies, practices and procedures are properly designed to prevent unreasonable risk of environmental damage and personal injury and that our handling, manufacture, use and disposal of hazardous or toxic substances are in accordance with environmental and safety laws and regulations. However, mainly because of past operations and operations of predecessor companies, we, like other companies engaged in similar businesses, have incurred remedial response and voluntary cleanup costs for site contamination and are a party to lawsuits and claims associated with environmental and safety matters, including past production of products containing toxic substances. Additional lawsuits, claims and costs involving environmental matters are likely to continue to arise in the future.

With respect to environmental matters involving site contamination, we continually conduct studies, individually or jointly with other potentially responsible parties, to determine the feasibility of various remedial techniques to address environmental matters. It is our policy (see Note 1 to the financial statements) to record appropriate liabilities for environmental matters when remedial efforts or damage claim payments are probable and the costs can be reasonably estimated. Such liabilities are based on our best estimate of the undiscounted future costs required to complete the remedial work. The recorded liabilities are adjusted periodically as remediation efforts progress or as additional

technical or legal information becomes available. Given the uncertainties regarding the status of laws, regulations, enforcement policies, the impact of other potentially responsible parties, technology and information related to individual sites, we do not believe it is possible to develop an estimate of the range of reasonably possible environmental loss in excess of our recorded liabilities. We expect to fund expenditures for these matters from operating cash flow. The timing of cash expenditures depends on a number of factors, including the timing of litigation and settlements of remediation liability, personal injury and property damage claims, regulatory approval of cleanup projects, execution timeframe of projects, remedial techniques to be utilized and agreements with other parties.

Remedial response and voluntary cleanup payments were $267, $264 and $247 million in 2007, 2006, and 2005, respectively, and are currently estimated to be approximately $300 million in 2008. We expect to fund such expenditures from operating cash flow.

Remedial response and voluntary cleanup costs charged against pretax earnings were $230, $210 and $186 million in 2007, 2006 and 2005, respectively. At December 31, 2007 and 2006, the recorded liabilities for environmental matters was $799 and $831 million, respectively. In addition, in 2007 and 2006 we incurred operating costs for ongoing businesses of approximately $81 and $101 million, respectively, relating to compliance with environmental regulations.

Although we do not currently possess sufficient information to reasonably estimate the amounts of liabilities to be recorded upon future completion of studies, litigation or settlements, and neither the timing nor the amount of the ultimate costs associated with environmental matters can be determined, they could be material to our consolidated results of operations or operating cash flows in the periods recognized or paid. However, considering our past experience and existing reserves, we do not expect that environmental matters will have a material adverse effect on our consolidated financial position.

See Note 21 to the financial statements for a discussion of our commitments and contingencies, including those related to environmental matters and toxic tort litigation.

Financial Instruments

As a result of our global operating and financing activities, we are exposed to market risks from changes in interest and foreign currency exchange rates and commodity prices, which may adversely affect our operating results and financial position. We minimize our risks from interest and foreign currency exchange rate and commodity price fluctuations through our normal operating and financing activities and, when deemed appropriate, through the use of derivative financial instruments. We do not use derivative financial instruments for trading or other speculative purposes and do not use leveraged derivative financial instruments. A summary of our accounting policies for derivative financial instruments is included in Note 1 to the financial statements.

We conduct our business on a multinational basis in a wide variety of foreign currencies. Our exposure to market risk from changes in foreign currency exchange rates arises from international financing activities between subsidiaries, foreign currency denominated monetary assets and liabilities and anticipated transactions arising from international trade. Our objective is to preserve the economic value of non–functional currency cash flows. We attempt to hedge transaction exposures with natural offsets to the fullest extent possible and, once these opportunities have been exhausted, through foreign currency forward and option agreements with third parties. Our principal currency exposures relate to the U.S. dollar, Euro, British pound, Canadian dollar, Hong Kong dollar, Mexican peso, Swiss franc, Czech koruna, Chinese renminbi and Japanese yen.

Our exposure to market risk from changes in interest rates relates primarily to our net debt and pension obligations. As described in Notes 14 and 16 to the financial statements, we issue both fixed and variable rate debt and use interest rate swaps to manage our exposure to interest rate movements and reduce overall borrowing costs.

Financial instruments, including derivatives, expose us to counterparty credit risk for nonperformance and to market risk related to changes in interest or currency exchange rates. We manage our exposure to counterparty credit risk through specific minimum credit standards, diversification of counterparties, and procedures to monitor concentrations of credit risk. Our counterparties are substantial investment and commercial banks with significant experience using such derivative instruments. We monitor the impact of market risk on the fair value and expected future cash flows of

our derivative and other financial instruments considering reasonably possible changes in interest and currency exchange rates and restrict the use of derivative financial instruments to hedging activities.

The following table illustrates the potential change in fair value for interest rate sensitive instruments based on a hypothetical immediate one-percentage-point increase in interest rates across all maturities, the potential change in fair value for foreign exchange rate sensitive instruments based on a 10 percent weakening of the U.S. dollar versus local currency exchange rates across all maturities, and the potential change in fair value of contracts hedging commodity purchases based on a 20 percent decrease in the price of the underlying commodity across all maturities at December 31, 2007 and 2006.

	Face or Notional Amount	Carrying Value(1)	Fair Value(1)	Estimated Increase (Decrease) In Fair Value
		(Dollars in millions)		
December 31, 2007				
Interest Rate Sensitive Instruments				
Long-term debt (including current maturities)	$ (5,817)	$ (5,837)	$ (5,928)	$ (281)
Interest rate swap agreements	300	20	20	(45)
Foreign Exchange Rate Sensitive Instruments				
Foreign currency exchange contracts(2)	3,295	4	4	12
Commodity Price Sensitive Instruments				
Forward commodity contracts(3)	8	—	—	(1)
December 31, 2006				
Interest Rate Sensitive Instruments				
Long-term debt (including current maturities)	$ (4,329)	$ (4,332)	$ (4,521)	$ (194)
Interest rate swap agreements	700	3	3	(31)
Foreign Exchange Rate Sensitive Instruments				
Foreign currency exchange contracts(2)	2,572	—	—	8
Commodity Price Sensitive Instruments				
Forward commodity contracts(3).	60	(9)	(9)	(10)

(1) Asset or (liability).

(2) Changes in the fair value of foreign currency exchange contracts are offset by changes in the fair value or cash flows of underlying hedged foreign currency transactions.

(3) Changes in the fair value of forward commodity contracts are offset by changes in the cash flows of underlying hedged commodity transactions.

The above discussion of our procedures to monitor market risk and the estimated changes in fair value resulting from our sensitivity analyses are forward-looking statements of market risk assuming certain adverse market conditions occur. Actual results in the future may differ materially from these estimated results due to actual developments in the global financial markets. The methods used by us to assess and mitigate risk discussed above should not be considered projections of future events.

CRITICAL ACCOUNTING POLICIES

The preparation of our consolidated financial statements in accordance with generally accepted accounting principles is based on the selection and application of accounting policies that require us to make significant estimates and assumptions about the effects of matters that are inherently uncertain. We consider the accounting policies discussed below to be critical to the understanding of our financial statements. Actual results could differ from our estimates and assumptions, and any such differences could be material to our consolidated financial statements.

We have discussed the selection, application and disclosure of these critical accounting policies with the Audit Committee of our Board of Directors and our Independent Registered Public Accountants. New accounting standards effective in 2007 which had a material impact on our

consolidated financial statements are described in the Recent Accounting Pronouncements section in Note 1 to the financial statements.

Contingent Liabilities—We are subject to a number of lawsuits, investigations and claims (some of which involve substantial dollar amounts) that arise out of the conduct of our global business operations or those of previously owned entities. These contingencies primarily relate to product liabilities (including asbestos), contractual matters, and environmental, health and safety matters. We recognize a liability for any contingency that is probable of occurrence and reasonably estimable. We continually assess the likelihood of any adverse judgments or outcomes to our contingencies, as well as potential amounts or ranges of probable losses, and recognize a liability, if any, for these contingencies based on a careful analysis of each matter with the assistance of outside legal counsel and, if applicable, other experts. Such analysis includes making judgments concerning matters such as the costs associated with environmental matters, the outcome of negotiations, the number and cost of pending and future asbestos claims, and the impact of evidentiary requirements. Because most contingencies are resolved over long periods of time, liabilities may change in the future due to new developments (including new discovery of fact, changes in legislation and outcomes of similar cases through the judicial system), changes in assumptions or changes in our settlement strategy. For a discussion of our contingencies related to environmental, asbestos and other matters, including management's judgment applied in the recognition and measurement of specific liabilities, see Notes 1 and 21 to the financial statements.

Asbestos Related Contingencies and Insurance Recoveries—We are a defendant in personal injury actions related to products containing asbestos (refractory and friction products). We recognize a liability for any asbestos related contingency that is probable of occurrence and reasonably estimable. Regarding North American Refractories Company (NARCO) asbestos related claims, we accrue for pending claims based on terms and conditions, including evidentiary requirements, in definitive agreements or agreements in principle with current claimants. We also accrued for the probable value of future NARCO asbestos related claims through 2018 based on the disease criteria and payment values contained in the NARCO trust as described in Note 21 to the financial statements. In light of the inherent uncertainties in making long term projections regarding claims filing rates and disease manifestation, we do not believe that we have a reasonable basis for estimating NARCO asbestos claims beyond 2018 under Statement of Financial Accounting Standards No. 5, "Accounting for Contingencies" (SFAS No. 5). Regarding Bendix asbestos related claims, we accrue for the estimated value of pending claims based on expected claim resolution values and historic dismissal rates. Since the fourth quarter of 2006, we also accrue for the estimated cost of future anticipated claims related to Bendix for the next five years based on our assessment of additional claims that may be brought against us and anticipated resolution values in the tort system. In December 2006, we also changed our methodology for valuing Bendix pending and future claims from using average resolution values for the previous five years to using average resolution values for the previous two years. The claims filing experience and resolution data for Bendix related claims has become more reliable over the past several years. Accordingly, in the fourth quarter of 2007, we updated our methodology for valuing Bendix pending and future claims using the average resolution values for the past three years. We will continue to updated the expected resolution values used to estimate the cost of pending and future Bendix claims during the fourth quarter each year. For additional information see Note 21 to the financial statements. We continually assess the likelihood of any adverse judgments or outcomes to our contingencies, as well as potential ranges of probable losses and recognize a liability, if any, for these contingencies based on an analysis of each individual issue with the assistance of outside legal counsel and, if applicable, other experts.

In connection with the recognition of liabilities for asbestos related matters, we record asbestos related insurance recoveries that are deemed probable. In assessing the probability of insurance recovery, we make judgments concerning insurance coverage that we believe are reasonable and consistent with our historical experience with our insurers, our knowledge of any pertinent solvency issues surrounding insurers, various judicial determinations relevant to our insurance programs and our consideration of the impacts of any settlements with our insurers. At December 31, 2007, we have recorded insurance receivables of $939 million that can be specifically allocated to NARCO related asbestos liabilities. We also have $1.9 billion in coverage remaining for Bendix related asbestos

liabilities although there are gaps in our coverage due to insurance company insolvencies, certain uninsured periods and insurance settlements, resulting in approximately 50 percent of these claims on a cumulative historical basis being reimbursable by insurance. Our insurance is with both the domestic insurance market and the London excess market. While the substantial majority of our insurance carriers are solvent, some of our individual carriers are insolvent, which has been considered in our analysis of probable recoveries. Projecting future events is subject to various uncertainties that could cause the insurance recovery on asbestos related liabilities to be higher or lower than that projected and recorded. Given the inherent uncertainty in making future projections, we reevaluate our projections concerning our probable insurance recoveries in light of any changes to the projected liability, our recovery experience or other relevant factors that may impact future insurance recoveries. See Note 21 to the financial statements for a discussion of management's judgments applied in the recognition and measurement of insurance recoveries for asbestos related liabilities.

Defined Benefit Pension Plans—We maintain defined benefit pension plans covering a majority of our employees and retirees. For financial reporting purposes, net periodic pension expense is calculated based upon a number of significant actuarial assumptions, including a discount rate for plan obligations and an expected long–term rate of return on plan assets. We determine the expected long–term rate of return on plan assets utilizing historic and expected plan asset returns over varying long–term periods combined with current market conditions and broad asset mix considerations (see Note 22 to the financial statements for actual and targeted asset allocation percentages for our pension plans). The discount rate reflects the market rate on December 31 (measurement date) for high–quality fixed–income investments with maturities corresponding to our benefit obligations and is subject to change each year. Further information on all our major actuarial assumption is included in Note 22 to the financial statements.

The key assumptions used in developing our 2007, 2006 and 2005 net periodic pension expense for our U.S. plans included the following:

	2007	2006	2005
Discount rate	6.0 %	5.75 %	5.875 %
Assets:			
Expected rate of return	9 %	9 %	9 %
Actual rate of return	9 %	14 %	8 %
Actual 10 year average annual compounded rate of return	9 %	10 %	10 %

The discount rate can be volatile from year to year because it is determined based upon the prevailing rate as of the measurement date. We will use a 6.50 percent discount rate in 2008, reflecting the increase in the market interest rate environment. We plan to continue to use an expected rate of return on plan assets of 9 percent for 2008 based principally on our historical experience of actual plan returns. The net losses for our pension plans were $1.7 billion at December 31, 2007 compared with $2.4 billion at December 31, 2006. This decrease of $700 million is due primarily to lower net losses in our U.S. plans due to a higher discount rate at December 31, 2007 and loss amortization in 2007. The net losses at December 31, 2007 principally result from the decline each year in the discount rate for the period 2002 through 2006 and from actual plan asset returns below expected rates of return during 2000 through 2002. Such net losses were recognized as of December 31, 2006 on our consolidated balance sheet and as a component of other comprehensive income (loss), net of tax, in accordance with SFAS No. 158, "Employers' Accounting for Defined Benefit Pension and Other Postretirement Plans (SFAS No. 158) which is discussed in detail in Notes 1 and 22 to the financial statements. In the future we will continue to systematically recognize such net losses in net periodic pension expense in accordance with Statement of Financial Accounting Standards No. 87, "Employers Accounting for Pensions" (SFAS No. 87). Under SFAS No. 87, we use the market–related value of plan assets reflecting changes in the fair value of plan assets over a three–year period. Further, net losses in excess of 10 percent of the greater of the market–related value of plan assets or the plans' projected benefit obligation (the corridor) are recognized over a six–year period.

Changes in net periodic pension expense may occur in the future due to changes in our expected rate of return on plan assets and discount rate resulting from economic events. The following table

highlights the sensitivity of our U.S. pension obligations and expense to changes in these assumptions, assuming all other assumptions remain constant:

Change in Assumption	Impact on Annual Pension Expense	Impact on PBO
0.25 percentage point decrease in discount rate	Increase $50 million	Increase $314 million
0.25 percentage point increase in discount rate	Decrease $50 million	Decrease $309 million
0.25 percentage point decrease in expected rate of return on assets	Increase $30 million	—
0.25 percentage point increase in expected rate of return on assets	Decrease $30 million	—

The sensitivities above regarding changes in the discount rate are applicable only when there are unrecognized losses outside of the corridor subject to amortization over a six–year period. At December 31, 2007, there were no losses outside of the corridor subject to amortization in our U.S. plans. In the future, if the discount rate were to increase from the current rate of 6.50 percent there would not be a significant change to annual pension expense. Only if the discount rate were to decrease to 6.25% would the sensitivities described in the table be applicable.

Net periodic pension expense for our pension plans is expected to be approximately $30 million in 2008, a $148 million decrease from 2007 due principally to a decrease in the amortization of net losses in our U.S. plans. The decline in the amortization of net losses results principally from an increase in the discount rate at December 31, 2007 and actual plan asset returns higher than the expected rate of return in 2004 and 2006.

In 2007, 2006 and 2005 we were not required to make a contribution to satisfy minimum statutory funding requirements in our U.S. pension plans. We made voluntary contributions of $42 and $68 million to our U.S. pension plans in 2007 and 2006, respectively, mainly for government contracting purposes. Future plan contributions are dependent upon actual plan asset returns and interest rates. Assuming that actual plan returns are consistent with our expected plan return of 9 percent in 2008 and beyond, and that interest rates remain constant, we would not be required to make any contributions to our U.S. pension plans to satisfy minimum statutory funding requirements for the foreseeable future. However, we expect to make voluntary contributions of approximately $40 million in cash in 2008 to certain of our U.S. pension plans for government contracting purposes. We also expect to contribute approximately $125 million in cash in 2008 to our non–U.S. defined benefit pension plans to satisfy regulatory funding standards.

Long–Lived Assets (including Tangible and Definite–Lived Intangible Assets)—To conduct our global business operations and execute our business strategy, we acquire tangible and intangible assets, including property, plant and equipment and definite–lived intangible assets. At December 31, 2007, the net carrying amount of these long–lived assets totaled $6.4 billion. The determination of useful lives (for depreciation/amortization purposes) and whether or not these assets are impaired involves the use of accounting estimates and assumptions, changes in which could materially impact our financial condition or operating performance if actual results differ from such estimates and assumptions. We periodically evaluate the recoverability of the carrying amount of our long–lived assets whenever events or changes in circumstances indicate that the carrying amount of a long–lived asset group may not be fully recoverable. The principal factors we consider in deciding when to perform an impairment review are as follows:

- significant under–performance (i.e., declines in sales, earnings or cash flows) of a business or product line in relation to expectations;
- annual operating plans or five–year strategic plans that indicate an unfavorable trend in operating performance of a business or product line;
- significant negative industry or economic trends; and
- significant changes or planned changes in our use of the assets.

Once it is determined that an impairment review is necessary, recoverability of assets is measured by comparing the carrying amount of the asset grouping to the estimated future undiscounted cash flows. If the carrying amount exceeds the estimated future undiscounted cash flows, the asset grouping is considered to be impaired. The impairment is then measured as the difference between the carrying

amount of the asset grouping and its fair value. We use the best information available to determine fair value, which are usually either market prices (if available) or an estimate of the future discounted cash flow. The key estimates in our discounted cash flow analysis include expected industry growth rates, our assumptions as to volume, selling prices and costs, and the discount rate selected. As described in more detail in the repositioning and other charges section of our MD&A, we have recorded impairment charges related to long–lived assets of $9 and $12 million in 2007 and 2006, respectively, principally related to businesses in our Specialty Materials segment. These businesses were significantly under–performing or were in industries with negative economic trends and subsequently these businesses were significantly restructured, sold or are in the process of being sold.

Goodwill Impairment Testing—Goodwill represents the excess of acquisition costs over the fair value of the net tangible assets and identifiable intangible assets acquired in a business combination. Goodwill is not amortized, but is subject to impairment testing. Our Goodwill balance, $9.2 billion as of December 31, 2007, is subject to impairment testing annually as of March 31, or whenever events or changes in circumstances indicate that the carrying amount may not be fully recoverable, using the guidance and criteria described in Statement of Financial Accounting Standards No. 142, (SFAS No. 142) "Goodwill and Other Intangible Assets". This testing compares carrying values to fair values and, when appropriate, the carrying value is reduced to fair value. The fair value of our reporting units is estimated utilizing a discounted cash flow approach incorporating historic and projected future operating performance. This impairment test involves the use of accounting estimates and assumptions, changes in which could materially impact our financial condition or operating performance if actual results differ from such estimates and assumptions. We completed our annual impairment test as of March 31, 2007 and determined that there was no impairment as of that date.

Income Taxes—Deferred tax assets and liabilities are determined based on the difference between the financial statements and tax basis of assets and liabilities using enacted tax rates in effect for the year in which the differences are expected to reverse. Our provision for income taxes is based on domestic and international statutory income tax rates and tax planning opportunities in the jurisdictions in which we operate. Significant judgment is required in determining income tax provisions as well as deferred tax asset and liability balances, including the estimation of valuation allowances and the evaluation of tax positions.

As of December 31, 2007, we recognized a net deferred tax asset of $1,611 million, less a valuation allowance of $490 million. Net deferred tax assets are primarily comprised of net deductible temporary differences, net operating loss carryforwards and tax credit carryforwards that are available to reduce taxable income in future periods. The determination of the amount of valuation allowance to be provided on recorded deferred tax assets involves estimates regarding (1) the timing and amount of the reversal of taxable temporary differences, (2) expected future taxable income, and (3) the impact of tax planning strategies. A valuation allowance is required when it is more likely than not that all or a portion of a deferred tax asset will not be realized. In assessing the need for a valuation allowance, we consider all available positive and negative evidence, including past operating results, projections of future taxable income and the feasibility of ongoing tax planning strategies. The projections of future taxable income include a number of estimates and assumptions regarding our volume, pricing and costs. Additionally, valuation allowances related to deferred tax assets can be impacted by changes to tax laws.

Our net deferred tax asset of $1,611 million is comprised of $1,095 million related to U.S. operations and $516 million related to non–U.S. operations. The U.S. net deferred tax asset of $1,095 million is comprised of net deductible temporary differences, tax credit carryforwards and state tax net operating losses which we believe will more likely than not be realized through the generation of future taxable income in the U.S. and tax planning strategies. We maintain a valuation allowance of $63 million against such asset related to capital losses and state tax net operating losses. The non–U.S. net deferred tax asset of $516 million is comprised principally of net operating and capital loss carryforwards, mainly in Germany, France and the United Kingdom. We maintain a valuation allowance of $427 million against these deferred tax assets reflecting our historical experience and lower expectations of taxable income over the applicable carryforward periods. As more fully described in Note 6 to the financial statements, our valuation allowance decreased by $26 million in 2007 and increased by $39 and $139 million in 2006 and 2005, respectively. In the event we determine that we will not be able to realize our net deferred tax assets in the future, we will reduce such amounts through a charge to income in the period such

determination is made. Conversely, if we determine that we will be able to realize net deferred tax assets in excess of the carrying amounts, we will decrease the recorded valuation allowance through a credit to income or a credit to goodwill in the period that such determination is made. If a valuation allowance is recognized for the net deferred tax asset for an acquired entity's deductible temporary differences, operating loss, capital loss, or tax credit carryforwards at the acquisition date, the tax benefits for those items recognized after the acquisition date shall be applied first to reduce to zero goodwill related to the acquisition, second to reduce to zero other non-current intangible assets related to the acquisition, and third to reduce income tax expense.

Significant judgment is required in determining income tax provisions under Statement of Financial Accounting Standards No. 109 "Accounting for Income Taxes" (SFAS No. 109) and in evaluating tax positions. We establish additional provisions for income taxes when, despite the belief that tax positions are fully supportable, there remain certain positions that do not meet the minimum probability threshold, as defined by FASB Interpretation ("FIN") No. 48, "Accounting for Uncertainty in Income Taxes—An Interpretation of FASB Statement 109" ("FIN 48"), which is a tax position that is more likely than not to be sustained upon examination by the applicable taxing authority. In the normal course of business, the Company and its subsidiaries are examined by various Federal, State and foreign tax authorities. We regularly assess the potential outcomes of these examinations and any future examinations for the current or prior years in determining the adequacy of our provision for income taxes. We continually assess the likelihood and amount of potential adjustments and adjust the income tax provision, the current tax liability and deferred taxes in the period in which the facts that give rise to a revision become known.

As described in further detail in the Recent Accounting Pronouncements section in Note 1 to the financial statements, FIN 48 was effective beginning January 1, 2007. FIN 48 establishes a single model to address accounting for uncertainty in tax positions. FIN 48 clarifies the accounting for income taxes by prescribing a minimum recognition threshold a tax position is required to meet before being recognized in the financial statements. FIN 48 also provides guidance on derecognition, measurement, classification, interest and penalties, accounting in interim periods, disclosure and transition. Upon adoption as of January 1, 2007, we reduced our existing reserves for uncertain tax positions by $33 million, largely related to a reduction in state income tax matters, partially offset by a net increase for federal and international tax reserves. This reduction was recorded as a cumulative effect adjustment to shareholders' equity. Additionally, we decreased a deferred tax asset and its associated valuation allowance by $44 million and increased goodwill by $1 million.

Sales Recognition on Long-Term Contracts—In 2007, we recognized approximately 13 percent of our total net sales using the percentage-of-completion method for long-term contracts in our Automation and Control Solutions, Aerospace and Specialty Materials segments. These long-term contracts are measured on the cost-to-cost basis for engineering-type contracts and the units-of-delivery basis for production-type contracts. Accounting for these contracts involves management judgment in estimating total contract revenue and cost. Contract revenues are largely determined by negotiated contract prices and quantities, modified by our assumptions regarding contract options, change orders, incentive and award provisions associated with technical performance and price adjustment clauses (such as inflation or index-based clauses). Contract costs are incurred over a period of time, which can be several years, and the estimation of these costs requires management judgment. Cost estimates are largely based on negotiated or estimated purchase contract terms, historical performance trends and other economic projections. Significant factors that influence these estimates include inflationary trends, technical and schedule risk, internal and subcontractor performance trends, business volume assumptions, asset utilization, and anticipated labor agreements. Revenue and cost estimates are regularly monitored and revised based on changes in circumstances. Anticipated losses on long-term contracts are recognized when such losses become evident. We maintain financial controls over the customer qualification, contract pricing and estimation processes to reduce the risk of contract losses.

OTHER MATTERS

Litigation

See Note 21 to the financial statements for a discussion of environmental, asbestos and other litigation matters.

Recent Accounting Pronouncements

See Note 1 to the financial statements for a discussion of recent accounting pronouncements.

Item 7A. Quantitative and Qualitative Disclosures About Market Risk

Information relating to market risk is included in Item 7. Management Discussion and Analysis of Financial Condition and Results of Operations under the caption "Financial Instruments".

Item 8. Financial Statements and Supplementary Data

HONEYWELL INTERNATIONAL INC.
CONSOLIDATED STATEMENT OF OPERATIONS

	Years Ended December 31,		
	2007	2006	2005
	(Dollars in millions, except per share amounts)		
Product sales	$ 27,805	$ 25,165	$ 22,257
Service sales	6,784	6,202	5,395
Net sales	34,589	31,367	27,652
Costs, expenses and other			
Cost of products sold	21,629	19,649	17,681
Cost of services sold	4,671	4,447	3,843
	26,300	24,096	21,524
Selling, general and administrative expenses	4,565	4,210	3,707
Other (income)/expense	(53)	(111)	(231)
Interest and other financial charges	456	374	356
	31,268	28,569	25,356
Income from continuing operations before taxes	3,321	2,798	2,296
Tax expense	877	720	732
Income from continuing operations	2,444	2,078	1,564
Income from discontinued operations, net of taxes	—	5	95
Cumulative effect of accounting change, net of taxes	—	—	(21)
Net income	$ 2,444	$ 2,083	$ 1,638
Earnings (loss) per share of common stock—basic:			
Income from continuing operations	$ 3.20	$ 2.53	$ 1.85
Income from discontinued operations	—	0.01	0.11
Cumulative effect of accounting change	—	—	(0.03)
Net income	$ 3.20	$ 2.54	$ 1.93
Earnings (loss) per share of common stock—assuming dilution:			
Income from continuing operations	$ 3.16	$ 2.51	$ 1.84
Income from discontinued operations	—	0.01	0.11
Cumulative effect of accounting change	—	—	(0.03)
Net income	$ 3.16	$ 2.52	$ 1.92

The Notes to Financial Statements are an integral part of this statement.

HONEYWELL INTERNATIONAL INC.
CONSOLIDATED BALANCE SHEET

	December 31, 2007	2006
	(Dollars in millions)	
ASSETS		
Current assets:		
Cash and cash equivalents	$ 1,829	$ 1,224
Accounts, notes and other receivables	6,387	5,740
Inventories	3,861	3,588
Deferred income taxes	1,241	1,215
Other current assets	367	537
Total current assets	13,685	12,304
Investments and long-term receivables	500	382
Property, plant and equipment—net	4,985	4,797
Goodwill	9,175	8,403
Other intangible assets—net	1,498	1,247
Insurance recoveries for asbestos related liabilities	1,086	1,100
Deferred income taxes	637	1,075
Prepaid pension benefit cost	1,256	695
Other assets	983	938
Total assets	$ 33,805	$ 30,941
LIABILITIES		
Current liabilities:		
Accounts payable	$ 3,962	$ 3,518
Short-term borrowings	64	62
Commercial paper	1,756	669
Current maturities of long-term debt	418	423
Accrued liabilities	5,741	5,463
Total current liabilities	11,941	10,135
Long-term debt	5,419	3,909
Deferred income taxes	734	352
Postretirement benefit obligations other than pensions	2,025	2,090
Asbestos related liabilities	1,405	1,262
Other liabilities	3,059	3,473
CONTINGENCIES		
SHAREOWNERS' EQUITY		
Capital—common stock—Authorized 2,000,000,000 shares (par value $1 per share):		
—issued 957,599,900 shares		
—additional paid-in capital	958	958
Common stock held in treasury, at cost:	4,014	3,845
2007—211,046,037 shares; 2006—157,008,412 shares		
Accumulated other comprehensive income (loss)	(9,479)	(6,339)
Retained earnings	(544)	(1,307)
Total shareowners' equity	14,273	12,563
Total liabilities and shareowners' equity	9,222	9,720
	$ 33,805	$ 30,941

The Notes to Financial Statements are an integral part of this statement.

HONEYWELL INTERNATIONAL INC.
CONSOLIDATED STATEMENT OF CASH FLOWS

	Years Ended December 31,		
	2007	2006	2005
	(Dollars in millions)		
Cash flows from operating activities:			
Net income	$ 2,444	$ 2,083	$ 1,638
Adjustments to reconcile net income to net cash provided by operating activities:			
Cumulative effect of accounting change	—	—	21
Depreciation and amortization	837	794	653
Repositioning and other charges	543	483	412
Payments of repositioning and other charges	(504)	(559)	(1,008)
Pension and other postretirement expense	322	459	561
Pension and other postretirement benefit payments	(300)	(353)	(199)
Stock option expense	65	77	—
Deferred income taxes	332	450	42
Excess tax benefits from share based payment arrangements	(86)	(31)	—
Other	161	20	(56)
Changes in assets and liabilities, net of the effects of acquisitions and divestitures:			
Accounts, notes and other receivables	(467)	(573)	(94)
Inventories	(183)	(128)	37
Other current assets	17	(11)	61
Accounts payable	397	516	181
Accrued liabilities	333	(16)	193
Net cash provided by operating activities	3,911	3,211	2,442
Cash flows from investing activities:			
Expenditures for property, plant and equipment	(767)	(733)	(684)
Proceeds from disposals of property, plant and equipment	98	87	71
Increase in investments	(20)	—	—
Decrease in investments	6	—	285
Cash paid for acquisitions, net of cash acquired	(1,150)	(633)	(2,679)
Proceeds from sales of businesses, net of fees paid	51	665	997
Net cash (used for) investing activities	(1,782)	(614)	(2,010)
Cash flows from financing activities:			
Net increase/(decrease) in commercial paper	1,078	(86)	534
Net (decrease)/increase in short-term borrowings	(3)	(224)	100
Payment of debt assumed with acquisitions	(40)	(346)	(702)
Proceeds from issuance of common stock	603	396	167
Proceeds from issuance of long-term debt	1,885	1,239	—
Payments of long-term debt	(430)	(1,019)	(982)
Excess tax benefits from share based payment arrangements	86	31	—
Repurchases of common stock	(3,986)	(1,896)	(1,133)
Cash dividends paid on common stock	(767)	(744)	(700)
Net cash (used for) financing activities	(1,574)	(2,649)	(2,716)
Effect of foreign exchange rate changes on cash and cash equivalents	50	42	(68)
Net increase/(decrease) in cash and cash equivalents	605	(10)	(2,352)
Cash and cash equivalents at beginning of period	1,224	1,234	3,586
Cash and cash equivalents at end of period	$ 1,829	$ 1,224	$ 1,234

The Notes to Financial Statements are an integral part of this statement.

HONEYWELL INTERNATIONAL INC.
CONSOLIDATED STATEMENT OF SHAREOWNERS' EQUITY

	Common Stock Issued			Common Stock Held in Treasury		Accumulated Other Comprehensive Income (Loss)		
	Shares	Amount	Additional Paid-in Capital	Shares	Amount		Retained Earnings	Total Shareowners' Equity
				(In millions, except per share amounts)				
Balance at December 31, 2004	957.6	$ 958	$ 3,574	(107.6)	$ (4,185)	$ 138	$ 10,292	$ 10,777
Net income							1,638	1,638
Foreign exchange translation adjustments						(147)		(147)
Minimum pension liability adjustment						(16)		(16)
Other Comprehensive Income (Loss)								1,475
Common stock issued for employee savings and option plans (including related tax benefits of $17)			50	9.7	283			333
Repurchases of common stock				(30.6)	(1,133)			(1,133)
Cash dividends on common stock ($0.825 per share)							(700)	(700)
Other owner changes			2	.4	8			10
Balance at December 31, 2005	957.6	958	3,626	(128.1)	(5,027)	(25)	11,230	10,762
Net income							2,083	2,083
Foreign exchange translation adjustments						233		233
Change in fair value of effective cash flow hedges						(3)		(3)
Minimum pension liability adjustment						196		196
Other Comprehensive Income (Loss)								2,509
Pension and other postretirement benefits (including related tax benefits of $912)						(1,708)		(1,708)
Common stock issued for employee savings and option plans (including related tax benefits of $31)			29	16.2	573			602
Stock based compensation expense			77					77
Reclassification to equity of obligations settled in stock			112					112
Repurchases of common stock				(45.4)	(1,896)			(1,896)
Dividends on common stock ($0.9075 per share)							(750)	(750)
Other owner changes			1	.3	11			12
Balance at December 31, 2006	957.6	958	3,845	(157.0)	(6,339)	(1,307)	12,563	9,720
Net income							2,444	2,444
Foreign exchange translation adjustments						248		248
Pension and other postretirement benefits (including related tax benefits of $285)						518		518
Change in fair value of effective cash flow hedges						(3)		(3)

Other Comprehensive Income (Loss)									3,207
Common stock issued for employee savings and option plans (including related tax benefits of $101)			101	20.0	837				938
Stock based compensation expense			65						65
Repurchases of common stock				(74.2)	(3,987)				(3,987)
Uncertain tax positions							33		33
Cash dividends on common stock ($1.00 per share)							(767)		(767)
Other owner changes			3	2	10				13
Balance at December 31, 2007	957.6	$ 958	$ 4,014	(211.0)	$ (9,479)	$ (544)	$ 14,273	$	9,222

The Notes to Financial Statements are an integral part of this statement.

Note 1—Summary of Significant Accounting Policies

Accounting Principles—The financial statements and accompanying notes are prepared in accordance with accounting principles generally accepted in the United States of America. The following is a description of the significant accounting policies of Honeywell International Inc.

Principles of Consolidation—The consolidated financial statements include the accounts of Honeywell International Inc. and all of its subsidiaries and entities in which a controlling interest is maintained. Our consolidation policy requires the consolidation of entities where a controlling financial interest is obtained as well as consolidation of variable interest entities in which we bear a majority of the risk to the entities' potential losses or stand to gain from a majority of the entities' expected returns. All intercompany transactions and balances are eliminated in consolidation.

Cash and Cash Equivalents—Cash and cash equivalents include cash on hand and on deposit and highly liquid, temporary cash investments with an original maturity of three months or less.

Inventories—Inventories are valued at the lower of cost or market using the first–in, first–out or the average cost method and the last–in, first–out (LIFO) method for certain qualifying domestic inventories.

Investments—Investments in affiliates over which we have a significant influence, but not a controlling interest, are accounted for using the equity method of accounting. Other investments are carried at market value, if readily determinable, or at cost. All equity investments are periodically reviewed to determine if declines in fair value below cost basis are other–than–temporary. Significant and sustained decreases in quoted market prices or a series of historic and projected operating losses by investees are strong indicators of other–than–temporary declines. If the decline in fair value is determined to be other–than–temporary, an impairment loss is recorded and the investment is written down to a new carrying value.

Property, Plant and Equipment—Property, plant and equipment are recorded at cost, including any asset retirement obligations, less accumulated depreciation. For financial reporting, the straight–line method of depreciation is used over the estimated useful lives of 10 to 50 years for buildings and improvements and 2 to 15 years for machinery and equipment. Statement of Financial Accounting Standards No. 143, "Accounting for Asset Retirement Obligations" (SFAS No. 143) and FASB Interpretation No. 47 ("FIN 47") require recognition of the fair value of obligations associated with the retirement of tangible long–lived assets when there is a legal obligation to incur such costs. Upon adoption of FIN 47 on December 31, 2005, we recorded an increase of $14 million to property, plant and equipment and recognized an asset retirement obligation liability of $46 million. This resulted in the recognition of a non–cash charge of $32 million ($21 million after tax) that was reported as a cumulative effect of an accounting change. Upon initial recognition of a liability the cost is capitalized as part of the related long–lived asset and depreciated over the corresponding asset's useful life. See Note 11 and Note 17 for additional details.

Goodwill and Indefinite–Lived Intangible Assets—Goodwill represents the excess of acquisition costs over the fair value of tangible net assets and identifiable intangible assets of businesses acquired. Goodwill and certain other intangible assets deemed to have indefinite lives are not amortized. Intangible assets determined to have definite lives are amortized over their useful lives. Goodwill and indefinite lived intangible assets are subject to impairment testing annually as of March 31, or whenever events or changes in circumstances indicate that the carrying amount may not be fully recoverable, using the guidance and criteria described in Statement of Financial Accounting Standards No. 142, "Goodwill and Other Intangible Assets". This testing compares carrying values to fair values and, when appropriate, the carrying value of these assets is reduced to fair value. We completed our annual goodwill impairment test as of March 31, 2007 and determined that there was no impairment as of that date. See Note 12 for additional details on goodwill balances.

Other Intangible Assets with Determinable Lives—Other intangible assets with determinable lives consist of customer lists, technology, patents and trademarks and other intangibles and are amortized over their estimated useful lives, ranging from 2 to 24 years.

Long–Lived Assets—We periodically evaluate the recoverability of the carrying amount of long–lived assets (including property, plant and equipment and intangible assets with determinable lives) whenever events or changes in circumstances indicate that the carrying amount of an asset may not be fully recoverable. We evaluate events or changes in circumstances based on a number of factors including operating results, business plans and forecasts, general and industry trends and, economic projections and anticipated cash flows. An impairment is assessed when the undiscounted expected future cash flows derived from an asset are less than its carrying amount. Impairment losses are measured as the amount by which the carrying value of an asset exceeds its fair value and are recognized in earnings. We also continually evaluate the estimated useful lives of all long–lived assets and periodically revise such estimates based on current events.

Sales Recognition—Product and service sales are recognized when persuasive evidence of an arrangement exists, product delivery has occurred or services have been rendered, pricing is fixed or determinable, and collection is reasonably assured. Service sales, principally representing repair, maintenance and engineering activities in our Aerospace and Automation and Control Solutions segments, are recognized over the contractual period or as services are rendered. Sales under long–term contracts in the Aerospace and Automation and Control Solutions segments are recorded on a percentage–of–completion method measured on the cost–to–cost basis for engineering–type contracts and the units–of–delivery basis for production–type contracts. Provisions for anticipated losses on long– term contracts are recorded in full when such losses become evident. Revenues from contracts with multiple element arrangements are recognized as each element is earned based on the relative fair value of each element provided the delivered elements have value to customers on a standalone basis. Amounts allocated to each element are based on its objectively determined fair value, such as the sales price for the product or service when it is sold separately or competitor prices for similar products or services.

Environmental Expenditures—Environmental expenditures that relate to current operations are expensed or capitalized as appropriate. Expenditures that relate to an existing condition caused by past operations, and that do not provide future benefits, are expensed as incurred. Liabilities are recorded when environmental remedial efforts or damage claim payments are probable and the costs can be reasonably estimated. Such liabilities are based on our best estimate of the undiscounted future costs required to complete the remedial work. The recorded liabilities are adjusted periodically as remediation efforts progress or as additional technical, regulatory or legal information becomes available. Given the uncertainties regarding the status of laws, regulations, enforcement policies, the impact of other potentially responsible parties, technology and information related to individual sites, we do not believe it is possible to develop an estimate of the range of reasonably possible environmental loss in excess of our recorded liabilities.

Asbestos Related Contingencies and Insurance Recoveries—Honeywell is a defendant in personal injury actions related to products containing asbestos (refractory and friction products). We recognize a liability for any asbestos related contingency that is probable of occurrence and reasonably estimable. Regarding North American Refractories Company (NARCO) asbestos related claims, we accrue for pending claims based on terms and conditions, including evidentiary requirements, in definitive agreements or agreements in principle with current claimants. We also accrued for the probable value of future NARCO asbestos related claims through 2018 based on the disease criteria and payment values contained in the NARCO trust as described in Note 21. In light of the inherent uncertainties in making long term projections regarding claims filing rates and disease manifestation, we do not believe that we have a reasonable basis for estimating NARCO asbestos claims beyond 2018 under Statement of Financial Accounting Standards No. 5, "Accounting for Contingencies" (SFAS

No. 5). Regarding Bendix asbestos related claims, we accrue for the estimated value of pending claims based on expected claim resolution values and historic dismissal rates. Since the fourth quarter of 2006, we also accrue for the estimated cost of future anticipated claims related to Bendix for the next five years based on our assessment of additional claims that may be brought against us and anticipated resolution values in the tort system. In December 2006, we also changed our methodology for valuing Bendix pending and future claims from using average resolution values for the previous five years to using average resolution values for the previous two years. The claims filing experience and resolution data for Bendix related claims has become more reliable over the past several years. Accordingly, in the fourth quarter of 2007, we updated our methodology for valuing Bendix pending and future claims using the average resolution values for the past three years. We will continue to update the expected resolution values used to estimate the cost of pending and future Bendix claims during the fourth quarter each year. For additional information see Note 21. We continually assess the likelihood of any adverse judgments or outcomes to our contingencies, as well as potential ranges of probable losses and recognize a liability, if any, for these contingencies based on an analysis of each individual issue with the assistance of outside legal counsel and, if applicable, other experts.

In connection with the recognition of liabilities for asbestos related matters, we record asbestos related insurance recoveries that are deemed probable. In assessing the probability of insurance recovery, we make judgments concerning insurance coverage that we believe are reasonable and consistent with our historical experience with our insurers, our knowledge of any pertinent solvency issues surrounding insurers, various judicial determinations relevant to our insurance programs and our consideration of the impacts of any settlements with our insurers.

Aerospace Sales Incentives—We provide sales incentives to commercial aircraft manufacturers and airlines in connection with their selection of our aircraft equipment, predominately wheel and braking system hardware and auxiliary power units, for installation on commercial aircraft. These incentives principally consist of free or deeply discounted products, but also include credits for future purchases of product and upfront cash payments. These costs are expensed as provided. For aircraft manufacturers, incentives are recorded when the products are delivered; for airlines, incentives are recorded when the associated aircraft are delivered by the aircraft manufacturer to the airline.

Research and Development—Research and development costs for company–sponsored research and development projects are expensed as incurred. Such costs are principally included in Cost of Products Sold and were $1,459, $1,411 and $1,072 million in 2007, 2006 and 2005, respectively.

Stock–Based Compensation Plans—Effective January 1, 2006, we adopted SFAS No. 123 (revised 2004), "Share–Based Payment" (SFAS No. 123R) requiring that compensation cost relating to share–based payment awards made to employees and directors be recognized in the financial statements. The principal awards issued under our stock–based compensation plans, which are described in Note 20 include non–qualified stock options and restricted stock units (RSUs). The cost for such awards is measured at the grant date based on the fair value of the award. The value of the portion of the award that is ultimately expected to vest is recognized as expense over the requisite service periods (generally the vesting period of the equity award) in our Consolidated Statement of Operations.

Prior to January 1, 2006, we accounted for share–based compensation cost using the intrinsic value method in accordance with Accounting Principles Board No. 25, "Accounting for Stock Issued to Employees" (APB No. 25), and related interpretations. We also followed disclosure requirements of SFAS No. 123, "Accounting for Stock–Based Compensation", as amended by SFAS No. 148, "Accounting for Stock–Based Compensation—Transition and Disclosure". Under APB No. 25 there was no compensation cost recognized in our Consolidated Statement of Operations for our stock option awards. Compensation cost for RSUs is recognized in our Consolidated Statement of Operations and

is included in selling, general and administrative expenses, and was not affected by our adoption of FAS No. 123R.

We adopted SFAS No. 123R using the modified prospective method and, accordingly, the 2005 Consolidated Statement of Operations has not been restated to reflect the fair value method of recognizing compensation cost relating to stock options. Share–based compensation cost relating to stock options recognized in 2007 and 2006 is based on the value of the portion of the award that is ultimately expected to vest. SFAS No. 123R requires forfeitures to be estimated at the time of grant in order to estimate the portion of the award that will ultimately vest. The estimate is based on our historical rates of forfeiture. In our pro forma information required under SFAS No. 123 for 2005, we accounted for forfeitures as they occurred.

Pension and Other Postretirement Benefits—We sponsor both funded and unfunded U.S. and non–U.S. defined benefit pension plans covering the majority of our employees and retirees. We also sponsor postretirement benefit plans that provide health care benefits and life insurance coverage to eligible retirees. For our U.S. defined benefit pension plans we use the market–related value of plan assets reflecting changes in the fair value of plan assets over a three–year period. Further, net actuarial (gains) or losses in excess of 10 percent of the greater of the market–related value of plan assets or the plans' projected benefit obligation (the corridor) are recognized over a six year period. We adopted SFAS No. 158, "Employers' Accounting for Defined Benefit Pension and Other Postretirement Plans" (SFAS No. 158) as of December 31, 2006. See Note 22 for additional disclosures.

Foreign Currency Translation—Assets and liabilities of subsidiaries operating outside the United States with a functional currency other than U.S. dollars are translated into U.S. dollars using year–end exchange rates. Sales, costs and expenses are translated at the average exchange rates in effect during the year. Foreign currency translation gains and losses are included as a component of Accumulated Other Comprehensive Income (Loss). For subsidiaries operating in highly inflationary environments, inventories and property, plant and equipment, including related expenses, are remeasured at the exchange rate in effect on the date the assets were acquired, while monetary assets and liabilities are remeasured at year–end exchange rates. Remeasurement adjustments for these subsidiaries are included in earnings.

Derivative Financial Instruments—As a result of our global operating and financing activities, we are exposed to market risks from changes in interest and foreign currency exchange rates and commodity prices, which may adversely affect our operating results and financial position. We minimize our risks from interest and foreign currency exchange rate and commodity price fluctuations through our normal operating and financing activities and, when deemed appropriate through the use of derivative financial instruments. Derivative financial instruments are used to manage risk and are not used for trading or other speculative purposes and we do not use leveraged derivative financial instruments. Derivative financial instruments used for hedging purposes must be designated and effective as a hedge of the identified risk exposure at the inception of the contract. Accordingly, changes in fair value of the derivative contract must be highly correlated with changes in fair value of the underlying hedged item at inception of the hedge and over the life of the hedge contract.

All derivatives are recorded on the balance sheet as assets or liabilities and measured at fair value. For derivatives designated as hedges of the fair value of assets or liabilities, the changes in fair values of both the derivatives and the hedged items are recorded in current earnings. For derivatives designated as cash flow hedges, the effective portion of the changes in fair value of the derivatives are recorded in Accumulated Other Comprehensive Income (Loss) and subsequently recognized in earnings when the hedged items impact earnings. Cash flows of such derivative financial instruments are classified consistent with the underlying hedged item.

Transfers of Financial Instruments—Sales, transfers and securitization of financial instruments are accounted for under Statement of Financial Accounting Standards No. 140, "Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities". We sell interests in

designated pools of trade accounts receivables to third parties. The receivables are removed from the Consolidated Balance Sheet at the time they are sold. The value assigned to our subordinated interests and undivided interests retained in trade receivables sold is based on the relative fair values of the interests retained and sold. The carrying value of the retained interests approximates fair value due to the short-term nature of the collection period for the receivables.

Income Taxes—Deferred tax liabilities or assets reflect temporary differences between amounts of assets and liabilities for financial and tax reporting. Such amounts are adjusted, as appropriate, to reflect changes in tax rates expected to be in effect when the temporary differences reverse. A valuation allowance is established to offset any deferred tax assets if, based upon the available evidence, it is more likely than not that some or all of the deferred tax assets will not be realized. The determination of the amount of a valuation allowance to be provided on recorded deferred tax assets involves estimates regarding (1) the timing and amount of the reversal of taxable temporary differences, (2) expected future taxable income, and (3) the impact of tax planning strategies. In assessing the need for a valuation allowance, we consider all available positive and negative evidence, including past operating results, projections of future taxable income and the feasibility of ongoing tax planning strategies. The projections of future taxable income include a number of estimates and assumptions regarding our volume, pricing and costs. Additionally, valuation allowances related to deferred tax assets can be impacted by changes to tax laws.

Significant judgment is required in determining income tax provisions under Statement of Financial Accounting Standards No. 109 "Accounting for Income Taxes" (SFAS No. 109) and in evaluating tax positions. We establish additional provisions for income taxes when, despite the belief that tax positions are fully supportable, there remain certain positions that do not meet the minimum probability threshold, as defined by FASB Interpretation ("FIN") No. 48, "Accounting for Uncertainty in Income Taxes" (FIN 48), which is a tax position that is more likely than not to be sustained upon examination by the applicable taxing authority. In the normal course of business, the Company and its subsidiaries are examined by various Federal, State and foreign tax authorities. We regularly assess the potential outcomes of these examinations and any future examinations for the current or prior years in determining the adequacy of our provision for income taxes. We continually assess the likelihood and amount of potential adjustments and adjust the income tax provision, the current tax liability and deferred taxes in the period in which the facts that give rise to a revision become known.

Earnings Per Share—Basic earnings per share is based on the weighted average number of common shares outstanding. Diluted earnings per share is based on the weighted average number of common shares outstanding and all dilutive potential common shares outstanding.

Use of Estimates—The preparation of consolidated financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts in the financial statements and related disclosures in the accompanying notes. Actual results could differ from those estimates. Estimates and assumptions are periodically reviewed and the effects of revisions are reflected in the consolidated financial statements in the period they are determined to be necessary.

Reclassifications—Certain prior year amounts have been reclassified to conform to the current year presentation.

Recent Accounting Pronouncements—In June 2006, the Financial Accounting Standards Board ("FASB") issued FIN 48, which establishes a single model to address accounting for uncertain tax positions. FIN 48 clarifies the accounting for income taxes by prescribing a minimum recognition threshold a tax position is required to meet before being recognized in the financial statements. FIN 48 also provides guidance on derecognition, measurement classification, interest and penalties, accounting in interim periods, disclosure and transition. Upon adoption as of January 1, 2007, we reduced our existing reserves for uncertain tax positions by $33 million, largely related to a reduction in state income tax matters, partially offset by a net increase for federal and international tax reserves.

This reduction was recorded as a cumulative effect adjustment to shareowners' equity. Additionally, we decreased a deferred tax asset and its associated valuation allowance by $44 million and increased goodwill by $1 million. See Note 6 for additional FIN 48 information and disclosure.

In May 2007, the FASB issued FASB Staff Position ("FSP") FIN 48–1 "Definition of Settlement in FASB Interpretation No. 48" (FSP FIN 48–1). FSP FIN 48–1 provides guidance on how to determine whether a tax position is effectively settled for the purpose of recognizing previously unrecognized tax benefits. FSP FIN 48–1 is effective retroactively to January 1, 2007. The implementation of this standard did not have a material impact on our consolidated financial position or results of operations.

In September 2006, the FASB issued FSP AUG AIR–1 "Accounting for Planned Major Maintenance Activities" (FSP AUG AIR–1). FSP AUG AIR–1 amends the guidance on the accounting for planned major maintenance activities; specifically it precludes the use of the previously acceptable "accrue in advance" method. FSP AUG AIR–1 is effective for fiscal years beginning after December 15, 2006. The implementation of this standard did not have a material impact on our consolidated financial position or results of operations.

In September 2006, the FASB issued Statement of Financial Accounting Standard ("SFAS") No. 157, "Fair Value Measurements" (SFAS No. 157). SFAS No. 157 establishes a common definition for fair value to be applied to US GAAP requiring use of fair value, establishes a framework for measuring fair value, and expands disclosure about such fair value measurements. SFAS No. 157 is effective for fiscal years beginning after November 15, 2007.

In February 2008, the FASB issued FSP 157–2 "Partial Deferral of the Effective Date of Statement 157" (FSP 157–2). FSP 157–2 delays the effective date of SFAS No. 157, for all nonfinancial assets and nonfinancial liabilities, except those that are recognized or disclosed at fair value in the financial statements on a recurring basis (at least annually) to fiscal years beginning after November 15, 2008. The Company is currently assessing the impact of SFAS No. 157 for nonfinancial assets and nonfinancial liabilities on its consolidated financial position and results of operations. The implementation of this standard, for financial assets and financial liabilities, will not have a material impact on our consolidated financial position and results of operations.

In February 2007, the FASB issued SFAS No. 159 "The Fair Value Option for Financial Assets and Financial Liabilities" (SFAS No. 159). SFAS No. 159 permits entities to choose to measure many financial assets and financial liabilities at fair value. Unrealized gains and losses on items for which the fair value option has been elected are reported in earnings. SFAS No. 159 is effective for fiscal years beginning after November 15, 2007. The implementation of this standard will not have a material impact on our consolidated financial position and results of operations.

In March 2007, the FASB ratified Emerging Issues Task Force ("EITF") Issue No. 06–10 "Accounting for Collateral Assignment Split–Dollar Life Insurance Agreements" (EITF 06–10). EITF 06–10 provides guidance for determining a liability for postretirement benefit obligations as well as recognition and measurement of the associated asset on the basis of the terms of the collateral assignment agreement. EITF 06–10 is effective for fiscal years beginning after December 15, 2007. The implementation of this standard will not have a material impact on our consolidated financial position and results of operations.

In June 2007, the FASB ratified EITF 06–11 "Accounting for the Income Tax Benefits of Dividends on Share–Based Payment Awards" (EITF 06–11). EITF 06–11 provides that tax benefits associated with dividends on share–based payment awards be recorded as a component of additional paid–in capital. EITF 06–11 is effective, on a prospective basis, for fiscal years beginning after December 15, 2007. The implementation of this standard will not have a material impact on our consolidated financial position and results of operations.

In December 2007, the FASB issued SFAS No. 141(revised 2007), "Business Combinations" (SFAS No. 141R). SFAS No. 141R provides revised guidance on how acquirers recognize and

measure the consideration transferred, identifiable assets acquired, liabilities assumed, noncontrolling interests, and goodwill acquired in a business combination. SFAS No. 141R also expands required disclosures surrounding the nature and financial effects of business combinations. SFAS No. 141R is effective, on a prospective basis, for fiscal years beginning after December 15, 2008. The Company is currently assessing the impact of SFAS No. 141R on its consolidated financial position and results of operations.

In December 2007, the FASB issued SFAS No. 160, "Noncontrolling Interests in Consolidated Financial Statements" (SFAS No. 160). SFAS No. 160 establishes requirements for ownership interests in subsidiaries held by parties other than the Company (sometimes called "minority interests") be clearly identified, presented, and disclosed in the consolidated statement of financial position within equity, but separate from the parent's equity. All changes in the parent's ownership interests are required to be accounted for consistently as equity transactions and any noncontrolling equity investments in deconsolidated subsidiaries must be measured initially at fair value. SFAS No. 160 is effective, on a prospective basis, for fiscal years beginning after December 15, 2008. However, presentation and disclosure requirements must be retrospectively applied to comparative financial statements. The Company is currently assessing the impact of SFAS No. 160 on its consolidated financial position and results of operations.

Note 2—Acquisitions and Divestitures

We acquired businesses for an aggregate cost of $1,190, $979 and $3,500 million in 2007, 2006 and 2005, respectively. All of our acquisitions were accounted for under the purchase method of accounting, and accordingly, the assets and liabilities of the acquired businesses were recorded at their estimated fair values at the dates of acquisition. Significant acquisitions made in these years are discussed below.

In July 2007, the Company completed the acquisition of Dimensions International, a defense logistics business, for a purchase price of approximately $230 million. 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. The Company has assigned $21 million to identifiable intangible assets, predominantly contractual relationships. These intangible assets are being amortized over their estimated life of 5 years using straight–line and accelerated amortization methods. The excess of the purchase price over the estimated fair values of net assets acquired approximating $180 million, was recorded as goodwill. This goodwill is non–deductible for tax purposes. This acquisition was accounted for by the purchase method, and, accordingly, results of operations are included in the consolidated financial statements from the date of acquisition. The results from the acquisition date through December 31, 2007 are included in the Aerospace segment and were not material to the consolidated financial statements.

In July 2007, the Company completed the acquisition of Enraf Holding B.V., a provider of comprehensive solutions for the control and management of transportation, storage and blending operations in the oil and gas industry, for a purchase price of approximately $264 million, including the assumption of approximately $40 million of debt. 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. The Company has assigned $90 million to identifiable intangible assets, predominantly customer relationships, existing technology and trademarks. These intangible assets are being amortized over their estimated life of 8–15 years using straight–line and accelerated amortization methods. The excess of the purchase price over the estimated fair values of net assets acquired approximating $167 million, was recorded as goodwill. Goodwill will be deducted over a 15 year period for tax purposes. This acquisition was accounted for by the purchase method, and, accordingly, results of operations are included in the consolidated financial statements from the date of acquisition. The results from the acquisition date through December 31, 2007 are included in

the Automation and Control Solutions segment and were not material to the consolidated financial statements.

In December 2007, the Company, specifically the Automation and Control Solutions segment, completed the acquisition of Maxon Corporation, a leading industrial combustion business, for a purchase price of approximately $185 million. 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 acquisition date. The Company has assigned $88 million to identifiable intangible assets, predominantly customer relationships and trademarks. These intangible assets are being amortized over their estimated lives which range from 6–10 years using straight line and accelerated amortization methods. The excess of the purchase price over the estimated fair values of net assets acquired approximating $92 million, was recorded as goodwill. This goodwill is non–deductible for tax purposes. This acquisition was accounted for by the purchase method, and, accordingly, results of operations are included in the consolidated financial statements from the date of acquisition. The results from the acquisition date through December 31, 2007 were not material to the consolidated financial statements.

In December 2007, the Company, specifically the Automation and Control Solutions segment, completed the acquisition of Hand Held Products, Inc. a privately held automatic identification and data collection company, for a purchase price of approximately $390 million. 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. The Company has assigned $114 million to identifiable intangible assets, predominantly customer relationships and existing technology. These intangible assets are being amortized over their estimated lives which range from 6 to 10 years using straight–line and accelerated amortization methods. The excess of the purchase price over the estimated fair values of net assets acquired approximating $259 million, was recorded as goodwill. This goodwill is non–deductible for tax purposes. This acquisition was accounted for by the purchase method, and, accordingly, results of operations are included in the consolidated financial statements from the date of acquisition. The results from the acquisition date through December 31, 2007 were not material to the consolidated financial statements.

In May 2006, the Company purchased Gardiner Groupe, a privately held company. 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 and lives at the acquisition date. The Company has assigned $47 million to identifiable intangible assets, predominantly customer relationships and trademarks. These intangible assets are being amortized over their estimated lives which range from 3 to 15 years using straight–line and accelerated amortization methods. The excess of the purchase price over the estimated fair values of net assets acquired approximating $130 million, was recorded as goodwill. This goodwill is non–deductible for tax purposes. This acquisition was accounted for by the purchase method, and, accordingly, results of operations are included in the consolidated financial statements from the date of acquisition. The results from the acquisition date through December 31, 2006 are included in the Automation and Control Solutions segment and were not material to the consolidated financial statements.

In March 2006, the Company purchased First Technology plc, a U.K. publicly listed company. The aggregate value of the purchase price was $723 million, including the assumption of approximately $217 million of outstanding debt and $23 million of transaction costs. 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. The Company has assigned $155 million to identifiable intangible assets, predominantly customer relationships, existing technology and trademarks. These intangible assets are being amortized over their estimated lives which range from 2 to 15 years using straight–line and accelerated amortization methods. The excess of the purchase price over the estimated fair values of net assets acquired approximating $432 million, was

recorded as goodwill. This goodwill is non–deductible for tax purposes. This acquisition was accounted for by the purchase method, and, accordingly, results of operations are included in the consolidated financial statements from the date of acquisition. The results from the acquisition date through December 31, 2006 are included in the Automation and Control Solutions segment and were not material to the consolidated financial statements. During the year, the Company completed the sales of the First Technology Safety & Analysis business for $93 million and First Technology Automotive for $90 million which were accounted for as part of the purchase price allocation.

In November 2005, the Company acquired the remaining 50 percent of UOP LLC giving Honeywell full ownership of the entity. The aggregate value of the purchase price was approximately $825 million, including the assumption of approximately $115 million of outstanding debt. 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. The Company has assigned $339 million to identifiable intangible assets, predominantly existing technology, which is being amortized over 15 years on a straight–line basis and trade names, which are not amortized. The excess of the purchase price over the estimated fair values of net assets acquired approximating $336 million, was recorded as goodwill. This goodwill is non–deductible for tax purposes. Following this acquisition, which is being accounted for by the purchase method, results of operations have been included into the Specialty Materials segment. Prior to that date, UOP results for the 50 percent share that the Company owned was included in equity income of affiliated companies.

On March 31, 2005, the Company purchased 100% of the issued and ordinary preference share capital of NOVAR plc (NOVAR) for $1.7 billion, net of cash acquired, which represented $2.4 billion for consideration of all outstanding shares and outstanding options to be exercised, net of the assumption of debt of $0.7 billion. Transaction costs related to this acquisition were $49 million. In December 2005, we completed the sale of the Security Printing business to M&F Worldwide Corp. for $800 million in cash. In February 2006, we completed the sale of Indalex to an affiliate of private investment firm Sun Capital Partners, Inc. for approximately $425 million in cash. The Indalex business was classified as held for sale in our December 31, 2005 Consolidated Balance Sheet and both the Indalex and Security Printing businesses have been presented as discontinued operations in our Statement of Operations for periods prior to the sale. Goodwill of approximately $1.3 billion was recognized and we allocated $261 million to other intangible assets (contractual customer relationships, existing technology and trademarks). These intangible assets are being amortized over their estimated useful lives which range from 5 to 15 years using straight–line and accelerated amortization methods. In addition, accrued liabilities included $76 million of restructuring costs related to the integration of the NOVAR operations.

As of December 31, 2007, the purchase accounting for Dimensions International, Enraf Holding B.V., Hand Held Products, Inc. and Maxon Corporation are still subject to final adjustment primarily for useful lives, amounts allocated to intangible assets and goodwill, for certain pre–acquisition contingencies, and for settlement of post closing purchase price adjustments.

In connection with all acquisitions in 2007, 2006 and 2005, the amounts recorded for transaction costs and the costs of integrating the acquired businesses into Honeywell were not material.

The pro forma results for 2007, 2006 and 2005, assuming these acquisitions had been made at the beginning of the year, would not be materially different from consolidated reported results.

Note 3—Repositioning and Other Charges

A summary of repositioning and other charges follows:

	Years Ended December 31,		
	2007	2006	2005
Severance	$ 186	$ 102	$ 248
Asset impairments.	14	15	5
Exit costs	9	7	14
Reserve adjustments	(18)	(22)	(25)
Total net repositioning charge.	191	102	242
Asbestos related litigation charges, net of insurance	100	126	10
Probable and reasonably estimable environmental liabilities.	225	210	186
Business impairment charges	9	12	23
Arbitration award related to phenol supply agreement	—	(18)	(67)
Other	18	51	18
Total net repositioning and other charges.	$ 543	$ 483	$ 412

The following table summarizes the pretax distribution of total net repositioning and other charges by income statement classification.

	Years Ended December 31,		
	2007	2006	2005
Cost of products and services sold	$ 495	$ 472	$ 357
Selling, general and administrative expenses	48	11	43
Other (income) expense	—	—	12
	$ 543	$ 483	$ 412

The following table summarizes the pretax impact of total net repositioning and other charges by segment.

	Years Ended December 31,		
	2007	2006	2005
Aerospace	$ 37	$ 10	$ 96
Automation and Control Solutions	127	39	85
Specialty Materials	14	5	(34)
Transportation Systems	119	293	82
Corporate	246	136	183
	$ 543	$ 483	$ 412

In 2007, we recognized repositioning charges totaling $209 million primarily for severance costs related to workforce reductions of 3,408 manufacturing and administrative positions mainly in our Automation and Control Solutions and Aerospace segments. Also, $18 million of previously established accruals, primarily for severance at our Transportation Systems and Aerospace segments, were returned to income in 2007 due mainly to changes in the scope of previously announced severance programs and due to fewer employee separations than originally planned associated with prior severance programs.

In 2006, we recognized repositioning charges totaling $124 million primarily for severance costs related to workforce reductions of 2,253 manufacturing and administrative positions across all of our segments. Also, $22 million of previously established accruals, primarily for severance at our Aerospace, Transportation Systems and Specialty Materials segments were returned to income in 2006 due mainly to changes in the scope of previously announced severance programs and due to

fewer employee separations than originally planned associated with prior Aerospace severance programs.

In 2005, we recognized repositioning charges totaling $267 million primarily for severance costs related to workforce reductions of 5,269 manufacturing and administrative positions across all of our segments including the implementation of a new organizational structure in our Aerospace segment (substantially implemented in the third quarter of 2005) which reorganized our Aerospace businesses to better align with customer segments. Also, $25 million of previously established accruals, primarily for severance at our Corporate, Specialty Materials and Automation and Control Solutions segments were returned to income in 2005. The reversal of severance liabilities related to changes in the scope of previously announced severance programs, excise taxes related to an executive severance amount previously paid which were determined to no longer be payable, and severance amounts previously paid to an outside service provider as part of an outsourcing arrangement which were refunded to Honeywell.

The following table summarizes the status of our total repositioning reserves.

	Severance Costs	Asset Impairments	Exit Costs	Total
Balance at December 31, 2004	$ 97	$ —	$ 19	$ 116
2005 charges	248	5	14	267
2005 usage	(156)	(5)	(15)	(176)
Adjustments	(21)	—	(4)	(25)
Balance at December 31, 2005	168	—	14	182
2006 charges	102	15	7	124
2006 usage	(134)	(15)	(8)	(157)
Adjustments	(18)	—	(4)	(22)
Balance at December 31, 2006	118	—	9	127
2007 charges	186	14	9	209
2007 usage	(85)	(14)	(7)	(106)
Adjustments	(18)	—	—	(18)
Balance at December 31, 2007	$ 201	$ —	$ 11	$ 212

In 2007, we recognized a charge of $225 million for environmental liabilities deemed probable and reasonably estimable during the year. We recognized asbestos related litigation charges, net of insurance, of $100 million which are discussed in Note 21. We recognized other charges of $18 million for a business sales tax related to a prior divestiture ($8 million) and for contemplated settlements of certain legal matters ($10 million). We also recognized impairment charges of $9 million related to the write–down of property, plant and equipment held for sale in our Specialty Materials segment.

In 2006, we recognized a charge of $210 million for environmental liabilities deemed probable and reasonably estimable during the year. We recognized asbestos related litigation charges, net of insurance, of $126 million which are discussed in Note 21. We recognized other charges of $51 million related to our Corporate segment primarily for the settlement of a property damage claim litigation matter in Brunswick, GA and our entrance into a plea agreement related to an environmental matter at our Baton Rouge, LA facility. We recognized impairment charges of $12 million related to the write– down of property, plant and equipment held for sale in our Specialty Materials segment. We also recognized a credit of $18 million in connection with an arbitration award for overcharges by a supplier of phenol to our Specialty Materials business for 2005 transactions.

In 2005, we recognized a charge of $186 million for environmental liabilities deemed probable and reasonably estimable during the year. We recognized asbestos related litigation charges, net of insurance, of $10 million which are discussed in Note 21. We recognized a credit of $67 million in

connection with an arbitration award for overcharges by a supplier of phenol to our Specialty Materials business from June 2003 through the end of 2004. We recognized impairment charges of $23 million related to the write-down of property, plant and equipment held and used in our Specialty Materials segment. We also recognized other charges of $18 million principally related to the modification of a lease agreement for the Corporate headquarters facility ($10 million) and for various legal settlements ($7 million).

Note 4—Other (Income)/Expense

	Years Ended December 31,		
	2007	2006	2005
Gain on sale of non-strategic businesses and assets	$ (19)	$ (30)	$ (36)
Equity (income)/loss of affiliated companies	(10)	(13)	(134)(1)
Interest income	(81)	(94)	(84)
Foreign exchange	34	18	21
Other (net)	23	8	2
	$ (53)	$ (111)	$ (231)

(1) Includes equity income of $107 million in 2005 from UOP (acquisition to full ownership in November 2005).

Note 5—Interest and Other Financial Charges

	Years Ended December 31,		
	2007	2006	2005
Total interest and other financial charges	$ 478	$ 396	$ 373
Less—capitalized interest	(22)	(22)	(17)
	$ 456	$ 374	$ 356

The weighted average interest rate on short-term borrowings and commercial paper outstanding at December 31, 2007 and 2006 was 4.65 percent and 5.67 percent, respectively.

Note 6—Income Taxes

Income from continuing operations before taxes

	Years Ended December 31,		
	2007	2006	2005
United States	$ 2,084	$ 1,882	$ 1,530
Foreign	1,237	916	766
	$ 3,321	$ 2,798	$ 2,296

Tax expense

	Years Ended December 31,		
	2007	2006	2005
United States	$ 542	$ 412	$ 427
Foreign	335	308	305
	$ 877	$ 720	$ 732

	Years Ended December 31,		
	2007	2006	2005
Tax expense consist of:			
Current:			
United States	$ 249	$ (39)	$ 395
State.	64	26	19
Foreign	232	283	276
	545	270	690
Deferred:			
United States	225	376	19
State	4	49	(6)
Foreign	103	25	29
	332	450	42
	$ 877	$ 720	$ 732

	Years Ended December 31,		
	2007	2006	2005
The U.S. statutory federal income tax rate is reconciled to our effective income tax rate as follows:			
Statutory U.S. federal income tax rate	35.0 %	35.0 %	35.0 %
Taxes on foreign earnings below U.S. tax rate (1)	(4.6)	(4.0)	(1.4)
Asset basis differences	—	—	(3.6)
Nondeductible amortization	—	—	.6
State income taxes (1)	.9	1.7	.7
Tax benefits on export sales	—	(1.9)	(3.3)
Domestic Manufacturing Deduction	(.8)	(.3)	(.3)
ESOP Dividend Tax Benefit	(.5)	(.7)	(.9)
Tax credits	(.6)	(.7)	(.5)
Equity income	—	—	(.5)
Repatriation expense related to American Jobs Creation Act of 2004	—	—	6.8
Audit Settlements	(2.9)	(2.9)	(.6)
All other items—net	(.1)	(.5)	(.1)
	26.4 %	25.7 %	31.9 %

(1) Net of changes in valuation allowance.

The Company's effective tax rate increased by 0.7 of a percentage point in 2007 compared with 2006 due principally to the expiration of the tax benefit on export sales, partially offset by a decrease in the overall state and foreign effective tax rate and an increase in the tax benefit for the domestic manufacturing deduction and the favorable resolution of certain tax audits.

Deferred tax assets (liabilities)

Deferred income taxes represent the future tax effects of transactions which are reported in different periods for tax and financial reporting purposes. The tax effects of temporary differences and tax carryforwards which give rise to future income tax benefits and payables are as follows:

	December 31, 2007	December 31, 2006
Property, plant and equipment basis differences	$ (563)	$ (608)
Postretirement benefits other than pensions and post employment benefits	770	747
Investment and other asset basis differences.	(376)	(396)
Other accrued items	1,025	1,567
Net operating and capital losses	783	786
Tax credits	33	315
Undistributed earnings of subsidiaries	(40)	(40)
All other items—net	(21)	43
	1,611	2,414
Valuation allowance	(490)	(516)
	$ 1,121	$ 1,898

There were $32 million of U.S. federal tax net operating losses available for carryforward at December 31, 2007 which were generated by certain subsidiaries prior to their acquisition and have expiration dates through 2024. The use of pre–acquisition operating losses is subject to limitations imposed by the Internal Revenue Code. We do not anticipate that these limitations will affect utilization of the carryforwards prior to their expiration. Various subsidiaries have state tax net operating loss carryforwards of $3.3 billion at December 31, 2007 with varying expiration dates through 2026. We have U.S. federal capital losses available for carryforward of $112 million which expire in 2011 and state capital losses available for carryforward of $286 million with varying expiration dates. We do not anticipate using these capital losses before expiration. We also have foreign net operating and capital losses of $2.6 billion which are available to reduce future income tax payments in several countries, subject to varying expiration rules.

We have state tax credit carryforwards of $42 million at December 31, 2007, including carryforwards of $29 million with various expiration dates through 2027 and tax credits of $13 million which are not subject to expiration. In addition, we have $5 million of foreign tax credits available for carryback or carryforward on the U.S. federal tax return at December 31, 2007 with varying expiration dates through 2013.

The valuation allowance against deferred tax assets was decreased by $26 million in 2007 and increased by $39 and $139 million in 2006 and 2005, respectively. The 2007 decrease in the valuation allowance was primarily due to a decrease in valuation allowances related to state and foreign net operating losses partially offset by a valuation allowance against U.S. capital losses. The 2006 increase in the valuation allowance was primarily due to an increase in foreign net operating losses attributable to acquired businesses not expected to be realized and a partial valuation allowance against a deferred tax asset established in connection with the adoption of SFAS No. 158 partially offset by a decrease in state tax net operating loss carryforwards (net of federal impact).

Federal income taxes have not been provided on undistributed earnings of the majority of our international subsidiaries as it is our intention to reinvest these earnings into the respective businesses. At December 31, 2007 Honeywell has not provided for U.S. federal income and foreign withholding taxes on approximately $4.1 billion of such earnings of our non–U.S. operations. It is not practicable to estimate the amount of tax that might be payable if some or all of such earnings were to be remitted, and foreign tax credits would be available to reduce or eliminate the resulting U.S. income tax liability.

As of January 1, 2007, we adopted the provisions of FIN 48 as described in Note 1. As of that date, we had $744 million of unrecognized tax benefits. If recognized, approximately $575 million would be recorded as a component of income tax expense. For year ended December 31, 2007, the Company decreased its unrecognized tax benefits by $78 million due to the tax benefit from the favorable resolution of tax audits, partially offset by foreign currency translation and additional reserves for various international and U.S. tax audit matters. The net decrease was recorded as a benefit to income tax expense. As of December 31, 2007 we had $666 million of unrecognized tax benefits. If recognized, approximately $547 million would be recorded as a component of income tax expense.

The following table summarizes the activity related to our unrecognized tax benefits:

	Total
Balance at January 1, 2007	$ 744
Gross increases related to current period tax positions	68
Gross increases related to prior periods tax positions	100
Gross decreases related to prior periods tax positions	(167)
Decrease related to settlements with Tax Authorities	(101)
Expiration of the statute of limitations for the assessment of taxes	—
Foreign Currency Translation	22
Balance at December 31, 2007	$ 666

In many cases our uncertain tax positions are related to tax years that remain subject to examination by the relevant tax authorities. The following table summarizes these open tax years by major jurisdiction as of December 31, 2007:

	Open Tax Year	
Jurisdiction	**Examination in progress**	**Examination not yet initiated**
United States (1)	1998 – 2006	2007
United Kingdom	2001 – 2005	2006 – 2007
Canada (1)	2002 – 2004	2005 – 2007
Germany (1)	1998 – 2004	2005 – 2007
France	2000 – 2006	2007
Netherlands	2002	2004 – 2007
Australia	N/A	2003 – 2007
China	N/A	1997 – 2007
India	1999 – 2005	2006 – 2007

(1) includes federal as well as state, provincial or similar local jurisdictions, as applicable

Based on the outcome of these examinations, or as a result of the expiration of statute of limitations for specific jurisdictions, it is reasonably possible that the related unrecognized tax benefits for tax positions taken regarding previously filed tax returns will materially change from those recorded as liabilities for uncertain tax positions in our financial statements. In addition, the outcome of these examinations may impact the valuation of certain deferred tax assets (such as net operating losses) in future periods. Based on the number of tax years currently under audit by the relevant U.S federal, state and foreign tax authorities, the Company anticipates that several of these audits may be finalized in the foreseeable future. However, based on the status of these examinations, and the protocol of finalizing audits by the relevant tax authorities, which could include formal legal proceedings, at this time it is not possible to estimate the impact of any amount of such changes, if any, to previously recorded uncertain tax positions.

Unrecognized tax benefits for the above listed examinations in progress were $502 million and $373 million as of January 1, 2007 and December 31, 2007, respectively. This decrease is primarily due to the settlement of tax examinations during the year.

Estimated interest and penalties related to the underpayment of income taxes are classified as a component of Tax Expense in the Consolidated Statement of Operations and totaled $20 million for the twelve months ended December 31, 2007. Accrued interest and penalties were $98 million and $118 million as of January 1, 2007 and December 31, 2007, respectively.

Note 7—Earnings (Loss) Per Share

The following table sets forth the computations of basic and diluted earnings (loss) per share:

	2007		2006		2005	
	Basic	Assuming Dilution	Basic	Assuming Dilution	Basic	Assuming Dilution
Income						
Income from continuing operations	$ 2,444	$ 2,444	$ 2,078	$ 2,078	$ 1,564	$ 1,564
Income from discontinued operations, net of taxes	—	—	5	5	95	95
Cumulative effect of accounting change, net of taxes	—	—	—	—	(21)	(21)
Net income	$ 2,444	$ 2,444	$ 2,083	$ 2,083	$ 1,638	$ 1,638
Average shares						
Average shares outstanding	764,543,613	764,543,613	820,845,838	820,845,838	848,740,395	848,740,395
Dilutive securities issuable in connection with stock plans	—	9,683,868	—	5,432,435	—	3,594,592
Total average shares	764,543,613	774,227,481	820,845,838	826,278,273	848,740,395	852,334,987
Earnings (loss) per share of common stock						
Income from continuing operations	$ 3.20	$ 3.16	$ 2.53	$ 2.51	$ 1.85	$ 1.84
Income from discontinued operations, net of taxes	—	—	0.01	0.01	0.11	0.11
Cumulative effect of accounting change, net of taxes	—	—	—	—	(0.03)	(0.03)
Net income	$ 3.20	$ 3.16	$ 2.54	$ 2.52	$ 1.93	$ 1.92

In 2007, 2006 and 2005, the diluted earnings per share calculation excludes the effect of stock options when the options' exercise prices exceed the average market price of the common shares during the period. In 2007, 2006 and 2005, the number of stock options not included in the computation were 8,599,620, 22,749,056 and 17,793,385, respectively. These stock options were outstanding at the end of each of the respective years.

Note 8—Accounts, Notes and Other Receivables

	December 31,	
	2007	2006
Trade	$ 6,070	$ 5,373
Other	498	584
	6,568	5,957
Less—Allowance for doubtful accounts	(181)	(217)
	$ 6,387	$ 5,740

Trade Accounts Receivable includes $946 and $808 million of unbilled balances under long–term contracts as of December 31, 2007 and 2006, respectively. These amounts are billed in accordance with the terms of the customer contracts to which they relate.

We sell interests in designated pools of trade accounts receivables to third parties. The sold receivables are over–collateralized by $101 million at December 31, 2007 and we retain a subordinated interest in the pool of receivables representing that over–collateralization as well as an undivided interest in the balance of the receivables pools. New receivables are sold under the agreement as previously sold receivables are collected. Losses are recognized when our interest in the receivables are sold. The retained interests in the receivables are shown at the amounts expected to be collected by us, and such carrying value approximates the fair value of our retained interests. We are compensated for our services in the collection and administration of the receivables.

	December 31, 2007	2006
Designated pools of trade receivables	$ 1,322	$ 1,250
Interest sold to third parties	(500)	(500)
Retained interest	$ 822	$ 750

Losses on sales of receivables were $29, $27 and $18 million in 2007, 2006 and 2005, respectively. No credit losses were incurred during those years.

Note 9—Inventories

	December 31, 2007	2006
Raw materials	$ 1,692	$ 1,625
Work in process	870	808
Finished products	1,501	1,342
	4,063	3,775
Less—		
Progress payments	(3)	(17)
Reduction to LIFO cost basis	(199)	(170)
	$ 3,861	$ 3,588

Inventories valued at LIFO amounted to $247 and $205 million at December 31, 2007 and 2006, respectively. Had such LIFO inventories been valued at current costs, their carrying values would have been approximately $199 and $170 million higher at December 31, 2007 and 2006, respectively.

Note 10—Investments and Long–Term Receivables

	December 31, 2007	2006
Investments	$ 40	$ 49
Long–term trade and other receivables	223	206
Long–term financing receivables	237	127
	$ 500	$ 382

Long–Term Trade and Other Receivables includes $63 and $68 million of unbilled balances under long–term contracts as of December 31, 2007 and 2006, respectively. These amounts are billed in accordance with the terms of the customer contracts to which they relate.

Note 11—Property, Plant and Equipment

	December 31, 2007	2006
Land and improvements	$ 409	$ 408
Machinery and equipment	10,243	9,888
Buildings and improvements	2,244	2,056
Construction in progress	466	447
	13,362	12,799
Less—Accumulated depreciation and amortization	(8,377)	(8,002)
	$ 4,985	$ 4,797

Depreciation expense was $675, $650 and $578 million in 2007, 2006 and 2005, respectively.

Note 12—Goodwill and Other Intangibles—Net

The change in the carrying amount of goodwill for the years ended December 31, 2007 and 2006 by segment are as follows:

	December 31, 2006	Acquisitions	Divestitures	Currency Translation Adjustment	December 31, 2007
Aerospace	$ 1,745	$ 180	$ —	$ 14	$ 1,939
Automation and Control Solutions	4,959	547	—	23	5,529
Specialty Materials	1,151	2	(6)	9	1,156
Transportation Systems	548	—	—	3	551
	$ 8,403	$ 729	$ (6)	$ 49	$ 9,175

	December 31, 2005	Acquisitions	Divestitures	Currency Translation Adjustment	December 31, 2006
Aerospace	$ 1,723	$ —	$ —	$ 22	$ 1,745
Automation and Control Solutions	4,333	572	—	54	4,959
Specialty Materials	1,066	80	(4)	9	1,151
Transportation Systems	538	—	—	10	548
	$ 7,660	$ 652	$ (4)	$ 95	$ 8,403

Intangible assets are comprised of:

	December 31, 2007			December 31, 2006		
	Gross Carrying Amount	Accumulated Amortization	Net Carrying Amount	Gross Carrying Amount	Accumulated Amortization	Net Carrying Amount
Intangible assets with determinable lives:						
Patents and technology	$ 965	$ (407)	$ 558	$ 801	$ (301)	$ 500
Customer relationships	682	(113)	569	462	(60)	402
Trademarks	192	(35)	157	101	(16)	85
Other	458	(351)	107	512	(359)	153
	2,297	(906)	1,391	1,876	(736)	1,140
Trademarks with indefinite lives	107	—	107	107	—	107
	$ 2,404	$ (906)	$ 1,498	$ 1,983	$ (736)	$ 1,247

Intangible assets amortization expense was $162, $144 and $75 million in 2007, 2006 and 2005, respectively. Estimated intangible assets amortization expense for each of the next five years approximates $190 million in 2008, $190 million in 2009, $180 million in 2010, $160 million in 2011 and $140 million in 2012.

Note 13—Accrued Liabilities

	December 31, 2007	2006
Compensation, benefit and other employee related	$ 1,472	$ 1,138
Customer advances and deferred income	1,259	1,067
Income taxes	320	418
Environmental costs	311	251
Asbestos related liabilities	250	557
Product warranties and performance guarantees	380	347
Restructuring	212	127
Other taxes (payroll, sales, VAT etc.)	195	124
Insurance	96	110
Accrued interest	126	116
Other (primarily operating expenses)	1,120	1,208
	$ 5,741	$ 5,463

Note 14—Long-term Debt and Credit Agreements

	December 31, 2007	2006
7.0% notes due 2007	$ —	350
7 1/8% notes due 2008	200	200
6.20% notes due 2008	200	200
Floating rate notes due 2009	500	—
Floating rate notes due 2009	300	300
Zero coupon bonds and money multiplier notes, 13.0%–14.26%, due 2009	100	100
Floating rate notes due 2009–2011	220	239
7.50% notes due 2010	1,000	1,000
6 1/8% notes due 2011	500	500
5.625% notes due 2012	400	—
5.40% notes due 2016	400	400
5.30% notes due 2017	400	—
Industrial development bond obligations, floating rate maturing at various dates through 2037	60	65
6 5/8% debentures due 2028	216	216
9.065% debentures due 2033	51	51
5.70% notes due 2036	550	550
5.70% notes due 2037	600	—
Other (including capitalized leases), 1.54%–15.50%, maturing at various dates through 2017	140	161
	5,837	4,332
Less—current portion	(418)	(423)
	$ 5,419	$ 3,909

The schedule of principal payments on long-term debt is as follows:

	At December 31, 2007
2008	$ 418
2009	1,024
2010	1,121
2011	533
2012	401
Thereafter	2,340
	5,837
Less—current portion	(418)
	$ 5,419

We maintain a $2.8 billion five year revolving credit facility with a group of banks, arranged by Citigroup Global Markets Inc. and J.P.Morgan Securities Inc. This credit facility contains a $700 million sub-limit for the issuance of letters of credit. The $2.8 billion credit facility is maintained for general corporate purposes, including support for the issuance of commercial paper. We had no borrowings outstanding or letters of credit issued under the credit facility at December 31, 2007.

The credit agreement does not restrict our ability to pay dividends and contains no financial covenants. The failure to comply with customary conditions or the occurrence of customary events of default contained in the credit agreement would prevent any further borrowings and would generally require the repayment of any outstanding borrowings under the credit agreement. Such events of

default include: (a) non–payment of credit agreement debt, interest or fees; (b) non–compliance with the terms of the credit agreement covenants; (c) cross–default to other debt in certain circumstances; (d) bankruptcy; and (e) defaults upon obligations under Employee Retirement Income Security Act. Additionally, each of the banks has the right to terminate its commitment to lend additional funds or issue letters of credit under the agreement if any person or group acquires beneficial ownership of 30 percent or more of our voting stock, or, during any 12–month period, individuals who were directors of Honeywell at the beginning of the period cease to constitute a majority of the Board of Directors (the Board).

Loans under the $2.8 billion credit facility are required to be repaid no later than May 14, 2012. We have agreed to pay a facility fee of 0.05 percent per annum on the aggregate commitment.

Interest on borrowings under the $2.8 billion credit facility would be determined, at Honeywell's option, by (a) an auction bidding procedure; (b) the highest of the floating base rate publicly announced by Citibank, N.A., 0.5 percent above the average CD rate, or 0.5 percent above the Federal funds rate; or (c) the Eurocurrency rate plus 0.15 percent (applicable margin).

The facility fee, the applicable margin over the Eurocurrency rate and the letter of credit issuance fee, are subject to change, based upon a grid determined by our long term debt ratings. The credit agreement is not subject to termination based upon a decrease in our debt ratings or a material adverse change.

In March 2007, the Company issued $400 million of 5.30% Senior Notes due 2017 and $600 million 5.70% Senior Notes due 2037 (collectively, the "Notes"). The Notes are senior unsecured and unsubordinated obligations of Honeywell and rank equally with all of Honeywell's existing and future senior unsecured debt and senior to all Honeywell's subordinated debt. The offering resulted in gross proceeds of $1 billion, offset by $12 million in discount and issuance costs.

In July 2007, the Company issued $500 million Floating Rate Senior Notes due 2009 and $400 million 5.625% Senior Notes due 2012 (collectively, the "Senior Notes"). The Senior Notes are senior unsecured and unsubordinated obligations of Honeywell and rank equally with all of Honeywell's existing and future senior unsecured debt and senior to all Honeywell's subordinated debt. The offering resulted in gross proceeds of $900 million, offset by $3 million in discount and issuance costs.

In the first quarter of 2007, the Company repaid $350 million of its 7.0% Notes, primarily through issuance of the Notes. The proceeds from the Senior Notes were used to repay commercial paper.

Note 15—Lease Commitments

Future minimum lease payments under operating leases having initial or remaining noncancellable lease terms in excess of one year are as follows:

	At December 31, 2007
2008	$ 327
2009	233
2010	164
2011	120
2012	77
Thereafter	264
	$ 1,185

We have entered into agreements to lease land, equipment and buildings. Principally all our operating leases have initial terms of up to 25 years, and some contain renewal options subject to customary conditions. At any time during the terms of some of our leases, we may at our option

purchase the leased assets for amounts that approximate fair value. We do not expect that any of our commitments under the lease agreements will have a material adverse effect on our consolidated results of operations, financial position or liquidity.

Rent expense was $365, $341 and $326 million in 2007, 2006 and 2005, respectively.

Note 16—Financial Instruments

Credit and Market Risk—Financial instruments, including derivatives, expose us to counterparty credit risk for nonperformance and to market risk related to changes in interest or currency exchange rates. We manage our exposure to counterparty credit risk through specific minimum credit standards, diversification of counterparties, and procedures to monitor concentrations of credit risk. Our counterparties in derivative transactions are substantial investment and commercial banks with significant experience using such derivative instruments. We monitor the impact of market risk on the fair value and cash flows of our derivative and other financial instruments considering reasonably possible changes in interest and currency exchange rates and restrict the use of derivative financial instruments to hedging activities.

We continually monitor the creditworthiness of our customers to which we grant credit terms in the normal course of business. While concentrations of credit risk associated with our trade accounts and notes receivable are considered minimal due to our diverse customer base, a significant portion of our customers are in the commercial air transport industry (aircraft manufacturers and airlines) accounting for approximately 21 percent of our consolidated sales in 2007. The terms and conditions of our credit sales are designed to mitigate or eliminate concentrations of credit risk with any single customer. Our sales are not materially dependent on a single customer or a small group of customers.

Foreign Currency Risk Management—We conduct our business on a multinational basis in a wide variety of foreign currencies. Our exposure to market risk for changes in foreign currency exchange rates arises from international financing activities between subsidiaries, foreign currency denominated monetary assets and liabilities and anticipated transactions arising from international trade. Our objective is to preserve the economic value of non–functional currency denominated cash flows. We attempt to hedge transaction exposures with natural offsets to the fullest extent possible and, once these opportunities have been exhausted, through foreign currency forward and option agreements with third parties. Our principal currency exposures relate to the U.S. dollar, Euro, British pound, Canadian dollar, Hong Kong dollar, Mexican peso, Swiss franc, Czech koruna, Chinese renminbi and Japanese yen.

We hedge monetary assets and liabilities denominated in non–functional currencies. Prior to conversion into U.S dollars, these assets and liabilities are remeasured at spot exchange rates in effect on the balance sheet date. The effects of changes in spot rates are recognized in earnings and included in Other/(Income) Expense. We hedge our exposure to changes in foreign exchange rates principally with forward contracts. Forward contracts are marked–to–market with the resulting gains and losses similarly recognized in earnings offsetting the gains and losses on the non–functional currency denominated monetary assets and liabilities being hedged.

We partially hedge forecasted 2008 sales and purchases denominated in non–functional currencies with currency forward contracts. When a functional currency strengthens against nonfunctional currencies, the decline in value of forecasted non–functional currency cash inflows (sales) or outflows (purchases) is partially offset by the recognition of gains (sales) and losses (purchases), respectively, in the value of the forward contracts designated as hedges. Conversely, when a functional currency weakens against non–functional currencies, the increase in value of forecasted nonfunctional currency cash inflows (sales) or outflows (purchases) is partially offset by the recognition of losses (sales) and gains (purchases), respectively, in the value of the forward contracts

designated as hedges. Market value gains and losses on these contracts are recognized in earnings when the hedged transaction is recognized. All open forward contracts mature by December 31, 2008.

At December 31, 2007 and 2006, we had contracts with notional amounts of $3,295 and $2,572 million, respectively, to exchange foreign currencies, principally the US dollar, Euro, British pound, Canadian dollar, Hong Kong dollar, Mexican peso, Swiss franc, Czech koruna, Chinese renminbi, and Japanese yen.

Commodity Price Risk Management—Our exposure to market risk for commodity prices can result in changes in our cost of production. We primarily mitigate our exposure to commodity price risk through the use of long–term, fixed–price contracts with our suppliers and formula price agreements with suppliers and customers. We also enter into forward commodity purchase agreements with third parties designated as hedges of anticipated purchases of several commodities. Forward commodity purchase agreements are marked–to–market, with the resulting gains and losses recognized in earnings when the hedged transaction is recognized.

Interest Rate Risk Management—We use a combination of financial instruments, including long–term, medium–term and short–term financing, variable–rate commercial paper, and interest rate swaps to manage the interest rate mix of our total debt portfolio and related overall cost of borrowing. At December 31, 2007 and 2006, interest rate swap agreements designated as fair value hedges effectively changed $300 and $700 million, respectively, of fixed rate debt at an average rate of 6.01 and 6.38 percent, respectively, to LIBOR based floating rate debt. Our interest rate swaps mature through 2037.

Fair Value of Financial Instruments—The carrying value of cash and cash equivalents, trade accounts and notes receivables, payables, commercial paper and short–term borrowings contained in the Consolidated Balance Sheet approximates fair value. Summarized below are the carrying values and fair values of our other financial instruments at December 31, 2007 and 2006. The fair values are based on the quoted market prices for the issues (if traded), current rates offered to us for debt of the same remaining maturity and characteristics, or other valuation techniques, as appropriate.

	December 31, 2007		December 31, 2006	
	Carrying Value	Fair Value	Carrying Value	Fair Value
Assets				
Long–term receivables	$ 460	$ 428	$ 333	$ 306
Interest rate swap agreements	20	20	3	3
Foreign currency exchange contracts	22	22	3	3
Forward commodity contracts	—	—	—	—
Liabilities				
Long–term debt and related current maturities	$ (5,837)	$ (5,928)	$ (4,332)	$ (4,521)
Foreign currency exchange contracts	(18)	(18)	(3)	(3)
Forward commodity contracts	—	—	(9)	(9)

Note 17—Other Liabilities

Other liabilities consist of the following:

	December 31, 2007	December 31, 2006
Pension and other employee related	$ 1,536	$ 1,748
Environmental	488	580
Income taxes	416	575
Insurance	143	134
Asset retirement obligations (1)	93	92
Deferred income	69	56
Other	314	288
	$ 3,059	$ 3,473

(1) Asset retirement obligations primarily relate to costs associated with the future retirement of nuclear fuel conversion facilities in our Specialty Materials segment and the future retirement of facilities in our Automation and Control Solutions segment.

A reconciliation of our liability for asset retirement obligations for the year ended December 31, 2007, is as follows:

Balance at December 31, 2006	$ 92
Liabilities settled	(3)
Adjustments	—
Accretion expense	4
Balance at December 31, 2007	$ 93

Note 18—Capital Stock

We are authorized to issue up to 2,000,000,000 shares of common stock, with a par value of one dollar. Common shareowners are entitled to receive such dividends as may be declared by the Board, are entitled to one vote per share, and are entitled, in the event of liquidation, to share ratably in all the assets of Honeywell which are available for distribution to the common shareowners. Common shareowners do not have preemptive or conversion rights. Shares of common stock issued and outstanding or held in the treasury are not liable to further calls or assessments. There are no restrictions on us relative to dividends or the repurchase or redemption of common stock.

Under the Company's previously reported $3.0 billion share repurchase program, $2.7 billion remained available as of December 31, 2007 for additional share repurchases. The amount and timing of repurchases may vary depending on market conditions and the level of other investing activities.

We are authorized to issue up to 40,000,000 shares of preferred stock, without par value, and can determine the number of shares of each series, and the rights, preferences and limitations of each series. At December 31, 2007, there was no preferred stock outstanding.

Note 19—Accumulated Other Comprehensive Income (Loss)

Total accumulated other comprehensive income (loss) is included in the Consolidated Statement of Shareowners' Equity. The changes in Accumulated Other Comprehensive Income (Loss) are as follows:

	Pretax	Tax	After–Tax
Year Ended December 31, 2007			
Foreign exchange translation adjustments	$ 248	$ —	$ 248
Change in fair value of effective cash flow hedges	(5)	2	(3)
Pension and postretirement benefit adjustment	803	(285)	518
	$ 1,046	$ (283)	$ 763
Year Ended December 31, 2006			
Foreign exchange translation adjustments	$ 233	$ —	$ 233
Change in fair value of effective cash flow hedges	(5)	2	(3)
Minimum pension liability adjustment	268	(72)	196
Pension and postretirement benefit adjustment	(2,620)	912	(1,708)
	$ (2,124)	$ 842	$ (1,282)
Year Ended December 31, 2005			
Foreign exchange translation adjustments	$ (147)	$ —	$ (147)
Minimum pension liability adjustment	(26)	10	(16)
	$ (173)	$ 10	$ (163)

The components of Accumulated Other Comprehensive Income (Loss) are as follows:

	December 31, 2007	2006
Cumulative foreign exchange translation adjustments	$ 823	$ 575
Fair value of effective cash flow hedges	2	5
Pension and postretirement benefit adjustment	(1,369)	(1,887)
	$ (544)	$ (1,307)

Note 20—Stock–Based Compensation Plans

We have stock–based compensation plans available to grant non–qualified stock options, incentive stock options, stock appreciation rights, restricted units and restricted stock to key employees. Under the 2006 Stock Incentive Plan of Honeywell International Inc. and its Affiliates (the Plan), which was approved by the shareowners at the Annual Meeting of Shareowners and became effective on April 24, 2006, a maximum of 43 million shares of Honeywell common stock may be awarded. We expect that common stock awarded on an annual basis will be between 1.0 and 1.5 percent of total common stock outstanding. Following approval of the Plan on April 24, 2006, we will not grant any new awards under any previously existing stock–based compensation plans. Additionally, under the 2006 Stock Plan for Non–Employee Directors of Honeywell International Inc. (the Directors Plan), which was approved by the shareowners at the Annual Meeting of Shareowners and became effective on April 24, 2006, 500,000 shares of Honeywell common stock may be awarded. The Directors Plan replaced the 1994 Stock Plan for Non–Employee Directors of Honeywell International Inc.

Stock Options—The exercise price, term and other conditions applicable to each option granted under our stock plans are generally determined by the Management Development and Compensation Committee of the Board. The exercise price of stock options is set on the grant date and may not be less than the fair market value per share of our stock on that date. The fair value is recognized as an expense over the employee's requisite service period (generally the vesting period of the award). Options have generally vested over a three–year period and expire after ten years. Starting with 2007 option grants the vesting period was extended to four years.

The fair value of each option award is estimated on the date of grant using the Black–Scholes option–pricing model. Expected volatility is based on implied volatilities from traded options on Honeywell common stock. We used a Monte Carlo simulation model to derive an expected term. Such model uses historical data to estimate option exercise activity and post–vest termination behavior. The expected term represents an estimate of the time options are expected to remain outstanding. The risk–free rate for periods within the contractual life of the option is based on the U.S. treasury yield curve in effect at the time of grant.

Compensation cost on a pre–tax basis related to stock options recognized in operating results (included in selling, general and administrative expenses) under SFAS No. 123R in 2007 and 2006 was $65 and $77 million, respectively. The associated future income tax benefit recognized in 2007 and 2006 was $25 and $28 million, respectively. Compensation cost related to stock options recognized in our Consolidated Statement of Operations in 2007 and 2006 includes (1) compensation cost for stock option awards granted prior to, but not yet vested as of December 31, 2005, based on the grant–date fair value estimated in accordance with the pro forma provisions of SFAS No. 123 and (2) compensation cost for stock option awards granted subsequent to December 31, 2005, based on the grant–date fair value estimated in accordance with the provisions of SFAS No. 123R.

The following table illustrates the effect on net income and earnings per share as if we had applied the fair value recognition provisions of SFAS No. 123 in 2005, the year prior to the adoption of FAS No. 123R.

	2005
Net income, as reported	$ 1,638
Deduct: Total stock–based employee compensation cost determined under fair value method for stock option plans, net of related tax effects	(53)
Pro forma net income	$ 1,585
Earnings per share of common stock:	
Basic—as reported	$ 1.93
Basic—pro forma	$ 1.87
Earnings per share of common stock:	
Assuming dilution—as reported	$ 1.92
Assuming dilution—pro forma	$ 1.86

The following table sets forth fair value per share information, including related weighted–average assumptions, used to determine compensation cost consistent with the requirements of SFAS No. 123R in 2007 and 2006, and SFAS No. 123 in 2005.

	Years Ended December 31,		
	2007	2006	2005
Weighted average fair value per share of options granted during the year(1)	$ 10.27	$ 9.44	$ 10.67
Assumptions:			
Expected annual dividend yield	2.09 %	2.15 %	2.4 %
Expected volatility	20.18 %	22.32 %	34.8 %
Risk–free rate of return	4.66 %	4.63 %	3.7 %
Expected option term (years)	5.3	5.0	5.0

(1) Estimated on date of grant using Black–Scholes option–pricing model.

The following table summarizes information about stock option activity for the three years ended December 31, 2007:

	Number of Options	Weighted Average Exercise Price
Outstanding at December 31, 2004	58,524,929	$ 38.09
Granted	10,327,350	36.75
Exercised	(5,372,501)	29.07
Lapsed or canceled	(4,261,523)	40.46
Outstanding at December 31, 2005	59,218,255	38.50
Granted	9,193,200	42.35
Exercised	(11,466,491)	33.61
Lapsed or canceled	(2,712,287)	42.27
Outstanding at December 31, 2006	54,232,677	39.98
Granted	5,963,500	47.59
Exercised	(16,037,530)	36.95
Lapsed or canceled	(2,761,278)	45.74
Outstanding at December 31, 2007	41,397,369	$ 41.88
Vested and expected to vest at December 31, 2007(1)	39,026,398	$ 41.70
Exercisable at December 31, 2007	28,624,279	$ 41.14

(1) The expected to vest options are the result of applying the pre–vesting forfeiture rate assumption to total outstanding options.

The following table summarizes information about stock options outstanding and exercisable at December 31, 2007:

	Options Outstanding				Options Exercisable		
Range of exercise prices	Number Outstanding	Weighted Average Life(1)	Weighted Average Exercise Price	Aggregate Intrinsic Value	Number Exercisable	Weighted Average Exercise Price	Aggregate Intrinsic Value
$21.75–$32.99	3,158,742	5.15	$ 24.20	$ 118	3,146,342	$ 24.19	$ 118
$33.00–$39.99	17,183,835	5.49	35.98	440	14,712,835	35.87	378
$40.00–$49.99	15,232,246	7.50	44.44	261	5,184,431	43.26	95
$50.00–$74.95	5,822,546	2.16	62.19	3	5,580,671	62.60	1
	41,397,369	5.73	41.88	$ 822	28,624,279	41.14	$ 592

(1) Average remaining contractual life in years.

There were 37,902,956 and 42,416,585 options exercisable at weighted average exercise prices of $40.16 and $40.01 at December 31, 2006 and 2005, respectively. There were 38,279,009 shares available for future grants under the terms of our stock option plans at December 31, 2007.

The total intrinsic value of options (which is the amount by which the stock price exceeded the exercise price of the options on the date of exercise) exercised during 2007 and 2006 was $281 and $92 million, respectively. During 2007 and 2006, the amount of cash received from the exercise of stock options was $592 and $385 million, respectively, with an associated tax benefit realized of $101 and $31 million, respectively. Consistent with the requirements of SFAS No. 123R, in 2007 and 2006 we classified $86 and $31 million, respectively, of this benefit as a financing cash inflow in the Consolidated Statement of Cash

Flows, and the balance was classified as cash from operations.

At December 31, 2007, there was $73 million of total unrecognized compensation cost related to non–vested stock option awards which is expected to be recognized over a weighted–average period of 2.18 years. The total fair value of options vested during 2007 and 2006 was $83 and $70 million, respectively.

Restricted Stock Units—Restricted stock unit (RSU) awards entitle the holder to receive one share of common stock for each unit when the units vest. RSU's are issued to certain key employees at fair market value at the date of grant as compensation. RSUs typically become fully vested over periods ranging from three to seven years and are payable in Honeywell common stock upon vesting.

The following table summarizes information about RSU activity for the three years ended December 31, 2007:

	Number of Restricted Stock Units	Weighted Average Grant Date Fair Value Per Share
Non–vested at December 31, 2004	3,691,556	$ 31.20
Granted	1,163,984	$ 37.39
Vested	(424,175)	$ 32.84
Forfeited	(465,834)	$ 30.11
Non–vested at December 31, 2005	3,965,531	$ 32.97
Granted	1,948,650	$ 39.11
Vested	(759,015)	$ 30.04
Forfeited	(403,167)	$ 34.25
Non–vested at December 31, 2006	4,751,999	$ 35.85
Granted	1,980,850	$ 54.47
Vested	(372,105)	$ 32.48
Forfeited	(503,747)	$ 37.93
Non–vested at December 31, 2007	5,856,997	$ 42.18

As of December 31, 2007, there was approximately $153 million of total unrecognized compensation cost related to non–vested RSUs granted under our stock plans which is expected to be recognized over a weighted–average period of 2.06 years. Compensation expense related to RSUs was $47, $29 and $24 million in 2007, 2006 and 2005, respectively.

Non–Employee Directors' Plan—Under the Directors' Plan each new director receives a one–time grant of 3,000 shares of common stock, subject to specific restrictions.

The Directors' Plan also provides for an annual grant to each director of options to purchase 5,000 shares of common stock at the fair market value on the date of grant. Options have generally become exercisable over a three–year period and expire after ten years. Starting with 2007 option grants, the vesting period was extended to four years.

Note 21—Commitments and Contingencies

Environmental Matters

We are subject to various federal, state, local and foreign government requirements relating to the protection of the environment. We believe that, as a general matter, our policies, practices and procedures are properly designed to prevent unreasonable risk of environmental damage and personal injury and that our handling, manufacture, use and disposal of hazardous or toxic substances are in accordance with environmental and safety laws and regulations. However, mainly because of past operations and operations of predecessor companies, we, like other companies engaged in similar businesses, have incurred remedial response and voluntary cleanup costs for site contamination and are a party to lawsuits and claims associated with environmental and safety matters, including past production of products containing toxic substances. Additional lawsuits, claims and costs involving environmental matters are likely to continue to arise in the future.

With respect to environmental matters involving site contamination, we continually conduct studies, individually or jointly with other potentially responsible parties, to determine the feasibility of various remedial techniques to address environmental matters. It is our policy to record appropriate liabilities for environmental matters when remedial efforts or damage claim payments are probable and the costs can be reasonably estimated. Such liabilities are based on our best estimate of the undiscounted future costs required to complete the remedial work. The recorded liabilities are adjusted periodically as remediation efforts progress or as additional technical, regulatory or legal information becomes available. Given the uncertainties regarding the status of laws, regulations, enforcement policies, the impact of other potentially responsible parties, technology and information related to individual sites, we do not believe it is possible to develop an estimate of the range of reasonably possible environmental loss in excess of our recorded liabilities. We expect to fund expenditures for these matters from operating cash flow. The timing of cash expenditures depends on a number of factors, including the timing of remedial investigations and feasibility studies, the timing of litigation and settlements of remediation liability, personal injury and property damage claims, regulatory approval of cleanup projects, remedial techniques to be utilized and agreements with other parties. The following table summarizes information concerning our recorded liabilities for environmental costs:

	Years Ended December 31,		
	2007	2006	2005
Beginning of year	$ 831	$ 879	$ 895
Accruals for environmental matters deemed probable and reasonably estimable	230	218	186
Environmental liability payments	(267)	(264)	(247)
Other adjustments (1)	5	(2)	45
End of year	$ 799	$ 831	$ 879

(1) In 2005, $45 million principally relates to reclassification of the carrying value of land to property, plant and equipment with a corresponding increase to environmental liabilities.

Environmental liabilities are included in the following balance sheet accounts:

	December 31,	
	2007	2006
Accrued liabilities	$ 311	$ 251
Other liabilities	488	580
	$ 799	$ 831

Although we do not currently possess sufficient information to reasonably estimate the amounts of liabilities to be recorded upon future completion of studies, litigation or settlements, and neither the timing nor the amount of the ultimate costs associated with environmental matters can be determined, they could be material to our consolidated results of operations or operating cash flows in the periods recognized or paid. However, considering our past experience and existing reserves, we do not expect that these environmental matters will have a material adverse effect on our consolidated financial position.

New Jersey Chrome Sites—Provisions have been made in our financial statements for the estimated costs of the court-ordered excavation and transport for offsite disposal of approximately one million tons of chromium residue present at a predecessor Honeywell site located in Jersey City, New Jersey, known as Study Area 7 ("SA 7"). These expenditures have been and are expected to continue to be incurred evenly over a five-year period that started in April 2006. We do not expect implementation of this remedy to have a material adverse effect on our future consolidated results of

operations, operating cash flows or financial position. Provision also has been made in our financial statements for the estimated costs of implementing related groundwater remedial plans approved by the court, as well as sediment remedial plans which are presently under review by the court in which litigation concerning the site is pending. The ultimate cost of remediating the river sediments may be reduced as numerous third parties could be responsible for an as yet undetermined portion of these costs.

The above-referenced site is the most significant of the twenty-one sites located in Hudson County, New Jersey that are the subject of an Administrative Consent Order (ACO) entered into with the New Jersey Department of Environmental Protection (NJDEP) in 1993. Remedial investigations and activities consistent with the ACO have been conducted and are underway at the other sites (the "Honeywell ACO Sites"). We have recorded reserves for the Honeywell ACO Sites where appropriate under the accounting policy described above.

On May 3, 2005, NJDEP filed a lawsuit in New Jersey Superior Court against Honeywell and two other companies seeking declaratory and injunctive relief, unspecified damages, and the reimbursement of unspecified total costs relating to sites in New Jersey allegedly contaminated with chrome ore processing residue. The claims against Honeywell relate to the activities of a predecessor company which ceased its New Jersey manufacturing operations in the mid-1950's. While the complaint is not entirely clear, it appears that approximately 100 sites are at issue, including 17 of the Honeywell ACO Sites, sites that the other two companies have agreed to remediate under separate administrative consent orders, as well as approximately 53 other sites (identified in the complaint as the "Publicly Funded Sites") for which none of the three companies has signed an administrative consent order. In addition to claims specific to each company, NJDEP claims that all three companies should be collectively liable for all the chrome sites based on a "market share" theory. In addition, NJDEP is seeking treble damages for all costs it has incurred or will incur at the Publicly Funded Sites. Honeywell believes that it has no connection with the sites covered by the other companies' administrative consent orders and, therefore, has no responsibility for those sites. At the Honeywell ACO Sites, we are conducting remedial investigations and activities consistent with the ACO; thus, we do not believe the lawsuit will significantly change our obligations with respect to the Honeywell ACO Sites.

Lawsuits have also been filed against Honeywell in the District Court under the Resource Conservation and Recovery Act (RCRA) by Jersey City and two of its municipal utilities seeking the cleanup of chromium residue at two Honeywell ACO Sites. In January 2008, Honeywell and Jersey City agreed to settle these claims, which settlement will become effective only upon the receipt of NJDEP approval of the remedial action workplan for these sites, classification by Jersey City of these and other related sites as an area in need of redevelopment and approval of the related redevelopment plan and agreement, and Court approval of this settlement. The remedial actions contemplated by this settlement are consistent with our recorded reserves.

RCRA litigation has also been filed against Honeywell by a citizens' group and thirteen other defendants with respect to contamination on about a dozen of the Honeywell ACO Sites. For the reasons stated above, we do not believe this lawsuit will significantly change our obligations with respect to the Honeywell ACO sites.

Although it is not possible at this time to predict the ultimate outcome or resolution of the litigation and administrative proceedings discussed above, we do not expect that these matters will have a material adverse effect on our consolidated financial position. While we expect to prevail on or settle these claims, an adverse litigation outcome could have a material adverse impact on our consolidated results of operations and operating cash flows in the periods recognized or paid.

Dundalk Marine Terminal, Baltimore—Chrome residue from legacy chrome plant operations in Baltimore was deposited as fill at the Dundalk Marine Terminal ("DMT"), which is owned and operated by the Maryland Port Administration ("MPA"). Honeywell and the MPA have been sharing costs to

investigate and mitigate related environmental issues, and have entered into a cost sharing agreement under which Honeywell will bear a 77 percent share of the costs of developing and implementing permanent remedies for the DMT facility. The investigative phase (which began in April 2006) is expected to take approximately 18 to 36 months, after which the appropriate remedies will be identified and chosen. We have negotiated a Consent Decree with the MPA and Maryland Department of the Environment ("MDE") with respect to the investigation and remediation of the DMT facility. The Consent Decree is being challenged in federal court by BUILD, a Baltimore community group, together with a local church and two individuals (collectively "BUILD"). In October 2007, the Court dismissed BUILD's state law claims with prejudice and dismissed BUILD's RCRA claims regarding neighborhoods near the DMT facility without prejudice. BUILD has since sent notice letters indicating that they intend to re– file these latter claims, which we will continue to oppose. The Court is expected to schedule a hearing in the second quarter of 2008 on the Company's motion to dismiss BUILD's remaining claims on the grounds that MDE is diligently prosecuting the investigation and remediation of the DMT. We do not believe that this matter will have a material adverse impact on our consolidated financial position or operating cash flows. Given the scope and complexity of this project, it is possible that the cost of remediation, when determinable, could have a material adverse impact on our results of operations in the periods recognized.

Onondaga Lake, Syracuse, NY—A predecessor company to Honeywell operated a chemical plant which is alleged to have contributed mercury and other contaminants to the Lake. In July 2005, the New York State Department of Environmental Conservation (the DEC) issued its Record of Decision with respect to remediation of industrial contamination in the Lake. In October 2006, Honeywell entered into a Consent Decree with the State of New York to implement the remedy set forth in the Record of Decision. In January 2007, the Consent Decree was approved by the United States District Court for the Northern District of New York.

The Record of Decision calls for a combined dredging/capping remedy generally in line with the approach recommended in the Feasibility Study submitted by Honeywell in May 2004. Based on currently available information and analysis performed by our engineering consultants, we have accrued for our estimated cost of implementing the remedy set forth in the Record of Decision. Our estimating process considered a range of possible outcomes and the amounts recorded reflect our best estimate at this time. Given the scope and complexity of this project, it is possible that actual costs could exceed estimated costs by an amount that could have a material adverse impact on our consolidated results of operations and operating cash flows in the periods recognized or paid. At this time, however, we cannot identify any legal, regulatory or technical reason to conclude that a specific alternative outcome is more probable than the outcome for which we have made provisions in our financial statements. The DEC's aggregate cost estimate, which is higher than the amount reserved, is based on the high end of the range of potential costs for major elements of the Record of Decision and includes a contingency. The actual cost of the Record of Decision will depend upon, among other things, the resolution of certain technical issues during the design phase of the remediation. We do not believe that this matter will have a material adverse impact on our consolidated financial position. In December 2006, the United States Fish and Wildlife Service published notice of its intent to pursue natural resource damages related to the site. It is not possible to predict the outcome or timing of its assessments, which are typically lengthy processes lasting several years, or the amounts of or responsibility for these damages.

Asbestos Matters

Like many other industrial companies, Honeywell is a defendant in personal injury actions related to asbestos. We did not mine or produce asbestos, nor did we make or sell insulation products or other construction materials that have been identified as the primary cause of asbestos related disease in the vast majority of claimants. Products containing asbestos previously manufactured by Honeywell or

by previously owned subsidiaries primarily fall into two general categories: refractory products and friction products.

Refractory Products—Honeywell owned North American Refractories Company (NARCO) from 1979 to 1986. NARCO produced refractory products (high temperature bricks and cement) that were sold largely to the steel industry in the East and Midwest. Less than 2 percent of NARCO'S products contained asbestos.

When we sold the NARCO business in 1986, we agreed to indemnify NARCO with respect to personal injury claims for products that had been discontinued prior to the sale (as defined in the sale agreement). NARCO retained all liability for all other claims. On January 4, 2002, NARCO filed for reorganization under Chapter 11 of the U.S Bankruptcy Code.

As a result of the NARCO bankruptcy filing, all of the claims pending against NARCO are automatically stayed pending the reorganization of NARCO. In addition, the bankruptcy court enjoined both the filing and prosecution of NARCO–related asbestos claims against Honeywell. The stay has remained in effect continuously since January 4, 2002. In connection with NARCO's bankruptcy filing, we paid NARCO's parent company $40 million and agreed to provide NARCO with up to $20 million in financing. We also agreed to pay $20 million to NARCO's parent company upon the filing of a plan of reorganization for NARCO acceptable to Honeywell (which amount was paid in December 2005 following the filing of NARCO's Third Amended Plan of Reorganization), and to pay NARCO's parent company $40 million, and to forgive any outstanding NARCO indebtedness to Honeywell, upon the effective date of the plan of reorganization.

We believe that, as part of NARCO plan of reorganization, a trust will be established for the benefit of all asbestos claimants, current and future, pursuant to Trust Distribution Procedures negotiated with the NARCO Asbestos Claimants Committee and the Court–appointed legal representative for future asbestos claimants. If the trust is put in place and approved by the Court as fair and equitable, Honeywell as well as NARCO will be entitled to a permanent channeling injunction barring all present and future individual actions in state or federal courts and requiring all asbestos related claims based on exposure to NARCO products to be made against the federally–supervised trust. Honeywell has reached agreement with the representative for future NARCO claimants and the Asbestos Claimants Committee to cap its annual contributions to the trust with respect to future claims at a level that would not have a material impact on Honeywell's operating cash flows.

In November 2007, the Bankruptcy Court entered an amended order confirming the NARCO Plan without modification and approving the 524(g) trust and channeling injunction in favor of NARCO and Honeywell. In December 2007, certain insurers filed an appeal from the Bankruptcy Court's amended confirmation order. This appeal is pending in the United States District Court for the Western District of Pennsylvania. No assurances can be given as to the time frame or outcome of this appeal. We expect that the stay enjoining litigation against NARCO and Honeywell to remain in effect during the pendency of these proceedings.

Our consolidated financial statements reflect an estimated liability for settlement of pending and future NARCO–related asbestos claims as of December 31, 2007 and 2006 of $1.1 and $1.3 billion, respectively. The estimated liability for pending claims is based on terms and conditions, including evidentiary requirements, in definitive agreements with approximately 260,000 current claimants, and an estimate of the unsettled claims pending as of the time NARCO filed for bankruptcy protection. Substantially all settlement payments with respect to current claims have been made as of December 31, 2007. Approximately $95 million of payments due pursuant to these settlements is due only upon establishment of the NARCO trust.

The estimated liability for future claims represents the estimated value of future asbestos related bodily injury claims expected to be asserted against NARCO through 2018 and the aforementioned obligations to NARCO's parent. In light of the uncertainties inherent in making long–term projections we

do not believe that we have a reasonable basis for estimating asbestos claims beyond 2018 under SFAS No. 5, "Accounting for Contingencies". The estimate is based upon the disease criteria and payment values contained in the NARCO Trust Distribution Procedures negotiated with the NARCO Asbestos Claimants Committee and the NARCO future claimants' representative. Honeywell projected the probable number and value, including trust claim handling costs, of asbestos related future liabilities based upon experience of asbestos claims filing rates in the tort system and in certain operating asbestos trusts, and the claims experience in those forums. The valuation methodology also includes an analysis of the population likely to have been exposed to asbestos containing products, epidemiological studies to estimate the number of people likely to develop asbestos related diseases, NARCO claims filing history, the pending inventory of NARCO asbestos related claims and payment rates expected to be established by the NARCO trust. This methodology used to estimate the liability for future claims has been commonly accepted by numerous courts and is the same methodology that is utilized by an expert who is routinely retained by the asbestos claimants committee in asbestos related bankruptcies. In December 2006, as a result of significantly varying experiences of asbestos claims filing rates in the tort system (as a result of more clearly defined proof requirements) and in certain operating asbestos trusts, we updated the range of estimated liability for future NARCO–related claims. Such update resulted in a range of estimated liability for future claims of $743 to $961 million. We believe that no amount within this range is a better estimate than any other amount. Accordingly, in December 2006 we recorded the minimum amount in the range which resulted in a reduction of $207 million in our estimated liability for future NARCO–related asbestos claims. There has been no new data or developments during 2007 which would warrant a change in our estimated liability for future NARCO–related asbestos claims.

As of December 31, 2007 and 2006, our consolidated financial statements reflect an insurance receivable corresponding to the liability for settlement of pending and future NARCO–related asbestos claims of $939 and $955 million, respectively. This coverage reimburses Honeywell for portions of the costs incurred to settle NARCO related claims and court judgments as well as defense costs and is provided by a large number of insurance policies written by dozens of insurance companies in both the domestic insurance market and the London excess market. At December 31, 2007, a significant portion of this coverage is with insurance companies with whom we have agreements to pay full policy limits based on corresponding Honeywell claims costs. We conduct analyses to determine the amount of insurance that we estimate is probable of recovery in relation to payment of current and estimated future claims. While the substantial majority of our insurance carriers are solvent, some of our individual carriers are insolvent, which has been considered in our analysis of probable recoveries. We made judgments concerning insurance coverage that we believe are reasonable and consistent with our historical dealings with our insurers, our knowledge of any pertinent solvency issues surrounding insurers and various judicial determinations relevant to our insurance programs.

In the second quarter of 2006, Travelers Casualty and Insurance Company ("Travelers") filed a lawsuit against Honeywell and other insurance carriers in the Supreme Court of New York, County of New York, disputing obligations for NARCO–related asbestos claims under high excess insurance coverage issued by Travelers and other insurance carriers. Approximately $340 million of coverage under these policies is included in our NARCO–related insurance receivable at December 31, 2007. Honeywell believes it is entitled to the coverage at issue and has filed counterclaims in the Superior Court of New Jersey seeking, among other things, declaratory relief with respect to this coverage. In the third quarter of 2007, Honeywell prevailed in the New York action on a critical choice of law issue concerning the appropriate method of allocating NARCO–related asbestos liabilities to triggered policies. The Court's ruling is subject to appeal. While Honeywell expects to prevail in this matter, an adverse outcome could have a material impact on our results of operations in the period recognized but would not be material to our consolidated financial position or operating cash flows.

Projecting future events is subject to many uncertainties that could cause the NARCO related asbestos liabilities or assets to be higher or lower than those projected and recorded. There is no assurance that the plan of reorganization will become final, that insurance recoveries will be timely or whether there will be any NARCO related asbestos claims beyond 2018. Given the inherent uncertainty in predicting future events, we review our estimates periodically, and update them based on our experience and other relevant factors. Similarly we will reevaluate our projections concerning our probable insurance recoveries in light of any changes to the projected liability or other developments that may impact insurance recoveries.

Friction Products—Honeywell's Bendix friction materials (Bendix) business manufactured automotive brake parts that contained chrysotile asbestos in an encapsulated form. There is a group of existing and potential claimants consisting largely of individuals who allege exposure to asbestos from brakes from either performing or being in the vicinity of individuals who performed brake replacements.

From 1981 through December 31, 2007, we have resolved approximately 113,000 Bendix related asbestos claims. Trials covering 126 plaintiffs resulted in 125 favorable verdicts and one mistrial. Trials covering ten individuals resulted in adverse verdicts; however, two of these verdicts were reversed on appeal, five are or shortly will be on appeal, and the remaining three claims were settled. The following tables present information regarding Bendix related asbestos claims activity:

Claims Activity	Years Ended December 31, 2007	2006
Claims Unresolved at the beginning of year	57,108	79,502
Claims Filed	2,771	4,391
Claims Resolved	(8,221)	(26,785)
Claims Unresolved at the end of year	51,658	57,108

Disease Distribution of Unresolved Claims	December 31, 2007	2006
Mesothelioma and Other Cancer Claims	5,011	4,843
Other Claims	46,647	52,265
Total Claims	51,658	57,108

Approximately 45 percent of the approximately 52,000 pending claims at December 31, 2007 are on the inactive, deferred, or similar dockets established in some jurisdictions for claimants who allege minimal or no impairment. The approximately 52,000 pending claims also include claims filed in jurisdictions such as Texas, Virginia, and Mississippi that historically allowed for consolidated filings. In these jurisdictions, plaintiffs were permitted to file complaints against a pre–determined master list of defendants, regardless of whether they have claims against each individual defendant. Many of these plaintiffs may not actually intend to assert claims against Honeywell. Based on state rules and prior experience in these jurisdictions, we anticipate that many of these claims will ultimately be dismissed. During 2006 approximately 16,000 cases were dismissed. More than 85 percent of these dismissals occurred in Mississippi as a result of judicial rulings relating to non–resident filings and venue. We continue to experience dismissals in this jurisdiction.

Honeywell has experienced average resolution values per claim excluding legal costs as follows:

	Years Ended December 31, 2007	2006	2005
		(in whole dollars)	
Malignant claims	$ 33,000	$ 33,000	$ 58,000
Nonmalignant claims	$ 500	$ 250	$ 600

It is not possible to predict whether resolution values for Bendix related asbestos claims will increase, decrease or stabilize in the future.

Our consolidated financial statements reflect an estimated liability for resolution of pending and future Bendix related asbestos claims of $517 and $528 million at December 31, 2007 and 2006, respectively. Prior to December 2006, we only accrued for the estimated cost of pending Bendix related asbestos claims as we could not reasonably estimate losses which could arise from future Bendix related asbestos claims. Due to the steady three–year decline in the rate of Bendix related asbestos claims filed and reduced volatility in those rates, we felt that it was now possible to determine a reasonable estimate of the costs that would be incurred for claims filed over the next five years. Accordingly, during the fourth quarter of 2006, we recorded a reserve of $335 million for the estimated cost of future Bendix related asbestos claims based on the historic claims filing experience, disease classifications, expected resolution values, and historic dismissal rates. In December 2007, we updated our analysis of the estimated cost of future Bendix related asbestos claims which resulted in a reduction of the reserve to $327 million at December 31, 2007. In December 2006, we also changed our methodology for valuing Bendix pending and future claims from using average resolution values for the previous five years to using average resolution values for the previous two years which resulted in a reduction of $118 million in the reserve for pending Bendix claims in the fourth quarter of 2006. The claims filing experience and resolution data for Bendix related claims has become more reliable over the past several years. Accordingly, in the fourth quarter of 2007, we updated our methodology for valuing Bendix pending and future claims using the average resolution values for the past three years of data, which resulted in a $10 million reduction in the reserve for pending Bendix claims. We will continue to update the expected resolution values used to estimate the cost of pending and future Bendix claims during the fourth quarter each year.

The estimated liability for future claims represents the estimated value of future asbestos related bodily injury claims expected to be asserted against Bendix over the next five years. In light of the uncertainties inherent in making long–term projections, as well as certain factors unique to friction product asbestos claims, we do not believe that we have a reasonable basis for estimating asbestos claims beyond the next five years under SFAS No. 5, "Accounting for Contingencies". The estimate is based upon Bendix historical experience in the tort system for the three years ended December 31, 2007 with respect to claims filing and resolution values. The methodology used to estimate the liability for future claims has been commonly accepted by numerous courts. It is similar to that used to estimate the future NARCO related asbestos claims liability.

Honeywell currently has approximately $1.9 billion of insurance coverage remaining with respect to pending and potential future Bendix related asbestos claims, of which $197 and $302 million are reflected as receivables in our consolidated balance sheet at December 31, 2007 and 2006, respectively. This coverage is provided by a large number of insurance policies written by dozens of insurance companies in both the domestic insurance market and the London excess market. Insurance receivables are recorded in the financial statements simultaneous with the recording of the liability for the estimated value of the underlying asbestos claims. The amount of the insurance receivable recorded is based on our ongoing analysis of the insurance that we estimate is probable of recovery. This determination is based on our analysis of the underlying insurance policies, our historical experience with our insurers, our ongoing review of the solvency of our insurers, our interpretation of judicial determinations relevant to our insurance programs, and our consideration of the impacts of any settlements reached with our insurers. Insurance receivables are also recorded when structured insurance settlements provide for future fixed payment streams that are not contingent upon future claims or other events. Such amounts are recorded at the net present value of the fixed payment stream.

On a cumulative historical basis, Honeywell has recorded insurance receivables equal to approximately 50 percent of the value of the underlying asbestos claims recorded. However, because

there are gaps in our coverage due to insurance company insolvencies, certain uninsured periods, and insurance settlements, this rate is expected to decline for any future Bendix related asbestos liabilities that may be recorded. Future recoverability rates may also be impacted by numerous other factors, such as future insurance settlements, insolvencies and judicial determinations relevant to our coverage program, which are difficult to predict. Assuming continued defense and indemnity spending at current levels, we estimate that the cumulative recoverability rate could decline over the next five years to approximately 40 percent.

Honeywell believes it has sufficient insurance coverage and reserves to cover all pending Bendix related asbestos claims and Bendix related asbestos claims estimated to be filed within the next five years. Although it is impossible to predict the outcome of either pending or future Bendix related asbestos claims, we do not believe that such claims would have a material adverse effect on our consolidated financial position in light of our insurance coverage and our prior experience in resolving such claims. If the rate and types of claims filed, the average resolution value of such claims and the period of time over which claim settlements are paid (collectively, the "Variable Claims Factors") do not substantially change, Honeywell would not expect future Bendix related asbestos claims to have a material adverse effect on our results of operations or operating cash flows in any fiscal year. No assurances can be given, however, that the Variable Claims Factors will not change.

Refractory and Friction Products—The following tables summarize information concerning NARCO and Bendix asbestos related balances:

Asbestos Related Liabilities

	Year Ended December 31, 2007			Year Ended December 31, 2006			Year Ended December 31, 2005		
	Bendix	NARCO	Total	Bendix	NARCO	Total	Bendix	NARCO	Total
Beginning of year	$ 528	$ 1,291	$ 1,819	$ 287	$ 1,782	$ 2,069	$ 355	$ 2,395	$ 2,750
Accrual for pending claims and defense costs incurred	122	—	122	125	—	125	170	—	170
Accrual for estimated cost of future claims	—	—	—	335	—	335	—	—	—
Reduction in estimated cost of future claims	(8)	—	(8)	—	(207)	(207)	—	—	—
Asbestos related liability payments	(115)	(153)	(268)	(103)	(316)	(419)	(153)	(597)	(750)
Settlement with plaintiff firms of certain pending asbestos claims(1)	—	—	—	—	32	32	—	(21)	(21)
Update of expected resolution values for pending claims	(10)	—	(10)	(118)	—	(118)	(85)	—	(85)
Other	—	—	—	2	—	2	—	5	5
End of year	$ 517	$ 1,138	$ 1,655	$ 528	$ 1,291	$ 1,819	$ 287	$ 1,782	$ 2,069

(1) In 2006, charge of $32 million reflects a settlement of certain pending asbestos claims. In 2005, consists of a charge of $52 million to reflect a settlement of certain pending asbestos claims during the year and a credit of $73 million related to a re-estimation of asbestos reserves in connection with an additional settlement.

Insurance Recoveries for Asbestos Related Liabilities

	Year Ended December 31, 2007			Year Ended December 31, 2006			Year Ended December 31, 2005		
	Bendix	NARCO	Total	Bendix	NARCO	Total	Bendix	NARCO	Total
Beginning of year	$ 302	$ 955	$ 1,257	$ 377	$ 1,096	$ 1,473	$ 336	$ 1,226	$ 1,562
Probable insurance recoveries related to claims filed	6	—	6	11	—	11	34	—	34
Probable insurance recoveries related to annual update of expected resolution values for pending claims	(4)	—	(4)	39	—	39	(15)	—	(15)
Insurance receipts for asbestos related liabilities	(107)	(16)	(123)	(166)	(100)	(266)	(33)	(127)	(160)
Insurance receivables settlements and write-offs(1)	—	—	—	34	(41)	(7)	41	—	41
Other	—	—	—	7	—	7	14	(3)	11
End of year	$ 197	$ 939	$ 1,136	$ 302	$ 955	$ 1,257	$ 377	$ 1,096	$ 1,473

(1) In 2006, $34 million reflects gains from settlements with two Bendix insurance carriers and $41 million represents the write-down of the NARCO insurance receivable to reflect the reduction in the estimated cost of future claims. In 2005, consists of gains from insurance settlements of $172 million principally related to a structured insurance settlement with a carrier which converted a policy into a future, fixed, non-contingent payment stream, and charges of $131 million for write-offs of certain amounts due from insurance carriers.

NARCO and Bendix asbestos related balances are included in the following balance sheet accounts:

	December 31, 2007	December 31, 2006
Other current assets	$ 50	$ 157
Insurance recoveries for asbestos related liabilities	1,086	1,100
	$ 1,136	$ 1,257
Accrued liabilities	$ 250	$ 557
Asbestos related liabilities	1,405	1,262
	$ 1,655	$ 1,819

Other Matters

Allen, et, al. v. Honeywell Retirement Earnings Plan—During the third quarter of 2007, we agreed to a settlement in principle with the plaintiffs in this class action lawsuit relating to allegations that, among other things, Honeywell impermissibly reduced the pension benefits of certain employees of the former Garrett Corporation (a predecessor entity by merger) when the plan was amended in 1983 and failed to calculate certain benefits in accordance with the terms of the plan. Under the terms of the settlement, 18 of the 21 claims alleged by plaintiffs would be dismissed with prejudice in exchange for approximately $35 million, and the maximum aggregate liability for the remaining three claims would be capped at $500 million. During the third quarter of 2007, we recorded the $35 million settlement as part of pension expense (see Note 22). Any amounts payable, including the settlement amount, will be paid from the Company's pension plan. The definitive settlement agreement received final approval from the U.S. District Court for the District of Arizona in February 2008. We continue to expect to prevail on the remaining claims in light of applicable law and our substantial affirmative defenses, which have not yet been considered by the Court. Accordingly, we do not believe that a liability is probable of occurrence and reasonably estimable with respect to these claims and we have

not recorded a provision for the remaining claims in our financial statements. Although we expect to prevail on all three of the remaining claims, an adverse ruling on one or more of these claims could have a material adverse effect on our results of operations in the periods recognized. We do not believe that an adverse outcome in this matter would have a material adverse effect on our consolidated operating cash flows or consolidated financial position.

We are subject to a number of other lawsuits, investigations and disputes (some of which involve substantial amounts claimed) arising out of the conduct of our business, including matters relating to commercial transactions, government contracts, product liability, prior acquisitions and divestitures, employee benefit plans, intellectual property, and health and safety matters. We recognize a liability for any contingency that is probable of occurrence and reasonably estimable. We continually assess the likelihood of adverse judgments of outcomes in these matters, as well as potential ranges of probable losses (taking into consideration any insurance recoveries), based on a careful analysis of each matter with the assistance of outside legal counsel and, if applicable, other experts.

Given the uncertainty inherent in litigation, we do not believe it is possible to develop estimates of the range of reasonably possible loss in excess of current accruals for these matters. Considering our past experience and existing accruals, we do not expect the outcome of these matters, either individually or in the aggregate, to have a material adverse effect on our consolidated financial position. Because most contingencies are resolved over long periods of time, potential liabilities are subject to change due to new developments, changes in settlement strategy or the impact of evidentiary requirements, which could cause us to pay damage awards or settlements (or become subject to equitable remedies) that could have a material adverse effect on our results of operations or operating cash flows in the periods recognized or paid.

Warranties and Guarantees—We have issued or are a party to the following direct and indirect guarantees at December 31, 2007:

	Maximum Potential Future Payments
Operating lease residual values	$ 39
Other third parties' financing	4
Unconsolidated affiliates' financing	3
Customer financing	23
	$ 69

We do not expect that these guarantees will have a material adverse effect on our consolidated results of operations, financial position or liquidity.

In connection with the disposition of certain businesses and facilities we have indemnified the purchasers for the expected cost of remediation of environmental contamination, if any, existing on the date of disposition. Such expected costs are accrued when environmental assessments are made or remedial efforts are probable and the costs can be reasonably estimated.

In the normal course of business we issue product warranties and product performance guarantees. We accrue for the estimated cost of product warranties and performance guarantees based on contract terms and historical experience at the time of sale. Adjustments to initial obligations for warranties and guarantees are made as changes in the obligations become reasonably estimable. The following table summarizes information concerning our recorded obligations for product warranties and product performance guarantees:

	Years Ended December 31,		
	2007	2006	2005
Beginning of year	$ 363	$ 347	299
Accruals for warranties/guarantees issued during the year	233	268	203
Adjustment of pre-existing warranties/guarantees	3	(22)	17
Settlement of warranty/guarantee claims	(203)	(230)	(172)
End of year	$ 396	$ 363	347

Product warranties and product performance guarantees are included in the following balance sheet accounts:

	2007	2006
Accrued liabilities	$ 380	347
Other liabilities	16	16
	$ 396	363

Note 22—Pension and Other Postretirement Benefits

We sponsor both funded and unfunded U.S. and non-U.S. defined benefit pension plans covering the majority of our employees and retirees. Pension benefits for substantially all U.S. employees are provided through non-contributory, qualified and non-qualified defined benefit pension plans. U.S. defined benefit pension plans comprise 73 percent of our projected benefit obligation. Non-U.S. employees, who are not U.S. citizens, are covered by various retirement benefit arrangements, some of which are considered to be defined benefit pension plans for accounting purposes. Non-U.S. defined benefit pension plans comprise 27 percent of our projected benefit obligation.

We also sponsor postretirement benefit plans that provide health care benefits and life insurance coverage to eligible retirees. Our retiree medical plans mainly cover U.S. employees who retire with pension eligibility for hospital, professional and other medical services. All non-union hourly and salaried employees joining Honeywell after January 1, 2000 are not eligible to participate in our retiree medical and life insurance plans. Most of the U.S. retiree medical plans require deductibles and copayments, and virtually all are integrated with Medicare. Retiree contributions are generally required based on coverage type, plan and Medicare eligibility. Honeywell has limited its subsidy of its retiree medical plans to a fixed-dollar amount for substantially all future retirees and for almost half of its current retirees. This cap of retiree medical benefits under our plans limits our exposure to the impact of future health care cost increases. The retiree medical and life insurance plans are not funded. Claims and expenses are paid from our operating cash flow.

As discussed in Note 1, we adopted SFAS No. 158 as of December 31, 2006. SFAS No. 158 requires that we recognize on a prospective basis the funded status of our defined benefit pension and other postretirement benefit plans on the consolidated balance sheet and recognize as a component of accumulated other comprehensive income (loss), net of tax, the gains or losses and prior service costs or credits that arise during the period but are not recognized as components of net periodic benefit cost. Additional minimum pension liabilities and related intangible assets were also derecognized upon adoption of the new standard. The adjustment for SFAS No. 158 affected our 2006 Consolidated Balance Sheet as follows:

Decrease in prepaid pension benefit cost	$ (2,071)
Decrease in intangible asset	(79)
Decrease in accrued and minimum pension liability	138
Increase in postretirement benefit obligations other than pensions	(340)
Increase in accumulated other comprehensive loss, pre-tax	(2,352)
Increase in income tax benefit	840
Increase in accumulated other comprehensive loss, net of tax(1)	$ (1,512)

(1) Represents $1,708 million reduction of shareowners' equity including a $196 million adjustment related to our additional minimum liability.

The following tables summarize the balance sheet impact, including the benefit obligations, assets and funded status associated with our significant pension and other postretirement benefit plans at December 31, 2007 and 2006.

	Pension Benefits		Other Postretirement Benefits	
	2007	2006	2007	2006
Change in benefit obligation:				
Benefit obligation at beginning of year	$ 17,008	$ 16,168	$ 2,265	$ 2,318
Service cost	264	274	15	17
Interest cost	960	908	128	122
Plan amendments	22	7	(7)	(11)
Actuarial (gains) losses	(647)	(183)	(11)	(14)
Acquisitions	—	75	—	—
Benefits paid	(1,073)	(1,070)	(198)	(186)
Settlements and curtailments	34	(15)	—	—
Other	202	844	—	19
Benefit obligation at end of year	16,770	17,008	2,192	2,265
Change in plan assets:				
Fair value of plan assets at beginning of year	16,578	14,653	—	—
Actual return on plan assets	1,281	1,897	—	—
Company contributions	238	347	—	—
Acquisitions	—	65	—	—
Benefits paid	(1,073)	(1,070)	—	—
Other	170	686	—	—
Fair value of plan assets at end of year	17,194	16,578	—	—
Funded status of plans	$ 424	$ (430)	$ (2,192)	$ (2,265)
Amounts recognized in Consolidated Balance Sheet consist of:				
Prepaid pension benefit cost	$ 1,231	$ 685	$ —	$ —
Accrued liabilities	—	—	(197)	(197)
Postretirement benefit obligations other than pensions(1)	—	—	(1,995)	(2,068)
Accrued pension liability(2)	(807)	(1,115)	—	—
Net amount recognized	$ 424	$ (430)	$ (2,192)	$ (2,265)

(1) Excludes Non-U.S. plans of $30 and $22 million in 2007 and 2006, respectively.

(2) Included in Other Liabilities—Non-Current on Consolidated Balance Sheet.

Amounts recognized in Accumulated Other Comprehensive Income (loss) at December 31, 2007 and 2006 are as follows.

	Pension Benefits		Other Postretirement Benefits	
	2007	2006	2007	2006
Transition obligation	$ 12	$ 11	$ —	$ —
Prior service cost or (benefit)	94	98	(116)	(146)
Actuarial losses	1,675	2,423	429	486
Net amount recognized	$ 1,781	$ 2,532	$ 313	$ 340

The accumulated benefit obligation for our defined benefit pension plans was $16.0 and $16.2 billion at December 31, 2007 and 2006, respectively.

The components of net periodic benefit cost and other amounts recognized in other comprehensive (income) loss for our significant plans include the following components:

Net Periodic Benefit Cost	Pension Benefits Years Ended December 31,			Other Postretirement Benefits Years Ended December 31,		
	2007	2006	2005	2007	2006	2005
Service cost	$ 264	$ 274	$ 236	$ 15	$ 17	$ 17
Interest cost	960	908	815	128	122	120
Expected return on plan assets	(1,347)	(1,251)	(1,104)	—	—	—
Amortization of prior service cost (credit)	26	27	30	(37)	(40)	(39)
Recognition of actuarial losses	210	348	392	46	52	63
Settlements and curtailments	35	(13)	—	—	—	—
Net periodic benefit cost	$ 148	$ 293	$ 369	$ 152	$ 151	$ 161

Other Changes in Plan Assets and Benefit Obligations Recognized in Other Comprehensive (Income) Loss	2007	2007
Actuarial (gains)	$ (581)	$ (11)
Prior service cost (credit)	22	(7)
Amortization of prior service cost (credit)	(26)	37
Recognition of actuarial losses	(210)	(46)
Foreign exchange translation adjustments	19	—
Total recognized in other comprehensive (income) loss	$ (776)	$ (27)
Total recognized in net periodic benefit cost and other comprehensive (income) loss	$ (628)	$ 125

The estimated net loss and prior service cost for pension benefits that will be amortized from accumulated other comprehensive income (loss) into net periodic benefit cost in 2008 are expected to be $48 and $28 million, respectively. The estimated net loss and prior service credit for other postretirement benefits that will be amortized from accumulated other comprehensive income (loss) into net periodic benefit cost in 2008 are expected to be $35 and $(40) million, respectively.

Major actuarial assumptions used in determining the benefit obligations and net periodic benefit cost for our U.S. benefit plans are presented in the following table. For non–U.S. benefit plans, no one of which was individually material, assumptions reflect economic assumptions applicable to each country.

	Pension Benefits			Other Postretirement Benefits		
	2007	2006	2005	2007	2006	2005
Actuarial assumptions used to determine benefit obligations as of December 31:						
Discount rate	6.50%	6.00%	5.75%	5.90%	5.70%	5.50%
Expected annual rate of compensation increase	4.50%	4.00%	4.00%	—	—	—
Actuarial assumptions used to determine net periodic benefit cost for years ended December 31:						
Discount rate	6.00%	5.75%	5.875%	5.70%	5.50%	5.50%
Expected rate of return on plan assets	9.00%	9.00%	9.00%	—	—	—
Expected annual rate of compensation increase	4.00%	4.00%	4.00%	—	—	—

To select a discount rate for our retirement benefit plans, we use a modeling process that involves matching the expected cash outflows of our benefit plans to a yield curve constructed from a portfolio of double A rated fixed–income debt instruments. We use the average yield of this hypothetical portfolio as a discount rate benchmark. The discount rate used to determine the other postretirement benefit obligation is lower due to a shorter expected duration of other postretirement plan obligations as compared to pension plan obligations.

Our expected rate of return on plan assets of 9 percent is a long–term rate based on historic plan asset returns over varying long–term periods combined with current market conditions and broad asset mix considerations. The expected rate of return is a long–term assumption and generally does not change annually.

Mortality assumptions for our U.S. benefit plans were updated as of December 31, 2005 using the RP2000 Mortality table for all participants.

Pension Benefits

Included in the aggregate data in the tables below are the amounts applicable to our pension plans with accumulated benefit obligations exceeding the fair value of plan assets, as well as plans with projected benefit obligations exceeding the fair value of plan assets. Amounts related to such plans were as follows:

	December 31,	
	2007	2006
Plans with accumulated benefit obligations in excess of plan assets		
Accumulated benefit obligations	$ 2,766	$ 3,493
Fair value of plan assets	$ 2,140	$ 2,692
Plans with projected benefit obligations in excess of plan assets		
Projected benefit obligations	$ 4,329	$ 5,042
Fair value of plan assets	$ 3,522	$ 3,927

Our U.S. pension plans assets were $13.0 and $12.8 billion and our non–U.S. pension plans assets were $4.2 and $3.8 billion at December 31, 2007 and 2006, respectively. Our asset allocation and target allocation for our pension plans assets are as follows:

Asset Category	Percentage of Plans Assets at December 31, 2007	2006	Long–term Target Allocation
Equity securities	63 %	63 %	45–70 %
Debt securities, including cash	26	29	15–30
Real estate	6	5	5–10
Other	5	3	5–15
	100 %	100 %	

Our asset investment strategy focuses on maintaining a diversified portfolio using various asset classes in order to achieve our long–term investment objectives on a risk adjusted basis. Our actual invested positions in various securities change over time based on short and longer–term investment opportunities. To achieve our objectives, our U.S. investment policy requires that our U.S. Master Retirement Trust be invested as follows: (a) no less than 5 percent be invested in fixed income securities; (b) no more than 10 percent in private real estate investments; and (c) no more than 18 percent in other investment alternatives involving limited partnerships of various types. There is no stated limit on investments in publicly–held U.S. and international equity securities. Our non–U.S. investment policies are different for each country, but the long–term investment objectives remain the same.

Our general funding policy for qualified pension plans is to contribute amounts at least sufficient to satisfy regulatory funding standards. In 2007 and 2006, we made voluntary contributions of $42 and $68 million, respectively, to our U.S. defined benefit pension plans primarily for government contracting purposes. Assuming that actual plan asset returns are consistent with our expected rate of 9 percent in 2008 and beyond, and that interest rates remain constant, we would not be required to make any contributions to our U.S. pension plans for the foreseeable future. We expect to make voluntary contributions of approximately $40 million in cash in 2008 to certain of our U.S. plans for government contracting purposes. We also expect to contribute approximately $125 million in cash in 2008 to our non–U.S. defined benefit pension plans to satisfy regulatory funding standards. These contributions do not reflect benefits to be paid directly from Company assets.

Benefit payments, including amounts to be paid from Company assets, and reflecting expected future service, as appropriate, are expected to be paid as follows:

2008	$ 1,076
2009	1,081
2010	1,088
2011	1,098
2012	1,116
2013–2017	5,873

Other Postretirement Benefits

FASB Staff Position No. 106–2 "Accounting and Disclosure Requirements Related to the Medicare Prescription Drug, Improvement and Modernization Act of 2003" (FSP No. 106–2) provides guidance on accounting for the effects of the Medicare Prescription Drug, Improvement and Modernization Act of 2003 (the Act) for employers that sponsor postretirement health care plans that provide prescription drug coverage that is at least actuarially equivalent to that offered by Medicare Part D. The impact of

the Act reduced other postretirement benefits expense by approximately $25, $37 and $45 million in 2007, 2006 and 2005, respectively.

	December 31, 2007	2006
Assumed health care cost trend rate:		
Health care cost trend rate assumed for next year	8.5 %	9.0 %
Rate that the cost trend rate gradually declines to	5.5 %	5.5 %
Year that the rate reaches the rate it is assumed to remain at	2014	2014

The assumed health care cost trend rate has a significant effect on the amounts reported. A one-percentage-point change in the assumed health care cost trend rate would have the following effects:

	1 percentage point Increase	Decrease
Effect on total of service and interest cost components	$ 6	$ (5)
Effect on postretirement benefit obligation	$ 79	$ (70)

Benefit payments reflecting expected future service, as appropriate, are expected to be paid as follows:

	Without Impact of Medicare Subsidy	Net of Medicare Subsidy
2008	$ 221	$ 206
2009	224	208
2010	223	208
2011	221	207
2012	198	185
2013–2017	855	790

Employee Savings Plans

We sponsor employee savings plans under which we match, in the form of our common stock, savings plan contributions for certain eligible U.S. employees. Shares issued under the stock match plans were 3.7, 4.5 and 4.1 million at a cost of $199, $179 and $153 million in 2007, 2006 and 2005, respectively.

Note 23—Segment Financial Data

We globally manage our business operations through four reportable operating segments serving customers worldwide with aerospace products and services, control, sensing and security technologies for buildings, homes and industry, automotive products and chemicals. Segment information is consistent with how management reviews the businesses, makes investing and resource allocation decisions and assesses operating performance. Our four reportable segments are as follows:

- Aerospace is organized by customer end–market (Air Transport and Regional, Business and General Aviation and Defense and Space) and provides products and services which include auxiliary power units; propulsion engines; environmental control systems; engine controls; repair and overhaul services; hardware; logistics; electric power systems; flight safety, communications, navigation, radar and surveillance systems; aircraft lighting; management and technical services; advanced systems and instruments; and aircraft wheels and brakes.

- Automation and Control Solutions includes Products (controls for heating, cooling, indoor air quality, ventilation, humidification and home automation; advanced software applications for home/ building control and optimization; sensors, switches, control systems and instruments for measuring pressure, air flow, temperature and electrical current; security, fire and gas detection; access control; video surveillance; and remote patient monitoring systems); Building Solutions (installs, maintains and upgrades systems that keep buildings safe, comfortable and productive); and Process Solutions (provides a full range of automation and control solutions for industrial plants, offering advanced software and automation systems that integrate, control and monitor complex processes in many types of industrial settings).

- Specialty Materials includes fluorocarbons, specialty films, advanced fibers, customized research chemicals and intermediates, electronic materials and chemicals, and catalysts and adsorbents.

- Transportation Systems includes Honeywell Turbo Technologies (turbochargers and charge–air and thermal systems); and the Consumer Products Group (car care products including anti–freeze, filters, spark plugs, and cleaners, waxes and additives; and brake hard parts and other friction materials).

The accounting policies of the segments are the same as those described in Note 1. Honeywell's senior management evaluates segment performance based on segment profit. Segment profit is business unit income (loss) before taxes excluding general corporate unallocated expenses, other income (expense), interest and other financial charges, pension and other postretirement benefits (expense), stock option expense, repositioning and other charges and accounting changes. Intersegment sales approximate market prices and are not significant. Reportable segment data follows:

	Years Ended December 31,		
	2007	2006	2005
Net sales			
Aerospace	$ 12,236	$ 11,124	$ 10,496
Automation and Control Solutions	12,478	11,020	9,416
Specialty Materials	4,866	4,631	3,234
Transportation Systems	5,009	4,592	4,505
Corporate	—	—	1
	$ 34,589	$ 31,367	$ 27,652
Depreciation and amortization			
Aerospace	$ 199	$ 195	$ 188
Automation and Control Solutions	264	240	202
Specialty Materials	216	221	137
Transportation Systems	110	101	93
Corporate	48	37	33
	$ 837	$ 794	$ 653
Segment profit			
Aerospace	$ 2,197	$ 1,892	$ 1,676
Automation and Control Solutions	1,405	1,223	1,065
Specialty Materials	658	568	257
Transportation Systems	583	574	557
Corporate	(189)	(177)	(173)
	$ 4,654	$ 4,080	$ 3,382
Capital expenditures			
Aerospace	$ 172	$ 178	$ 178
Automation and Control Solutions	186	165	136
Specialty Materials	215	186	155
Transportation Systems	131	109	143
Corporate	63	95	72
	$ 767	$ 733	$ 684

	December 31,		
	2007	2006	2005
Total assets			
Aerospace	$ 8,743	$ 7,914	$ 7,696
Automation and Control Solutions	12,999	11,287	10,080
Specialty Materials	5,065	4,674	4,732
Transportation Systems	3,304	3,038	2,880
Corporate	3,694	4,028	6,245
	$ 33,805	$ 30,941	$ 31,633

A reconciliation of segment profit to consolidated income from continuing operations before taxes is as follows:

	Years Ended December 31,		
	2007	2006	2005
Segment profit	$ 4,654	$ 4,080	$ 3,382
Other income (expense)	53	111	231
Interest and other financial charges	(456)	(374)	(356)
Stock option expense(1)	(65)	(77)	—
Pension and other postretirement benefits (expense)(1)	(322)	(459)	(561)
Repositioning and other charges(1)	(543)	(483)	(400)
Income from continuing operations before taxes	$ 3,321	$ 2,798	$ 2,296

(1) Amounts included in cost of products and services sold and selling, general and administrative expenses.

Note 24—Geographic Areas—Financial Data

	Net Sales(1)			Long-lived Assets(2)		
	Years Ended December 31,			Years Ended December 31,		
	2007	2006	2005	2007	2006	2005
United States	$ 21,101	$ 19,821	$ 17,956	$ 11,916	$ 11,438	$ 10,842
Europe	9,104	7,781	6,552	2,706	2,161	1,958
Other International	4,384	3,765	3,144	1,036	848	691
	$ 34,589	$ 31,367	$ 27,652	$ 15,658	$ 14,447	$ 13,491

(1) Sales between geographic areas approximate market and are not significant. Net sales are classified according to their country of origin. Included in United States net sales are export sales of $3,427, $3,493 and $2,780 million in 2007, 2006 and 2005, respectively.

(2) Long-lived assets are comprised of property, plant and equipment, goodwill and other intangible assets.

Note 25—Supplemental Cash Flow Information

	Years Ended December 31,		
	2007	2006	2005
Payments for repositioning and other charges:			
Severance and exit cost payments	$ (92)	$ (142)	$ (171)
Environmental payments	(267)	(264)	(247)
Proceeds from sale of insurance receivable	97	100	—
Insurance receipts for asbestos related liabilities	26	166	160
Asbestos related liability payments	(268)	(419)	(750)
	$ (504)	$ (559)	$ (1,008)
Interest paid, net of amounts capitalized	$ 444	$ 361	$ 397
Income taxes paid, net of refunds	474	471	235
Non-cash investing and financing activities:			
Common stock contributed to U.S. savings plans	199	179	153

Note 26—Unaudited Quarterly Financial Information

	2007					2006				
	Mar. 31	June 30	Sept. 30	Dec. 31	Year	Mar. 31	June 30	Sept. 30	Dec. 31	Year
Net sales	$ 8,041	$ 8,538	$ 8,735	$ 9,275	$ 34,589	$ 7,241	$ 7,898	$ 7,952	$ 8,276	$ 31,367
Gross profit	1,891	2,047	2,089	2,262	8,289	1,641	1,871	1,841	1,918	7,271
Income from continuing operations	526	611	618	689	2,444	431	521	541	585	2,078
Income from discontinued operations	—	—	—	—	—	5	—	—	—	5
Net income	526	611	618	689	2,444	436	521	541	585	2,083
Earnings per share—basic:										
Income from continuing operations	.66	.79	.83	.92	3.20	.51	.63	.66	.72	2.53
Income from discontinued operations	—	—	—	—	—	.01	—	—	—	.01
Net income	.66	.79	.83	.92	3.20	.52	.63	.66	.72	2.54
Earnings per share—assuming dilution:										
Income from continuing operations	.66	.78	.81	.91	3.16	.51	.63	.66	.72	2.51
Income from discontinued operations	—	—	—	—	—	.01	—	—	—	.01
Net income	.66	.78	.81	.91	3.16	.52	.63	.66	.72	2.52
Dividends paid	.25	.25	.25	.25	1.00	.226875	.226875	.226875	.226875	.9075
Market price(1)										
High	48.31	58.87	61.45	61.77	61.77	42.85	44.16	41.37	45.46	45.46
Low	44.13	46.15	54.12	53.19	44.13	35.84	37.62	36.21	41.35	35.84

(1) From composite tape—stock is primarily traded on the New York Stock Exchange.

REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

TO THE BOARD OF DIRECTORS AND SHAREOWNERS OF
HONEYWELL INTERNATIONAL INC.:

In our opinion, the consolidated financial statements listed in the index appearing under Item 15(a)(1.) present fairly, in all material respects, the financial position of Honeywell International Inc. and its subsidiaries at December 31, 2007 and 2006, and the results of their operations and their cash flows for each of the three years in the period ended December 31, 2007 in conformity with accounting principles generally accepted in the United States of America. In addition, in our opinion, the financial statement schedule listed in the index appearing under Item 15(a)(2.) presents fairly, in all material respects, the information set forth therein when read in conjunction with the related consolidated financial statements. Also in our opinion, the Company maintained, in all material respects, effective internal control over financial reporting as of December 31, 2007, based on criteria established in *Internal Control–Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO). The Company's management is responsible for these financial statements and financial statement schedule, for maintaining effective internal control over financial reporting and for its assessment of the effectiveness of internal control over financial reporting, included in Management's Report on Internal Control Over Financial Reporting appearing under Item 9A. Our responsibility is to express opinions on these financial statements, on the financial statement schedule, and on the Company's internal control over financial reporting based on our integrated audits. We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audits to obtain reasonable assurance about whether the financial statements are free of material misstatement and whether effective internal control over financial reporting was maintained in all material respects. Our audits of the financial statements included 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. Our audit of internal control over financial reporting included obtaining an understanding of internal control over financial reporting, assessing the risk that a material weakness exists, and testing and evaluating the design and operating effectiveness of internal control based on the assessed risk. Our audits also included performing such other procedures as we considered necessary in the circumstances. We believe that our audits provide a reasonable basis for our opinions.

As discussed in Note 1 to the consolidated financial statements, the Company changed the manner in which it accounts for income tax uncertainties in 2007, the manner in which it accounts for stock– based compensation and defined benefit pension and other postretirement plans in 2006 and the manner in which it accounts for conditional asset retirement obligations in 2005.

A company's internal control over financial reporting is a process designed 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 (i) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the company; (ii) 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 (iii) 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 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.

/s/ PricewaterhouseCoopers LLP

Florham Park, New Jersey
February 14, 2008

Item 9. Changes in and Disagreements with Accountants on Accounting and Financial Disclosure

Not Applicable.

Item 9A. Controls and Procedures

Honeywell management, including the Chief Executive Officer and Chief Financial Officer, conducted an evaluation of the effectiveness of our disclosure controls and procedures as of the end of the period covered by this Annual Report on Form 10–K. Based upon that evaluation, the Chief Executive Officer and the Chief Financial Officer concluded that such disclosure controls and procedures were effective as of the end of the period covered by this Annual Report on Form 10–K to ensure information required to be disclosed in the reports that Honeywell files or submits under the Exchange Act is recorded, processed, sumarized, and reported within the time periods specified in the Securities and Exchange Commission rules and forms. There have been no changes that have materially affected, or are reasonably likely to materially affect, Honeywell's internal control over financial reporting that have occurred during the period covered by this Annual Report on Form 10–K.

Management's Report on Internal Control Over Financial Reporting

Honeywell management is responsible for establishing and maintaining adequate internal control over financial reporting as defined in Rules 13a–15(f) and 15d–15(f) under the Securities Exchange Act of 1934. Honeywell's internal control over financial reporting is a process designed 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. Honeywell's internal control over financial reporting includes those policies and procedures that:

(i) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of Honeywell's assets;

(ii) 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 Honeywell's management and directors; and

(iii) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use or disposition of Honeywell's assets that could have a material effect on the financial statements.

Because of 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.

Management assessed the effectiveness of Honeywell's internal control over financial reporting as of December 31, 2007. In making this assessment, management used the criteria set forth by the Committee of Sponsoring Organizations of the Treadway Commission (COSO) in *Internal Control–Integrated Framework.*

Based on this assessment, management determined that Honeywell maintained effective internal control over financial reporting as of December 31, 2007.

The effectiveness of Honeywell's internal control over financial reporting as of December 31, 2007 has been audited by PricewaterhouseCoopers LLP, an independent registered public accouting firm, as stated in their report which is included in "Item 8. Financial Statements and Supplementary Data."

Item 9B. Other Information

Not Applicable.

Part III.

Item 10. Directors and Executive Officers of the Registrant

Information relating to the Directors of Honeywell, as well as information relating to compliance with Section 16(a) of the Securities Exchange Act of 1934, will be contained in our definitive Proxy Statement involving the election of the Directors which will be filed with the SEC pursuant to Regulation 14A not later than 120 days after December 31, 2007, and such information is incorporated herein by reference. Certain other information relating to the Executive Officers of Honeywell appears in Part I of this Annual Report on Form 10–K under the heading "Executive Officers of the Registrant".

The members of the Audit Committee of our Board of Directors are: Scott Davis (Chair), Linnet Deily, James J. Howard, Eric K. Shinseki, John R. Stafford, and Michael W. Wright. The Board has determined that Mr. Davis is the "audit committee financial expert" as defined by applicable SEC rules and that Mr. Davis and Ms. Deily satisfy the "accounting or related financial management expertise" criteria established by the NYSE. All members of the Audit Committee are "independent" as that term is defined in applicable SEC Rules and NYSE listing standards.

Honeywell's Code of Business Conduct is available, free of charge, on our website under the heading "Investor Relations" (see "Corporate Governance"), or by writing to Honeywell, 101 Columbia Road, Morris Township, New Jersey 07962, c/o Vice President and Corporate Secretary. Honeywell's Code of Business Conduct applies to all Honeywell directors, officers (including the Chief Executive Officer, Chief Financial Officer and Controller) and employees. Amendments to or waivers of the Code of Business Conduct granted to any of Honeywell's directors or executive officers will be published on our website within five business days of such amendment or waiver.

Item 11. Executive Compensation

Information relating to executive compensation is contained in the Proxy Statement referred to above in "Item 10. Directors and Executive Officers of the Registrant," and such information is incorporated herein by reference.

Item 12. Security Ownership of Certain Beneficial Owners and Management and Related Stockholder Matters

Information relating to security ownership of certain beneficial owners and management and related stockholder matters is contained in the Proxy Statement referred to above in "Item 10. Directors and Executive Officers of the Registrant," and such information is incorporated herein by reference.

EQUITY COMPENSATION PLANS

As of December 31, 2007 Information about our equity compensation plans is as follows:

Plan Category	Number of Shares to be Issued Upon Exercise of Outstanding Options, Warrants and Rights	Weighted–Average Exercise Price of Outstanding Options, Warrants and Rights	Number of Securities Remaining Available for Future Issuance Under Equity Compensation Plans (Excluding Securities Reflected in Column(a))
	(a)	(b)	(c)
Equity compensation plans approved by security holders	47,079,091 (1)	$ 41.68 (2)	41,704,400 (3)
Equity compensation plans not approved by security holders	716,150 (4)	N/A (5)	N/A (6)
Total	47,795,241	$ 41.68	41,704,400

(1) Equity compensation plans approved by shareowners that are included in column (a) of the table are the 2006 Stock Incentive Plan of Honeywell International Inc. and its Affiliates (the "2006 Stock Incentive Plan") (6,103,925 shares of Common Stock to be issued for options; 3,771,170 restricted units subject to continued employment); the 2003 Stock Incentive Plan of Honeywell International Inc. and its Affiliates (the "2003 Stock Incentive Plan") (17,494,110 shares of Common Stock to be issued for options; 4,500 shares to be issued for SARs; 1,779,975 restricted units subject to continued employment; and 947,025 deferred restricted units of earned and vested awards under prior plans approved by shareowners where delivery of shares has been deferred); the 1993 Stock Plan for Employees of Honeywell International Inc. and its Affiliates (16,149,756 shares of Common Stock to be issued for options; 69,900 shares to be issued for SARs; and 431,230 restricted units subject to continued employment); the 2006 Stock Plan for Non–Employee Directors of Honeywell International Inc. (the "Non–Employee Director Plan") (110,000 shares of Common Stock to be issued for options and 3,000 shares of restricted stock), and the 1994 Stock Plan for Non–Employee Directors of Honeywell International Inc. (181,500 shares of Common Stock to be issued for options and 33,000 shares of restricted stock).

822,060 growth plan units were issued in the first quarter of 2005 pursuant to a long–term compensation program established under the 2003 Stock Incentive Plan. The ultimate value of any growth plan award may be paid in cash or shares of Common Stock and, thus, growth plan units are not included in the table above. The ultimate value of growth plan units depends upon the achievement of pre–established performance goals during a two–year performance cycle relating to growth in earnings per share, revenue and return on investment. The growth plan units issued in the first quarter of 2005 relate to the performance cycle commencing January 1, 2005 and ending December 31, 2006. 50% of any cash payment related to these growth plan units was paid in March 2007 and the remaining 50% of the cash payment will be paid in March 2008, subject to active employment on the payment dates.

899,840 growth plan units were issued in the first quarter of 2007 for the performance cycle commencing on January 1, 2007 and ending December 31, 2008 pursuant to the 2006 Stock Incentive Plan. The ultimate value of any growth plan award may be paid in cash or shares of Common Stock and, thus, growth plan units are not included in the table above. The ultimate value of growth plan units depends upon the achievement of pre–established performance goals during a two–year performance cycle relating to growth in earnings per share, revenue and return on investment. 50% of any payment related to these growth plan units will be paid in March 2009 and the remaining 50% will be paid in March 2010, subject to active employment on the payment dates.

Because the number of future shares that may be distributed to employees participating in the Honeywell Global Stock Plan is unknown, no shares attributable to that plan are included in column (a) of the table above.

(2) Column (b) does not include any exercise price for restricted units or growth plan units granted to employees or non–employee directors under equity compensation plans approved by shareowners. Restricted units do not have an exercise price because their value is dependent upon attainment of

certain performance goals or continued employment or service and they are settled for shares of Common Stock on a one–for–one basis. Growth plan units are denominated in cash units and the ultimate value of the award is dependent upon attainment of certain performance goals.

(3) The number of shares that may be issued under the 2006 Stock Incentive Plan as of December 31, 2007 is 37,894,009 which includes the following additional shares under the 2006 Stock Incentive Plan (or any Prior Plan as defined in the 2006 Stock Incentive Plan) that may again be available for issuance: shares that are settled for cash, expire, are cancelled, are tendered in satisfaction of an option exercise price or tax withholding obligations, are reacquired with cash tendered in satisfaction of an option exercise price or with monies attributable to any tax deduction enjoyed by Honeywell to the exercise of an option, and are under any outstanding awards assumed under any equity compensation plan of an entity acquired by Honeywell.

The number of shares that may be issued under the Honeywell Global Stock Plan as of December 31, 2007 is 3,425,391. This plan is an umbrella plan for five plans maintained solely for eligible employees of participating non–U.S. countries. One sub–plan, the Global Employee Stock Purchase Plan, allows eligible employees to contribute between 2.2% and 8.8% of base pay from January through September of each year to purchase shares of Common Stock at a 15% discount the following November. For 2007 and prior years, Honeywell purchased shares through non–dilutive, open market purchases. Employees purchased 429,383 shares of Common Stock at $38.335 per share in 2007 and 383,178 shares of Common Stock at $31.84 per share in 2006.

Another sub–plan, the UK Sharebuilder Plan, allows an eligible UK employee to contribute a specified percentage of taxable earnings that is then invested in shares. The company matches those shares and dividends paid are used to purchase additional shares. Matched shares are subject to a three–year vesting schedule. Shares taken out of the plan before five years lose their tax–favored status. For the year ending December 31, 2007, 126,267 shares were credited to participants' accounts under the UK Sharebuilder Plan.

The remaining three sub–plans, Honeywell International Technologies Employees Share Ownership Plan (Ireland), the Honeywell Measurex (Ireland) Limited Group Employee Profit Sharing Scheme and the Honeywell Ireland Software Employees Share Ownership Plan, allow eligible Irish employees to contribute specified percentages of base pay, bonus or performance pay that are then invested in shares. Shares must be held in trust for at least two years and lose their tax–favored status if they are taken out of the plan before three years. For the year ending December 31, 2007, 18,959 shares were credited to participants' accounts under these three plans.

The remaining 385,000 shares included in column (c) are shares remaining for future grants under the Non–Employee Director Plan.

(4) Equity compensation plans not approved by shareowners that are included in the table are the Supplemental Non–Qualified Savings Plan for Highly Compensated Employees of Honeywell International Inc. and its Subsidiaries, the AlliedSignal Incentive Compensation Plan for Executive Employees of AlliedSignal Inc. and its Subsidiaries, and the Deferred Compensation Plan for Non– Employee Directors of Honeywell International Inc.

The Supplemental Non–Qualified Savings Plan for Highly Compensated Employees of Honeywell International Inc. and its Subsidiaries is an unfunded, non–tax qualified plan that provides benefits equal to the employee deferrals and company matching allocations that would have been provided under Honeywell's U.S. tax–qualified savings plan if the Internal Revenue Code limitations on compensation and contributions did not apply. The company matching contribution is credited to participants' accounts in the form of notional shares of Common Stock. Additional notional shares are credited to participants' accounts equal to the value of any cash dividends payable on actual shares of Common Stock. The notional shares are distributed in the form of actual shares of Common Stock when payments are made to participants under the plan.

The AlliedSignal Incentive Compensation Plan for Executive Employees of AlliedSignal Inc. and its Subsidiaries was a cash incentive compensation plan maintained by AlliedSignal Inc. This plan has expired. Employees were permitted to defer receipt of a cash bonus payable under the plan and

invest the deferred bonus in notional shares of Common Stock. The notional shares are distributed in the form of actual shares of Common Stock when payments are made to participants under the plan. No further deferrals can be made under this plan. The number of shares of Common Stock that remain to be issued under this expired plan as of December 31, 2007 is 52,797.

The Deferred Compensation Plan for Non–Employee Directors of Honeywell International Inc. provides for mandatory and elective deferral of certain payments to non–employee directors. Mandatory deferrals are invested in notional shares of Common Stock. Directors may also invest any elective deferrals in notional shares of Common Stock. Additional notional shares are credited to participant accounts equal to the value of any cash dividends payable on actual shares of Common Stock. Notional shares of Common Stock are converted to an equivalent amount of cash at the time the distributions are made from the plan to directors. However, one former director is entitled to receive periodic distributions of actual shares of Common Stock that were notionally allocated to his account in years prior to 1992. The number of shares of Common Stock that remain to be issued to directors under this plan as of December 31, 2007 is 1,497.

(5) Column (b) does not include any exercise price for notional shares allocated to employees under Honeywell's equity compensation plans not approved by shareowners because all of these shares are notionally allocated as a matching contribution under the non–tax qualified savings plans or as a notional investment of deferred bonuses or fees under the cash incentive compensation and directors' plans as described in note 4 and are only settled for shares of Common Stock on a one–for–one basis.

(6) No securities are available for future issuance under the AlliedSignal Incentive Compensation Plan for Executive Employees of AlliedSignal Inc. and its Subsidiaries and the Deferred Compensation Plan for Non–Employee Directors of Honeywell International Inc. The cash incentive compensation plan has expired. All notional investments in shares of Common Stock are converted to cash when payments are made under the directors' plan (other than with respect to 1,497 shares of Common Stock included in column (a) that is payable to one former director). The amount of securities available for future issuance under the Supplemental Non–Qualified Savings Plan for Highly Compensated Employees of Honeywell International Inc. and its Subsidiaries is not determinable because the number of securities that may be issued under this plan depends upon the amount deferred to the plan by participants in future years.

The table does not contain information for the following plans and arrangements:

- Employee benefit plans of Honeywell intended to meet the requirements of Section 401(a) of the Internal Revenue Code and a small number of foreign employee benefit plans that are similar to such Section 401(a) plans.

- Equity compensation plans maintained by Honeywell Inc. immediately prior to the merger of Honeywell Inc. and AlliedSignal Inc. on December 1, 1999. The right to receive Honeywell International Inc. securities was substituted for the right to receive Honeywell Inc. securities under these plans. No new awards have been granted under these plans after the merger date. The number of shares to be issued under these plans upon exercise of outstanding options, warrants and rights is 1,251,561 and their weighted–average exercise price is $48.18.

Item 13. Certain Relationships and Related Transactions

Information relating to certain relationships and related transactions is contained in the Proxy Statement referred to above in "Item 10. Directors and Executive Officers of the Registrant," and such information is incorporated herein by reference.

Item 14. Principal Accounting Fees and Services

Information relating to fees paid to and services performed by PricewaterhouseCoopers LLP in 2007 and 2006 and our Audit Committee's pre–approval policies and procedures with respect to non– audit services are contained in the Proxy Statement referred to above in "Item 10. Directors and Executive Officers of the Registrant," and such information is incorporated herein by reference.

Part IV.

Item 15. Exhibits and Financial Statement Schedules

(a)(1.) Consolidated Financial Statements:	Page Number in Form 10–K
Consolidated Statement of Operations for the years ended December 31, 2007, 2006 and 2005	47
Consolidated Balance Sheet at December 31, 2007 and 2006	48
Consolidated Statement of Cash Flows for the years ended December 31, 2007, 2006 and 2005	49
Consolidated Statement of Shareowners' Equity for the years ended December 31, 2007, 2006 and 2005	50
Notes to Financial Statements	51
Report of Independent Registered Public Accounting Firm	101

(a)(2.) Consolidated Financial Statement Schedules:	Page Number in Form 10–K
Schedule II—Valuation and Qualifying Accounts	113

All other financial statement schedules have been omitted because they are not applicable to us or the required information is shown in the consolidated financial statements or notes thereto.

(a)(3.) Exhibits

See the Exhibit Index on pages 109 through 112 of this Annual Report on Form 10–K.

SIGNATURES

Pursuant to the requirements of Section 13 or 15(d) of the Securities Exchange Act of 1934, the Registrant has duly caused this annual report to be signed on its behalf by the undersigned, thereunto duly authorized.

HONEYWELL INTERNATIONAL INC.

February 15, 2008

By: /s/ Talia M. Griep
Talia M. Griep
Vice President and Controller

Pursuant to the requirements of the Securities Exchange Act of 1934, this annual report has been signed below by the following persons on behalf of the Registrant and in the capacities and on the date indicated:

Name	Name
*	*
David M. Cote Chairman of the Board, Chief Executive Officer and Director	James J. Howard Director
*	*
Gordon M. Bethune Director	Ivan G. Seidenberg Director
*	*
Jaime Chico Pardo Director	Bradley T. Sheares, Ph.D. Director
*	*
D. Scott Davis Director	Eric K. Shinseki Director
*	*
Linnet F. Deily Director	John R. Stafford Director
*	*
Clive R. Hollick Director	Michael W. Wright Director
/s/ David J. Anderson	/s/ Talia M. Griep
David J. Anderson Senior Vice President and Chief Financial Officer (Principal Financial Officer)	Talia M. Griep Vice President and Controller (Principal Accounting Officer)

*By: /s/ David J. Anderson
(David J. Anderson
Attorney–in–fact)

February 15, 2008

EXHIBIT INDEX

Exhibit No.	Description
2	Omitted (Inapplicable)
3(i)	Restated Certificate of Incorporation of Honeywell International Inc., as amended April 25, 2005 (incorporated by reference to Exhibit 3(i) to Honeywell's Form 10–K for the year ended December 31, 2005)
3(ii)	By–laws of Honeywell, as amended December 8, 2006 (incorporated by reference to Exhibit 3(ii) to Honeywell's Form 8–K filed December 11, 2006)
4	Honeywell International Inc. is a party to several long–term debt instruments under which, in each case, the total amount of securities authorized does not exceed 10% of the total assets of Honeywell and its subsidiaries on a consolidated basis. Pursuant to paragraph 4(iii)(A) of Item 601(b) of Regulation S–K, Honeywell agrees to furnish a copy of such instruments to the Securities and Exchange Commission upon request.
9	Omitted (Inapplicable)
10.1*	2003 Stock Incentive Plan of Honeywell International Inc., and its Affiliates (incorporated by reference to Honeywell's Proxy Statement, dated March 17, 2003, filed pursuant to Rule 14a–6 of the Securities and Exchange Act of 1934 and amended by Exhibit 10.1 to Honeywell's Form 8–K filed December 21, 2004 and by Exhibit 10.1 to Honeywell's Form 10–K for the year ended December 31, 2006)
10.2*	Deferred Compensation Plan for Non–Employee Directors of Honeywell International Inc., as amended and restated (incorporated by reference to Exhibit 10.2 to Honeywell's Form 10–Q for quarter ended June 30, 2003, amended by Exhibit 10.1 to Honeywell's Form 8–K filed December 21, 2004 and by Exhibit 10.2 to Honeywell's Form 10–K for the year ended December 31, 2005)
10.3*	Stock Plan for Non–Employee Directors of AlliedSignal Inc., as amended (incorporated by reference to Exhibit 10.3 to Honeywell's Form 10–Q for the quarter ended June 30, 2003 and by Exhibit 10.2 to Honeywell's Form 10–Q for the quarter ended June 30, 2007)
10.4*	1985 Stock Plan for Employees of AlliedSignal Inc. and its Subsidiaries, as amended (incorporated by reference to Exhibit 19.3 to Honeywell's Form 10–Q for the quarter ended September 30, 1991)
10.5*	AlliedSignal, Inc. Incentive Compensation Plan for Executive Employees, as amended (incorporated by reference to Exhibit B to Honeywell's Proxy Statement, dated March 10, 1994, filed pursuant to Rule 14a–6 of the Securities and Exchange Act of 1934, and amended by Exhibit 10.5 to Honeywell's Form 10–Q for the quarter ended June 30, 1999)
10.6*	Supplemental Non–Qualified Savings Plan for Highly Compensated Employees of Honeywell International Inc. and its Subsidiaries as amended and restated (incorporated by reference to Exhibit 10.6 to Honeywell's Form 10–Q for the quarter ended September 30, 2005 and by Exhibit 10.6 to Honeywell's Form 10–K for the year ended December 31, 2006)
10.7*	Honeywell International Inc. Severance Plan for Senior Executives, as amended and restated (incorporated by reference to Exhibit 10.7 to Honeywell's Form 10–K for the year ended December 31, 2003, and amended by Exhibit 10.7 to Honeywell's Form 10–Q for the quarter ended June 30, 2004)
10.8*	Salary and Incentive Award Deferral Plan for Selected Employees of Honeywell International Inc., and its Affiliates, as amended and restated (incorporated by reference to Exhibit 10.8 to Honeywell's Form 10–Q for the quarter ended September 30, 2005 and by Exhibit 10.8 to Honeywell's Form 10–K for the year ended December 31, 2006)

Exhibit No.	Description
10.9*	1993 Stock Plan for Employees of Honeywell International Inc. and its Affiliates, as amended (incorporated by reference to Exhibit A to Honeywell's Proxy Statement, dated March 10, 1994, filed pursuant to Rule 14a–6 of the Securities and Exchange Act of 1934, and amended by Exhibit 10.1 to Honeywell's Form 8–K filed December 21, 2004, Exhibit 10.9 to Honeywell's Form 10–K for the year ended December 31, 2006 and by Exhibit 10.3 to Honeywell's Form 10–Q for the quarter ended June 30, 2007)
10.10*	Honeywell International Inc. Supplemental Pension Plan, as amended and restated (incorporated by reference to Exhibit 10.13 to Honeywell's Form 10–K for the year ended December 31, 2000, and amended by Exhibit 10.1 to Honeywell's Form 8–K filed December 21, 2004 and by Exhibit 10.2 to Honeywell's Form 10–Q for the quarter ended September 30, 2006)
10.11*	Employment Separation Agreement and Release between J. Kevin Gilligan and Honeywell International Inc. dated February 10, 2004 (incorporated by reference to Honeywell's Form 10– K for year ended December 31, 2003)
10.12*	Honeywell International Inc. Supplemental Executive Retirement Plan for Executives in Career Band 6 and Above (incorporated by reference to Exhibit 10.14 to Honeywell's Form 10–Q for the quarter ended June 30, 2004, and amended by Exhibit 10.1 to Honeywell's Form 8–K filed December 21, 2004 and by Exhibit 10.2 to Honeywell's Form 10–Q for the quarter ended September 30, 2006)
10.13*	Honeywell Supplemental Defined Benefit Retirement Plan, as amended and restated (incorporated by reference to Exhibit 10.15 to Honeywell's Form 10–Q for the quarter ended June 30, 2004, and amended by Exhibit 10.1 to Honeywell's Form 8–K filed December 21, 2004 and by Exhibit 10.2 to Honeywell's Form 10–Q for the quarter ended September 30, 2006)
10.14*	Letter between David J. Anderson and Honeywell International Inc. dated June 12, 2003 (incorporated by reference to Exhibit 10.26 to Honeywell's Form 10–Q for the quarter ended June 30, 2003)
10.15*	Employment Separation Agreement and Release between Richard F. Wallman and Honeywell International Inc. dated July 17, 2003 (incorporated by reference to Exhibit 10.2 to Honeywell's Form 10–Q for the quarter ended September 30, 2003)
10.16*	Honeywell International Inc. Severance Plan for Corporate Staff Employees (Involuntary Termination Following a Change in Control), as amended and restated (incorporated by reference to Exhibit 10.19 to Honeywell's Form 10–K for the year ended December 31, 2002 and amended by the attached amendment (filed herewith))
10.17*	Employment Agreement dated as of February 18, 2002 between Honeywell and David M. Cote (incorporated by reference to Exhibit 10.24 to Honeywell's Form 8–K filed March 4, 2002)
10.18*	2003 Stock Incentive Plan for Employees of Honeywell International Inc. and its Affiliates Award Agreement (incorporated by reference to Exhibit 10.1 to Honeywell's Form 8–K filed February 7, 2005)
10.19*	2003 Stock Incentive Plan for Employees of Honeywell International Inc. and its Affiliates Restricted Unit Agreement (incorporated by reference to Exhibit 10.21 to Honeywell's Form 10–K for the year ended December 31, 2005)
10.20*	2003 Stock Incentive Plan for Employees of Honeywell International Inc. and its Affiliates Growth Plan Agreement (incorporated by reference to Exhibit 10.22 to Honeywell's Form 10–K for the year ended December 31, 2005)

Exhibit No.	Description
10.21*	Stock Plan For Non–Employee Directors of Honeywell International Inc. Option Agreement (incorporated by reference to Exhibit 10.1 to Form 8–K filed April 29, 2005)
10.22*	Deferred Compensation Agreement dated August 4, 2006 between Honeywell and David M. Cote (incorporated by reference to Exhibit 10.22 to Honeywell's Form 10–K for the year ended December 31, 2006)
10.23*	Letter Agreement dated July 27, 2001 between Honeywell and Larry E. Kittelberger (incorporated by reference to Exhibit 10.23 to Honeywell's Form 10–K for the year ended December 31, 2006)
10.24*	Honeywell Supplemental Retirement Plan (incorporated by reference to Exhibit 10.24 to Honeywell's Form 10–K for the year ended December 31, 2006)
10.25*	Pittway Corporation Supplemental Executive Retirement Plan (incorporated by reference to Exhibit 10.25 to Honeywell's Form 10–K for the year ended December 31, 2006)
10.26*	2006 Stock Incentive Plan of Honeywell International Inc. and Its Affiliates (incorporated by reference to Honeywell's Proxy Statement, dated March 13, 2006, filed pursuant to Rule 14a–6 of the Securities and Exchange Act of 1934 and to Exhibit 10.2 to Honeywell's Form 10–Q for the quarter ended June 30, 2006, and amended by Exhibit 10.26 to Honeywell's Form 10– K for the year ended December 31, 2006)
10.27*	2006 Stock Incentive Plan of Honeywell International Inc. and Its Affiliates–Form of Option Award Agreement (incorporated by reference to Exhibit 10.27 to Honeywell's Form 10–K for the year ended December 31, 2006)
10.28*	2006 Stock Incentive Plan of Honeywell International Inc. and Its Affiliates–Form of Restricted Unit Agreement (filed herewith)
10.29*	2006 Stock Incentive Plan of Honeywell International Inc. and Its Affiliates–Form of Growth Plan Agreement (incorporated by reference to Exhibit 10.5 to Honeywell's form 10–Q for the quarter ended June 30, 2006)
10.30*	2006 Stock Incentive Plan of Honeywell International Inc. and Its Affiliates Form of Performance Share Agreement (incorporated by reference to Exhibit 10.30 to Honeywell's Form 10–K for the year ended December 31, 2006)
10.31*	2006 Stock Plan for Non–Employee Directors of Honeywell International Inc. (incorporated by reference to Honeywell's Proxy Statement dated March 13, 2006, filed pursuant to Rule 14a– 6 of the Securities and Exchange Act of 1934 and to Exhibit 10.6 to Honeywell's Form 10–Q for the quarter ended June 30, 2006, and amended by Exhibit 10.31 to Honeywell's Form 10–K for the year ended December 31, 2006)
10.32*	2006 Stock Plan for Non–Employee Directors of Honeywell International Inc.–Form of Option Agreement (incorporated by reference to Exhibit 10.7 to Honeywell's Form 10–Q for the quarter ended June 30, 2006)
10.33*	2006 Stock Plan for Non–Employee Directors of Honeywell International Inc.–Form of Restricted Stock Agreement (incorporated by reference to Exhibit 10.8 to Honeywell's Form 10–Q for the quarter ended June 30, 2006)
10.34*	2007 Honeywell Global Employee Stock Plan (incorporated by reference to Honeywell's Proxy Statement, dated March 12, 2007, filed pursuant to Rule 14a–6 of the Securities and Exchange Act of 1934)
10.35*	Letter Agreement dated July 20, 2007 between Honeywell and Roger Fradin (incorporated by reference to Exhibit 10.1 to Honeywell's Form 10–Q for the quarter ended September 30, 2007)

Exhibit No.	Description
10.36	Amended and Restated Five Year Credit Agreement dated as of May 14, 2007 by and among Honeywell International Inc., the banks, financial institutions and other institutional lenders parties thereto, Citicorp USA, Inc., as administrative agent, Citibank International PLC, as swing line agent, JPMorgan Chase Bank, N.A., as syndication agent, Bank of America, N.A., Barclays Bank PLC, Deutsche Bank AG New York Branch and UBS Loan Finance LLC, as documentation agents, and Citigroup Global Markets Inc. and J.P. Morgan Securities Inc., as joint lead arrangers and co–book managers (incorporated by reference to Exhibit 10.1 to Honeywell's 8–K filed May 18, 2007)
10.37	Purchase and Sale Agreement between Catalysts, Adsorbents and Process Systems, Inc., and Honeywell Specialty Materials, LLC, dated September 30, 2005 (incorporated by reference to Exhibit 10.23 to Honeywell's Form 10–Q for the quarter ended September 30, 2005)
10.38	Stock Purchase Agreement by and between Honeywell International Inc. and M&F Worldwide Corp. (incorporated by reference to Exhibit 2.1 to Honeywell's Form 8–K filed November 1, 2005)
11	Omitted (Inapplicable)
12	Statement re: Computation of Ratio of Earnings to Fixed Charges (filed herewith)
16	Omitted (Inapplicable)
18	Omitted (Inapplicable)
21	Subsidiaries of the Registrant (filed herewith)
22	Omitted (Inapplicable)
23	Consent of PricewaterhouseCoopers LLP (filed herewith)
24	Powers of Attorney (filed herewith)
31.1	Certification of Principal Executive Officer Pursuant to Section 302 of the Sarbanes–Oxley Act of 2002 (filed herewith)
31.2	Certification of Principal Financial Officer Pursuant to Section 302 of the Sarbanes–Oxley Act of 2002 (filed herewith)
32.1	Certification of Principal Executive Officer Pursuant to 18 U.S.C. Section 1350, as Adopted Pursuant to Section 906 of the Sarbanes–Oxley Act of 2002 (filed herewith)
32.2	Certification of Principal Financial Officer Pursuant to 18 U.S.C. Section 1350, as Adopted Pursuant to Section 906 of the Sarbanes–Oxley Act of 2002 (filed herewith)
99	Omitted (Inapplicable)

The Exhibits identified above with an asterisk (*) are management contracts or compensatory plans or arrangements.

HONEYWELL INTERNATIONAL INC
SCHEDULE II—VALUATION AND QUALIFYING ACCOUNTS
Three Years Ended December 31, 2007
(In millions)

Allowance for Doubtful Accounts:

Balance December 31, 2004	$ 137
Provision charged to income	83
Deductions from reserves(1)	(71)
Acquisitions	30
Balance December 31, 2005	179
Provision charged to income	111
Deductions from reserves(1)	(77)
Acquisitions	4
Balance December 31, 2006	217
Provision charged to income	79
Deductions from reserves(1)	(115)
Balance December 31, 2007	$ 181

(1) Represents uncollectible accounts written off, less recoveries, translation adjustments and reserves acquired.

Deferred Tax Assets—Valuation Allowance

Balance December 31, 2004	$ 338
Additions charged to income tax expense	46
Reductions credited to income tax expense	(126)
Additions charged to goodwill, due to acquisitions	219
Balance December 31, 2005	477
Additions charged to income tax expense	40
Reductions credited to income tax expense	(3)
Reductions charged to goodwill, due to acquisitions	(24)
Additions charged to other comprehensive income (loss), upon adoption of SFAS No. 158	28
Reductions charged to deferred tax asset, due to expired NOL	(2)
Balance December 31, 2006	516
Additions charged to income tax expense	56
Reductions credited to income tax expense	(114)
Additions charged to equity	28
Reductions credited to deferred tax assets, due to expired NOL	(19)
Additions charged to deferred tax assets, due to capital loss carryforwards	51
Reductions credited to goodwill	(28)
Balance December 31, 2007	$ 490

MERCK & CO INC (MRK)

ONE MERCK DR
P O BOX 100
WHITEHOUSE STATION, NJ 08889-0100
908. 423.1688
http://www.merck.com/

10-K

FORM 10-K
Filed on 02/28/2008 - Period: 12/31/2007
File Number 001-03305

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www.gsionline.com

As filed with the Securities and Exchange Commission on February 28, 2008

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D. C. 20549

FORM 10–K

(MARK ONE)

☑ **Annual Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934**
For the Fiscal Year Ended December 31, 2007

or

☐ **Transition Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934**
For the transition period from _____ to _____

Commission File No. 1–3305

Merck & Co., Inc.

One Merck Drive
Whitehouse Station, N. J. 08889–0100
(908) 423–1000

Incorporated in New Jersey

I.R.S. Employer Identification No. 22–1109110

Securities Registered pursuant to Section 12(b) of the Act:

Title of Each Class	*Name of Each Exchange on which Registered*
Common Stock ($0.01 par value)	New York and Philadelphia Stock Exchanges

Number of shares of Common Stock ($0.01 par value) outstanding as of January 31, 2008: 2,165,289,746.

Aggregate market value of Common Stock ($0.01 par value) held by non–affiliates on June 30, 2007 based on closing price on June 30, 2007: $107,919,000,000.

Indicate by check mark if the registrant is a well–known seasoned issuer, as defined in Rule 405 of the Securities Act. **Yes** ☑ **No** ☐

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act. **Yes** ☐ **No** ☑

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

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S–K is not contained herein, and will not be contained, to the best of registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10–K or any amendment to this Form 10–K. ☐

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non–accelerated filer, or a smaller reporting company. See the definitions of "large accelerated filer," "accelerated filer" and "smaller reporting company" in Rule 12b–2 of the Exchange Act. (Check One):

Large accelerated filer ☑ | Accelerated filer ☐ | Non–accelerated filer ☐ (Do not check if a smaller reporting company) | Smaller reporting company ☐

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

Documents Incorporated by Reference:

Document	*Part of Form 10–K*
Proxy Statement for the Annual Meeting of Stockholders to be held April 22, 2008, to be filed with	Part III

the Securities and Exchange Commission within 120 days after the close of the fiscal year covered by this report

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EX-24.2: CERTIFIED RESOLUTION OF BOARD OF DIRECTORS
EX-31.1: CERTIFICATION
EX-31.2: CERTIFICATION
EX-32.1: CERTIFICATION
EX-32.2: CERTIFICATION

PART I

Item 1. Business.

Merck & Co., Inc. ("Merck" or the "Company") is a global research-driven pharmaceutical company that discovers, develops, manufactures and markets a broad range of innovative products to improve human and animal health. The Company's operations are principally managed on a products basis and are comprised of two reportable segments: the Pharmaceutical segment and the Vaccines segment. The Pharmaceutical segment includes human health pharmaceutical products marketed either directly or through joint ventures. These products consist of therapeutic and preventive agents, sold by prescription, for the treatment of human disorders. Merck sells these human health pharmaceutical products primarily to drug wholesalers and retailers, hospitals, government agencies and managed health care providers such as health maintenance organizations, pharmacy benefit managers and other institutions. The Vaccines segment includes human health vaccine products marketed either directly or through a joint venture. These products consist of preventative pediatric, adolescent and adult vaccines, primarily administered at physician offices. Merck sells these human health vaccines primarily to physicians, wholesalers, physician distributors and government entities. The Company's professional representatives communicate the effectiveness, safety and value of our pharmaceutical and vaccine products to health care professionals in private practice, group practices and managed care organizations.

For financial information and other information about the Pharmaceutical segment and the Vaccines segment, see Item 7. "Management's Discussion and Analysis of Financial Condition and Results of Operations" and Item 8. "Financial Statements and Supplementary Data" below.

Overview — During 2007, Merck began realizing benefits from its multi-year strategic plan designed to reengineer the way the Company develops and distributes medicines and vaccines worldwide. The Company is benefiting from the evolution of a new commercial model designed to align the Company's product research, development and marketing efforts utilizing the latest technologies and broadening its engagement with customers, physicians and scientific leaders to get needed medicines and vaccines through the development pipeline and to patients sooner. The Company is also working to build a sustainable research and development advantage by leveraging technologies to facilitate drug discovery and development and has successfully reduced clinical development cycle-time.

The progress of these efforts is demonstrated in part by the Company's revenue growth in 2007, which reflected the continued market penetration and global rollout of *Gardasil* [Human Papillomavirus Quadrivalent (Types 6, 11, 16 and 18) Vaccine, Recombinant], a vaccine to help prevent cervical cancer, pre-cancerous and low-grade lesions, vulvar and vaginal pre-cancers, and genital warts caused by human papillomavirus ("HPV") types 6, 11, 16 and 18; *Januvia* (sitagliptin phosphate), a medicine that enhances a natural body system to improve blood sugar control in patients with type 2 diabetes; and *RotaTeq* (Rotavirus Vaccine Live, Oral, Pentavalent), a pediatric vaccine to help prevent rotavirus gastroenteritis in infants and children, coupled with the strong performance of several in-line products. The growth in these products has more than offset 2007 revenue declines associated with the 2006 loss of U.S. market exclusivity for *Zocor* and *Proscar*.

Additionally, the Company continued the advancement of drug candidates through its pipeline. During 2007, the U.S. Food and Drug Administration (the "FDA") approved both *Janumet* (sitagliptin phosphate and metformin hydrochloride), an oral antihyperglycemic agent that combines *Januvia* with metformin in a single tablet to address all three key defects of type 2 diabetes, and *Isentress* (raltegravir), a first-in-class integrase inhibitor for the treatment of HIV-1 infection in treatment-experienced patients. In addition, on January 25, 2008, the FDA approved *Emend* (fosaprepitant dimeglumine) for Injection, an intravenous therapy for the prevention of chemotherapy-induced nausea and vomiting ("CINV"). Also, the Company anticipates the FDA will take action in 2008 on the New Drug Application ("NDA") for *Cordaptive*, the proposed trademark for MK-0524A, an extended-release ("ER") niacin combined with laropiprant, a novel flushing pathway inhibitor, for cholesterol management. Further, the Company made a supplemental filing with the FDA in January 2008 for *Gardasil*, for an expanded indication for women through age 45, and anticipates making a supplemental filing for *Isentress* later in 2008, for an expanded indication for use in treatment-naïve patients. The Company currently has seven candidates in Phase III development and anticipates making NDA filings with respect to two of the candidates in 2008: MK-0524B, simvastatin

combined with laropiprant and ER niacin, and MK–0364, taranabant, an investigational medication for the treatment of obesity. The Company's research and development efforts are more fully discussed in "Research and Development" below.

As part of implementing the new commercial model, the Company is reengineering its core business to be more efficient with the goal of reducing aspects of its cost base and realizing gross margin improvement. The reengineering includes the implementation of manufacturing and marketing cost savings initiatives. The initial phase of the global restructuring program announced in 2005 was designed to reduce the Company's cost structure, increase efficiency and enhance competitiveness. The scope of this initial phase included the implementation of a new supply strategy by the Merck Manufacturing Division over a three–year period, focusing on establishing lean supply chains, leveraging low–cost external manufacturing and consolidating our manufacturing plant network. As part of this program, through January 2008, Merck had closed, sold or ceased operations at five manufacturing sites and two preclinical sites and eliminated approximately 7,200 positions company–wide (comprised of actual headcount reductions and the elimination of contractors and vacant positions). The Company, however, continues to hire new employees as the business requires. The pretax costs of this restructuring program since inception through the end of 2007 were $2.1 billion, of which approximately 70% are non–cash, relating primarily to accelerated depreciation for those facilities scheduled for closure and approximately 30% represent separation and other restructuring related costs. These costs were $810.1 million in 2007 and are expected to be approximately $100 million to $300 million in 2008, at which time the initial phase of the restructuring program relating to the manufacturing strategy is expected to be substantially complete. Merck continues to expect the initial phase of its cost reduction program, combined with cost savings the Company expects to achieve in its marketing and administrative and research and development expenses, will yield cumulative pretax savings of $4.5 to $5.0 billion from 2006 through 2010.

On November 9, 2007, Merck entered into an agreement (the "Settlement Agreement") with the law firms that comprise the executive committee of the Plaintiffs' Steering Committee of the federal multidistrict *Vioxx* litigation as well as representatives of plaintiffs' counsel in state coordinated proceedings to resolve state and federal myocardial infarction ("MI") and ischemic stroke ("IS") claims already filed against the Company in the United States. If certain participation conditions under the Settlement Agreement are met (or waived), the Company will pay an aggregate fixed amount of $4.85 billion into two funds for qualifying claims consisting of $4.0 billion for qualifying MI claims and $850 million for qualifying IS claims that enter into the resolution process (the "Settlement Program"). As a consequence of the Settlement Agreement, the Company recorded a pretax charge of $4.85 billion in the fourth quarter of 2007. In addition, the Company recorded a pretax gain of $455 million relating to insurance proceeds which the Company was awarded (or agreed to receive pursuant to negotiated settlements) in the previously disclosed arbitration with the Company's upper level excess product liability insurance carriers relating to coverage for costs incurred in the *Vioxx* product liability litigation. These items are discussed more fully in Item 3. "Legal Proceedings" below.

Also in the fourth quarter of 2007, the Company recorded a pretax charge of $671 million in connection with the anticipated resolution of investigations of civil claims by federal and state authorities relating to certain past marketing and selling activities, including nominal pricing programs and samples. On February 7, 2008, the Company entered into definitive agreements resolving the investigations. This item is discussed more fully in Item 3. "Legal Proceedings" below.

Earnings per common share ("EPS") assuming dilution for 2007 were $1.49 per share including the impact of the U.S. *Vioxx* Settlement Agreement charge, costs associated with the global restructuring program, the charge related to the resolution of certain civil governmental investigations and the gain from an insurance arbitration award related to *Vioxx* product liability litigation coverage, which collectively reduced EPS by $1.71 per share. In addition, EPS in 2007 reflects an acquired research charge related to the acquisition of NovaCardia, Inc. ("NovaCardia"), additional reserves established solely for future legal defense costs for *Vioxx* litigation and the favorable impact of gains on sales of assets and product divestitures, as well as a net gain on the settlements of certain patent disputes. All of these items are discussed more fully in the notes to the consolidated financial statements.

Product Sales

Sales[1] of the Company's products were as follows:

($ in millions)	2007	2006	2005
Singulair	$ 4,266.3	$ 3,579.0	$ 2,975.6
Cozaar/Hyzaar	3,350.1	3,163.1	3,037.2
Fosamax	3,049.0	3,134.4	3,191.2
Zocor	876.5	2,802.7	4,381.7
Cosopt/Trusopt	786.8	697.1	617.2
Primaxin	763.5	704.8	739.6
Januvia	667.5	42.9	–
Cancidas	536.9	529.8	570.0
Vasotec/Vaseretic	494.6	547.2	623.1
Maxalt	467.3	406.4	348.4
Proscar	411.0	618.5	741.4
Propecia	405.4	351.8	291.9
Arcoxia	329.1	265.4	218.2
Crixivan/Stocrin	310.2	327.3	348.4
Emend	204.2	130.8	87.0
Invanz	190.2	139.2	93.7
Janumet	86.4	–	–
Other pharmaceutical[2]	2,465.9	2,780.5	2,295.1
	19,660.9	20,220.9	20,559.7
Vaccines:[3]			
Gardasil	1,480.6	234.8	–
RotaTeq	524.7	163.4	–
Zostavax	236.0	38.6	–
ProQuad/M-M-R II/Varivax	1,347.1	820.1	597.4
Hepatitis vaccines	279.9	248.5	194.5
Other vaccines	409.9	354.0	311.4
	4,278.2	1,859.4	1,103.3
Other[4]	258.6	555.7	348.9
	$ 24,197.7	$ 22,636.0	$ 22,011.9

(1) *Presented net of discounts and returns.*

(2) *Other pharmaceutical primarily includes sales of other human pharmaceutical products and revenue from the Company's relationship with Astra Zeneca LP ("AZLP") primarily relating to sales of* Nexium, *as well as* Prilosec. *Revenue from AZLP was $1.7 billion, $1.8 billion and $1.7 billion in 2007, 2006 and 2005, respectively. In 2006, other pharmaceutical also reflected certain supply sales, including supply sales associated with the Company's arrangement with Dr. Reddy's Laboratories ("Dr. Reddy's") for the sale of generic simvastatin.*

(3) *These amounts do not reflect sales of vaccines sold in most major European markets through the Company's joint venture, Sanofi Pasteur MSD, the results of which are reflected in Equity income from affiliates.*

(4) *Other primarily includes other human and animal health joint venture supply sales and other miscellaneous revenues.*

The Company's pharmaceutical products include therapeutic and preventive agents, generally sold by prescription, for the treatment of human disorders. Among these are *Singulair* (montelukast sodium), a leukotriene receptor antagonist for the chronic treatment of asthma and for the relief of symptoms of allergic rhinitis; *Cozaar* (losartan potassium), *Hyzaar* (losartan potassium and hydrochlorothiazide), *Vasotec* (enalapril maleate) and *Vaseretic* (enalapril maleate–hydrochlorothiazide), the Company's most significant hypertension and/or heart

failure products; *Fosamax* (alendronate sodium) and *Fosamax Plus D* (alendronate sodium/cholecalciferol), Merck's osteoporosis products for the treatment and, in the case of *Fosamax*, prevention of osteoporosis; *Zocor* (simvastatin), Merck's atherosclerosis product; *Cosopt* (dorzolamide hydrochloride and timolol maleate ophthalmic solution) and *Trusopt* (dorzolamide hydrochloride ophthalmic solution), Merck's largest-selling ophthalmological products; *Primaxin* (imipenem and cilastatin sodium) and *Cancidas* (caspofungin acetate), anti-bacterial/anti-fungal products; *Januvia* and *Janumet* for the treatment of type 2 diabetes; *Maxalt* (rizatriptan benzoate), an acute migraine product; *Proscar* (finasteride), a urology product for the treatment of symptomatic benign prostate enlargement; *Propecia* (finasteride), a product for the treatment of male pattern hair loss; *Arcoxia* (etoricoxib) for the treatment of arthritis and pain; *Crixivan* (indinavir sulfate) and *Stocrin* (efavirenz) for the treatment of HIV infection; *Emend* (aprepitant) for the prevention of chemotherapy-induced and post-operative nausea and vomiting; and *Invanz* (ertapenem sodium) for the treatment of infection.

The Company's vaccine products include *Gardasil,* a vaccine to help prevent cervical cancer, pre-cancerous and low-grade lesions, vulvar and vaginal pre-cancers, and genital warts caused by HPV types 6, 11, 16 and 18, *RotaTeq*, a vaccine to help protect against rotavirus gastroenteritis in infants and children, *Zostavax* (Zoster Vaccine Live), a vaccine to help prevent shingles (herpes zoster), *Varivax* [Varicella Virus Vaccine Live (Oka/Merck)], a vaccine to help prevent chickenpox, *ProQuad* [Measles, Mumps, Rubella and VaricellaVirus Vaccine Live], a pediatric combination vaccine against measles, mumps, rubella and varicella, and *M-M-R* II (Measles, Mumps and Rubella Virus Vaccine Live), a vaccine against measles, mumps and rubella. For a further discussion of sales of the Company's products, see Item 7. "Management's Discussion and Analysis of Financial Condition and Results of Operations" below.

U.S. Product Approvals — On March 30, 2007, the FDA approved *Janumet*, Merck's oral antihyperglycemic agent that combines *Januvia* with metformin in a single tablet to address all three key defects of type 2 diabetes. *Janumet* has been approved, as an adjunct to diet and exercise, to improve blood sugar (glucose) control in adult patients with type 2 diabetes who are not adequately controlled on metformin or sitagliptin alone, or in patients already being treated with the combination of sitagliptin and metformin.

On October 12, 2007, the FDA granted *Isentress* accelerated approval for use in combination with other antiretroviral agents for the treatment of HIV-1 infection in treatment-experienced adult patients who have evidence of viral replication and HIV-1 strains resistant to multiple antiretroviral agents. *Isentress* is the first medicine to be approved in a new class of antiretroviral drugs called integrase inhibitors. *Isentress* works by inhibiting the insertion of HIV DNA into human DNA by the integrase enzyme. Inhibiting integrase from performing this essential function limits the ability of the virus to replicate and infect new cells. The FDA's decision was based on a 24-week analysis of clinical trials in which *Isentress,* in combination with optimized background therapy in treatment-experienced patients, provided significant reductions in HIV RNA viral load and increases in CD4 cell counts. In February 2008, the Company announced 48 week data that demonstrated *Isentress*, in combination with other anti-HIV medicines, maintained significant HIV-1 viral load suppression and increased CD4 cell counts through 48 weeks of therapy compared to placebo in combination with anti-HIV medicines, in two Phase III studies of treatment-experienced patients failing antiretroviral therapies. Patients in the studies had HIV resistant to at least one drug in each of three classes of oral antiretroviral medicines. By the end of 2007, the medicine was approved for use in the EU, Canada and Mexico. Merck is also conducting Phase III clinical trials of *Isentress* in the treatment-naïve (previously untreated) HIV population. Potent antiretroviral activity has been demonstrated with no significant changes in serum lipids at week 48 and *Isentress* was generally well tolerated in patients. The Company anticipates making a supplemental filing with the FDA for the treatment-naïve indication in 2008.

On January 25, 2008, the FDA approved *Emend* for Injection, 115 mg, for the prevention of CINV. *Emend* for Injection provides a new option for day one oral *Emend* (125 mg) as part of the recommended three-day regimen that delivers five days of protection from nausea and vomiting. Prior to the FDA decision, the European Union ("EU") on January 11, 2008 granted marketing approval for *Emend* for Injection, known as *IVEmend* in the EU, an action that applies to all 27 EU member countries as well as Norway and Iceland.

Vioxx *U.S. Product Liability Settlement* — On September 30, 2004, Merck announced a voluntary worldwide withdrawal of *Vioxx*, its arthritis and acute pain medication. The Company's decision, which was

effective immediately, was based on new three-year data from a prospective, randomized, placebo-controlled clinical trial, APPROVe (Adenomatous Polyp Prevention on *Vioxx*).

On November 9, 2007, the Company announced that it had entered into an agreement (the "Settlement Agreement") with the law firms that comprise the executive committee of the Plaintiffs' Steering Committee of the federal multidistrict *Vioxx* litigation as well as representatives of plaintiffs' counsel in the Texas, New Jersey and California state coordinated proceedings to resolve state and federal myocardial infarction ("MI") and ischemic stroke ("IS") claims filed as of that date in the United States. The Settlement Agreement, which also applies to tolled claims, was signed by the parties after several meetings with three of the four judges overseeing the coordination of more than 95 percent of the current claims in the *Vioxx* litigation. The Settlement Agreement applies only to U.S. legal residents and those who allege that their MI or IS occurred in the United States.

Under the Settlement Agreement, if, by March 1, 2008 (subject to extension), plaintiffs enroll in the resolution process (the "Settlement Program") at least 85 percent of each of all currently pending and tolled (i) MI claims, (ii) IS claims, (iii) eligible MI and IS claims together which involve death, and (iv) eligible MI and IS claims which together allege more than 12 months of use, Merck will pay an aggregate of $4.85 billion into two funds for qualifying claims consisting of $4.0 billion for qualifying MI claims and $850 million for qualifying IS claims. The Company expects that the participation conditions will be met; however, if they are not, the Company will have the right to waive the conditions or terminate the Settlement Agreement.

Acquisitions — On September 11, 2007, Merck completed the acquisition of NovaCardia, a privately held clinical-stage pharmaceutical company focused on cardiovascular disease. This acquisition added rolofylline (MK-7418), NovaCardia's investigational Phase III compound for acute heart failure, to Merck's pipeline.

Joint Ventures — The Company has a number of joint ventures relating to its Pharmaceutical and Vaccines segments.

Pharmaceutical

In 2000, the Company and Schering-Plough Corporation ("Schering-Plough") entered into agreements to create separate equally-owned partnerships to develop and market in the United States new prescription medicines in the cholesterol-management and respiratory therapeutic areas. In December 2001, the cholesterol-management partnership agreements were expanded to include all the countries of the world, excluding Japan. In October 2002, *Zetia* (ezetimibe) (marketed as *Ezetrol* outside the United States), the first in a new class of cholesterol-lowering agents, was launched in the United States. In July 2004, *Vytorin* (marketed as *Inegy* outside the United States), a combination product containing the active ingredients of both *Zetia* and *Zocor,* was approved in the United States.

The Company and Schering-Plough sell *Vytorin* and *Zetia* through their joint venture company, Merck/Schering-Plough Pharmaceuticals (the "MSP Partnership"). On January 14, 2008, the MSP Partnership announced the primary endpoint and other results of the ENHANCE (Effect of Combination Ezetimibe and High-Dose Simvastatin vs. Simvastatin Alone on the Atherosclerotic Process in Patients with Heterozygous Familial Hypercholesterolemia) trial. The MSP Partnership submitted an abstract on the ENHANCE trial for presentation at the American College of Cardiology meeting in March 2008 and was notified of its acceptance by the College. ENHANCE was a surrogate endpoint trial conducted in 720 patients with Heterozygous Familial Hypercholesterolemia, a rare condition that affects approximately 0.2% of the population. All analyses were conducted in accordance with the original statistical analysis plan. The primary endpoint was the mean change in the intima-media thickness measured at three sites in the carotid arteries (the right and left common carotid, internal carotid and carotid bulb) between patients treated with ezetimibe/simvastatin 10/80 mg versus patients treated with simvastatin 80 mg alone over a two year period. There was no statistically significant difference between treatment groups on the primary endpoint. There was also no statistically significant difference between the treatment groups for each of the components of the primary endpoint, including the common carotid artery. Key secondary imaging endpoints showed no statistical difference between treatment groups. The overall incidence rates of treatment-related adverse events, serious adverse events or adverse events leading to discontinuation were generally similar between treatment groups. Both medicines were generally well tolerated. Overall, the safety profiles of ezetimibe/simvastatin and simvastatin alone were similar and generally consistent with their product labels. In the trial, there was a significant difference in low-density lipoprotein ("LDL") cholesterol lowering seen between the treatment

groups — 58% LDL cholesterol lowering at 24 months on ezetimibe/simvastatin as compared to 41% at 24 months on simvastatin alone. This surrogate endpoint study was not powered nor designed to assess cardiovascular clinical event outcomes. The MSP Partnership is currently conducting the IMPROVE–IT trial, a large clinical cardiovascular outcomes trial comparing *Vytorin* (ezetimibe/simvastatin) and simvastatin and including more than 10,000 patients. *Vytorin* contains two medicines: ezetimibe and simvastatin. *Vytorin* has not been shown to reduce heart attacks or strokes more than simvastatin alone.

During December 2007 and through February 26, 2008, the Company and its joint–venture partner, Schering–Plough, received several joint letters from the House Committee on Energy and Commerce and the House Subcommittee on Oversight and Investigations, and one letter from the Senate Finance Committee, collectively seeking a combination of witness interviews, documents and information on a variety of issues related to the ENHANCE clinical trial, the sale and promotion of *Vytorin*, as well as sales of stock by corporate officers. On January 25, 2008, the companies and the MSP Partnership each received two subpoenas from the New York State Attorney General's Office seeking similar information and documents. Merck and Schering–Plough have also each received a letter from the Office of the Connecticut Attorney General dated February 1, 2008 requesting documents related to the marketing and sale of *Vytorin* and *Zetia* and the timing of disclosures of the results of ENHANCE. The Company is cooperating with these investigations and working with Schering–Plough to respond to the inquiries. In addition, since mid–January 2008, the Company has become aware of or been served with approximately 85 civil class action lawsuits alleging common law and state consumer fraud claims in connection with the MSP Partnership's sale and promotion of *Vytorin* and *Zetia*.

In 1982, the Company entered into an agreement with Astra AB ("Astra") to develop and market Astra products in the United States. In 1994, the Company and Astra formed an equally owned joint venture that developed and marketed most of Astra's new prescription medicines in the United States including *Prilosec*, the first in a class of medications known as proton pump inhibitors, which slows the production of acid from the cells of the stomach lining.

In 1998, the Company and Astra restructured the joint venture whereby the Company acquired Astra's interest in the joint venture, renamed KBI Inc. ("KBI"), and contributed KBI's operating assets to a new U.S. limited partnership named Astra Pharmaceuticals, L.P. (the "Partnership"), in which the Company maintains a limited partner interest. The Partnership, renamed AstraZeneca LP, became the exclusive distributor of the products for which KBI retained rights. The Company earns certain Partnership returns as well as ongoing revenue based on sales of current and future KBI products. The Partnership returns include a priority return provided for in the Partnership Agreement, variable returns based, in part, upon sales of certain former Astra USA, Inc. products, and a preferential return representing the Company's share of undistributed Partnership GAAP earnings. In conjunction with the 1998 restructuring, for a payment of $443.0 million, Astra purchased an option to buy the Company's interest in the KBI products, excluding the Company's interest in the gastrointestinal medicines *Nexium* and *Prilosec*. The Company also granted Astra an option (the "Shares Option") to buy the Company's common stock interest in KBI, at an exercise price based on the present value of estimated future net sales of *Nexium* and *Prilosec*.

In April 1999, Astra merged with Zeneca Group Plc, forming AstraZeneca AB ("AstraZeneca"). As a result of the merger, in exchange for the Company's relinquishment of rights to future Astra products with no existing or pending U.S. patents at the time of the merger, Astra paid $967.4 million, which is subject to a true–up calculation in 2008 that may require repayment of all or a portion of this amount. The merger also triggers a partial redemption of the Company's limited partner interest in 2008. Furthermore, as a result of the merger, AstraZeneca's option (the "Asset Option") to buy the Company's interest in the KBI products is exercisable in 2010 and the Company has the right to require AstraZeneca to purchase such interest in 2008. In February 2008, the Company advised AZLP that it will not exercise the Asset Option. In addition, the Shares Option is exercisable two years after Astra's purchase of the Company's interest in the KBI products. The exercise of this option by Astra is also provided for in the year 2017 or if combined annual sales of the two products fall below a minimum amount provided, in each case, only so long as AstraZeneca's option in 2010 has been exercised. The exercise price is based on the present value of estimated future net sales of *Nexium* and *Prilosec* as determined at the time of exercise subject to certain true–up mechanisms.

In 1989, the Company formed a joint venture with Johnson & Johnson to develop and market a broad range of nonprescription medicines for U.S. consumers. This 50% owned joint venture also includes Canada.

Significant joint venture products are *Pepcid AC* (famotidine), an over-the-counter form of the Company's ulcer medication *Pepcid* (famotidine), as well as *Pepcid Complete,* an over-the-counter product which combines the Company's ulcer medication with antacids (calcium carbonate and magnesium hydroxide).

Vaccines

In 1994, the Company and Pasteur Mérieux Connaught (now Sanofi Pasteur S.A.) formed a joint venture to market human vaccines in Europe and to collaborate in the development of combination vaccines for distribution in the then existing EU and the European Free Trade Association. The Company and Sanofi Pasteur contributed, among other things, their European vaccine businesses for equal shares in the joint venture, known as Pasteur Mérieux MSD, S.N.C. (now Sanofi Pasteur MSD, S.N.C.). The joint venture maintains a presence, directly or through affiliates or branches in Belgium, Italy, Germany, Spain, France, Austria, Ireland, Sweden, Portugal, the Netherlands, Switzerland and the United Kingdom, and through distributors in the rest of its territory.

Other

In 1997, the Company and Rhône-Poulenc S.A. (now Sanofi-Aventis S.A.) combined their respective animal health and poultry genetics businesses to form Merial Limited ("Merial"), a fully integrated animal health company, which is a stand-alone joint venture, equally owned by each party. Merial provides a comprehensive range of pharmaceuticals and vaccines to enhance the health, well-being and performance of a wide range of animal species.

Competition — The markets in which the Company conducts its business are highly competitive and often highly regulated. Global efforts toward health care cost containment continue to exert pressure on product pricing and access.

Such competition involves an intensive search for technological innovations and the ability to market these innovations effectively. With its long-standing emphasis on research and development, the Company is well prepared to compete in the search for technological innovations. Additional resources to meet competition include quality control, flexibility to meet customer specifications, an efficient distribution system and a strong technical information service. The Company is active in acquiring and marketing products through joint ventures and licenses and has been refining its sales and marketing efforts to further address changing industry conditions. To enhance its product portfolio, the Company continues to pursue external alliances, from early-stage to late-stage product opportunities, including joint ventures and targeted acquisitions. However, the introduction of new products and processes by competitors may result in price reductions and product replacements, even for products protected by patents. For example, the number of compounds available to treat diseases typically increases over time and has resulted in slowing the growth in sales of certain of the Company's products.

Legislation enacted in all states in the United States, particularly in the area of human pharmaceutical products, allows, encourages or, in a few instances, in the absence of specific instructions from the prescribing physician, mandates the use of "generic" products (those containing the same active chemical as an innovator's product) rather than "brand-name" products. Governmental and other pressures toward the dispensing of generic products have significantly reduced the sales of certain of the Company's products no longer protected by patents, such as *Zocor,* which lost market exclusivity in the U.S. in 2006 and the Company experienced a significant decline in *Zocor* sales thereafter. *Fosamax* lost market exclusivity in the United States in February 2008. *Fosamax Plus D* will lose marketing exclusivity in the United States in April 2008. As a result of these events, the Company expects significant declines in U.S. *Fosamax* and *Fosamax Plus D* sales.

Distribution — The Company sells its human health pharmaceutical products primarily to drug wholesalers and retailers, hospitals, government agencies and managed health care providers such as health maintenance organizations, pharmacy benefit managers and other institutions. Human health vaccines are sold primarily to physicians, wholesalers, physician distributors and government entities. The Company's professional representatives communicate the effectiveness, safety and value of the Company's pharmaceutical and vaccine products to health care professionals in private practice, group practices and managed care organizations.

Raw Materials — Raw materials and supplies, which are generally available from multiple sources, are purchased worldwide and are normally available in quantities adequate to meet the needs of the Company's Pharmaceutical and Vaccines segments.

Government Regulation and Investigation — The pharmaceutical industry is subject to global regulation by regional, country, state and local agencies. Of particular importance is the FDA in the United States, which administers requirements covering the testing, approval, safety, effectiveness, manufacturing, labeling and marketing of prescription pharmaceuticals. In many cases, the FDA requirements have increased the amount of time and money necessary to develop new products and bring them to market in the United States. In 1997, the Food and Drug Administration Modernization Act (the "FDA Modernization Act") was passed and was the culmination of a comprehensive legislative reform effort designed to streamline regulatory procedures within the FDA and to improve the regulation of drugs, medical devices and food. The legislation was principally designed to ensure the timely availability of safe and effective drugs and biologics by expediting the premarket review process for new products. A key provision of the legislation is the re-authorization of the Prescription Drug User Fee Act of 1992, which permits the continued collection of user fees from prescription drug manufacturers to augment FDA resources earmarked for the review of human drug applications. This helps provide the resources necessary to ensure the prompt approval of safe and effective new drugs.

In the United States, the government expanded health care access by enacting the Medicare Prescription Drug Improvement and Modernization Act of 2003, which was signed into law in December 2003. Prescription drug coverage began on January 1, 2006. This legislation supports the Company's goal of improving access to medicines by expanding insurance coverage, while preserving market-based incentives for pharmaceutical innovation. At the same time, the legislation will ensure that prescription drug costs will be controlled by competitive pressures and by encouraging the appropriate use of medicines. The U.S. Congress has considered, and may consider again, proposals to increase the government's role in pharmaceutical pricing in the Medicare program.

For many years, the pharmaceutical industry has been under federal and state oversight with the approval process for new drugs, drug safety, advertising and promotion, drug purchasing and reimbursement programs and formularies variously under review. The Company believes that it will continue to be able to conduct its operations, including the introduction of new drugs to the market, in this regulatory environment. One type of federal initiative to contain federal health care spending is the prospective or "capitated" payment system, first implemented to reduce the rate of growth in Medicare reimbursement to hospitals. Such a system establishes in advance a flat rate for reimbursement for health care for those patients for whom the payor is fiscally responsible. This type of payment system and other cost containment systems are now widely used by public and private payors and have caused hospitals, health maintenance organizations and other customers of the Company to be more cost-conscious in their treatment decisions, including decisions regarding the medicines to be made available to their patients. The Company continues to work with private and federal employers to slow increases in health care costs. Further, the Company's efforts to demonstrate that its medicines can help save costs in other areas have encouraged the use of the Company's medicines and have helped offset the effects of increasing cost pressures.

Also, federal and state governments have pursued methods to directly reduce the cost of drugs and vaccines for which they pay. For example, federal laws require the Company to pay specified rebates for medicines reimbursed by Medicaid, to provide discounts for outpatient medicines purchased by certain Public Health Service entities and "disproportionate share" hospitals (hospitals meeting certain criteria), and to provide minimum discounts of 24% off of a defined "non-federal average manufacturer price" for purchases by certain components of the federal government such as the Department of Veterans Affairs and the Department of Defense.

Initiatives in some states seek rebates beyond the minimum required by Medicaid legislation, in some cases for patients beyond those who are eligible for Medicaid. Under the Federal Vaccines for Children entitlement program, the U.S. Centers for Disease Control and Prevention ("CDC") funds and purchases recommended pediatric vaccines at a public sector price for the immunization of Medicaid-eligible, uninsured, Native American and certain underinsured children. The Company was awarded a CDC contract in April 2007 which is in effect until March 2008 for the supply of pediatric vaccines for the Vaccines for Children program. As of January 1, 2006, patients previously eligible for Medicaid who are also Medicare beneficiaries (65 years and older or disabled) left the state-administered Medicaid system to be covered by the new Medicare prescription drug benefit.

Outside the United States, the Company encounters similar regulatory and legislative issues in most of the countries where it does business. There, too, the primary thrust of governmental inquiry and action is toward determining drug safety and effectiveness, often with mechanisms for controlling the prices of or reimbursement for prescription drugs and the profits of prescription drug companies. The EU has adopted directives concerning the classification, labeling, advertising, wholesale distribution and approval for marketing of medicinal products for human use. The Company's policies and procedures are already consistent with the substance of these directives; consequently, it is believed that they will not have any material effect on the Company's business.

In addition, certain countries within the EU, recognizing the economic importance of the research–based pharmaceutical industry and the value of innovative medicines to society, are working with industry representatives to improve the competitive climate through a variety of means including market deregulation.

The European Commission is conducting a pharmaceutical sector inquiry involving a number of companies concerning competition and the introduction of innovative and generic medicines. As part of its inquiry, the Company's offices in Germany were inspected by the authorities beginning on January 15, 2008. The Commission has not alleged that the Company or any of its subsidiaries have engaged in any unlawful practices. The Company is cooperating with the Commission in this sector inquiry.

As previously disclosed, in May 2007 the government of Brazil issued a compulsory license for *Stocrin*, which makes it possible for *Stocrin* to be produced by a generic manufacturer despite the Company's patent protection on *Stocrin*. In November 2006, the government of Thailand stated that it had issued a compulsory license for *Stocrin*, despite the Company's patent protection on *Stocrin*, which the government of Thailand contends makes it possible for *Stocrin* to be produced by a generic manufacturer. The Company remains committed to exploring mutually acceptable agreements with the governments of Brazil and Thailand.

The Company is subject to the jurisdiction of various regulatory agencies and is, therefore, subject to potential administrative actions. Such actions may include seizures of products and other civil and criminal sanctions. Under certain circumstances, the Company on its own may deem it advisable to initiate product recalls. The Company believes that it should be able to compete effectively within this environment.

The Company is subject to a number of privacy and data protection laws and regulations globally. The legislative and regulatory landscape for privacy and data protection continues to evolve, and there has been an increasing amount of focus on privacy and data protection issues with the potential to affect directly the Company's business.

Patents, Trademarks and Licenses — Patent protection is considered, in the aggregate, to be of material importance in the Company's marketing of human health products in the United States and in most major foreign markets. Patents may cover products *per se*, pharmaceutical formulations, processes for or intermediates useful in the manufacture of products or the uses of products. Protection for individual products extends for varying periods in accordance with the legal life of patents in the various countries. The protection afforded, which may also vary from country to country, depends upon the type of patent and its scope of coverage.

Patent portfolios developed for products introduced by the Company normally provide market exclusivity. The Company has the following key U.S. patent protection and Pediatric Exclusivity for major marketed products:

Product	Year of Expiration (in U.S.)
Cancidas	2015 (compound) / 2017 (formulation)
Comvax	2020
Cosopt	2008
Cozaar	2010
Crixivan	2012 (compound) / 2018 (formulation)
Emend	2012 (compound) / 2015 (Patent Term Restoration)
Gardasil	2020
Hyzaar	2010
Invanz	2016 (compound and Pediatric Exclusivity) / 2017 (composition)
Isentress	2023
Januvia/Janumet	2022
Maxalt	2012 (compound) / 2014 (other)
Primaxin	2009
Propecia	2013
Recombivax	2020
RotaTeq	2014 (product) / 2019 (Patent Term Restoration)
Singulair	2012
Trusopt	2008
Zetia/Vytorin	2015 (ezetimibe – component in both products) / 2016 (Patent Term Restoration)
Zolinza	2011 (compound) / 2015 (Patent Term Restoration)
Zostavax	2016

A basic patent is also in effect for Sustiva/*Stocrin* (efavirenz). Bristol–Myers Squibb ("BMS"), under an exclusive license from the Company, sells Sustiva in the United States, Canada and certain European countries. The Company markets *Stocrin* in other countries throughout the world. The basic patent for *Aggrastat* (tirofiban hydrochloride) in the United States was divested with the product in 2003. The Company retains basic patents for *Aggrastat* outside the United States.

The FDA Modernization Act includes a Pediatric Exclusivity Provision that may provide an additional six months of market exclusivity in the United States for indications of new or currently marketed drugs if certain agreed upon pediatric studies are completed by the applicant. These exclusivity provisions were re–authorized by the Prescription Drug User Fee Act passed in September 2007. Current U.S. patent law provides additional patent term under Patent Term Restoration for periods when the patented product was under regulatory review before the FDA. For further information with respect to the Company's patents, see "Patent Litigation" below.

While the expiration of a product patent normally results in a loss of market exclusivity for the covered pharmaceutical product, commercial benefits may continue to be derived from: (i) later–granted patents on processes and intermediates related to the most economical method of manufacture of the active ingredient of such product; (ii) patents relating to the use of such product; (iii) patents relating to novel compositions and formulations; and (iv) in the United States, market exclusivity that may be available under federal law. The effect of product patent expiration on pharmaceutical products also depends upon many other factors such as the nature of the market and the position of the product in it, the growth of the market, the complexities and economics of the process for manufacture of the active ingredient of the product and the requirements of new drug provisions of the Federal Food, Drug and Cosmetic Act or similar laws and regulations in other countries.

Additions to market exclusivity are sought in the United States and other countries through all relevant laws, including laws increasing patent life. Some of the benefits of increases in patent life have been partially offset

by a general increase in the number of, incentives for and use of generic products. Additionally, improvements in intellectual property laws are sought in the United States and other countries through reform of patent and other relevant laws and implementation of international treaties.

Fosamax lost market exclusivity in the United States in February 2008. *Fosamax Plus D* will lose marketing exclusivity in the United States in April 2008. As a result of these events, the Company expects significant declines in U.S *Fosamax* and *Fosamax Plus D* sales.

Worldwide, all of the Company's important products are sold under trademarks that are considered in the aggregate to be of material importance. Trademark protection continues in some countries as long as used; in other countries, as long as registered. Registration is for fixed terms and can be renewed indefinitely.

Royalties received during 2007 on patent and know-how licenses and other rights amounted to $156.4 million. The Company also paid royalties amounting to $1.326 billion in 2007 under patent and know-how licenses it holds.

Research and Development

The Company's business is characterized by the introduction of new products or new uses for existing products through a strong research and development program. Approximately 11,700 people are employed in the Company's research activities. Expenditures for the Company's research and development programs were $4.9 billion in 2007, $4.8 billion in 2006 and $3.8 billion in 2005. The Company maintains its ongoing commitment to research over a broad range of therapeutic areas and clinical development in support of new products.

The Company maintains a number of long-term exploratory and fundamental research programs in biology and chemistry as well as research programs directed toward product development. Merck's research and development model is designed to increase productivity and improve the probability of success by prioritizing the Company's research and development resources on disease areas such as atherosclerosis, hypertension, diabetes and obesity, novel vaccines, neurodegenerative and psychiatric diseases and targeted oncology therapies. These therapeutic areas were carefully chosen based on a set of criteria including unmet medical needs, scientific opportunity and commercial opportunity. Within these therapeutic areas, Merck will commit resources to achieve research breadth and depth and to develop best-in-class targeted and differentiated products that are valued highly by patients, payers and physicians.

The Company will also make focused investments in other areas of important unmet medical need. In addition, the Company will continue to pursue appropriate external licensing opportunities.

In the development of human health products, industry practice and government regulations in the United States and most foreign countries provide for the determination of effectiveness and safety of new chemical compounds through preclinical tests and controlled clinical evaluation. Before a new drug may be marketed in the United States, recorded data on preclinical and clinical experience are included in the NDA or the Biologics License Application to the FDA for the required approval. The development of certain other products is also subject to government regulations covering safety and efficacy in the United States and many foreign countries.

Once the Company's scientists discover a new compound that they believe has promise to treat a medical condition, the Company commences preclinical testing with that compound. Preclinical testing includes laboratory testing and animal safety studies to gather data on chemistry, pharmacology and toxicology. Pending acceptable preclinical data, the Company will initiate clinical testing in accordance with established regulatory requirements. The clinical testing begins with Phase I studies, which are designed to assess safety, tolerability, pharmacokinetics, and preliminary pharmacodynamic activity of the compound in humans. If favorable, additional, larger Phase II studies are initiated to determine the efficacy of the compound in the affected population, define appropriate dosing for the compound, as well as identify any adverse effects that could limit the compound's usefulness. If data from the Phase II trials are satisfactory, the Company commences large-scale Phase III trials to confirm the compound's efficacy and safety. Upon completion of those trials, if satisfactory, the Company submits regulatory filings with the appropriate regulatory agencies around the world to have the product candidate approved for marketing. There can be no assurance that a compound that is the result of any particular program will obtain the regulatory approvals necessary for it to be marketed.

In the United States, the FDA review process begins once a complete NDA is submitted and received by the FDA. Pursuant to the Prescription Drug User Fee Act, the FDA review period targets for NDAs or supplemental NDAs is either six months, for priority review, or ten months, for a standard review. Within 60 days after receipt of an NDA, the FDA determines if the application is sufficiently complete to permit a substantive review. The FDA also assesses, at that time, whether the application will be granted a priority review or standard review. Once the review timelines are defined, the FDA will act upon the application within those timelines, unless a major amendment has been submitted (either at the Company's own initiative or the FDA's request) to the pending application. If this occurs, the FDA may extend the review period to allow for review of the new information, but by no more than 180 days. Extensions to the review period are communicated to the Company. The FDA can act on an application by issuing an approval letter, a non-approvable letter, or an approvable letter.

The Company has one drug candidate currently under FDA review:

In August 2007, the FDA accepted for standard review the NDA for *Cordaptive*, the Company's investigational compound containing Merck's own ER niacin and laropiprant, a novel flushing pathway inhibitor designed to reduce flushing often associated with niacin treatment. Merck anticipates FDA action in April 2008. The Company is also moving forward as planned with filings in countries outside the United States.

The Company anticipates filing two NDAs with the FDA in 2008:

The Company anticipates filing an NDA for MK-0524B, a drug candidate that combines the novel approach to raising HDL-cholesterol and lowering triglycerides from ER niacin combined with laropiprant with the proven benefits of simvastatin in one combination product. In November 2007, the Company presented results of a study at the American Heart Association 2007 Scientific Sessions which demonstrate ER niacin/laropiprant (*Cordaptive)* coadministered with simvastatin had significant additive effects on reducing LDL-C, increasing HDL-C and reducing triglyceride levels in a Phase III study with patients with primary hypercholesterolemia or mixed dyslipidemia. In the study, 2 g (two 1-gram tablets) of *Cordaptive* coadministered with simvastatin (pooled across 20 mg or 40 mg doses) reduced LDL-C by 48%, increased HDL-C by 28%, and reduced triglyceride levels by 33% following 12 weeks of treatment. The primary study endpoint was LDL-C reduction; secondary endpoints included increased HDL-C, triglyceride reduction and effects on other lipoproteins. A 1 g tablet of *Cordaptive* contains 1 g of Merck-developed ER niacin and 20 mg of laropiprant.

The Company also anticipates filing an NDA for MK-0364, taranabant, a highly selective cannabinoid-1 receptor inverse agonist that in early clinical studies has demonstrated weight loss versus placebo. Taranabant was generally well-tolerated, however, as reported with another cannabinoid-1 receptor inverse agonist, some dose-dependent psychiatric adverse events were observed. The Company previously announced the initiation of a targeted Phase III program in 2006.

Merck currently has seven products in Phase III development (including MK-0524B and MK-0364 discussed above):

MK-0974, an investigational oral calcitonin gene-related peptide receptor antagonist, utilizes a new mechanism for the treatment of migraines that has demonstrated efficacy at least comparable to triptans in early clinical studies. In June 2007, clinical results from a Phase II study were presented for the first time at the American Headache Society annual meeting which showed that MK-0974 significantly improved migraine pain relief two hours after dosing compared to placebo, and the relief was sustained through 24 hours. MK-0974 was generally well tolerated in the study. In addition to the measure of migraine pain, MK-0974 provided relief of migraine-associated symptoms, including nausea and sensitivity to light and sound, and improved functional disability two hours post dose, as well as reduced patients' need for rescue medication. The drug candidate entered Phase III development during 2007. The Company anticipates filing an NDA in 2009.

MK-7418, rolofylline, is a Phase III investigational drug being evaluated for the treatment of acute heart failure. Phase III pilot study preliminary results indicated that rolofylline was generally well tolerated and that treatment resulted in a greater proportion of patients with improved dyspnea, fewer patients with worsening heart failure and greater weight loss compared to placebo. These benefits were achieved while preserving renal function compared to progressive worsening of renal function in patients treated with placebo. Merck acquired the drug candidate as part of the 2007 acquisition of NovaCardia and anticipates filing an NDA with the FDA in 2009.

MK–8669, deforolimus, is a novel mTOR (mammalian target of rapamycin) inhibitor being evaluated for the treatment of cancer. The drug candidate is being jointly developed and commercialized with ARIAD Pharmaceuticals, Inc. under an agreement reached in mid–2007. The Company anticipates filing an NDA for a metastatic sarcoma indication in 2010.

A novel investigational hepatitis B vaccine, V270, currently is being evaluated in a Phase III clinical trial in adults and in patients undergoing dialysis treatment. Merck is jointly developing V270 with Dynavax Technologies Corporation ("Dynavax") under an agreement reached in late 2007. Merck anticipates filing an NDA in 2010 for adults.

MK–0822, odanacatib, is an investigational highly selective inhibitor of cathepsin K enzyme, which is being evaluated for the treatment of osteoporosis. The cathepsin K enzyme is believed to play a role in both osteoclastic bone resorption and in degrading the protein component of bone. The inhibition of the cathepsin K enzyme by the investigational compound odanacatib is a mechanism of action different from that of currently approved treatments such as bisphosphonates. In September 2007, twelve month results from a Phase IIB study with odanacatib demonstrated dose–dependent increases in bone mineral density ("BMD") at key fracture sites, and reduced bone turnover compared to placebo in postmenopausal women with low BMD when given at doses of 10, 25 or 50 mg. These findings were presented at the 29th Annual Meeting of the American Society for Bone and Mineral Research. BMD reflects the amount of mineralized bone tissue in a certain volume of bone, and correlates with the strength of bones and with their resistance to fracture. A BMD test is used to measure bone density and to help determine fracture risk. The Phase III program began in mid–2007. Merck anticipates filing an NDA with the FDA in 2012.

Additionally, in December 2007, the Company announced it plans to initiate a sequenced Phase III program in 2008 for MK–0859, anacetrapib, its investigational selective cholesteryl ester transfer protein ("CETP") inhibitor, to obtain additional clinical experience in patients before initiating an outcomes study. In October 2007, the Company presented results from a Phase IIb study demonstrating that MK–0859 significantly reduced LDL–C and Apolipoprotein B and increased HDL–C and Apolipoprotein A–1 both as monotherapy and in combination with atorvastatin 20 mg compared to placebo in patients with dyslipidemia. Anacetrapib produced these positive effects on lipids with no observed blood pressure changes. CETP inhibitors work by inhibiting CETP, a plasma protein that facilitates the transport of cholesteryl esters and triglycerides between the lipoproteins.

The Company's clinical pipeline includes candidates in multiple disease areas, including atherosclerosis, cancer, heart failure, hypertension, infectious diseases, migraine, neurodegenerative diseases, psychiatric diseases, ophthalmic diseases, pain, and respiratory disease. The Company supplements its internal research with an aggressive licensing and external alliance strategy focused on the entire spectrum of collaborations from early research to late–stage compounds, as well as new technologies. The Company completed 55 transactions in 2007, including targeted acquisitions, research collaborations, preclinical and clinical compounds, and technology transactions across a broad range of therapeutic categories.

In July 2007, Merck and ARIAD announced that they had entered into a global collaboration to jointly develop and commercialize deforolimus (MK–8669), ARIAD's novel mTOR inhibitor, for use in cancer.

In November 2007, Dynavax and Merck announced a global license and development collaboration agreement to jointly develop V270, which is currently being evaluated in a multi–center Phase III clinical trial involving adults and in patients on dialysis.

Also, in November 2007, GTx, Inc. ("GTx") and Merck announced an agreement providing for a research and development and global strategic collaboration for selective androgen receptor modulators ("SARMs"), a new class of drugs with the potential to treat age–related muscle loss (sarcopenia) as well as other musculoskeletal conditions. This collaboration includes GTx's lead SARM candidate, Ostarine (MK–2866), which is currently being evaluated in a Phase II clinical trial for the treatment of muscle loss in patients with cancer, and establishes a broad SARM collaboration under which GTx and Merck will pool their programs and partner to discover, develop, and commercialize current as well as future SARM molecules.

The chart below reflects the Company's current research pipeline as of February 15, 2008. Candidates shown in Phase III include specific products. Candidates shown in Phase I and II include the most advanced

compound with a specific mechanism in a given therapeutic area. Small molecules and biologics are given MK–number designations and vaccine candidates are given V–number designations. Back–up compounds, regardless of their phase of development, additional indications in the same therapeutic area and additional claims, line extensions or formulations for in–line products are not shown.

Phase I

Alzheimer's Disease
V950
Atherosclerosis
MK–1903
MK–6213
Cancer
MK–0646
MK–0752
MK–2461
MK–4721
V930
Cardiovascular
MK–0448
MK–1809
Diabetes
MK–0941
MK–2662
MK–8245

Phase I

Infectious Disease
MK–3281
MK–4965
MK–7009
MK–8122
V512
Neurologic
MK–8998
MK–4305
Ophthalmic
MK–0140
Parkinson's Disease
MK–0657
Psychiatric Disease
MK–5757

Phase II

Alzheimer's Disease
MK–0249
Atherosclerosis
MK–0859
MK–0633
Cancer
MK–0457
MK–0822
Cardiovascular
MK–8141
Diabetes
MK–0893
HPV
V502
Infectious Disease
V419
V710
Neurologic
MK–0249
Ophthalmic
SIRNA–027[1]
Pain
MK–2295*
Psychiatric Disease
MK–0249
Respiratory Disease
MK–0633
Sarcopenia
MK–2866
Stroke
MK–0724

Phase III

Atherosclerosis
MK–0524B
Cancer
MK–8669
(deforolimus;
AP23573)
Heart Failure
MK–7418
(rolofylline;
KW3902)
Hepatitis B Vaccine

V270
Migraine
MK–0974
Obesity
MK–0364
(taranabant)
Osteoporosis
MK–0822
(odanacatib)

Under FDA Review

Atherosclerosis
Cordaptive
(pending trademark)
(MK–0524A)

2007 U.S. Approvals

Diabetes
Janumet
HIV
Isentress
(MK–0518)

2008 U.S. Approvals

CINV
Emend for Injection
(MK–0517)

* *Proof–of–Concept Molecule*

(1) Clinical Program conducted by Allergan, Inc.

All product or service marks appearing in type form different from that of the surrounding text are trademarks or service marks owned by or licensed to Merck, its subsidiaries or affiliates (including *Zetia* and *Vytorin*, trademarks owned by entities of the Merck/Schering–Plough partnership), except as noted. *Cozaar* and *Hyzaar* are registered trademarks of E.I. du Pont de Nemours and Company, Wilmington, DE and *Prilosec* and *Nexium* are trademarks of the AstraZeneca group. The U.S. trademarks for *Vasotec* and *Vaseretic* are owned by Biovail Laboratories Incorporated. The U.S. trademark for *Aggrastat* is owned by Guilford Pharmaceuticals Inc.

Employees

At the end of 2007, the Company had approximately 59,800 employees worldwide, with approximately 31,700 employed in the United States, including Puerto Rico. Approximately 20% of worldwide employees of the Company are represented by various collective bargaining groups.

As part of a cost–reduction initiative announced in October 2003 and completed at the end of 2004, the Company eliminated 5,100 positions. The Company completed a similar program in 2005 with 900 positions being eliminated through December 31, 2005.

In November 2005, the Company announced the first phase of a global restructuring program designed to reduce the Company's cost structure, increase efficiency, and enhance competitiveness. The initial steps included

the implementation of a new supply strategy by the Merck Manufacturing Division, which is intended to create a leaner, more cost–effective and customer–focused manufacturing model over a three–year period. As part of the global restructuring program, the Company announced that it expected to eliminate approximately 7,000 positions in manufacturing and other divisions worldwide by the end of 2008. About half of the position reductions are expected to occur in the United States, with the remainder in other countries. As of December 31, 2007, there have been approximately 7,200 positions eliminated throughout the Company since inception of the program (approximately 2,400 of which were eliminated during 2007 comprised of actual headcount reductions, and the elimination of contractors and vacant positions). The Company, however, continues to hire new employees as the business requires. Merck previously announced its intention to sell or close five of its 31 manufacturing facilities worldwide and two preclinical sites and to reduce operations at a number of other sites. Through the end of 2007, four of the manufacturing facilities had been closed, sold, or had ceased operations, and the two preclinical sites were closed. The remaining facility was sold in January 2008. The Company has also sold certain other facilities and related assets in connection with the restructuring program.

Environmental Matters

The Company believes that it is in compliance in all material respects with applicable environmental laws and regulations. In 2007, the Company incurred capital expenditures of approximately $9.3 million for environmental protection facilities. The Company is also remediating environmental contamination resulting from past industrial activity at certain of its sites. Expenditures for remediation and environmental liabilities were $19.5 million in 2007, $12.6 million in 2006, and are estimated at $69.1 million for the years 2008 through 2011. These amounts do not consider potential recoveries from other parties. The Company has taken an active role in identifying and providing for these costs and, in management's opinion, the liabilities for all environmental matters which are probable and reasonably estimable have been accrued and totaled $109.6 million at December 31, 2007. Although it is not possible to predict with certainty the outcome of these environmental matters, or the ultimate costs of remediation, management does not believe that any reasonably possible expenditures that may be incurred in excess of the liabilities accrued should exceed $54.0 million in the aggregate. Management also does not believe that these expenditures should have a material adverse effect on the Company's financial position, results of operations, liquidity or capital resources for any year.

Geographic Area Information

The Company's operations outside the United States are conducted primarily through subsidiaries. Sales worldwide by subsidiaries outside the United States were 39% of sales in 2007, 39% of sales in 2006 and 42% of sales in 2005.

The Company's worldwide business is subject to risks of currency fluctuations, governmental actions and other governmental proceedings abroad. The Company does not regard these risks as a deterrent to further expansion of its operations abroad. However, the Company closely reviews its methods of operations and adopts strategies responsive to changing economic and political conditions.

In recent years, the Company has been expanding its operations in countries located in Latin America, the Middle East, Africa, Eastern Europe and Asia Pacific where changes in government policies and economic conditions are making it possible for the Company to earn fair returns. Business in these developing areas, while sometimes less stable, offers important opportunities for growth over time.

Financial information about geographic areas of the Company's business is discussed in Item 8. "Financial Statements and Supplementary Data" below.

Available Information

The Company's Internet website address is www.merck.com. The Company will make available, free of charge at the "Investor Information" portion of its website, its Annual Report on Form 10–K, Quarterly Reports on Form 10–Q, Current Reports on Form 8–K, and all amendments to those reports filed or furnished pursuant to Section 13(a) or 15(d) of the Securities Exchange Act of 1934, as amended, as soon as reasonably practicable after such reports are electronically filed with, or furnished to, the Securities and Exchange Commission ("SEC").

The Company's corporate governance guidelines and the charters of the Board of Directors' six standing committees are available on the Company's website at www.merck.com/about/corporategovernance and all such information is available in print to any stockholder who requests it from the Company.

Item 1A. Risk Factors.

You should carefully consider all of the information set forth in this Form 10–K, including the following risk factors, before deciding to invest in any of the Company's securities. The risks below are not the only ones the Company faces. Additional risks not currently known to the Company or that the Company presently deems immaterial may also impair its business operations. The Company's business, financial condition, results of operations or prospects could be materially adversely affected by any of these risks. This Form 10–K also contains forward–looking statements that involve risks and uncertainties. The Company's results could materially differ from those anticipated in these forward–looking statements as a result of certain factors, including the risks it faces as described below and elsewhere. See "Cautionary Factors that May Affect Future Results" below.

The Company faces significant litigation related to *Vioxx*.

On September 30, 2004, the Company voluntarily withdrew *Vioxx*, its arthritis and acute pain medication, from the market worldwide. As of December 31, 2007, approximately 26,500 product liability lawsuits, involving approximately 47,275 plaintiff groups, alleging personal injuries resulting from the use of *Vioxx*, have been filed against the Company in state and federal courts in the United States. The Company is also a defendant in approximately 262 purported class actions related to the use of *Vioxx*. (All of these suits are referred to as the "*Vioxx* Product Liability Lawsuits".) As discussed above, on November 9, 2007, the Company announced that it had entered into an agreement (the "Settlement Agreement") with the law firms that comprise the executive committee of the Plaintiffs' Steering Committee of the federal multidistrict *Vioxx* litigation as well as representatives of plaintiffs' counsel in the Texas, New Jersey and California state coordinated proceedings to resolve state and federal myocardial infarction ("MI") and ischemic stroke ("IS") claims filed as of that date in the United States. The Settlement Agreement, which also applies to tolled claims, was signed by the parties after several meetings with three of the four judges overseeing the coordination of more than 95 percent of the current claims in the *Vioxx* product liability litigation. The Settlement Agreement applies only to U.S. legal residents and those who allege that their MI or IS occurred in the United States.

Under the Settlement Agreement, if, by March 1, 2008 (subject to extension), plaintiffs enroll in the resolution process (the "Settlement Program") at least 85 percent of each of all currently pending and tolled (i) MI claims, (ii) IS claims, (iii) eligible MI and IS claims together which involve death, and (iv) eligible MI and IS claims which together allege more than 12 months of use, Merck will pay an aggregate of $4.85 billion into two funds for qualifying claims consisting of $4.0 billion for qualifying MI claims and $850 million for qualifying IS claims. The Company expects that the participation conditions will be met; however, if they are not, the Company will have the right to waive the conditions or terminate the Settlement Agreement.

Claims of certain individual third–party payors remain pending in the New Jersey court, and counsel purporting to represent a large number of third–party payors has threatened to file numerous additional such actions. Activity in the pending cases is currently stayed.

There are also pending in various U.S. courts putative class actions purportedly brought on behalf of individual purchasers or users of *Vioxx* and claiming either reimbursement of alleged economic loss or an entitlement to medical monitoring. All of these cases are at early procedural stages, and no class has been certified. In New Jersey, the trial court dismissed the complaint in the case of Sinclair, a purported statewide medical monitoring class. The Appellate Division reversed the dismissal, and the issue is now on appeal to the New Jersey Supreme Court. That court heard argument on October 22, 2007.

In addition to the *Vioxx* Product Liability Lawsuits, various purported class actions and individual lawsuits have been brought against the Company and several current and former officers and directors of the Company alleging that the Company made false and misleading statements regarding *Vioxx* in violation of the federal and state securities laws (all of these suits are referred to as the "*Vioxx* Securities Lawsuits"). In addition, various putative class actions have been brought against the Company and several current and former employees,

officers, and directors of the Company alleging violations of the Employee Retirement Income Security Act ("ERISA"). (All of these suits are referred to as the "*Vioxx* ERISA Lawsuits".) In addition, shareholder derivative suits that were previously filed and dismissed are now on appeal and several shareholders have filed demands with the Company asserting claims against the Board members and Company officers. (All of these suits and demands are referred to as the "*Vioxx* Derivative Lawsuits" and, together with the *Vioxx* Securities Lawsuits and the *Vioxx* ERISA Lawsuits, the "*Vioxx* Shareholder Lawsuits".) The Company has also been named as a defendant in actions in various countries outside the United States. (All of these suits are referred to as the "*Vioxx* Foreign Lawsuits".) The Company has also been sued by seven states and two counties with respect to the marketing of *Vioxx*. The Company anticipates that additional lawsuits relating to *Vioxx* will be filed against it and/or certain of its current and former officers and directors in the future.

The SEC is conducting a formal investigation of the Company concerning *Vioxx*. The U.S. Department of Justice has issued a subpoena requesting information relating to the Company's research, marketing and selling activities with respect to *Vioxx* in a federal health care investigation under criminal statutes. There are also ongoing investigations by local authorities in Europe. A group of Attorneys General from thirty-one states and the District of Columbia are conducting an investigation of the Company's sales and marketing of *Vioxx*. The Company is cooperating with authorities in all of these investigations. (All of these investigations are referred to as the "*Vioxx* Investigations".) The Company can not predict the outcome of any of these investigations; however, they could result in potential civil and/or criminal liability.

To date, in the *Vioxx* product liability litigation, juries have decided in Merck's favor 12 times and in plaintiffs' favor five times. One Merck verdict was set aside by the court and has not been retried. Another Merck verdict was set aside and retried, leading to one of the five plaintiff verdicts. There have been two unresolved mistrials. With respect to the five plaintiffs' verdicts, Merck already has filed an appeal or sought judicial review in each of those cases, and in one of those four, a federal judge overturned the damage award shortly after trial. The *Vioxx* product liability litigation is discussed more fully in Item 3. "Legal Proceedings" below.

The outcomes of these *Vioxx* Product Liability trials should not be interpreted to indicate any trend or what outcome may be likely in future *Vioxx* trials.

The Company currently anticipates that a number of *Vioxx* Product Liability Lawsuits will be tried in 2008. A trial in the Oregon securities case is scheduled for 2008, but the Company cannot predict whether this trial will proceed on schedule or the timing of any of the other *Vioxx* Shareholder Lawsuit trials. The Company believes that it has meritorious defenses to the *Vioxx* Product Liability Lawsuits, *Vioxx* Shareholder Lawsuits and *Vioxx* Foreign Lawsuits (collectively, the "*Vioxx* Lawsuits") and will vigorously defend against them. The Company's insurance coverage with respect to the *Vioxx* Lawsuits will not be adequate to cover its defense costs and any losses.

During 2007, the Company spent $616 million, including $200 million in the fourth quarter, in the aggregate in legal defense costs worldwide related to (i) the *Vioxx* Product Liability Lawsuits, (ii) the *Vioxx* Shareholder Lawsuits, (iii) the *Vioxx* Foreign Lawsuits, and (iv) the *Vioxx* Investigations (collectively, the "*Vioxx* Litigation"). In the second quarter of 2007, the Company recorded a charge of $210 million and in the third quarter it recorded another charge of $70 million, to increase the reserve solely for its future legal defense costs related to the *Vioxx* Litigation from $858 million at December 31, 2006 to $522 million at December 31, 2007. In addition, as noted above, the Company recorded a pretax charge of $4.85 billion equal to the aggregate amount to be paid to the qualifying claimants in the Settlement Program. Thus, the Company's total reserve for the *Vioxx* Litigation at December 31, 2007 was $5.372 billion (the "*Vioxx* Reserve"). The *Vioxx* Reserve is based on certain assumptions, described below under "Legal Proceedings", and is the best estimate of the amount that the Company believes, at this time, will be spent through 2009.

The Company is not currently able to estimate any additional amount of damages that it may be required to pay in connection with the *Vioxx* Lawsuits or *Vioxx* Investigations. These proceedings are still expected to continue for years and the Company has very little information as to the course the proceedings will take. In view of the inherent difficulty of predicting the outcome of litigation, particularly where there are many claimants and the claimants seek unspecified damages, the Company is unable to predict the outcome of these matters, and at this time cannot reasonably estimate the possible loss or range of loss with respect to the *Vioxx* Lawsuits not included in the

Settlement Program. The Company has not established any reserves for any potential liability relating to the *Vioxx* Lawsuits not included in the Settlement Program or the *Vioxx* Investigations.

A series of unfavorable outcomes in the *Vioxx* Lawsuits or the *Vioxx* Investigations, resulting in the payment of substantial damages or fines or resulting in criminal penalties, in excess of the *Vioxx* Reserve, could have a material adverse effect on the Company's business, cash flow, results of operations, financial position and prospects.

Certain of the Company's major products are going to lose patent protection in the near future and, when that occurs, the Company expects a significant decline in sales of those products.

The Company depends upon patents to provide it with exclusive marketing rights for its products for some period of time. As product patents for several of the Company's products have recently expired, or are about to expire, in the United States and in other countries, the Company faces strong competition from lower price generic drugs. Loss of patent protection for one of the Company's products typically leads to a rapid loss of sales for that product, as lower priced generic versions of that drug become available. In the case of products that contribute significantly to the Company's sales, the loss of patent protection can have a material adverse effect on the Company's results of operations.

Fosamax lost market exclusivity in the United States in February 2008. *Fosamax Plus D* will lose marketing exclusivity in the United States in April 2008. As a result of these events, the Company expects significant declines in U.S. *Fosamax* and *Fosamax Plus D* sales. U.S. sales of *Fosamax* and *Fosamax Plus D* were $2.0 billion in the aggregate in 2007. Sales of *Fosamax* outside the United States have already been adversely affected by the availability of generic alendronate sodium products in some markets, including the United Kingdom, Canada and Germany.

The Company's research and development efforts may not succeed in developing commercially successful products and the Company may not be able to acquire commercially successful products in other ways; in consequence, the Company may not be able to replace sales of successful products that have lost patent protection.

Like other major pharmaceutical companies, in order to remain competitive, the Company must continue to launch new products each year. Declines in sales of products such as *Zocor* and *Fosamax* mean that the Company's future success is dependent on its pipeline of new products, including new products which it develops through joint ventures and products which it is able to obtain through license or acquisition. To accomplish this, the Company commits substantial effort, funds and other resources to research and development, both through its own dedicated resources, and through various collaborations with third parties. To support its research and development efforts the Company must make ongoing, substantial expenditures, without any assurance that the efforts it is funding will result in a commercially successful product. The Company must also commit substantial efforts, funds and other resources to recruiting and retaining high quality scientists and other personnel with pharmaceutical research and development expertise.

For a description of the research and development process, see "Research and Development" above. Each phase of testing is highly regulated, and during each phase there is a substantial risk that the Company will encounter serious obstacles or will not achieve its goals, and accordingly the Company may abandon a product in which it has invested substantial amounts of time and money. Some of the risks encountered in the research and development process include the following: pre-clinical testing of a new compound may yield disappointing results; clinical trials of a new drug may not be successful; a new drug may not be effective or may have harmful side effects; a new drug may not be approved by the FDA for its intended use; it may not be possible to obtain a patent for a new drug; or sales of a new product may be disappointing.

The Company cannot state with certainty when or whether any of its products now under development will be launched; whether it will be able to develop, license or otherwise acquire compounds, product candidates or products; or whether any products, once launched, will be commercially successful. The Company must maintain a continuous flow of successful new products and successful new indications or brand extensions for existing products sufficient both to cover its substantial research and development costs and to replace sales that are lost as profitable products, such as *Zocor* and *Fosamax*, lose patent protection or are displaced by competing products or

therapies. Failure to do so in the short term or long term would have a material adverse effect on the Company's business, results of operations, cash flow, financial position and prospects.

Issues concerning *Vytorin* and the ENHANCE clinical trial could have a material adverse effect on sales of *Vytorin* and *Zetia*.

The Company and Schering–Plough sell *Vytorin* and *Zetia* through their joint venture company, Merck/Schering–Plough Pharmaceuticals (the "MSP Partnership"). On January 14, 2008, the MSP Partnership announced the primary endpoint and other results of the ENHANCE (Effect of Combination Ezetimibe and High–Dose Simvastatin vs. Simvastatin Alone on the Atherosclerotic Process in Patients with Heterozygous Familial Hypercholesterolemia) trial. ENHANCE was a surrogate endpoint trial conducted in 720 patients with Heterozygous Familial Hypercholesterolemia, a rare condition that affects approximately 0.2% of the population. The primary endpoint was the mean change in the intima–media thickness measured at three sites in the carotid arteries (the right and left common carotid, internal carotid and carotid bulb) between patients treated with ezetimibe/simvastatin 10/80 mg versus patients treated with simvastatin 80 mg alone over a two year period. There was no statistically significant difference between treatment groups on the primary endpoint. There was also no statistically significant difference between the treatment groups for each of the components of the primary endpoint, including the common carotid artery.

During December 2007 and through February 26, 2008, the Company and its joint–venture partner, Schering–Plough, received several joint letters from the House Committee on Energy and Commerce and the House Subcommittee on Oversight and Investigations, and one letter from the Senate Finance Committee, collectively seeking a combination of witness interviews, documents and information on a variety of issues related to the ENHANCE clinical trial, the sale and promotion of *Vytorin*, as well as sales of stock by corporate officers. On January 25, 2008, the companies and the MSP Partnership each received two subpoenas from the New York State Attorney General's Office seeking similar information and documents. Merck and Schering–Plough have also each received a letter from the Office of the Connecticut Attorney General dated February 1, 2008, requesting documents related to the marketing and sale of *Vytorin* and *Zetia* and the timing of disclosures of the results of ENHANCE. The Company is cooperating with these investigations and working with Schering–Plough to respond to the inquiries. In addition, since mid–January 2008, the Company has become aware of or been served with approximately 85 civil class action lawsuits alleging common law and state consumer fraud claims in connection with the MSP Partnership's sale and promotion of *Vytorin* and *Zetia*.

The Company has been closely monitoring sales of *Vytorin* and *Zetia* following the release of the ENHANCE clinical trial results in a press release on January 14, 2008. To date, sales of both products in the U.S. have been below the Company's prior expectations. In addition, wholesalers in the U.S. have moderated their purchases of both products to reduce their inventory levels.

These issues concerning the ENHANCE clinical trial could have a material adverse effect on the MSP Partnership's sales of *Vytorin* and *Zetia*. If sales of such products are materially adversely affected, the Company's business, cash flow, results of operations, financial position and prospects could also be materially adversely affected. In addition, unfavorable outcomes resulting from the government investigations or the consumer fraud litigation concerning the sale and promotion of these products could have a material adverse effect on the Company's financial position, liquidity and results of operations.

The Company's products, including products in development, can not be marketed unless the Company obtains and maintains regulatory approval.

The Company's activities, including research, preclinical testing, clinical trials and manufacturing and marketing its products, are subject to extensive regulation by numerous federal, state and local governmental authorities in the United States, including the FDA, and by foreign regulatory authorities, including the European Commission. In the United States, the FDA is of particular importance to the Company, as it administers requirements covering the testing, approval, safety, effectiveness, manufacturing, labeling and marketing of prescription pharmaceuticals. In many cases, the FDA requirements have increased the amount of time and money necessary to develop new products and bring them to market in the United States. Regulation outside the United States also is primarily focused on drug safety and effectiveness and, in many cases, cost reduction. The

FDA and foreign regulatory authorities have substantial discretion to require additional testing, to delay or withhold registration and marketing approval and to mandate product withdrawals.

Even if the Company is successful in developing new products, it will not be able to market any of those products unless and until it has obtained all required regulatory approvals in each jurisdiction where it proposes to market the new products. Once obtained, the Company must maintain approval as long as it plans to market its new products in each jurisdiction where approval is required. The Company's failure to obtain approval, significant delays in the approval process, or its failure to maintain approval in any jurisdiction will prevent it from selling the new products in that jurisdiction until approval is obtained, if ever. The Company would not be able to realize revenues for those new products in any jurisdiction where it does not have approval.

The Company is dependent on its patent rights, and if its patent rights are invalidated or circumvented, its business would be adversely affected.

Patent protection is considered, in the aggregate, to be of material importance in the Company's marketing of human health products in the United States and in most major foreign markets. Patents covering products that it has introduced normally provide market exclusivity, which is important for the successful marketing and sale of its products. The Company seeks patents covering each of its products in each of the markets where it intends to sell the products and where meaningful patent protection is available.

Even if the Company succeeds in obtaining patents covering its products, third parties or government authorities may challenge or seek to invalidate or circumvent its patents and patent applications. It is important for the Company's business to defend successfully the patent rights that provide market exclusivity for its products. The Company is often involved in patent disputes relating to challenges to its patents or infringement and similar claims against the Company. The Company aggressively defends its important patents both within and outside the United States, including by filing claims of infringement against other parties. See Item 3. "Legal Proceedings — Patent Litigation" below. In particular, manufacturers of generic pharmaceutical products from time to time file Abbreviated New Drug Applications ("ANDA") with the FDA seeking to market generic forms of the Company's products prior to the expiration of relevant patents owned by the Company. The Company normally responds by vigorously defending its patent, including by filing lawsuits alleging patent infringement. Patent litigation and other challenges to the Company's patents are costly and unpredictable and may deprive the Company of market exclusivity for a patented product or, in some cases, third party patents may prevent the Company from marketing and selling a product in a particular geographic area.

If one or more important products lose patent protection in profitable markets, sales of those products are likely to decline significantly as a result of generic versions of those products becoming available. The Company's results of operations may be adversely affected by the lost sales unless and until the Company has successfully launched commercially successful replacement products.

The Company faces intense competition from lower–cost generic products.

In general, the Company faces increasing competition from lower–cost generic products. The patent rights that protect its products are of varying strengths and durations. In addition, in some countries, patent protection is significantly weaker than in the United States or the EU. In the United States, political pressure to reduce spending on prescription drugs has led to legislation which encourages the use of generic products. Although it is the Company's policy to actively protect its patent rights, generic challenges to the Company's products can arise at any time, and it may not be able to prevent the emergence of generic competition for its products.

Loss of patent protection for a product typically is followed promptly by generic substitutes, reducing the Company's sales of that product. Availability of generic substitutes for the Company's drugs may adversely affect its results of operations and cash flow. In addition, proposals emerge from time to time in the United States and other countries for legislation to further encourage the early and rapid approval of generic drugs. Any such proposal that is enacted into law could worsen this substantial negative effect on the Company's sales and, potentially, its results of operations and cash flow.

The Company faces intense competition from new products.

The Company's products face intense competition from competitors' products. This competition may increase as new products enter the market. In such an event, the competitors' products may be safer or more effective or more effectively marketed and sold than the Company's products. Alternatively, in the case of generic competition, they may be equally safe and effective products which are sold at a substantially lower price than the Company's products. As a result, if the Company fails to maintain its competitive position, this could have a material adverse effect on its business and results of operations.

The Company faces pricing pressure with respect to its products.

The Company's products are subject to increasing price pressures and other restrictions worldwide, including in the United States. These include (i) practices of managed care groups and institutional and governmental purchasers and (ii) U.S. federal laws and regulations related to Medicare and Medicaid, including the Medicare Prescription Drug Improvement and Modernization Act of 2003 (the "2003 Act").

The 2003 Act included a prescription drug benefit for individuals which first went into effect on January 1, 2006. The increased purchasing power of entities that negotiate on behalf of Medicare beneficiaries could result in further pricing pressures. The Company expects pricing pressures to increase in the future.

The Company may experience difficulties and delays in the manufacturing of its products.

The Company may experience difficulties and delays inherent in manufacturing its products, particularly its vaccines, such as (i) failure of the Company or any of its vendors or suppliers to comply with Current Good Manufacturing Practices and other applicable regulations and quality assurance guidelines that could lead to manufacturing shutdowns, product shortages and delays in product manufacturing; (ii) construction delays related to the construction of new facilities or the expansion of existing facilities, including those intended to support future demand for the Company's products; and (iii) other manufacturing or distribution problems including changes in manufacturing production sites and limits to manufacturing capacity due to regulatory requirements, changes in types of products produced, or physical limitations that could impact continuous supply. Manufacturing difficulties can result in product shortages, leading to lost sales.

Pharmaceutical products can develop unexpected safety or efficacy concerns.

Unexpected safety or efficacy concerns can arise with respect to marketed products, whether or not scientifically justified, leading to product recalls, withdrawals, or declining sales, as well as product liability, consumer fraud and/or other claims.

The Company has no product liability insurance for products first sold after August 1, 2004.

As a result of a number of factors, product liability insurance has become less available while the cost has increased significantly. The Company has evaluated its risks and has determined that the cost of obtaining product liability insurance outweighs the likely benefits of the coverage that is available and as such, has no insurance for certain product liabilities effective August 1, 2004, including liability for products first sold after that date.

Changes in laws and regulations could adversely affect the Company's business.

All aspects of the Company's business, including research and development, manufacturing, marketing, pricing, sales, litigation and intellectual property rights, are subject to extensive legislation and regulation. Changes in applicable federal and state laws and agency regulations could have a material adverse effect on the Company's business.

Cautionary Factors that May Affect Future Results
(Cautionary Statements Under the Private Securities Litigation Reform Act of 1995)

This report and other written reports and oral statements made from time to time by the Company may contain so-called "forward-looking statements," all of which are based on management's current expectations and are subject to risks and uncertainties which may cause results to differ materially from those set forth in the statements. One can identify these forward-looking statements by their use of words such as "expects," "plans,"

"will," "estimates," "forecasts," "projects" and other words of similar meaning. One can also identify them by the fact that they do not relate strictly to historical or current facts. These statements are likely to address the Company's growth strategy, financial results, product development, product approvals, product potential, and development programs. One must carefully consider any such statement and should understand that many factors could cause actual results to differ materially from the Company's forward–looking statements. These factors include inaccurate assumptions and a broad variety of other risks and uncertainties, including some that are known and some that are not. No forward–looking statement can be guaranteed and actual future results may vary materially. The Company does not assume the obligation to update any forward–looking statement. The Company cautions you not to place undue reliance on these forward–looking statements. Although it is not possible to predict or identify all such factors, they may include the following:

- Significant litigation related to *Vioxx*, including whether the Settlement Agreement will be consummated.
- Competition from generic products as the Company's products lose patent protection.
- Increased "brand" competition in therapeutic areas important to the Company's long–term business performance.
- The difficulties and uncertainties inherent in new product development. The outcome of the lengthy and complex process of new product development is inherently uncertain. A drug candidate can fail at any stage of the process and one or more late–stage product candidates could fail to receive regulatory approval. New product candidates may appear promising in development but fail to reach the market because of efficacy or safety concerns, the inability to obtain necessary regulatory approvals, the difficulty or excessive cost to manufacture and/or the infringement of patents or intellectual property rights of others. Furthermore, the sales of new products may prove to be disappointing and fail to reach anticipated levels.
- Pricing pressures, both in the United States and abroad, including rules and practices of managed care groups, judicial decisions and governmental laws and regulations related to Medicare, Medicaid and health care reform, pharmaceutical reimbursement and pricing in general.
- Changes in government laws and regulations and the enforcement thereof affecting the Company's business.
- Efficacy or safety concerns with respect to marketed products, whether or not scientifically justified, leading to product recalls, withdrawals or declining sales.
- Legal factors, including product liability claims, antitrust litigation and governmental investigations, including tax disputes, environmental concerns and patent disputes with branded and generic competitors, any of which could preclude commercialization of products or negatively affect the profitability of existing products.
- Lost market opportunity resulting from delays and uncertainties in the approval process of the FDA and foreign regulatory authorities.
- Increased focus on privacy issues in countries around the world, including the United States and the EU. The legislative and regulatory landscape for privacy and data protection continues to evolve, and there has been an increasing amount of focus on privacy and data protection issues with the potential to affect directly the Company's business.
- Changes in tax laws including changes related to the taxation of foreign earnings.
- Changes in accounting pronouncements promulgated by standard–setting or regulatory bodies, including the Financial Accounting Standards Board and the SEC, that are adverse to the Company.
- Economic factors over which the Company has no control, including changes in inflation, interest rates and foreign currency exchange rates.

This list should not be considered an exhaustive statement of all potential risks and uncertainties. See "Risk Factors" above.

Item 1B. Unresolved Staff Comments.

None

Item 2. Properties.

The Company's corporate headquarters is located in Whitehouse Station, New Jersey. The Company's U.S. pharmaceutical business is conducted through divisional headquarters located in Upper Gwynedd and West Point, Pennsylvania. The Company's vaccines business is conducted through divisional headquarters located in West Point. Principal research facilities for human health products are located in Rahway, New Jersey and West Point. The Company also has production facilities for human health products at seven locations in the United States and Puerto Rico. Branch warehouses provide services throughout the country. Outside the United States, through subsidiaries, the Company owns or has an interest in manufacturing plants or other properties in Australia, Canada, Japan, Singapore, South Africa, and other countries in Western Europe, Central and South America, and Asia.

Capital expenditures for 2007 were $1.0 billion compared with $980.2 million for 2006. In the United States, these amounted to $788.0 million for 2007 and $714.7 million for 2006. Abroad, such expenditures amounted to $223.0 million for 2007 and $265.5 million for 2006.

The Company and its subsidiaries own their principal facilities and manufacturing plants under titles which they consider to be satisfactory. The Company considers that its properties are in good operating condition and that its machinery and equipment have been well maintained. Plants for the manufacture of products are suitable for their intended purposes and have capacities and projected capacities adequate for current and projected needs for existing Company products. Some capacity of the plants is being converted, with any needed modification, to the requirements of newly introduced and future products.

Item 3. Legal Proceedings.

The Company is involved in various claims and legal proceedings of a nature considered normal to its business, including product liability, intellectual property, and commercial litigation, as well as additional matters such as antitrust actions.

***Vioxx* Litigation**

Product Liability Lawsuits

As previously disclosed, individual and putative class actions have been filed against the Company in state and federal courts alleging personal injury and/or economic loss with respect to the purchase or use of *Vioxx*. All such actions filed in federal court are coordinated in a multidistrict litigation in the U.S. District Court for the Eastern District of Louisiana (the "MDL") before District Judge Eldon E. Fallon. A number of such actions filed in state court are coordinated in separate coordinated proceedings in state courts in New Jersey, California and Texas, and the counties of Philadelphia, Pennsylvania and Washoe and Clark Counties, Nevada. As of December 31, 2007, the Company had been served or was aware that it had been named as a defendant in approximately 26,500 lawsuits, which include approximately 47,275 plaintiff groups, alleging personal injuries resulting from the use of *Vioxx*, and in approximately 262 putative class actions alleging personal injuries and/or economic loss. (All of the actions discussed in this paragraph are collectively referred to as the "*Vioxx* Product Liability Lawsuits".) Of these lawsuits, approximately 9,025 lawsuits representing approximately 26,275 plaintiff groups are or are slated to be in the federal MDL and approximately 15,575 lawsuits representing approximately 15,575 plaintiff groups are included in a coordinated proceeding in New Jersey Superior Court before Judge Carol E. Higbee.

In addition to the *Vioxx* Product Liability Lawsuits discussed above, the claims of over 6,350 plaintiffs had been dismissed as of December 31, 2007. Of these, there have been over 1,850 plaintiffs whose claims were dismissed with prejudice (i.e., they cannot be brought again) either by plaintiffs themselves or by the courts. Over 4,500 additional plaintiffs have had their claims dismissed without prejudice (i.e., subject to the applicable statute of limitations, they can be brought again).

Merck entered into a tolling agreement (the "Tolling Agreement") with the MDL Plaintiffs' Steering Committee ("PSC") that established a procedure to halt the running of the statute of limitations (tolling) as to certain

categories of claims allegedly arising from the use of *Vioxx* by non–New Jersey citizens. The Tolling Agreement applied to individuals who have not filed lawsuits and may or may not eventually file lawsuits and only to those claimants who seek to toll claims alleging injuries resulting from a thrombotic cardiovascular event that results in a myocardial infarction ("MI") or ischemic stroke ("IS"). The Tolling Agreement provided counsel additional time to evaluate potential claims. The Tolling Agreement required any tolled claims to be filed in federal court. As of December 31, 2007, approximately 13,230 claimants had entered into Tolling Agreements. The parties agreed that April 9, 2007 was the deadline for filing Tolling Agreements and no additional Tolling Agreements are being accepted.

On November 9, 2007, Merck announced that it had entered into an agreement (the "Settlement Agreement") with the law firms that comprise the executive committee of the PSC of the federal *Vioxx* MDL as well as representatives of plaintiffs' counsel in the Texas, New Jersey and California state coordinated proceedings to resolve state and federal MI and IS claims filed as of that date in the United States. The Settlement Agreement, which also applies to tolled claims, was signed by the parties after several meetings with three of the four judges overseeing the coordination of more than 95 percent of the current claims in the *Vioxx* Litigation. The Settlement Agreement applies only to U.S. legal residents and those who allege that their MI or IS occurred in the United States.

The entire Settlement Agreement, including accompanying exhibits, may be found at www.merck.com. The Company has included this website address only as an inactive textual reference and does not intend it to be an active link to its website nor does it incorporate by reference the information contained therein. If certain participation conditions under the Settlement Agreement are met, which conditions may be waived by Merck, Merck will pay a fixed aggregate amount of $4.85 billion into two funds for qualifying claims that enter into the resolution process (the "Settlement Program"). Individual claimants will be examined by administrators of the Settlement Program to determine qualification based on objective, documented facts provided by claimants, including records sufficient for a scientific evaluation of independent risk factors. The conditions in the Settlement Agreement also require claimants to pass three gates: an injury gate requiring objective, medical proof of an MI or IS (each as defined in the Settlement Agreement), a duration gate based on documented receipt of at least 30 *Vioxx* pills, and a proximity gate requiring receipt of pills in sufficient number and proximity to the event to support a presumption of ingestion of *Vioxx* within 14 days before the claimed injury.

The Settlement Agreement provides that Merck does not admit causation or fault. Merck's payment obligations under the Settlement Agreement will be triggered only if, among other conditions, (1) law firms on the federal and state PSCs and firms that have tried cases in the coordinated proceedings elect to recommend enrollment in the program to 100 percent of their clients who allege either MI or IS and (2) by March 1, 2008 (subject to extension), plaintiffs enroll in the Settlement Program at least 85 percent of each of all currently pending and tolled (i) MI claims, (ii) IS claims, (iii) eligible MI and IS claims together which involve death, and (iv) eligible MI and IS claims together which allege more than 12 months of use. The Company has the right to waive these participation conditions.

Under the Settlement Agreement, Merck will create separate funds in the amount of $4.0 billion for MI claims and $850 million for IS claims. Once triggered, Merck's total payment for both funds of $4.85 billion is a fixed amount to be allocated among qualifying claimants based on their individual evaluation. While at this time the exact number of claimants covered by the Settlement Agreement is unknown, the total dollar amount is fixed. Payments to individual qualifying claimants could begin as early as August 2008 and then will be paid over a period of time. Merck retains its right to terminate this process without any payment to any claimant, and to defend each claim individually at trial if any of the aforementioned participation conditions in the Settlement Agreement are not met.

After the Settlement Agreement was announced on November 9, 2007, judges in the Federal MDL, California, Texas and New Jersey State Coordinated Proceedings entered a series of orders. The orders: (1) temporarily stayed their respective litigations; (2) required plaintiffs to register their claims by January 15, 2008; (3) require plaintiffs with cases pending as of November 9, 2007 to preserve and produce records and serve expert reports; and (4) require plaintiffs who file thereafter to make similar productions on an accelerated schedule. The Clark County, Nevada coordinated proceeding was also generally stayed.

As of February 26, 2008, more than 57,000 plaintiffs had submitted registration materials, including more than 47,000 plaintiffs who allege an MI or IS. In addition, as of February 26, 2008, more than 33,000 claimants have started submitting enrollment materials. The registration and enrollment materials currently are being evaluated for eligibility, accuracy and completeness. The claims administrator continues to receive new materials from plaintiffs.

Several *Vioxx* Product Liability Lawsuits are currently scheduled for trial in 2008. The Company has provided a list of such trials at its website at www.merck.com which it will periodically update as appropriate. The Company has included its website address only as an inactive textual reference and does not intend it to be an active link to its website nor does it incorporate by reference the information contained therein.

The Company has previously disclosed the outcomes of several *Vioxx* Product Liability Lawsuits that were tried prior to September 30, 2007 (see chart below).

The following sets forth the results of trials and certain significant rulings that occurred in or after the fourth quarter of 2007 with respect to the *Vioxx* Product Liability Lawsuits.

On October 5, 2007, the jury in Kozic v. Merck, a case tried in state court in Tampa, Florida found unanimously in favor of Merck on all counts, rejecting a claim that the Company was liable for plaintiff's heart attack. In December 2007, plaintiff filed an appeal but agreed to an order staying all other post-trial activity pending his entry into the Settlement Program.

On January 18, 2007, Judge Victoria Chaney declared a mistrial in a consolidated trial of two cases, Appell v. Merck and Arrigale v. Merck, which had commenced on October 31, 2006 in California state court in Los Angeles, after the jury indicated that it could not reach a verdict. Judge Chaney had rescheduled the re-trial of the combined trial of Appell and Arrigale for January 8, 2008, but both of these cases are now stayed.

In April 2006, in a trial involving two plaintiffs, Thomas Cona and John McDarby, in Superior Court of New Jersey, Law Division, Atlantic County, the jury returned a split verdict. The jury determined that *Vioxx* did not substantially contribute to the heart attack of Mr. Cona, but did substantially contribute to the heart attack of Mr. McDarby. The jury also concluded that, in each case, Merck violated New Jersey's consumer fraud statute, which allows plaintiffs to receive their expenses for purchasing the drug, trebled, as well as reasonable attorneys' fees. The jury awarded $4.5 million in compensatory damages to Mr. McDarby and his wife, who also was a plaintiff in that case, as well as punitive damages of $9 million. On June 8, 2007, Judge Higbee denied Merck's motion for a new trial. On June 15, 2007, Judge Higbee awarded approximately $4 million in the aggregate in attorneys' fees and costs. The Company has appealed the judgments in both cases and the Appellate Division held oral argument on both cases on January 16, 2008.

On March 27, 2007, a jury found for Merck on all counts in Schwaller v. Merck, which was tried in state court in Madison County, Illinois. The plaintiff moved for a new trial on May 25, 2007. The plaintiff filed a supplemental motion for a new trial on September 5, 2007. On December 11, 2007, Judge Stack signed a consent order staying all post-trial activity in the case until March 2008.

On December 15, 2006, the jury in Albright v. Merck, a case tried in state court in Birmingham, Alabama, returned a verdict for Merck on all counts. Plaintiff appealed in July 2007 to the Alabama Supreme Court, but in December 2007, plaintiff agreed to stay his appeal pending his entry into the Settlement Program.

On April 19, 2007, Judge Randy Wilson, who presides over the Texas *Vioxx* coordinated proceeding, dismissed the failure to warn claim of plaintiff Ruby Ledbetter, whose case was scheduled to be tried on May 14, 2007. Judge Wilson relied on a Texas statute enacted in 2003 that provides that there can be no failure to warn regarding a prescription medicine if the medicine is distributed with FDA-approved labeling. There is an exception in the statute if required, material, and relevant information was withheld from the FDA that would have led to a different decision regarding the approved labeling, but Judge Wilson found that the exception is preempted by federal law unless the FDA finds that such information was withheld. Judge Wilson is currently presiding over approximately 1,000 *Vioxx* suits in Texas in which a principal allegation is failure to warn. Judge Wilson certified the decision for an expedited appeal to the Texas Court of Civil Appeals. Plaintiffs have appealed the decision. On October 11, 2007, Merck filed a motion to abate the hearing of the appeal until after the U.S. Supreme Court's decision in Warner Lambert v. Kent, which is to be decided in 2008. On October 25, 2007, the Texas Court of

Appeals denied Merck's motion to abate. The parties are currently briefing the appeal. The Company expects oral argument to be set sometime in the spring of 2008.

In July 2006, in Doherty v. Merck, in Superior Court of New Jersey, Law Division, Atlantic County, a jury returned a verdict in favor of the Company on all counts. The jury rejected a claim by the plaintiff that her nearly three years of *Vioxx* use caused her heart attack. The jury also found in Merck's favor on the plaintiff's consumer fraud claim. Plaintiff filed a motion for a new trial in August 2006. On December 21, 2007, Judge Higbee denied plaintiff's motion for a new trial without prejudice in light of plaintiff's expressed intention to participate in the Settlement Program.

A consolidated trial, Hermans v. Merck and the retrial of Humeston v. Merck, began on January 17, 2007, in the coordinated proceeding in New Jersey Superior Court before Judge Higbee. Humeston v. Merck was first tried in 2005, resulting in a jury verdict in favor of Merck on November 3, 2005. However, on August 17, 2006, Judge Higbee set aside the November 2005 jury verdict and ordered a new trial on the grounds of newly discovered evidence.

The Hermans/Humeston trial was separated into two phases: a general phase regarding Merck's conduct and a plaintiff-specific phase. On March 2, 2007, the jury found for Merck in the general phase on the Hermans failure to warn claim, and the consumer fraud claim was subsequently submitted to Judge Higbee for decision. On March 12, 2007, the jury found for plaintiffs in the Humeston case, awarding compensatory damages to Mr. Humeston in the amount of $18 million and to Mrs. Humeston in the amount of $2 million. The jury also awarded $27.5 million in punitive damages. Merck has moved for a judgment notwithstanding the verdict, a new trial, or reduction of the award. These and other post-trial motions are currently pending. On December 11, 2007, the Court dismissed the motion for new trial without prejudice in Hermans.

On July 31, 2007, the New Jersey Appellate Division unanimously upheld Judge Higbee's dismissal of *Vioxx* Product Liability Lawsuits brought by residents of the United Kingdom. Plaintiffs had asked the New Jersey Supreme Court to review the decision. On November 15, 2007, the New Jersey Supreme Court declined to review the decision.

Merck voluntarily withdrew *Vioxx* from the market on September 30, 2004. Most states have statutes of limitations for product liability claims of no more than three years, which require that claims must be filed within no more than three years after the plaintiffs learned or could have learned of their potential cause of action. As a result, some may view September 30, 2007 as a significant deadline for filing *Vioxx* cases. It is important to note, however, that the law regarding statutes of limitations can be complex and variable, depending on the facts and applicable law. Some states have longer statutes of limitations. There are also arguments that the statutes of limitations began running before September 30, 2004. New Jersey Superior Court Judge Higbee and Federal District Court Judge Fallon have issued orders in cases from New Jersey and eight other jurisdictions ruling that the statutory period for making *Vioxx* personal injury claims has passed. Judge Higbee's order was issued on October 15, 2007 and Judge Fallon's was issued on November 8, 2007.

The following chart sets forth the results of all U.S. *Vioxx* Product Liability trials to date. Juries have now decided in favor of the Company 12 times and in plaintiffs' favor five times. One Merck verdict was set aside by the court and has not been retried. Another Merck verdict was set aside and retried, leading to one of the five plaintiff verdicts. There have been two unresolved mistrials. With respect to the five plaintiffs' verdicts, Merck has filed an appeal or sought judicial review in each of those cases, and in one of those five, a federal judge reduced the damage award after trial. Certain of the plaintiffs in the trials listed below may be eligible for the Settlement Program.

Verdict Date	Plaintiff	State or Federal Court	Result	Comments
Aug. 19, 2005	Ernst	Texas	Verdict for Plaintiff	Jury awarded Plaintiff $253.4 million; the Court reduced amount to approximately $26.1 million plus interest. The judgment is now on appeal.
Nov. 3, 2005 and March 12, 2007	Humeston	New Jersey	Verdict for Merck, then judge set aside the verdict, ordering a new trial, which resulted in a verdict for Plaintiff.	In the 2005 trial, the jury found for Merck. In August 2006, the Court set aside the verdict, and ordered a new trial for January 2007. At the conclusion of the 2007 trial, the jury awarded Plaintiff a total of $47.5 million in damages. The jury also awarded Plaintiff the nominal sum of $36.00 on their Consumer Fraud Act claim. Merck has moved for a judgment notwithstanding the verdict, a reduced verdict amount, and for a new trial. These motions are still pending.
Dec. 12, 2005 and Feb. 17, 2006	Plunkett	Federal	Verdict for Merck, judge then set aside the verdict	Merck prevailed in the February 2006 retrial. The Court set aside the February 2006 verdict in May 2007. No date has been set for a new trial.
April 5, 2006	McDarby	N.J.	Verdict for Plaintiff	Plaintiff was awarded $13.5 million in damages. In June 2007, the Court awarded Plaintiffs in this and the Cona claim tried with it approximately $4 million in attorneys' fees and costs. Merck has appealed the judgment including the award of attorney's fees and costs.
April 5, 2006	Cona	N.J.	Verdict for Merck on failure to warn claim	The jury found for Merck on the failure to warn claim. The jury awarded Plaintiff the nominal sum of $135.00 for his Consumer Fraud Act claim. In June 2007, the Court awarded Plaintiffs in this and the McDarby claim tried with it approximately $4 million in attorneys' fees and costs. Merck has appealed the judgment including the award of attorney's fees and costs.
April 21, 2006	Garza	Texas	Verdict for Plaintiff	Judge reduced $32 million jury award to $8.7 million plus interest. Merck filed an appeal on March 20, 2007.

Verdict Date	Plaintiff	State or Federal Court	Result	Comments
July 13, 2006	Doherty	N.J.	Verdict for Merck	The Court denied the motion for new trial without prejudice pending Plaintiff's entry into the Settlement Program.
Aug. 2, 2006	Grossberg	California	Verdict for Merck	Plaintiff's motion for a new trial was denied, and his subsequent appeal was dismissed.
Aug. 17, 2006	Barnett	Federal	Verdict for Plaintiff	Jury awarded Plaintiff $51 million in damages. The judge ruled the award was "grossly excessive," and reduced the award to $1.6 million. Merck has appealed the Judgment to the Court of Appeals.
Sept. 26, 2006	Smith	Federal	Verdict for Merck	
Nov. 15, 2006	Mason	Federal	Verdict for Merck	
Dec. 13, 2006	Dedrick	Federal	Verdict for Merck	Plaintiff's motion for a new trial was denied in May 2007.
Dec. 15, 2006	Albright	Alabama	Verdict for Merck	Plaintiff appealed in July 2007 to the Alabama Supreme Court, but in December 2007, Plaintiff agreed to stay his appeal pending his entry into the Settlement Program.
Jan. 18, 2007	Arrigale/Appell	California	Mistrial declared after the jury deadlocked	Jury failed to return verdicts in cases filed by two Plaintiffs who alleged *Vioxx* contributed to their heart attacks. These cases are now stayed.
March 2, 2007	Hermans	New Jersey	Verdict for Merck on the failure to warn claim	The jury found for Merck on the failure to warn claim. The parties submitted the Consumer Fraud Act claim to the Court for resolution. This remains pending but subject to the stay.
March 27, 2007	Schwaller	Illinois	Verdict for Merck	Plaintiff moved for a new trial. On December 11, 2007, Judge Stack signed a consent order staying all post-trial activity in the case until March 2008.
Oct. 5, 2007	Kozic	Florida	Verdict for Merck	In December 2007, Plaintiff filed an appeal but agreed to an order staying all other post-trial activity pending his entry into the Settlement Program.

Other Lawsuits

As previously disclosed, on July 29, 2005, a New Jersey state trial court certified a nationwide class of third-party payors (such as unions and health insurance plans) that paid in whole or in part for the *Vioxx* used by their plan members or insureds. The named plaintiff in that case sought recovery of certain *Vioxx* purchase costs (plus penalties) based on allegations that the purported class members paid more for *Vioxx* than they would have had they known of the product's alleged risks. On March 31, 2006, the New Jersey Superior Court, Appellate Division, affirmed the class certification order. On September 6, 2007, the New Jersey Supreme Court reversed the certification of a nationwide class action of third-party payors, finding that the suit does not meet the requirements for a class action. Claims of certain individual third-party payors remain pending in the New Jersey court, and

counsel purporting to represent a large number of third-party payors has threatened to file numerous additional such actions. Activity in the pending cases is currently stayed.

There are also pending in various U.S. courts putative class actions purportedly brought on behalf of individual purchasers or users of *Vioxx* and claiming either reimbursement of alleged economic loss or an entitlement to medical monitoring. All of these cases are at early procedural stages, and no class has been certified. In New Jersey, the trial court dismissed the complaint in the case of Sinclair, a purported statewide medical monitoring class. The Appellate Division reversed the dismissal, and the issue is now on appeal to the New Jersey Supreme Court. That court heard argument on October 22, 2007.

As previously reported, the Company has also been named as a defendant in separate lawsuits brought by the Attorneys General of seven states, and the City of New York. A Colorado taxpayer has also filed a derivative suit, on behalf of the State of Colorado, naming the Company. These actions allege that the Company misrepresented the safety of *Vioxx* and seek (i) recovery of the cost of *Vioxx* purchased or reimbursed by the state and its agencies; (ii) reimbursement of all sums paid by the state and its agencies for medical services for the treatment of persons injured by *Vioxx*; (iii) damages under various common law theories; and/or (iv) remedies under various state statutory theories, including state consumer fraud and/or fair business practices or Medicaid fraud statutes, including civil penalties. In addition, the Company has been named in two other lawsuits containing similar allegations filed by governmental entities seeking the reimbursement of alleged Medicaid expenditures for *Vioxx*. Those lawsuits are (1) a class action filed by Santa Clara County, California on behalf of all similarly situated California counties, and (2) an action filed by Erie County, New York. With the exception of the case filed by Texas (which remains in Texas state court and is currently scheduled for trial in September 2008) and the New York Attorney General and Erie County cases (which are pending transfer), the rest of the actions described in this paragraph have been transferred to the federal MDL and have not experienced significant activity to date.

Shareholder Lawsuits

As previously disclosed, in addition to the *Vioxx* Product Liability Lawsuits, the Company and various current and former officers and directors are defendants in various putative class actions and individual lawsuits under the federal securities laws and state securities laws (the "*Vioxx* Securities Lawsuits"). All of the *Vioxx* Securities Lawsuits pending in federal court have been transferred by the Judicial Panel on Multidistrict Litigation (the "JPML") to the United States District Court for the District of New Jersey before District Judge Stanley R. Chesler for inclusion in a nationwide MDL (the "Shareholder MDL"). Judge Chesler has consolidated the *Vioxx* Securities Lawsuits for all purposes. The putative class action, which requested damages on behalf of purchasers of Company stock between May 21, 1999 and October 29, 2004, alleged that the defendants made false and misleading statements regarding *Vioxx* in violation of Sections 10(b) and 20(a) of the Securities Exchange Act of 1934, and sought unspecified compensatory damages and the costs of suit, including attorneys' fees. The complaint also asserted claims under Section 20A of the Securities and Exchange Act against certain defendants relating to their sales of Merck stock and under Sections 11, 12 and 15 of the Securities Act of 1933 against certain defendants based on statements in a registration statement and certain prospectuses filed in connection with the Merck Stock Investment Plan, a dividend reinvestment plan. On April 12, 2007, Judge Chesler granted defendants' motion to dismiss the complaint with prejudice. Plaintiffs have appealed Judge Chesler's decision to the United States Court of Appeals for the Third Circuit.

In October 2005, a Dutch pension fund filed a complaint in the District of New Jersey alleging violations of federal securities laws as well as violations of state law against the Company and certain officers. Pursuant to the Case Management Order governing the Shareholder MDL, the case, which is based on the same allegations as the *Vioxx* Securities Lawsuits, was consolidated with the *Vioxx* Securities Lawsuits. Defendants' motion to dismiss the pension fund's complaint was filed on August 3, 2007. In September 2007, the Dutch pension fund filed an amended complaint rather than responding to defendants' motion to dismiss. In addition in 2007, six new complaints were filed in the District of New Jersey on behalf of various foreign institutional investors also alleging violations of federal securities laws as well as violations of state law against the Company and certain officers. Defendants are not required to respond to these complaints until after the Third Circuit issues a decision on the securities lawsuit currently on appeal.

As previously disclosed, on August 15, 2005, a complaint was filed in Oregon state court by the State of Oregon through the Oregon state treasurer on behalf of the Oregon Public Employee Retirement Fund against the Company and certain current and former officers and directors under Oregon securities law. A trial date has been set for October 2008.

As previously disclosed, various shareholder derivative actions filed in federal court were transferred to the Shareholder MDL and consolidated for all purposes by Judge Chesler (the "*Vioxx* Derivative Lawsuits"). On May 5, 2006, Judge Chesler granted defendants' motion to dismiss and denied plaintiffs' request for leave to amend their complaint. Plaintiffs appealed, arguing that Judge Chesler erred in denying plaintiffs' leave to amend their complaint with materials acquired during discovery. On July 18, 2007, the United States Court of Appeals for the Third Circuit reversed the District Court's decision on the grounds that Judge Chesler should have allowed plaintiffs to make use of the discovery material to try to establish demand futility, and remanded the case for the District Court's consideration of whether, even with the additional materials, plaintiffs' request to amend their complaint would still be futile. Plaintiffs filed their brief in support of their request for leave to amend their complaint in November 2007. That motion is pending.

In addition, as previously disclosed, various putative class actions filed in federal court under the Employee Retirement Income Security Act ("ERISA") against the Company and certain current and former officers and directors (the "*Vioxx* ERISA Lawsuits" and, together with the *Vioxx* Securities Lawsuits and the *Vioxx* Derivative Lawsuits, the "*Vioxx* Shareholder Lawsuits") have been transferred to the Shareholder MDL and consolidated for all purposes. The consolidated complaint asserts claims on behalf of certain of the Company's current and former employees who are participants in certain of the Company's retirement plans for breach of fiduciary duty. The lawsuits make similar allegations to the allegations contained in the *Vioxx* Securities Lawsuits. On July 11, 2006, Judge Chesler granted in part and denied in part defendants' motion to dismiss the ERISA complaint. In October 2007, plaintiffs moved for certification of a class of individuals who were participants in and beneficiaries of the Company's retirement savings plans at any time between October 1, 1998 and September 30, 2004 and whose plan accounts included investments in the Merck Common Stock Fund and/or Merck common stock. That motion is pending.

As previously disclosed, on October 29, 2004, two individual shareholders made a demand on the Company's Board to take legal action against Mr. Raymond Gilmartin, former Chairman, President and Chief Executive Officer and other individuals for allegedly causing damage to the Company with respect to the allegedly improper marketing of *Vioxx*. In December 2004, the Special Committee of the Board of Directors retained the Honorable John S. Martin, Jr. of Debevoise & Plimpton LLP to conduct an independent investigation of, among other things, the allegations set forth in the demand. Judge Martin's report was made public in September 2006. Based on the Special Committee's recommendation made after careful consideration of the Martin report and the impact that derivative litigation would have on the Company, the Board rejected the demand. On October 11, 2007, the shareholders filed a lawsuit in state court in Atlantic County, NJ against current and former executives and directors of the Company alleging that the Board's rejection of their demand was unreasonable and improper, and that the defendants breached various duties to the Company in allowing *Vioxx* to be marketed.

International Lawsuits

As previously disclosed, in addition to the lawsuits discussed above, the Company has been named as a defendant in litigation relating to *Vioxx* in various countries (collectively, the "*Vioxx* Foreign Lawsuits") in Europe, as well as Canada, Brazil, Argentina, Australia, Turkey, and Israel.

Additional Lawsuits

Based on media reports and other sources, the Company anticipates that additional *Vioxx* Product Liability Lawsuits, *Vioxx* Shareholder Lawsuits and *Vioxx* Foreign Lawsuits (collectively, the "*Vioxx* Lawsuits") will be filed against it and/or certain of its current and former officers and directors in the future.

Insurance

As previously disclosed, the Company has product liability insurance for claims brought in the *Vioxx* Product Liability Lawsuits with stated upper limits of approximately $630 million after deductibles and co-

insurance. This insurance provides coverage for legal defense costs and potential damage amounts in connection with the *Vioxx* Product Liability Lawsuits. The Company's insurance coverage with respect to the *Vioxx* Lawsuits will not be adequate to cover its defense costs and losses.

As previously disclosed, the Company's upper level excess insurers (which provide excess insurance potentially applicable to all of the *Vioxx* Lawsuits) had commenced an arbitration seeking, among other things, to cancel those policies, to void all of their obligations under those policies and to raise other coverage issues with respect to the *Vioxx* Lawsuits. As previously disclosed, in November 2007, the tribunal in the arbitration ruled in the Company's favor ordering the upper level excess insurers to comply with their obligations under the policies. The Company recorded a $455 million gain in the fourth quarter as a result of certain other settlements and the tribunal's decision. In addition, prior to recording the gain in the fourth quarter of 2007, as a result of settlements with, and payments made by, certain of its insurers, the Company had previously received insurance proceeds of approximately $145 million. The Company still has claims that have not yet been resolved against lower level excess insurers to obtain reimbursement for amounts paid in connection with *Vioxx* Product Liability Lawsuits. As a result of settlements that have already been made, the Company will not recover the full amount of the limits discussed in the first paragraph of this section. The resolution of claims against lower level insurers will also affect the total amount of insurance that is recovered for these claims. Other than the remaining coverage of approximately $15 million from the lower level excess insurers, the Company has no additional insurance for the *Vioxx* Product Liability Lawsuits.

The Company has Directors and Officers insurance coverage applicable to the *Vioxx* Securities Lawsuits and *Vioxx* Derivative Lawsuits with stated upper limits of approximately $190 million. The Company has Fiduciary and other insurance for the *Vioxx* ERISA Lawsuits with stated upper limits of approximately $275 million. As a result of the arbitration, additional insurance coverage for these claims should also be available, if needed, under upper–level excess policies that provide coverage for a variety of risks. There are disputes with the insurers about the availability of some or all of the Company's insurance coverage for these claims and there are likely to be additional disputes. The amounts actually recovered under the policies discussed in this paragraph may be less than the stated upper limits.

Investigations

As previously disclosed, in November 2004, the Company was advised by the staff of the SEC that it was commencing an informal inquiry concerning *Vioxx*. On January 28, 2005, the Company announced that it received notice that the SEC issued a formal notice of investigation. Also, the Company has received subpoenas from the U.S. Department of Justice (the "DOJ") requesting information related to the Company's research, marketing and selling activities with respect to *Vioxx* in a federal health care investigation under criminal statutes. In addition, as previously disclosed, investigations are being conducted by local authorities in certain cities in Europe in order to determine whether any criminal charges should be brought concerning *Vioxx*. The Company is cooperating with these governmental entities in their respective investigations (the "*Vioxx* Investigations"). The Company cannot predict the outcome of these inquiries; however, they could result in potential civil and/or criminal dispositions.

As previously disclosed, the Company has received a number of Civil Investigative Demands ("CID") from a group of Attorneys General from 31 states and the District of Columbia who are investigating whether the Company violated state consumer protection laws when marketing *Vioxx*. The Company is cooperating with the Attorneys General in responding to the CIDs.

In addition, the Company received a subpoena in September 2006 from the State of California Attorney General seeking documents and information related to the placement of *Vioxx* on California's Medi–Cal formulary. The Company is cooperating with the Attorney General in responding to the subpoena.

Reserves

As discussed above, on November 9, 2007, Merck entered into the Settlement Agreement with the law firms that comprise the executive committee of the PSC of the federal *Vioxx* MDL as well as representatives of plaintiffs' counsel in the Texas, New Jersey and California state coordinated proceedings to resolve state and federal MI and IS claims filed as of that date in the United States. The Settlement Agreement, which also applies to tolled claims, was signed by the parties after several meetings with three of the four judges overseeing the coordination of

more than 95 percent of the current claims in the *Vioxx* Litigation. The Settlement Agreement applies only to U.S. legal residents and those who allege that their MI or IS occurred in the United States. As a result of entering into the Settlement Agreement, the Company recorded a pretax charge of $4.85 billion which represents the fixed aggregate amount to be paid to plaintiffs qualifying for payment under the Settlement Program.

The Company currently anticipates that a number of *Vioxx* Product Liability Lawsuits will be tried throughout 2008. A trial in the Oregon securities case is scheduled for 2008, but the Company cannot predict whether this trial will proceed on schedule or the timing of any of the other *Vioxx* Shareholder Lawsuit trials. The Company believes that it has meritorious defenses to the *Vioxx* Lawsuits and will vigorously defend against them. In view of the inherent difficulty of predicting the outcome of litigation, particularly where there are many claimants and the claimants seek indeterminate damages, the Company is unable to predict the outcome of these matters, and at this time cannot reasonably estimate the possible loss or range of loss with respect to the *Vioxx* Lawsuits not included in the Settlement Program. The Company has not established any reserves for any potential liability relating to the *Vioxx* Lawsuits not included in the Settlement Program or the *Vioxx* Investigations, including for those cases in which verdicts or judgments have been entered against the Company, and are now in post–verdict proceedings or on appeal. In each of those cases the Company believes it has strong points to raise on appeal and therefore that unfavorable outcomes in such cases are not probable. Unfavorable outcomes in the *Vioxx* Litigation could have a material adverse effect on the Company's financial position, liquidity and results of operations.

Legal defense costs expected to be incurred in connection with a loss contingency are accrued when probable and reasonably estimable. As of December 31, 2005, the Company had a reserve of $685 million solely for its future legal defense costs related to the *Vioxx* Litigation. During 2006, the Company spent $500 million in the aggregate in legal defense costs related to the *Vioxx* Litigation and recorded additional charges of $673 million. Thus, as of December 31, 2006, the Company had a reserve of $858 million solely for its future legal defense costs related to the *Vioxx* Litigation.

During 2007, the Company spent approximately $616 million in the aggregate, in legal defense costs worldwide related to (i) the *Vioxx* Product Liability Lawsuits, (ii) the *Vioxx* Shareholder Lawsuits, (iii) the *Vioxx* Foreign Lawsuits, and (iv) the *Vioxx* Investigations (collectively, the "*Vioxx* Litigation"). In the second quarter and third quarter of 2007, the Company recorded charges of $210 million and $70 million, respectively, to increase the reserve solely for its future legal defense costs related to the *Vioxx* Litigation. In increasing the reserve, the Company considered the same factors that it considered when it previously established reserves for the *Vioxx* Litigation. In the fourth quarter, the Company spent approximately $200 million in *Vioxx* legal defense costs which resulted in a reserve of $522 million at December 31, 2007 for its future legal defense costs related to the *Vioxx* Litigation. After entering into the Settlement Agreement, the Company reviewed its reserve for the *Vioxx* legal defense costs and allocated approximately $80 million of its reserve to Merck's anticipated future costs to administer the Settlement Program. Some of the significant factors considered in the review of the reserve were as follows: the actual costs incurred by the Company; the development of the Company's legal defense strategy and structure in light of the scope of the *Vioxx* Litigation, including the Settlement Agreement and the expectation that the Settlement Agreement will be consummated, but that certain lawsuits will continue to be pending; the number of cases being brought against the Company; the costs and outcomes of completed trials and the most current information regarding anticipated timing, progression, and related costs of pre–trial activities and trials in the *Vioxx* Product Liability Lawsuits. Events such as scheduled trials, that are expected to occur throughout 2008 and 2009, and the inherent inability to predict the ultimate outcomes of such trials and the disposition of *Vioxx* Product Liability Lawsuits not participating in or not eligible for the Settlement Program, limit the Company's ability to reasonably estimate its legal costs beyond 2009. Together with the $4.85 billion reserved for the Settlement Program, the aggregate amount of the reserve established for the *Vioxx* Litigation as of December 31, 2007 is approximately $5.372 billion (the "*Vioxx* Reserve").

While the Company does not anticipate that it will need to increase the reserve every quarter, it will continue to monitor its legal defense costs and review the adequacy of the associated reserves and may determine to increase its reserves for legal defense costs at any time in the future if, based upon the factors set forth, it believes it would be appropriate to do so.

Other Product Liability Litigation

As previously disclosed, the Company is a defendant in product liability lawsuits in the United States involving *Fosamax* (the "*Fosamax* Litigation"). As of December 31, 2007, approximately 403 cases, which include approximately 911 plaintiff groups had been filed and were pending against Merck in either federal or state court, including 7 cases which seek class action certification, as well as damages and medical monitoring. In these actions, plaintiffs allege, among other things, that they have suffered osteonecrosis of the jaw, generally subsequent to invasive dental procedures such as tooth extraction or dental implants, and/or delayed healing, in association with the use of *Fosamax*. On August 16, 2006, the JPML ordered that the *Fosamax* product liability cases pending in federal courts nationwide should be transferred and consolidated into one multidistrict litigation (the "*Fosamax* MDL") for coordinated pre-trial proceedings. The *Fosamax* MDL has been transferred to Judge John Keenan in the United States District Court for the Southern District of New York. As a result of the JPML order, approximately 350 of the cases are before Judge Keenan. Judge Keenan has issued a Case Management Order setting forth a schedule governing the proceedings which focuses primarily upon resolving the class action certification motions in 2007 and completing fact discovery in an initial group of 25 cases by August 1, 2008. Briefing and argument on plaintiffs' motions for certification of medical monitoring classes were completed in 2007 and Judge Keenan issued an order denying the motions on January 3, 2008. On January 28, 2008, Judge Keenan issued a further order dismissing with prejudice all class claims asserted in the first four class action lawsuits filed against Merck that sought personal injury damages and/or medical monitoring relief on a class wide basis. Discovery is ongoing in both the *Fosamax* MDL litigation as well as in various state court cases. The Company intends to defend against these lawsuits.

As of December 31, 2007, the Company had a remaining reserve of approximately $27 million solely for its future legal defense costs for the *Fosamax* Litigation. Some of the significant factors considered in the establishment of the reserve for the *Fosamax* Litigation legal defense costs were as follows: the actual costs incurred by the Company thus far; the development of the Company's legal defense strategy and structure in light of the creation of the *Fosamax* MDL; the number of cases being brought against the Company; and the anticipated timing, progression, and related costs of pre-trial activities in the *Fosamax* Litigation. The Company will continue to monitor its legal defense costs and review the adequacy of the associated reserves. Due to the uncertain nature of litigation, the Company is unable to estimate its costs beyond 2009. The Company has not established any reserves for any potential liability relating to the *Fosamax* Litigation. Unfavorable outcomes in the *Fosamax* Litigation could have a material adverse effect on the Company's financial position, liquidity and results of operations.

Commercial Litigation

As previously disclosed, the Company was joined in ongoing litigation alleging manipulation by pharmaceutical manufacturers of Average Wholesale Prices ("AWP"), which are sometimes used in calculations that determine public and private sector reimbursement levels. In 2002, the JPML ordered the transfer and consolidation of all pending federal AWP cases to federal court in Boston, Massachusetts. Plaintiffs filed one consolidated class action complaint, which aggregated the claims previously filed in various federal district court actions and also expanded the number of manufacturers to include some which, like the Company, had not been defendants in any prior pending case. In May 2003, the court granted the Company's motion to dismiss the consolidated class action and dismissed the Company from the class action case. Subsequent to the Company's dismissal, the plaintiffs filed an amended consolidated class action complaint, which did not name the Company as a defendant. The Company and many other pharmaceutical manufacturers are defendants in similar complaints pending in federal and state court brought individually by a number of counties in the State of New York. Forty of the county cases have been consolidated. The Company was dismissed from the Suffolk County case, which was the first of the New York county cases to be filed. In addition, as of December 31, 2007, the Company was a defendant in state cases brought by the Attorneys General of eleven states, all of which are being defended.

As previously disclosed, in January 2003, the DOJ notified the federal court in New Orleans, Louisiana that it was not going to intervene at that time in a pending Federal False Claims Act case that was filed under seal in December 1999 against the Company. The court issued an order unsealing the complaint, which was filed by a physician in Louisiana, and ordered that the complaint be served. The complaint, which alleged that the Company's discounting of *Pepcid* in certain Louisiana hospitals led to increases in costs to Medicaid, was dismissed. An

amended complaint was filed under seal and the case has been administratively closed by the Court until the seal is lifted. The State of Louisiana has filed its own amended complaint, incorporating the allegations contained in the sealed amended complaint. As part of the resolution of the government investigations discussed below, the seal in this case was lifted and the cases were dismissed.

In April 2005, the Company was named in a qui tam lawsuit under the Nevada False Claims Act. The suit, in which the Nevada Attorney General has intervened, alleges that the Company inappropriately offered nominal pricing and other marketing and pricing inducements to certain customers and also failed to comply with its obligations under the Medicaid Best Price scheme related to such arrangements. In May 2006, the Company's motion to dismiss this action was denied by the district court. This matter has also been dismissed as part of the resolution of the government investigations.

During December 2007 and through February 26, 2008, the Company and its joint-venture partner, Schering-Plough, received several joint letters from the House Committee on Energy and Commerce and the House Subcommittee on Oversight and Investigations, and one letter from the Senate Finance Committee, collectively seeking a combination of witness interviews, documents and information on a variety of issues related to the ENHANCE clinical trial, the sale and promotion of *Vytorin*, as well as sales of stock by corporate officers. On January 25, 2008, the companies and the MSP Partnership each received two subpoenas from the New York State Attorney General's Office seeking similar information and documents. Merck and Schering-Plough have also each received a letter from the Office of the Connecticut Attorney General dated February 1, 2008 requesting documents related to the marketing and sale of *Vytorin* and *Zetia* and the timing of disclosures of the results of ENHANCE. The Company is cooperating with these investigations and working with Schering-Plough to respond to the inquiries. In addition, since mid-January 2008, the Company has become aware of or been served with approximately 85 civil class action lawsuits alleging common law and state consumer fraud claims in connection with the MSP Partnership's sale and promotion of *Vytorin* and *Zetia*. Unfavorable outcomes resulting from the government investigations or the consumer fraud litigation could have a material adverse effect on the Company's financial position, liquidity and results of operations.

Governmental Proceedings

As previously disclosed, the Company had received a subpoena from the DOJ in connection with its investigation of the Company's marketing and selling activities, including nominal pricing programs and samples. The Company had also reported that it has received a CID from the Attorney General of Texas regarding the Company's marketing and selling activities relating to Texas. As previously disclosed, the Company received another CID from the Attorney General of Texas asking for additional information regarding the Company's marketing and selling activities related to Texas, including with respect to certain of its nominal pricing programs and samples. In April 2004, the Company received a subpoena from the office of the Inspector General for the District of Columbia in connection with an investigation of the Company's interactions with physicians in the District of Columbia, Maryland, and Virginia. In November 2004, the Company received a letter request from the DOJ in connection with its investigation of the Company's pricing of *Pepcid*.

On February 7, 2008, the Company announced that it entered into agreements with the government to settle federal and state civil cases alleging violations of the Medicaid Rebate Statute, as well as federal and state False Claims Acts in connection with certain nominal pricing programs and sales and marketing activities between 1994 and 2001. To resolve these matters, the Company agreed to pay approximately $649 million, plus interest and reasonable fees and expenses to the federal government, 49 states participating in the Medicaid program and the District of Columbia. In the fourth quarter of 2007, the Company recorded a pretax charge of $671 million in connection with the anticipated resolution of these investigations. Each of the investigations described in the preceding paragraph has been resolved as part of these settlement agreements.

The settlements described above arose out of civil actions filed under seal in the U.S. District Courts located in Philadelphia and New Orleans. Both actions contained allegations involving past pricing programs. The Philadelphia settlement relates to past programs in which the Company offered hospitals significantly discounted prices on certain medications, including *Mevacor*, *Vioxx* and *Zocor*. In the Philadelphia matter, the government alleged that the Company improperly excluded certain discounts — those which were nominal in amount — from

its best price reported to Medicaid under the Medicaid Rebate Agreement. The Philadelphia action also related to certain marketing and sales programs conducted between 1997 and 2001. The Philadelphia settlement accounts for $399 million plus interest of the total settlement amount.

The New Orleans settlement resolves a civil action containing allegations involving pricing discounts offered to hospitals for *Pepcid*. The original pricing program, known as the Flex Program, was launched in 1994 and continued to operate as the Flex–NP Program until its termination in April 2001. The New Orleans settlement accounts for $250 million plus interest of the total settlement amount.

In connection with these settlements, the Company entered into a corporate integrity agreement with the Department of Health and Human Services, which incorporates the Company's existing, comprehensive compliance program governing its pharmaceutical sales and marketing activities in the United States.

As previously disclosed, the Company had received a letter from DOJ advising it of the existence of a civil complaint brought under the qui tam provisions of the False Claims Act alleging that the Company violated certain rules related to its calculations of best price and other federal pricing benchmark calculations, certain of which may affect the Company's Medicaid rebate obligation. DOJ has informed the Company that it does not intend to intervene in this action and has closed its investigation. The lawsuit has now been dismissed.

The Company has cooperated with all of these investigations. In addition to these investigations, from time to time, other federal, state or foreign regulators or authorities may seek information about practices in the pharmaceutical industry or the Company's business practices in inquiries other than the investigations discussed in this section. It is not feasible to predict the outcome of any such inquiries.

Vaccine Litigation

As previously disclosed, the Company was a party in claims brought under the Consumer Protection Act of 1987 in the United Kingdom, which allege that certain children suffer from a variety of conditions as a result of being vaccinated with various bivalent vaccines for measles and rubella and/or trivalent vaccines for measles, mumps and rubella, including the Company's *M–M–R* II. The conditions include autism, with or without inflammatory bowel disease, epilepsy, encephalitis, encephalopathy, Guillain–Barre syndrome and transverse myelitis. All of the remaining cases have been discontinued or struck out by the Court and the group litigation has concluded. There are no claims outstanding against Merck. As previously disclosed, the Company is also a party to individual and class action product liability lawsuits and claims in the United States involving pediatric vaccines (e.g., hepatitis B vaccine) that contained thimerosal, a preservative used in vaccines. Merck has not distributed thimerosal–containing pediatric vaccines in the United States since the fall of 2001. As of December 31, 2007, there were approximately 234 active thimerosal related lawsuits with approximately 425 plaintiffs. Other defendants include other vaccine manufacturers who produced pediatric vaccines containing thimerosal as well as manufacturers of thimerosal. In these actions, the plaintiffs allege, among other things, that they have suffered neurological injuries as a result of exposure to thimerosal from pediatric vaccines. There are no cases currently scheduled for trial. The Company will defend against these lawsuits; however, it is possible that unfavorable outcomes could have a material adverse effect on the Company's financial position, liquidity and results of operations.

The Company has been successful in having cases of this type either dismissed or stayed on the ground that the action is prohibited under the National Childhood Vaccine Injury Act (the "Vaccine Act"). The Vaccine Act prohibits any person from filing or maintaining a civil action (in state or federal court) seeking damages against a vaccine manufacturer for vaccine–related injuries unless a petition is first filed in the United States Court of Federal Claims (hereinafter the "Vaccine Court"). Under the Vaccine Act, before filing a civil action against a vaccine manufacturer, the petitioner must either (a) pursue his or her petition to conclusion in Vaccine Court and then timely file an election to proceed with a civil action in lieu of accepting the Vaccine Court's adjudication of the petition or (b) timely exercise a right to withdraw the petition prior to Vaccine Court adjudication in accordance with certain statutorily prescribed time periods. The Company is not a party to Vaccine Court proceedings because the petitions are brought against the United States Department of Health and Human Services.

The Company is aware that there are approximately 900 cases pending in the Vaccine Court involving allegations that thimerosal–containing vaccines and/or the *M–M–R* II vaccine cause autism spectrum disorders. Not

all of the thimerosal–containing vaccines involved in the Vaccine Court proceeding are Company vaccines. The Company is the sole source of the *M–M–R* II vaccine domestically. In June 2007, the Special Masters presiding over the Vaccine Court proceedings held a two and a half week hearing in which both petitioners and the government presented evidence on the issue of whether the combination of *M–M–R* II vaccine and thimerosal in vaccines can cause autism spectrum disorders and whether it did cause autism spectrum disorder in the petitioner in that case. Two shorter additional evidentiary hearings of that type addressing that issue were held in the fall of 2007. Rulings in these three cases are expected in 2008. According to the Vaccine Court, it expects to hold evidentiary hearings in six additional so–called "test cases" by September 2008, addressing the issue of whether thimerosal in vaccines, or the *M–M–R–* II vaccine alone, can cause autism spectrum disorders, and did cause such disorders in those six petitioners. The Vaccine Court has indicated that it intends to use the evidence presented at these test case hearings to guide the adjudication of the remaining autism spectrum disorder cases.

Patent Litigation

From time to time, generic manufacturers of pharmaceutical products file ANDA's with the FDA seeking to market generic forms of the Company's products prior to the expiration of relevant patents owned by the Company. Generic pharmaceutical manufacturers have submitted ANDA's to the FDA seeking to market in the United States a generic form of *Fosamax, Propecia, Prilosec, Nexium, Singulair, Trusopt, Cosopt* and *Primaxin* prior to the expiration of the Company's (and AstraZeneca's in the case of *Prilosec* and *Nexium*) patents concerning these products. In addition, an ANDA has been submitted to the FDA seeking to market in the United States a generic form of *Zetia* prior to the expiration of Schering–Plough's patent concerning that product. The generic companies' ANDA's generally include allegations of non–infringement, invalidity and unenforceability of the patents. Generic manufacturers have received FDA approval to market a generic form of *Prilosec.* The Company has filed patent infringement suits in federal court against companies filing ANDA's for generic alendronate (*Fosamax*), finasteride (*Propecia*), dorzolamide (*Trusopt*), montelukast (*Singulair*), dorzolamide/timolol (*Cosopt*), imipenem/cilastatin (*Primaxin*) and AstraZeneca and the Company have filed patent infringement suits in federal court against companies filing ANDA's for generic omeprazole (*Prilosec*) and esomeprazole (*Nexium*). Also, the Company and Schering–Plough have filed a patent infringement suit in federal court against companies filing ANDA's for generic ezetimibe (*Zetia*). Similar patent challenges exist in certain foreign jurisdictions. The Company intends to vigorously defend its patents, which it believes are valid, against infringement by generic companies attempting to market products prior to the expiration dates of such patents. As with any litigation, there can be no assurance of the outcomes, which, if adverse, could result in significantly shortened periods of exclusivity for these products.

In February 2007, Schering–Plough received a notice from a generic company indicating that it had filed an ANDA for *Zetia* and that it is challenging the U.S. patents that are listed for *Zetia.* Merck and Schering Plough market *Zetia* through a joint venture, MSP Singapore Company LLC. On March 22, 2007, Schering–Plough and MSP Singapore Company LLC filed a patent infringement suit against Glenmark Pharmaceuticals Inc., USA and its parent corporation ("Glenmark"). The lawsuit automatically stays FDA approval of Glenmark's ANDA for 30 months or until an adverse court decision, if any, whichever may occur earlier.

As previously disclosed, in January 2007, the Company received a letter from Ranbaxy Laboratories Ltd. ("Ranbaxy") stating that it had filed an ANDA seeking approval of a generic version of Merck's *Primaxin.* In April 2007, the Company filed a patent infringement suit against Ranbaxy.

As previously disclosed, in February 2007, the Company received a notice from Teva Pharmaceuticals ("Teva"), a generic company, indicating that it had filed an ANDA for montelukast and that it is challenging the U.S. patent that is listed for *Singulair.* On April 2, 2007, the Company filed a patent infringement action against Teva. The lawsuit automatically stays FDA approval of Teva's ANDA for 30 months or until an adverse court decision, if any, whichever may occur earlier.

As previously disclosed, on January 28, 2005, the U.S. Court of Appeals for the Federal Circuit in Washington, D.C. found the Company's patent claims for once–weekly administration of *Fosamax* to be invalid. The Company exhausted all options to appeal this decision in 2005. Based on the Court of Appeals' decision, *Fosamax* lost market exclusivity in the United States in February 2008. *Fosamax Plus D* will lose marketing exclusivity in the

United States in April 2008. As a result of these events, the Company expects significant declines in U.S. *Fosamax* and *Fosamax Plus D* sales.

In May 2005, the Federal Court of Canada Trial Division issued a decision refusing to bar the approval of generic alendronate on the grounds that Merck's patent for weekly alendronate was likely invalid. This decision cannot be appealed and generic alendronate was launched in Canada in June 2005. In July 2005, Merck was sued in the Federal Court of Canada by Apotex Corp. ("Apotex") seeking damages for lost sales of generic weekly alendronate due to the patent proceeding.

As previously disclosed, in September 2004, the Company appealed a decision of the Opposition Division of the European Patent Office ("EPO") that revoked the Company's patent in Europe that covers the once–weekly administration of alendronate. On March 14, 2006, the Board of Appeal of the EPO upheld the decision of the Opposition Division revoking the patent. On March 28, 2007, the EPO issued another patent in Europe to the Company that covers the once–weekly administration of alendronate. Under its terms, this new patent is effective until July 2018. Oppositions have been filed in the EPO against this patent. Additionally, Merck has brought patent infringement suits in various European jurisdictions based upon this patent. Merck's basic patent covering the use of alendronate has been challenged in several European countries. The Company has received adverse decisions in Germany, Holland and the United Kingdom. The decision in the United Kingdom was upheld on appeal. The Company has appealed the decisions in Germany and Holland.

In addition, as previously disclosed, in Japan after a proceeding was filed challenging the validity of the Company's Japanese patent for the once–weekly administration of alendronate, the patent office invalidated the patent. The decision is under appeal.

On January 18, 2006, the Company sued Hi–Tech Pharmacal Co., Inc. ("Hi–Tech") of Amityville, New York for patent infringement in response to Hi–Tech's application to the FDA seeking approval of a generic version of Merck's ophthalmic drugs *Trusopt* and *Cosopt*, which are used to treat elevated intraocular pressure in patients with open–angle glaucoma or ocular hypertension. In the lawsuit, Merck sued to enforce a patent covering an active ingredient dorzolamide, which is present in both *Trusopt* and *Cosopt*, and the District Court entered judgment in Merck's favor which was upheld on appeal. The patent covering dorzolamide provides exclusivity for *Trusopt* and *Cosopt* until October 2008 (including six months of pediatric exclusivity). After such time, the Company expects significant declines in U.S. sales of these products. Merck has elected not to enforce two other U.S. patents listed with the FDA which cover the combination of dorzolamide and timolol, the two active ingredients in *Cosopt*.

In the case of omeprazole, on May 31, 2007, the trial court issued a decision with respect to four generic companies selling generic omeprazole. The court found that the Impax Laboratories Inc. and Apotex products infringed AstraZeneca's formulation patents, while products made by Mylan Laboratories and Lek Pharmaceutical and Chemical Co., d.d. did not infringe. The companies found to have infringed were ordered off the market until October 20, 2007, which was the expiration of the pediatric exclusivity period.

The Company and AstraZeneca received notice in October 2005 that Ranbaxy had filed an ANDA for esomeprazole magnesium. The ANDA contains Paragraph IV challenges to patents on *Nexium*. On November 21, 2005, the Company and AstraZeneca sued Ranbaxy in the United States District Court in New Jersey. Accordingly, FDA approval of Ranbaxy's ANDA is stayed for 30 months until April 2008 or until an adverse court decision, if any, whichever may occur earlier. The Company and AstraZeneca received notice in January 2006 that IVAX Pharmaceuticals, Inc., subsequently acquired by Teva, had filed an ANDA for esomeprazole magnesium. The ANDA contains Paragraph IV challenges to patents on *Nexium*. On March 8, 2006, the Company and AstraZeneca sued Teva in the United States District Court in New Jersey. Accordingly, FDA approval of Teva's ANDA is stayed for 30 months until September 2008 or until an adverse court decision, if any, whichever may occur earlier. In January 2008, the Company and AstraZeneca sued Dr. Reddy's in the District Court in New Jersey based on Dr. Reddy's filing of an ANDA for esomeprazole magnesium. Accordingly, FDA approval of Dr. Reddy's ANDA is stayed for 30 months until July 2010 or until an adverse court decision, if any, whichever may occur earlier.

In Europe, the Company is aware of various companies seeking registration for generic losartan (the active ingredient for *Cozaar*). The Company has patent rights to losartan via license from E.I. du Pont de Nemours

and Company ("du Pont"). The Company and du Pont have filed patent infringement proceedings against various companies in Portugal, Spain, Norway and Austria.

As previously disclosed, in the third quarter of 2007, the Company resolved certain patent disputes which resulted in a net gain to the Company.

Other Litigation

In November 2005, an individual shareholder delivered a letter to the Company's Board alleging that the Company had sustained damages through the Company's adoption of its Change in Control Separation Benefits Plan (the "CIC Plan") in November 2004. The shareholder made a demand on the Board to take legal action against the Board's current or former members for allegedly causing damage to the Company with respect to the adoption of the CIC Plan. In response to that demand letter, the independent members of the Board determined at the November 22, 2005 Board meeting that the Board would take the shareholder's request under consideration. After careful consideration by the Board, the shareholder was advised that the Board had determined not to take legal action.

In February 2008, an individual shareholder delivered a letter to the Company's Board of Directors demanding that the Board take legal action against the responsible individuals to recover the amounts paid by the Company to resolve the governmental investigations referred to above.

As previously disclosed, on August 20, 2004, the United States District Court for the District of New Jersey granted a motion by the Company, Medco Health Solutions, Inc. ("Medco Health") and certain officers and directors to dismiss a shareholder derivative action involving claims related to the Company's revenue recognition practice for retail co-payments paid by individuals to whom Medco Health provides pharmaceutical benefits as well as other allegations. The complaint was dismissed with prejudice. Plaintiffs appealed the decision. On December 15, 2005, the U.S. Court of Appeals for the Third Circuit upheld most of the District Court's decision dismissing the suit, and sent the issue of whether the Company's Board of Directors properly refused the shareholder demand relating to the Company's treatment of retail co-payments back to the District Court for reconsideration under a different legal standard. Plaintiffs moved to remand their action to state court on August 18, 2006, and the District Court granted that motion on February 1, 2007. The shareholder derivative suit was pending before the Superior Court of New Jersey, Chancery Division, Hunterdon County. All of the remaining issues were dismissed with prejudice in favor of Medco Health, Merck and the individual defendants on July 31, 2007.

As previously disclosed, prior to the spin-off of Medco Health, the Company and Medco Health agreed to settle, on a class action basis, a series of lawsuits asserting violations of ERISA (the "Gruer Cases"). The Company, Medco Health and certain plaintiffs' counsel filed the settlement agreement with the federal District Court in New York, where cases commenced by a number of plaintiffs, including participants in a number of pharmaceutical benefit plans for which Medco Health is the pharmacy benefit manager, as well as trustees of such plans, have been consolidated. Medco Health and the Company agreed to the proposed settlement in order to avoid the significant cost and distraction of prolonged litigation. The proposed class settlement has been agreed to by plaintiffs in five of the cases filed against Medco Health and the Company. Under the proposed settlement, the Company and Medco Health have agreed to pay a total of $42.5 million, and Medco Health has agreed to modify certain business practices or to continue certain specified business practices for a period of five years. The financial compensation is intended to benefit members of the settlement class, which includes ERISA plans for which Medco Health administered a pharmacy benefit at any time since December 17, 1994. The District Court held hearings to hear objections to the fairness of the proposed settlement and approved the settlement in 2004, but has not yet determined the number of class member plans that have properly elected not to participate in the settlement. The settlement becomes final only if and when all appeals have been resolved. Certain class member plans have indicated that they will not participate in the settlement. Cases initiated by three such plans and two individuals remain pending in the Southern District of New York. Plaintiffs in these cases have asserted claims based on ERISA as well as other federal and state laws that are the same as or similar to the claims that had been asserted by settling class members in the Gruer Cases. The Company and Medco Health are named as defendants in these cases.

Three notices of appeal were filed and the appellate court heard oral argument in May 2005. On December 8, 2005, the appellate court issued a decision vacating the District Court's judgment and remanding the

cases to the District Court to allow the District Court to resolve certain jurisdictional issues. A hearing was held to address such issues on February 24, 2006. The District Court issued a ruling on August 10, 2006 resolving such jurisdictional issues in favor of the settling plaintiffs. The class members and the other party that had previously appealed the District Court's judgment renewed their appeals. On October 4, 2007, the renewed appeals were affirmed in part and vacated in part by the federal court of appeals. The appeals court remanded the class settlement for further proceedings in the District Court.

After the spin-off of Medco Health, Medco Health assumed substantially all of the liability exposure for the matters discussed in the foregoing two paragraphs. These cases are being defended by Medco Health.

There are various other legal proceedings, principally product liability and intellectual property suits involving the Company, which are pending. While it is not feasible to predict the outcome of such proceedings or the proceedings discussed in this Item, in the opinion of the Company, all such proceedings are either adequately covered by insurance or, if not so covered, should not ultimately result in any liability that would have a material adverse effect on the financial position, liquidity or results of operations of the Company, other than proceedings for which a separate assessment is provided in this Item.

Environmental Matters

The Company is a party to a number of proceedings brought under the Comprehensive Environmental Response, Compensation and Liability Act, commonly known as Superfund, and other federal and state equivalents. These proceedings seek to require the operators of hazardous waste disposal facilities, transporters of waste to the sites and generators of hazardous waste disposed of at the sites to clean up the sites or to reimburse the government for cleanup costs. The Company has been made a party to these proceedings as an alleged generator of waste disposed of at the sites. In each case, the government alleges that the defendants are jointly and severally liable for the cleanup costs. Although joint and several liability is alleged, these proceedings are frequently resolved so that the allocation of cleanup costs among the parties more nearly reflects the relative contributions of the parties to the site situation. The Company's potential liability varies greatly from site to site. For some sites the potential liability is *de minimis* and for others the costs of cleanup have not yet been determined. While it is not feasible to predict the outcome of many of these proceedings brought by federal or state agencies or private litigants, in the opinion of the Company, such proceedings should not ultimately result in any liability which would have a material adverse effect on the financial position, results of operations, liquidity or capital resources of the Company. The Company has taken an active role in identifying and providing for these costs and such amounts do not include any reduction for anticipated recoveries of cleanup costs from former site owners or operators or other recalcitrant potentially responsible parties.

Merck has entered into a Consent Decree (the "Decree") with the United States of America, the Pennsylvania Department of Environmental Protection and the Pennsylvania Fish and Boat Commission resolving the government's claims asserted in an enforcement action, United States of America and Commonwealth of Pennsylvania v. Merck & Co., Inc., in response to the previously disclosed accidental release of 25 gallons of potassium thiocyanate from the site in June 2006 that resulted in a fish kill in the Wissahickon Creek as well as the discharge of materials on August 8, 9, and 16, 2006 that caused foaming in the creek. Pursuant to the terms of the Decree, Merck will pay civil penalties in the amount of $1.575 million; fund supplemental environmental projects in the amount of $9 million; and implement on-site remedial measures in the amount of $10 million. A motion to enter the Decree is pending with the court.

As previously disclosed on September 13, 2007, approximately 1,400 plaintiffs filed an amended complaint against Merck and 12 other defendants in United States District Court, Eastern District of California asserting claims under the Clean Water Act, the Resource Conservation and Recovery Act, as well as negligence and nuisance. The suit seeks damages for diminution of property value, medical monitoring and other alleged real and personal property damage associated with groundwater and soil contamination found at the site of a former Merck subsidiary in Merced, California. The Company intends to defend itself against these claims.

Item 4. Submission of Matters to a Vote of Security Holders.

Not applicable.

Executive Officers of the Registrant (ages as of February 1, 2008)

RICHARD T. CLARK — Age 61

April, 2007 — Chairman, President and Chief Executive Officer

May, 2005 — Chief Executive Officer and President

June, 2003 — President, Merck Manufacturing Division — responsible for the Company's manufacturing, information services and operational excellence organizations worldwide

January, 2003 — Chairman, President and Chief Executive Officer, Medco Health Solutions, Inc., formerly a wholly–owned subsidiary of the Company

ADELE D. AMBROSE — Age 51

December, 2007 — Vice President and Chief Communications Officer — responsible for the Global Communications organization

April, 2005 — On sabbatical

Prior to April 2005, Ms. Ambrose was Executive Vice President, Public Relations & Investor Communications at AT&T Wireless (wireless services provider from September 2001 to April 2005)

DAVID W. ANSTICE — Age 59

September, 2006 — Executive Vice President, Strategy Initiatives — responsible for the End–to–End and global support function initiatives and for providing strategic direction in key pharmaceutical emerging markets (China and India)

August, 2005 — President, Human Health–Asia Pacific — responsible for the Company's prescription drug business in the Asia Pacific region, Japan, Australia, New Zealand and the Company's joint venture relationship with Schering–Plough

January, 2003 — President, Human Health — responsible for the Company's prescription drug business in Japan, Latin America, Canada, Australia, New Zealand and the Company's joint venture relationship with Schering–Plough

JOHN CANAN — Age 51

January, 2008 — Senior Vice President and Controller — responsible for the Corporate Controller's Group

September, 2006 — Vice President, Controller — responsible for the Corporate Controller's Group

June, 2003 — Vice President, Corporate Audit & Assurance Services

September, 2002 — Vice President and Controller, Asia and Joint Ventures — responsible for financial and operational oversight of Asia Human Health and several of the Company's joint ventures

CELIA A. COLBERT — Age 51

January, 2008 — Senior Vice President, Secretary (since September, 1993) and Assistant General Counsel (since November, 1993) — Responsible for Corporate Secretary function and Corporate Staff Group.

WILLIE A. DEESE — Age 52

January, 2008 — Executive Vice President and President, Merck Manufacturing Division ("MMD") — responsible for the Company's global manufacturing, procurement, and operational excellence functions

May, 2005 — President, MMD — responsible for the Company's global manufacturing, procurement, and operational excellence functions

January, 2004 — Senior Vice President, Global Procurement

Prior to January 2004, Mr. Deese was Senior Vice President, Global Procurement and Logistics (2001 to 2003) for GlaxoSmithKline plc.

KENNETH C. FRAZIER — Age 53

August, 2007 — Executive Vice President and President, Global Human Health — responsible for the Company's marketing and sales organizations worldwide, including the global pharmaceutical and vaccine franchises

November, 2006 — Executive Vice President and General Counsel — responsible for legal and public affairs functions and The Merck Company Foundation (a not-for-profit charitable organization affiliated with the Company)

December, 1999 — Senior Vice President and General Counsel — responsible for legal and public affairs functions and The Merck Company Foundation (a not-for-profit charitable organization affiliated with the Company)

MIRIAN M. GRADDICK-WEIR — Age 53

January, 2008 — Executive Vice President, Human Resources — responsible for the Global Human Resources organization

September, 2006 — Senior Vice President, Human Resources

Prior to September 2006, Dr. Graddick-Weir was Executive Vice President of Human Resources and Employee Communications at AT&T (communications services provider), and has held several other senior Human Resources leadership positions at AT&T for more than 20 years.

PETER N. KELLOGG — Age 51

August, 2007 — Executive Vice President and Chief Financial Officer — responsible for the Company's worldwide financial organization, investor relations, corporate development and licensing, and the Company's joint venture relationships

Prior to August, 2007, Mr. Kellogg was Executive Vice President, Finance and Chief Financial Officer of Biogen Idec (biotechnology company) since November 2003, from the merger of Biogen, Inc. and IDEC Pharmaceuticals Corporation. Mr. Kellogg was formerly Executive Vice President, Finance and Chief Financial Officer of Biogen, Inc. after serving as Vice President, Finance and Chief Financial Officer since July 2000

PETER S. KIM — Age 49

January, 2008 — Executive Vice President and President, Merck Research Laboratories ("MRL") — responsible for the Company's research and development efforts worldwide

January, 2003 — President, MRL

BRUCE N. KUHLIK — Age 51

January, 2008 — Executive Vice President and General Counsel — responsible for legal, communications, and public policy functions and The Merck Company Foundation (a not-for-profit charitable organization affiliated with the Company)

May, 2005 — Vice President and Associate General Counsel — primary responsibility for the Company's *Vioxx* litigation defense

Prior to May 2005, Mr. Kuhlik was Senior Vice President and General Counsel for the Pharmaceutical Research and Manufacturers of America since October, 2002

MARK E. MCDONOUGH — Age 43

February, 2007 — Vice President and Treasurer — responsible for the Company's treasury function, and for providing financial support for Human Resources

January, 2004 — Assistant Treasurer, Global Capital Markets — responsible for managing the Company's investment and financing portfolios and the treasury share repurchase program

September, 2000 — Senior Director, Human Health Finance — responsible for providing global franchise–based financial reporting and analytics to Executive Committee and franchise and divisional stakeholders

MARGARET G. MCGLYNN — Age 48

August, 2007 — President, Merck Vaccines and Infectious Diseases — global responsibilities for the vaccines business and infectious diseases franchise including the Company's Sanofi–Pasteur joint venture

August, 2005 — President, Merck Vaccines — global responsibilities for the vaccines business including the Company's Sanofi–Pasteur joint venture

January, 2003 — President, U.S. Human Health — responsible for one of the two prescription drug divisions (hospital and specialty product franchises) comprising U.S. Human Health ("USHH"), and the Managed Care Group of USHH

STEFAN OSCHMANN — Age 50

September, 2006 — President, Europe, Middle East, Africa & Canada — responsible for the Company's business operations in Europe, Middle East, Africa and Canada

October, 2005 — Senior Vice President, Worldwide Human Health Marketing

January, 2001 — Managing Director, MSD Germany, a subsidiary of the Company

J. CHRIS SCALET — Age 49

January, 2008 — Executive Vice President, Global Services, and Chief Information Officer ("CIO") — responsible for Global Shared Services across the human resources, finance, site services and information services function; and the enterprise business process redesign initiative

January, 2006 — Senior Vice President, Global Services, and CIO — responsible for Global Shared Services across the human resources, finance, site services and information services function; and the enterprise business process redesign initiative

March, 2003 — Senior Vice President, Information Services, and CIO — responsible for all areas of information technology and services including application development, technical support, voice and data communications, and computer operations worldwide

Prior to March 2003, Mr. Scalet was Senior Vice President, Information Technology & CIO (1997 to 2003) for International Paper Company (global forest products, paper and packaging company).

ADAM H. SCHECHTER — Age 43

August, 2007 — President, Global Pharmaceuticals — global responsibilities for the Company's atherosclerosis/cardiovascular, diabetes/obesity, oncology, specialty/neuroscience, respiratory, bone, arthritis and analgesia franchises as well as commercial responsibility in the United States for the Company's portfolio of prescription medicines

July, 2006 — President, U.S. Human Health — commercial responsibility in the United States for the Company's portfolio of prescription medicines

October, 2005 — General Manager, U.S. Human Health Division — responsible for the Neuro–Psychiatry, Osteoporosis, Migraine, Respiratory, and New Products franchises

February, 2004 — Vice President/General Manager, Merck/Schering–Plough Pharmaceuticals U.S. Joint Venture

August, 2002 — Vice President, Merck Human Health Division, Arthritis & Analgesia Franchise Business Group

WENDY L. YARNO — Age 53

August, 2007 — Chief Marketing Officer — responsible for the global human health commercial operations support organization, including the Company's Global Human Health Business Process and Program Management, Global Marketing Support, Global Medical Affairs, Global Product Access and Outcomes Research, and Global Alliance Management and New Product Licensing

September, 2006 — Chief Marketing Officer — responsible for Global Marketing Services, Global Alliance Management and Global Pricing, Global Human Health Business Practices & Compliance and three franchises: Oncology, Specialty and Neuroscience; Respiratory, Bone and Arthritis and Analgesia; and Infectious Diseases and Hospital Products

November, 2005 — General Manager, Business Unit 3, U.S. Human Health

January, 2003 — Executive Vice President, Worldwide Human Health Marketing

All officers listed above serve at the pleasure of the Board of Directors. None of these officers was elected pursuant to any arrangement or understanding between the officer and the Board.

PART II

Item 5. Market for Registrant's Common Equity, Related Stockholder Matters and Issuer Purchases of Equity Securities.

The principal market for trading of the Company's Common Stock is the New York Stock Exchange ("NYSE") under the symbol MRK. The Common Stock market price information set forth in the table below is based on historical NYSE market prices.

The following table also sets forth, for the calendar periods indicated, the dividend per share information.

Cash Dividends Paid per Common Share

	Year	4th Q	3rd Q	2nd Q	1st Q
2007	**$ 1.52**	**$ 0.38**	**$ 0.38**	**$ 0.38**	**$ 0.38**
2006	$ 1.52	$ 0.38	$ 0.38	$ 0.38	$ 0.38

Common Stock Market Prices

2007	4th Q	3rd Q	2nd Q	1st Q
High	**$ 61.62**	**$ 53.81**	**$ 55.14**	**$ 46.55**
Low	**$ 51.44**	**$ 48.11**	**$ 44.52**	**$ 42.35**
2006				
High	$ 46.37	$ 42.51	$ 36.84	$ 36.65
Low	$ 41.24	$ 35.00	$ 32.75	$ 31.81

As of January 31, 2008, there were approximately 172,077 stockholders of record.

Equity Compensation Plan Information

The following table summarizes information about the options, warrants and rights and other equity compensation under the Company's equity plans as of the close of business on December 31, 2007. The table does not include information about tax qualified plans such as the Merck & Co., Inc. Employee Savings and Security Plan.

Plan Category	Number of securities to be issued upon exercise of outstanding options, warrants and rights (a)	Weighted–average exercise price of outstanding options, warrants and rights (b)	Number of securities remaining available for future issuance under equity compensation plans (excluding securities reflected in column (a)) (c)
Equity compensation plans approved by security holders[1]	242,047,383[2]	$ 53.60	149,753,161
Equity compensation plans not approved by security holders[3]	–	–	–
Total	242,047,383	$ 53.60	149,753,161

(1) *Includes options to purchase shares of Company Common Stock and other rights under the following stockholder–approved plans: the 1996 Incentive Stock Plan, the 2001 Incentive Stock Plan, the 2004 Incentive Stock Plan, the 2007 Incentive Stock Plan, the 1996 Non–Employee Directors Stock Option Plan, the 2001 Non–Employee Directors Stock Option Plan and the 2006 Non–Employee Directors Stock Option Plan.*

(2) *Excludes approximately 5,423,259 shares of restricted stock units and 2,813,690 performance share units (assuming maximum payouts) under the 2004 and 2007 Incentive Stock Plans. Also excludes 228,987 shares of phantom stock deferred under the Merck & Co., Inc. Deferral*

Program. As of December 31, 2006, no additional shares were reserved under the Deferral Program. Beginning January 1, 2007, one-tenth of 1 percent of the outstanding shares of Merck Common Stock on the last business day of the preceding calendar year plus any shares authorized under the Deferral Program but not issued are reserved for future issuance (2,679,958 as of December 31, 2007). The actual amount of shares to be issued prospectively equals the amount participants elect to defer from payouts under the Company's various incentive programs, such as the Executive Incentive Plan, into phantom stock, increased by the amount of dividends that would be paid on an equivalent number of shares of Merck Common Stock, divided by the market price of Merck Common Stock.

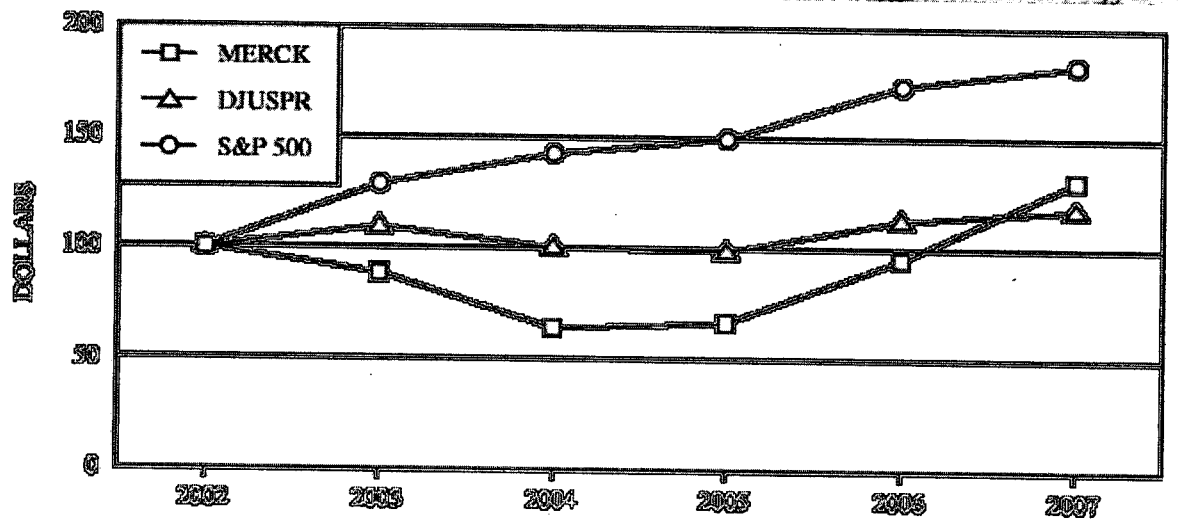
(3) *The table does not include information for equity compensation plans and options and other warrants and rights assumed by the Company in connection with mergers and acquisitions and pursuant to which there remain outstanding options or other warrants or rights (collectively, "Assumed Plans"), which include the following: Medco Containment Services, Inc. 1991 Class C Non-Qualified Stock Option Plan; SIBIA Neurosciences, Inc. 1996 Equity and Incentive Stock Option Plan; Provantage Health Services, Inc. 1999 Stock Incentive Plan; Rosetta Inpharmatics, Inc. 1997 and 2000 Employee Stock Option Plans. A total of 966,738 shares of Merck Common Stock may be purchased under the Assumed Plans, at a weighted average exercise price of $19.99. No further grants may be made under any Assumed Plans.*

Performance Graph

The following graph compares the cumulative total stockholder return (stock price appreciation plus reinvested dividends) on the Company's Common Stock with the cumulative total return (including reinvested dividends) of the Dow Jones US Pharmaceutical Index ("DJUSPR"), formerly referred to as the Dow Jones Pharmaceutical Index — United States Owned Companies, and the Standard & Poor's 500 Index ("S&P 500 Index") for the five years ended December 31, 2007. Amounts below have been rounded to the nearest dollar or percent.

Comparison of Five–Year Cumulative Total Return*
Merck & Co., Inc., Dow Jones US Pharmaceutical Index and S&P 500 Index

	End of Period Value	2007/2002 CAGR**
MERCK	$ 131	6%
DJUSPR	118	3
S&P 500	183	13



	2002	2003	2004	2005	2006	2007
MERCK	100.00	88.65	64.15	66.75	95.24	130.80
DJUSPR	100.00	109.45	100.39	98.73	112.93	117.98
S&P 500	100.00	128.67	142.65	149.65	173.27	182.78

* *Assumes that the value of the investment in Company Common Stock and each index was $100 on December 31, 2002 and that all dividends were reinvested.*

** *Compound Annual Growth Rate*

Issuer purchases of equity securities for the three month period ended December 31, 2007 are as follows:

Issuer Purchases of Equity Securities

Period	Total Number of Shares Purchased	Average Price Paid Per Share	Total Number of Shares Purchased as Part of Publicly Announced Plans or Programs[1]	($ in millions) Approx. Dollar Value of Shares That May Yet Be Purchased Under the Plans or Programs[1]
October 1 – October 31, 2007	0	$N/A	0	$ 5,952.8
November 1 – November 30, 2007	4,407,000	$57.74	4,407,000	$ 5,698.4
December 1 – December 31, 2007	10,099,600	$59.47	10,099,600	$ 5,097.7
Total	14,506,600	$58.95	14,506,600	$ 5,097.7

(1) These share repurchases were made as part of a plan announced in July 2002 to purchase $10 billion in Merck shares.

Item 6. Selected Financial Data.

The following selected financial data should be read in conjunction with Item 7. "Management's Discussion and Analysis of Financial Condition and Results of Operations" and consolidated financial statements and notes thereto contained in Item 8. "Financial Statements and Supplementary Data" of this report.

Merck & Co., Inc. and Subsidiaries
($ in millions except per share amounts)

	2007(1)	2006(2)	2005(3)	2004(4)	2003(5)
Results for Year:					
Sales	$ 24,197.7	$ 22,636.0	$ 22,011.9	$ 22,972.8	$ 22,567.8
Materials and production costs	6,140.7	6,001.1	5,149.6	4,965.7	4,443.7
Marketing and administrative expenses	7,556.7	8,165.4	7,155.5	7,238.7	6,200.3
Research and development expenses	4,882.8	4,782.9	3,848.0	4,010.2	3,279.9
Restructuring costs	327.1	142.3	322.2	107.6	194.6
Equity income from affiliates	(2,976.5)	(2,294.4)	(1,717.1)	(1,008.2)	(474.2)
U.S. *Vioxx Settlement Agreement charge*	4,850.0	–	–	–	–
Other (income) expense, net	46.2	(382.7)	(110.2)	(344.0)	(203.2)
Income from continuing operations before taxes	3,370.7	6,221.4	7,363.9	8,002.8	9,126.7
Taxes on income	95.3	1,787.6	2,732.6	2,172.7	2,492.7
Income from continuing operations	3,275.4	4,433.8	4,631.3	5,830.1	6,634.0
Income from discontinued operations, net of taxes	–	–	–	–	241.3
Net income	3,275.4	4,433.8	4,631.3	5,830.1	6,875.3
Basic earnings per common share					
Continuing operations	$1.51	$2.04	$2.11	$2.63	$2.97
Discontinued operations	–	–	–	–	0.11
Net income	$1.51	$2.04	$2.11	$2.63	$3.07(6)
Earnings per common share assuming dilution					
Continuing operations	$1.49	$2.03	$2.10	$2.62	$2.94
Discontinued operations	–	–	–	–	0.11
Net income	$1.49	$2.03	$2.10	$2.62	$3.05
Cash dividends declared	3,310.7	3,318.7	3,338.7	3,329.1	3,264.7
Cash dividends paid per common share	$1.52	$1.52	$1.52	$1.49	$1.45
Capital expenditures	1,011.0	980.2	1,402.7	1,726.1	1,915.9
Depreciation	1,752.4	2,098.1	1,544.2	1,258.7	1,129.6
Year-End Position:					
Working capital	$ 2,787.2	$ 2,507.5	$ 7,806.9	$ 1,688.8	$ 1,926.9
Property, plant and equipment, net	12,346.0	13,194.1	14,398.2	14,713.7	14,169.0
Total assets	48,350.7	44,569.8	44,845.8	42,572.8	40,587.5
Long-term debt	3,915.8	5,551.0	5,125.6	4,691.5	5,096.0
Stockholders' equity	18,184.7	17,559.7	17,977.7	17,349.3	15,620.8
Financial Ratios:					
Income from continuing operations as a % of sales	13.5%	19.6%	21.0%	25.4%	29.4%
Net income as a % of average total assets	7.0%	9.9%	10.6%	14.0%	15.0%
Year-End Statistics:					
Average common shares outstanding (millions)	2,170.5	2,177.6	2,197.0	2,219.0	2,236.7
Average common shares outstanding assuming dilution (millions)	2,192.9	2,187.7	2,200.4	2,226.4	2,253.1
Number of stockholders of record	173,000	184,200	198,200	216,100	233,000
Number of employees	59,800	60,000	61,500	62,600	63,200

(1) Amounts for 2007 include the impact of the U.S. Vioxx *Settlement Agreement charge, restructuring actions, a civil governmental investigations charge, an insurance arbitration settlement gain, acquired research expense resulting from an acquisition, additional* Vioxx *legal defense costs, gains on sales of assets and product divestitures, as well as a net gain on the settlements of certain patent disputes.*
(2) Amounts for 2006 include the impact of restructuring actions, acquired research expenses resulting from acquisitions, additional Vioxx *legal defense costs and the adoption of a new accounting standard requiring the expensing of stock options.*
(3) Amounts for 2005 include the impact of the net tax charge primarily associated with the American Jobs Creation Act repatriation, restructuring actions and additional Vioxx *legal defense costs.*
(4) Amounts for 2004 include the impact of the withdrawal of Vioxx, Vioxx *legal defense costs and restructuring actions.*
(5) Amounts for 2003 include the impact of the implementation of a new distribution program for U.S. wholesalers and restructuring actions.
(6) Amount does not add as a result of rounding.

Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations

Description of Merck's Business

Merck is a global research-driven pharmaceutical company that discovers, develops, manufactures and markets a broad range of innovative products to improve human and animal health. The Company's operations are principally managed on a products basis and are comprised of two reportable segments: the Pharmaceutical segment and the Vaccines segment. The Pharmaceutical segment includes human health pharmaceutical products marketed either directly or through joint ventures. These products consist of therapeutic and preventive agents, sold by prescription, for the treatment of human disorders. Merck sells these human health pharmaceutical products primarily to drug wholesalers and retailers, hospitals, government agencies and managed health care providers such as health maintenance organizations, pharmacy benefit managers and other institutions. The Vaccines segment includes human health vaccine products marketed either directly or through a joint venture. These products consist of preventative pediatric, adolescent and adult vaccines, primarily administered at physician offices. Merck sells these human health vaccines primarily to physicians, wholesalers, physician distributors and government entities. The Company's professional representatives communicate the effectiveness, safety and value of its pharmaceutical and vaccine products to health care professionals in private practice, group practices and managed care organizations.

Overview

During 2007, Merck began realizing benefits from its multi-year strategic plan designed to reengineer the way the Company develops and distributes medicines and vaccines worldwide. The Company is benefiting from the evolution of a new commercial model designed to align the Company's product research, development and marketing efforts utilizing the latest technologies and broadening its engagement with customers, physicians and scientific leaders to get needed medicines and vaccines through the development pipeline and to patients sooner. The Company is also working to build a sustainable research and development advantage by leveraging technologies to facilitate drug discovery and development and has successfully reduced clinical development cycle-time.

The progress of these efforts is demonstrated in part by the Company's revenue growth in 2007, which reflected the continued market penetration and global rollout of *Gardasil,* a vaccine to help prevent cervical cancer, pre-cancerous and low-grade lesions, vulvar and vaginal pre-cancers, and genital warts caused by human papillomavirus ("HPV") types 6, 11, 16 and 18; *Januvia,* a medicine that enhances a natural body system to improve blood sugar control in patients with type 2 diabetes; and *RotaTeq,* a pediatric vaccine to help prevent rotavirus gastroenteritis in infants and children, coupled with the strong performance of several in-line products. This growth has more than offset 2007 revenue declines associated with the 2006 loss of U.S. market exclusivity for *Zocor* and *Proscar.*

Additionally, the Company continued the advancement of drug candidates through its pipeline. During 2007, the U.S. Food and Drug Administration (the "FDA") approved both *Janumet,* an oral antihyperglycemic agent that combines sitagliptin (*Januvia*) with metformin in a single tablet to address all three key defects of type 2 diabetes, and *Isentress,* a first-in-class integrase inhibitor for the treatment of HIV-1 infection in treatment-experienced patients. In addition, on January 25, 2008, the FDA approved *Emend* for Injection, an intravenous therapy for the prevention of chemotherapy-induced nausea and vomiting ("CINV"). Also, the Company anticipates the FDA will take action in 2008 on the New Drug Application ("NDA") for *Cordaptive,* the proposed trademark for MK-0524A, an extended-release ("ER") niacin combined with laropiprant, a novel flushing pathway inhibitor, for cholesterol management. Further, the Company made a supplemental filing with the FDA in January 2008 for *Gardasil,* for an expanded indication for women through age 45, and anticipates making a supplemental filing for *Isentress* later in 2008, for an expanded indication for use in treatment-naïve patients. The Company currently has seven candidates in Phase III development and anticipates making NDA filings with respect to two of the candidates in 2008: MK-0524B, simvastatin combined with laropiprant and ER niacin, and MK-0364, taranabant, an investigational medication for the treatment of obesity.

As part of implementing the new commercial model, the Company is reengineering its core business to be more efficient with the goal of reducing aspects of its cost base and realizing gross margin improvement. The reengineering includes the implementation of manufacturing and marketing cost savings initiatives. The initial

phase of the global restructuring program announced in 2005 was designed to reduce the Company's cost structure, increase efficiency and enhance competitiveness. The scope of this initial phase included the implementation of a new supply strategy by the Merck Manufacturing Division over a three-year period, focusing on establishing lean supply chains, leveraging low-cost external manufacturing and consolidating our manufacturing plant network. As part of this program, through January 2008, Merck had closed, sold or ceased operations at five manufacturing sites and two preclinical sites and eliminated approximately 7,200 positions company-wide (comprised of actual headcount reductions and the elimination of contractors and vacant positions). The Company, however, continues to hire new employees as the business requires. The pretax costs of this restructuring program since inception through the end of 2007 were $2.1 billion, of which approximately 70% are non-cash, relating primarily to accelerated depreciation for those facilities scheduled for closure and approximately 30% represent separation and other restructuring related costs. These costs were $810.1 million in 2007 and are expected to be approximately $100 million to $300 million in 2008, at which time the initial phase of the restructuring program relating to the manufacturing strategy is expected to be substantially complete. Merck continues to expect the initial phase of its cost reduction program, combined with cost savings the Company expects to achieve in its marketing and administrative and research and development expenses, will yield cumulative pretax savings of $4.5 to $5.0 billion from 2006 through 2010.

On November 9, 2007, Merck entered into an agreement (the "Settlement Agreement") with the law firms that comprise the executive committee of the Plaintiffs' Steering Committee of the federal multidistrict *Vioxx* litigation as well as representatives of plaintiffs' counsel in state coordinated proceedings to resolve state and federal myocardial infarction ("MI") and ischemic stroke ("IS") claims already filed against the Company in the United States. If certain participation conditions under the Settlement Agreement are met (or waived), the Company will pay an aggregate fixed amount of $4.85 billion into two funds for qualifying claims consisting of $4.0 billion for qualifying MI claims and $850 million for qualifying IS claims that enter into the resolution process (the "Settlement Program"). As a consequence of the Settlement Agreement, the Company recorded a pretax charge of $4.85 billion in the fourth quarter of 2007. In addition, the Company recorded a pretax gain of $455 million relating to insurance proceeds which the Company was awarded (or agreed to receive pursuant to negotiated settlements) in the previously disclosed arbitration with the Company's upper level excess product liability insurance carriers relating to coverage for costs incurred in the *Vioxx* product liability litigation. See Note 10 to the consolidated financial statements for further information.

Also in the fourth quarter of 2007, the Company recorded a pretax charge of $671 million in connection with the anticipated resolution of investigations of civil claims by federal and state authorities relating to certain past marketing and selling activities, including nominal pricing programs and samples. On February 7, 2008, the Company entered into definitive agreements resolving the investigations. See Note 10 to the consolidated financial statements for further information.

Earnings per common share ("EPS") assuming dilution for 2007 were $1.49 per share including the impact of the U.S. *Vioxx* Settlement Agreement charge, costs associated with the global restructuring program, the charge related to the resolution of certain civil governmental investigations and the gain from an insurance arbitration award related to *Vioxx* product liability litigation coverage, which collectively reduced EPS by $1.71 per share. In addition, EPS in 2007 reflects an acquired research charge related to the acquisition of NovaCardia, Inc. ("NovaCardia"), additional reserves established solely for future legal defense costs for *Vioxx* litigation and the favorable impact of gains on sales of assets and product divestitures, as well as a net gain on the settlements of certain patent disputes. All of these items are discussed more fully in the notes to the consolidated financial statements.

Competition and the Health Care Environment

The markets in which the Company conducts its business are highly competitive and often highly regulated. Global efforts toward health care cost containment continue to exert pressure on product pricing and access.

In the United States, the government expanded health care access by enacting the Medicare Prescription Drug Improvement and Modernization Act of 2003, which was signed into law in December 2003. Prescription

drug coverage began on January 1, 2006. This legislation supports the Company's goal of improving access to medicines by expanding insurance coverage, while preserving market-based incentives for pharmaceutical innovation. At the same time, the legislation will ensure that prescription drug costs will be controlled by competitive pressures and by encouraging the appropriate use of medicines. The U.S. Congress has considered, and may consider again, proposals to increase the government's role in pharmaceutical pricing in the Medicare program.

In addressing cost-containment pressure, the Company has made a continuing effort to demonstrate that its medicines can help save costs in overall patient health care. In addition, pricing flexibility across the Company's product portfolio has encouraged growing use of its medicines and mitigated the effects of increasing cost pressures.

Outside the United States, in difficult environments encumbered by government cost-containment actions, the Company has worked in partnership with payers to encourage them to allocate scarce resources to optimize health care outcomes, limiting the potentially detrimental effects of government policies on sales growth and access to innovative medicines and vaccines, and to support the discovery and development of innovative products to benefit patients. The Company also is working with governments in many emerging markets in Eastern Europe, Latin America and Asia to encourage them to increase their investments in health and thereby improve their citizens' access to medicines. Within Europe, European institutions such as the European Commission ("EC") have recognized the economic importance of the research-based pharmaceutical industry and the value of innovative medicines to society. As a result, they are working with industry representatives to improve the competitive climate through a variety of means including market deregulation.

In order to advance the related policy debate, the EC launched the High Level Pharmaceutical Forum ("HLPF") at the end of 2005. This initiative aims at improving the prospects of the research-based pharmaceutical industry in Europe and thus the health prospects of all patients who will benefit from innovative therapies. Through an active dialogue among all stakeholders in the health care system (from payers to patients), this initiative is an attempt to tackle key policy issues in Europe: (i) promoting greater pricing flexibility for medicines; (ii) ensuring that health authorities apply best practices for the evaluation of the relative effectiveness of medicines; and (iii) improving greater access to information on medicines for patients in Europe. The Company has been actively engaged with the EC and other stakeholders in order to achieve a successful outcome for the HLPF that would help European patients gain greater and quicker access to its medicines.

The Company is committed to improving access to medicines and enhancing the quality of life for people around the world. The African Comprehensive HIV/AIDS Partnerships in Botswana, a partnership between the government of Botswana, the Bill & Melinda Gates Foundation and The Merck Company Foundation/Merck & Co., Inc., is supporting Botswana's response to HIV/AIDS through a comprehensive and sustainable approach to HIV prevention, care, treatment and support. In May 2005, the Company initiated a partnership with the People's Republic of China (focused initially in Sichuan Province) to help strengthen China's response to the HIV epidemic.

To further catalyze access to HIV medicines in developing countries, under price reduction guidelines that the Company announced in 2001, Merck makes no profit on the sale of its current HIV/AIDS medicines in the world's poorest countries and those hardest hit by the pandemic, and offers its HIV/AIDS medicines at significantly reduced prices to medium-income countries. In February 2007, Merck announced that it had again reduced the price of *Stocrin* in the least developed countries of the world and those hardest hit by the pandemic. By the end of 2007, more than 720,000 people living with HIV and AIDS in 81 developing countries and territories were estimated to be on treatment with antiretroviral regimens containing *Crixivan, Stocrin* or Atripla. Through these and other actions, Merck is working independently and with partners in the public and private sectors alike to focus on the most critical barriers to access to medicines in the developing world: the need for sustainable financing, increased international assistance and additional investments in education, training and health infrastructure and capacity in developing countries.

As previously disclosed, in May 2007 the government of Brazil issued a compulsory license for *Stocrin*, which makes it possible for *Stocrin* to be produced by a generic manufacturer despite the Company's patent protection on *Stocrin*. In November 2006, the government of Thailand stated that it had issued a compulsory license for *Stocrin*, despite the Company's patent protection on *Stocrin*, which the government of Thailand contends makes it possible for *Stocrin* to be produced by a generic manufacturer. The Company remains committed to exploring mutually acceptable agreements with the governments of Brazil and Thailand.

The Company is subject to a number of privacy and data protection laws and regulations globally. The legislative and regulatory landscape for privacy and data protection continues to evolve, and there has been an increasing amount of focus on privacy and data protection issues with the potential to affect directly the Company's business, including recently enacted laws in a majority of U.S. states requiring security breach notification.

Although no one can predict the outcome of these and other legislative, regulatory and advocacy initiatives, the Company is well positioned to respond to the evolving health care environment and market forces.

As patents on certain of the Company's products expire, Merck has entered into, and may continue to enter into, authorized generic agreements which reduce on a short–term limited basis, the impact of post–patent expiry sales erosion when these medicines become available in generic form.

The Company anticipates that the worldwide trend toward cost–containment will continue, resulting in ongoing pressures on health care budgets. As the Company continues to successfully launch new products, contribute to health care debates and monitor reforms, its new products, policies and strategies should enable it to maintain a strong position in the changing economic environment.

Acquisitions

In September 2007, Merck completed the acquisition of NovaCardia for $366.4 million which was paid through the issuance of Merck common stock. NovaCardia is a clinical–stage pharmaceutical company focused on cardiovascular disease. This acquisition added rolofylline (MK–7418), NovaCardia's investigational Phase III compound for acute heart failure, to Merck's pipeline. In connection with the acquisition, the Company recorded a charge of $325.1 million for acquired research associated with rolofylline as at the acquisition date, technological feasibility had not been established and no alternative future use existed. The charge was not deductible for tax purposes. The ongoing activity with respect to the future development of rolofylline is not expected to be material to the Company's research and development expenses.

In December 2006, Merck completed the acquisition of Sirna Therapeutics, Inc. ("Sirna") for approximately $1.1 billion. Sirna is a biotechnology company that is a leader in developing a new class of medicines based on RNA interference ("RNAi") technology, which could significantly alter the treatment of disease. In connection with the acquisition, the Company recorded a charge of $466.2 million for acquired research associated with Sirna's compounds currently under development, which related to the development of treatments for both the hepatitis B and hepatitis C viruses, which are in preclinical development, as well as licensing agreements held by Sirna. The charge was not deductible for tax purposes. The ongoing activity with respect to each of these compounds under development is not expected to be material to the Company's research and development expenses. The acquisition of Sirna is expected to increase Merck's ability to use RNAi technology to turn off a targeted gene in a human cell, potentially rendering inoperative a gene responsible for triggering a specific disease.

In June 2006, Merck acquired GlycoFi, Inc. ("GlycoFi"), a privately–held biotechnology company that is a leader in the field of yeast glycoengineering, which is the addition of specific carbohydrate modifications to the proteins in yeast, and optimization of biologic drug molecules, for $373 million in cash ($400 million purchase price net of $25 million of shares already owned and net transaction costs). The Company recorded a $296.3 million charge for acquired research in connection with the acquisition which was not deductible for tax purposes. In May 2006, Merck acquired Abmaxis, Inc. ("Abmaxis"), a privately–held biopharmaceutical company dedicated to the discovery and optimization of monoclonal antibody products for human therapeutics and diagnostics, for $80 million in cash. Substantially all of the purchase price was allocated to an intangible asset relating to Abmaxis' technology platform. While each of the acquisitions has independent scientific merits, the combination of the GlycoFi and Abmaxis platforms is potentially synergistic, giving Merck the ability to operate across the entire spectrum of therapeutic antibody discovery, development and commercialization.

See Note 4 to the consolidated financial statements for further discussion of these acquisitions.

Operating Results

Sales

Worldwide sales totaled $24.2 billion for 2007, an increase of 7%, primarily attributable to a 4% volume increase, a 2% favorable effect from foreign exchange and a less than 1% favorable effect from price changes. Sales performance over 2006 reflects strong growth of the Company's vaccines, including *Gardasil*, a vaccine to help prevent cervical cancer, pre-cancerous and low-grade lesions, vulvar and vaginal pre-cancers, and genital warts caused by HPV types 6, 11, 16 and 18, *Varivax*, a vaccine to help prevent chickenpox, *RotaTeq*, a vaccine to help protect against rotavirus gastroenteritis in infants and children, and *Zostavax*, a vaccine to help prevent shingles (herpes zoster). Also contributing to sales growth was strong performance of *Singulair*, a medicine indicated for the chronic treatment of asthma and the relief of symptoms of allergic rhinitis, higher sales of *Januvia* and sales of *Janumet* for the treatment of type 2 diabetes, as well as increased sales of *Cozaar/Hyzaar* for hypertension and/or heart failure. Sales growth was partially offset by lower sales of *Zocor*, the Company's statin for modifying cholesterol, and *Proscar*, a urology product for the treatment of symptomatic benign prostate enlargement. Merck's U.S. market exclusivity for *Zocor* and *Proscar* both expired in June 2006. Also offsetting sales growth in 2007 were lower revenues from the Company's relationship with AstraZeneca LP ("AZLP") and lower sales of *Fosamax* and *Fosamax Plus D* for the treatment and, in the case of *Fosamax*, prevention of osteoporosis.

Domestic sales increased 7% over 2006, while foreign sales also grew 7%. Foreign sales represented 39% of total sales in 2007. Domestic and foreign sales growth reflects the strong performance of the Company's vaccines and growth in *Singulair*. In addition, domestic sales in particular benefited from higher sales of *Januvia*. These increases were partially offset by the loss of *Zocor* and *Proscar* market exclusivity. Foreign sales were also negatively affected by continued generic erosion related to *Fosamax* products.

Worldwide sales for 2006 increased 3% in total over 2005 primarily driven by strong growth of *Singulair* and vaccines, as well as higher revenues from the Company's relationship with AZLP and increased sales of *Cozaar/Hyzaar*. In addition, sales in 2006 reflected certain supply sales, including the Company's arrangement with Dr. Reddy's Laboratories ("Dr. Reddy's") for the sale of generic simvastatin. These increases were partially offset by lower sales of *Zocor* and *Proscar*. Foreign exchange and price changes had virtually no impact on sales growth in 2006. Foreign sales represented 39% of total sales for 2006.

Sales[1] of the Company's products were as follows:

($ in millions)	2007	2006	2005
Singulair	$ 4,266.3	$ 3,579.0	$ 2,975.6
Cozaar/Hyzaar	3,350.1	3,163.1	3,037.2
Fosamax	3,049.0	3,134.4	3,191.2
Cosopt/Trusopt	876.5	2,802.7	4,381.7
Primaxin	786.8	697.1	617.2
Januvia	763.5	704.8	739.6
Cancidas	667.5	42.9	–
Vasotec/Vaseretic	536.9	529.8	570.0
Maxalt	494.6	547.2	623.1
Proscar	467.3	406.4	348.4
Propecia	411.0	618.5	741.4
Arcoxia	405.4	351.8	291.9
Crixivan/Stocrin	329.1	265.4	218.2
Emend	310.2	327.3	348.4
Invanz	204.2	130.8	87.0
Janumet	190.2	139.2	93.7
Other pharmaceutical [2]	86.4	–	–
	2,465.9	2,780.5	2,295.1
	19,660.9	20,220.9	20,559.7
Vaccines: [3]			
Gardasil	1,480.6	234.8	–
RotaTeq	524.7	163.4	–
Zostavax	236.0	38.6	–
ProQuad/M-M-R II/Varivax	1,347.1	820.1	597.4
Hepatitis vaccines	279.9	248.5	194.5
Other vaccines	409.9	354.0	311.4
	4,278.2	1,859.4	1,103.3
Other [4]	258.6	555.7	348.9
	$ 24,197.7	$ 22,636.0	$ 22,011.9

(1) *Presented net of discounts and returns.*

(2) *Other pharmaceutical primarily includes sales of other human pharmaceutical products and revenue from the Company's relationship with AZLP primarily relating to sales of* Nexium, *as well as* Prilosec. *Revenue from AZLP was $1.7 billion, $1.8 billion and $1.7 billion in 2007, 2006 and 2005, respectively. In 2006, other pharmaceutical also reflected certain supply sales, including supply sales associated with the Company's arrangement with Dr. Reddy's for the sale of generic simvastatin.*

(3) *These amounts do not reflect sales of vaccines sold in most major European markets through the Company's joint venture, Sanofi Pasteur MSD, the results of which are reflected in Equity income from affiliates.*

(4) *Other primarily includes other human and animal health joint venture supply sales and other miscellaneous revenues.*

The Company's pharmaceutical products include therapeutic and preventive agents, generally sold by prescription, for the treatment of human disorders. Among these are *Singulair*, a leukotriene receptor antagonist for the chronic treatment of asthma and for the relief of symptoms of allergic rhinitis; *Cozaar, Hyzaar, Vasotec* and *Vaseretic*, the Company's most significant hypertension and/or heart failure products; *Fosamax* and *Fosamax Plus D* (marketed as *Fosavance* throughout the European Union ("EU") and as *Fosamac* in Japan), for the treatment and, in the case of *Fosamax*, prevention of osteoporosis; *Zocor*, Merck's atherosclerosis product; *Cosopt* and *Trusopt*,

Merck's largest-selling ophthalmological products; *Primaxin* and *Cancidas*, anti-bacterial/anti-fungal products; *Januvia* and *Janumet*, for the treatment of type 2 diabetes; *Maxalt*, an acute migraine product; *Proscar*, a urology product for the treatment of symptomatic benign prostate enlargement; *Propecia*, a product for the treatment of male pattern hair loss; *Arcoxia*, for the treatment of arthritis and pain; *Crixivan* and *Stocrin*, for the treatment of HIV infection; *Emend*, for the prevention of chemotherapy-induced and post-operative nausea and vomiting; and *Invanz*, for the treatment of infection.

The Company's vaccine products include *Gardasil*, a vaccine to help prevent cervical cancer, pre-cancerous and low-grade lesions, vulvar and vaginal pre-cancers, and genital warts caused by HPV types 6, 11, 16 and 18; *RotaTeq*, a vaccine to help protect against rotavirus gastroenteritis in infants and children; *Zostavax*, a vaccine to help prevent shingles (herpes zoster); *Varivax*, a vaccine to help prevent chickenpox; *ProQuad*, a pediatric combination vaccine against measles, mumps, rubella and varicella; and *M-M-R* II, a vaccine against measles, mumps and rubella.

Segment Revenues

($ in millions)	2007	2006	2005
Pharmaceutical segment revenues	$ 20,101.5	$ 20,374.8	$ 20,678.8
Vaccines segment revenues[1]	3,837.6	1,705.5	984.2
Other segment revenues[2]	162.0	162.1	161.8
Other revenues[3]	96.6	393.6	187.1
Total revenues	$ 24,197.7	$ 22,636.0	$ 22,011.9

(1) *In accordance with segment reporting requirements, Vaccines segment revenues exclude $440.6 million, $153.9 million and $119.1 million in 2007, 2006 and 2005, respectively, of vaccines sales by certain non-U.S. subsidiaries managed by and included in the Pharmaceutical segment.*

(2) *Includes other non-reportable human and animal health segments.*

(3) *Other revenues are primarily comprised of miscellaneous corporate revenues, sales related to divested products or businesses and other supply sales not included in segment results.*

Pharmaceutical Segment Revenues

Sales of the Pharmaceutical segment declined 1% in both 2007 and 2006 primarily due to declines in *Zocor* and *Proscar* post patent expiration, partially offset by increases in *Singulair, Cozaar/Hyzaar* and for 2007, higher sales of *Januvia* and sales of *Janumet*.

Worldwide sales of *Singulair*, a medicine indicated for the chronic treatment of asthma and the relief of symptoms of allergic rhinitis, grew 19% reaching $4.3 billion in 2007 and rose 20% to $3.6 billion in 2006, reflecting the continued demand for asthma and seasonal and perennial allergic rhinitis medications. *Singulair* continues to be the number one prescribed product in the U.S. respiratory market. In April 2007, the FDA approved a new indication for *Singulair* for the prevention of exercise-induced bronchoconstriction in patients 15 years of age and older. *Singulair* is the first and only oral tablet approved in the United States for this use. In January 2008, *Singulair* was approved in Japan for the treatment of allergic rhinitis.

Global sales of *Cozaar*, and its companion agent *Hyzaar* (a combination of *Cozaar* and hydrochlorothiazide), for the treatment of hypertension increased 6% to $3.4 billion in 2007 and grew 4% to $3.2 billion in 2006. *Cozaar* and *Hyzaar* are among the leading members of the growing angiotensin receptor blocker class of medicines.

Worldwide sales of *Fosamax* and *Fosamax Plus D*, for the treatment and, in the case of *Fosamax*, prevention of osteoporosis, declined 3% in 2007 to $3.0 billion and decreased 2% in 2006 to $3.1 billion. U.S. sales of *Fosamax* and *Fosamax Plus D* were $2.0 billion in 2007, essentially flat compared with 2006. Sales outside of the United States were affected by the availability of generic alendronate sodium products in several key markets. *Fosamax* lost market exclusivity in the United States in February 2008. *Fosamax Plus D* will lose marketing exclusivity in the United States in April 2008. As a result of these events, the Company expects significant declines in U.S. *Fosamax* and *Fosamax Plus D* sales.

Worldwide sales of *Zocor*, Merck's statin for modifying cholesterol, declined 69% in 2007 and decreased 36% in 2006. Sales of *Zocor* in both periods were significantly negatively affected by the continuing impact of the loss of U.S. market exclusivity in June 2006.

In February 2006, the Company entered into an agreement with Dr. Reddy's that authorized the sale of generic simvastatin. Under the terms of the agreement, the Company was reimbursed on a cost–plus basis by Dr. Reddy's for supplying finished goods and received a share of the net profits recorded by Dr. Reddy's. In 2006, Merck recorded $208.9 million of revenue associated with the Dr. Reddy's arrangement for simvastatin. Merck continues to manufacture simvastatin for branded *Zocor*, *Vytorin* and the Company's investigational compound MK–0524B.

Global sales of *Januvia*, the first dipeptidyl peptidase–4 ("DPP–4") inhibitor approved in the United States for use in the treatment of type 2 diabetes, were $667.5 million in 2007 compared with $42.9 million in 2006. *Januvia* was approved by the FDA in October 2006 and by the EC in March 2007. DPP–4 inhibitors represent a new class of prescription medications that improve blood sugar control in patients with type 2 diabetes by enhancing a natural body system called the incretin system. By the end of 2007, *Januvia* was approved in 69 countries and territories, had been launched in more than 40 of those and was under review in more than a dozen others. Since the October 2006 U.S. approval, managed care formularies have made *Januvia* widely available.

In October 2007, Merck announced that the FDA approved expanded labeling for *Januvia*. The new regimens with *Januvia* described in the updated labeling include, as an adjunct to diet and exercise, initial therapy in combination with metformin; add–on therapy to a sulfonylurea (glimepiride) when the single agent alone does not provide adequate glycemic control; and add–on therapy to the combination of a sulfonylurea (glimepiride) and metformin when dual therapy does not provide adequate glycemic control.

In March 2007, the FDA approved *Janumet*, Merck's oral antihyperglycemic agent that combines *Januvia* with metformin in a single tablet to address all three key defects of type 2 diabetes. *Janumet* has been approved, as an adjunct to diet and exercise, to improve blood sugar control in adult patients with type 2 diabetes who are not adequately controlled on metformin or sitagliptin alone, or in patients already being treated with the combination of sitagliptin and metformin. By the end of 2007, *Janumet* was approved in seven countries. The Company is seeking the necessary approvals to make the medicine available for use in many other countries around the world. Global sales for *Janumet* were $86.4 million in 2007.

In October 2007, the FDA granted *Isentress* (raltegravir, previously known as MK–0518) accelerated approval for use in combination with other antiretroviral agents for the treatment of HIV–1 infection in treatment–experienced adult patients who have evidence of viral replication and HIV–1 strains resistant to multiple antiretroviral agents. *Isentress* is the first medicine to be approved in a new class of antiretroviral drugs called integrase inhibitors. *Isentress* works by inhibiting the insertion of HIV DNA into human DNA by the integrase enzyme. Inhibiting integrase from performing this essential function limits the ability of the virus to replicate and infect new cells. The FDA's decision was based on a 24–week analysis of clinical trials in which *Isentress*, in combination with optimized background therapy in treatment–experienced patients, provided significant reductions in HIV RNA viral load and increases in CD4 cell counts. In February 2008, the Company announced 48 week data that demonstrated *Isentress*, in combination with other anti–HIV medicines, maintained significant HIV–1 viral load suppression and increased CD4 cell counts through 48 weeks of therapy compared to placebo in combination with anti–HIV medicines, in two Phase III studies of treatment–experienced patients failing antiretroviral therapies. Patients in the studies had HIV resistant to at least one drug in each of three classes of oral antiretroviral medicines. By the end of 2007, the medicine was approved for use in the EU, Canada and Mexico. Merck is also conducting Phase III clinical trials of *Isentress* in the treatment–naïve (previously untreated) HIV population. Potent antiretroviral activity has been demonstrated with no significant changes in serum lipids at week 48 and *Isentress* was generally well tolerated in patients. The Company anticipates making a supplemental filing with FDA for the treatment–naïve indication in 2008. Sales for *Isentress* were $41.3 million in 2007.

Other products experiencing growth in 2007 include *Cosopt* to treat elevated intraocular pressure in patients with open–angle glaucoma or ocular hypertension, *Emend* for prevention of acute and delayed nausea and vomiting associated with moderately and highly emetogenic cancer chemotherapy, as well as for the treatment of post–operative nausea and vomiting, *Arcoxia* for the treatment of arthritis and pain, *Maxalt* to treat migraine pain,

Primaxin, an antibiotic, *Propecia* for male pattern hair loss and *Invanz* for the treatment of selected moderate to severe infection in adults.

The patent that provides U.S. market exclusivity for *Trusopt* and *Cosopt* expires in October 2008. After such time, the Company expects significant declines in U.S. sales of these products.

Proscar, Merck's urology product for the treatment of symptomatic benign prostate enlargement, lost market exclusivity in the United States in June 2006. Merck's U.S. sales of *Proscar* declined 76% in 2007 and 34% in 2006. The basic patent for *Proscar* also covers *Propecia*, however, *Propecia* is protected by additional patents which expire in October 2013.

In April 2007, the FDA issued a non–approvable letter in response to the Company's NDA for *Arcoxia* (etoricoxib) for the symptomatic treatment of osteoarthritis. *Arcoxia* had been under review by the FDA as an investigational selective COX–2 inhibitor since the NDA was submitted in December 2003 for a 60 mg once–daily dose along with review of a separate related NDA for a 30 mg once–daily dose submitted in April 2004. In the non–approvable letter, the FDA indicated that Merck would need to provide additional data in support of the benefit–to–risk profile for the proposed doses of *Arcoxia* in order to gain approval. Merck continues to evaluate the options available with regard to a potential path forward in the United States. *Arcoxia* is currently available in 65 countries in Europe, Latin America, the Asia–Pacific region and Middle East/Northern Africa. Merck will continue to market *Arcoxia* outside the United States, where it has been approved for a broad range of indications, including osteoarthritis.

In November 2007, Merck and GlaxoSmithKline ("GSK") announced that they had entered into an agreement for over–the–counter marketing rights for *Mevacor* (lovastatin). *Mevacor* is part of a class of cholesterol–reducing medicines known as "statins." The U.S. patent for *Mevacor* expired in 2001. In January 2008, Merck received a non–approvable letter from the FDA to its NDA seeking approval for over–the–counter *Mevacor*. The FDA indicated in its letter that it would require a revised label and additional data from Merck in order to gain marketing approval. As a consequence of the FDA's non–approvable letter, the Company terminated the agreement with GSK.

Vaccines Segment Revenues

Sales of the Vaccines segment were $3.8 billion in 2007, $1.7 billion in 2006 and $984.2 million in 2005. The increases in 2007 and 2006 are the result of new product launches in the latter part of 2006 and the continued success of in–line vaccines. The following discussion of vaccines includes total vaccines sales, of which the vast majority are included in the Vaccines segment and the remainder, representing certain sales of vaccines by non–U.S. subsidiaries, are managed by and included in the Pharmaceutical segment. These amounts do not reflect sales of vaccines sold in most major European markets through Sanofi Pasteur MSD ("SPMSD") the Company's joint venture with Sanofi Pasteur, the results of which are reflected in Equity income from affiliates.

Total vaccine sales as recorded by Merck in 2007 (including the $3.8 billion reflected in the Vaccines segment and the $440.6 million reflected in the Pharmaceutical segment) were $4.3 billion compared with $1.9 billion in 2006 and $1.1 billion in 2005. Growth in vaccines was led by *Gardasil*, as well as by the strong performance of *Varivax*, *RotaTeq* and *Zostavax*.

Total sales as recorded by Merck for *Gardasil* were $1.5 billion in 2007, which included initial purchases by many states through the U.S. Centers for Disease Control and Prevention ("CDC") Vaccines for Children program, compared with $234.8 million in 2006. *Gardasil* was approved by the FDA in June 2006 and is the only approved vaccine in the United States to help prevent cervical cancer, pre–cancerous and low–grade lesions, vulvar and vaginal pre–cancers, and genital warts caused by HPV types 6, 11, 16 and 18. *Gardasil* was approved for use in the EU in September 2006. *Gardasil* is a three dose, intra muscular vaccine given over six months, approved for 9– to 26–year–old girls and women. By the end of 2007, *Gardasil* was approved in 93 countries, many under fast–track or expedited review, with launches under way in 76 of those countries. The vaccine remains under review in approximately 40 other countries and territories. The Company is a party to certain third party license agreements with respect to *Gardasil* (including a cross–license and settlement agreement with GSK). As a result of these agreements, the Company pays royalties on worldwide *Gardasil* sales of approximately 24% to 26% in the aggregate, which are included in Materials and production costs.

In March 2007, the CDC adopted the unanimous recommendation of its Advisory Committee on Immunization Practices ("ACIP") for the use of *Gardasil*. In June 2006, the ACIP voted unanimously to recommend that girls and women 11 to 26 years old be vaccinated with *Gardasil*. The ACIP recommended that 9– and 10–year–old females be vaccinated with *Gardasil* at the discretion of their physicians. The vaccination guidelines, published in the CDC's *Morbidity and Mortality Weekly Report*, finalize the provisional recommendations issued by the ACIP.

In May 2007, the FDA accepted for standard review a supplemental Biologics License Application ("sBLA") for *Gardasil* which includes data on protection against vaginal and vulvar cancer caused by HPV types 16 and 18 and data on immune memory. In July 2007, the FDA accepted for standard review an sBLA for the prevention of cervical disease caused by non–vaccine types (cross protection). FDA action on both the vaginal and vulvar cancer sBLA and the cross protection sBLA is expected in the second quarter of 2008.

In November 2007, the Company presented data at the International Papillomavirus Conference about the efficacy of *Gardasil* in women through age 45. In January 2008, Merck submitted an sBLA with the FDA seeking an expanded indication for the use of *Gardasil* in women through age 45.

Clinical studies to evaluate the efficacy of *Gardasil* in males 16 to 26 years of age continue and the Company also expects to submit to the FDA an indication for males 16 to 26 years of age in 2008.

RotaTeq, Merck's vaccine to help protect against rotavirus gastroenteritis in infants and children, achieved worldwide sales as recorded by Merck of $524.7 million in 2007 compared with $163.4 million in 2006. The FDA approved *RotaTeq* in February 2006. By the end of 2007, *RotaTeq* was approved in 70 countries and was launched in 42.

In December 2007, the Company announced that the prescribing information for *RotaTeq* now includes data showing that *RotaTeq* reduced hospitalizations and emergency department visits caused by the G9P1A[8] rotavirus serotype by 100% (zero cases were seen in those who received *RotaTeq* compared with 14 cases in placebo recipients). These data are from a post–hoc analysis of healthcare utilization data from more than 68,000 infants in the Rotavirus Efficacy and Safety Trial (REST), one of the largest pre–licensure vaccine clinical trials ever conducted.

In July 2007, the Company announced that both *Gardasil* and *RotaTeq* have been adopted by all 55 U.S.–based immunization projects of the CDC Vaccines for Children program. The Vaccines for Children program provides vaccines to children who are Medicaid–eligible, uninsured, underinsured (when seen at a Federally Qualified Health Center or Rural Health Clinic), or Native American.

As previously disclosed, the Company has been working to resolve an issue related to the bulk manufacturing process for the Company's varicella zoster virus ("VZV")–containing vaccines. Manufacturing of bulk varicella has resumed, however product will not be available until the changes have been fully validated and approved by the applicable regulatory agencies. This situation does not affect the quality of any of Merck's VZV–containing vaccines currently on the market, any lots of vaccine in inventory that are ready for release to the market or any vaccines which will be filled and finished from existing VZV bulk. *ProQuad*, the Company's combination vaccine that protects against measles, mumps, rubella and chickenpox, one of the VZV–containing vaccines, is currently not available for ordering; however, orders have been transitioned, as appropriate, to *M–M–R* II and *Varivax*. Total sales as recorded by Merck for *ProQuad* were $264.4 million for 2007 compared with $234.8 million in 2006. Merck's sales of *Varivax*, the Company's vaccine for the prevention of chickenpox (varicella), were $854.9 million in 2007 compared with $327.9 million in 2006 as the ACIP's June 2006 second–dose recommendation continued to be implemented. *Varivax* is the only vaccine available in the United States to help protect against chickenpox.

Sales of *Zostavax*, the Company's vaccine to help prevent shingles (herpes zoster) recorded by Merck were $236.0 million in 2007 compared with $38.6 million in 2006. *Zostavax* was approved by the FDA as well as by regulatory authorities in Australia and the EU in May 2006. The vaccine is the first and only medical option for the prevention of shingles.

In December 2007, Merck announced that it had initiated a voluntary recall of 11 lots of its *Haemophilus influenzae* type B vaccine, *PedvaxHIB* [Haemophilus b Conjugate Vaccine (Meningococcal Protein Conjugate)],

and two lots of its combination *Haemophilus influenzae* type B/ hepatitis B vaccine, *Comvax* [Haemophilus b Conjugate (Meningococcal Protein Conjugate) and Hepatitis B (Recombinant) vaccine]. The recall was specific to these 13 lots and did not affect any other vaccines manufactured by Merck. Merck conducted the recall because it could not assure sterility of these specific vaccine lots. The potential contamination of these specific lots was identified as part of the Company's standard evaluation of its manufacturing processes. Sterility tests of the vaccine lots that are the subject of this recall have not found any contamination in the vaccine. The efficacy of the vaccine was not affected. Costs associated with the recall were not significant.

Merck temporarily stopped accepting orders for pediatric and adult vial formulations of *Vaqta*, a vaccine against hepatitis A, on October 1, 2007 in the United States. Merck will continue to accept orders for the adult formulation of *Vaqta* in pre-filled syringes until supplies are depleted. This situation is the result of manufacturing changes which require regulatory review and approval prior to product distribution. Until the manufacturing changes are approved, the availability of both pediatric and adult formulations of *Vaqta* will be affected. In the United States, the Company expects the pediatric formulation of *Vaqta* will be available again early in third quarter 2008. The adult formulation of *Vaqta* in vials is expected to be available again in fourth quarter 2008. Outside of the United States, the impact of this situation will vary depending on inventory levels and the regulatory requirements in each market. This situation does not in any way impact the quality or safety of *Vaqta* available on the market. Sales of *Vaqta* recorded by Merck were $148.5 million in 2007.

Costs, Expenses and Other

($ in millions)	2007	Change	2006	Change	2005
Materials and production	$ 6,140.7	2%	$ 6,001.1	17%	$ 5,149.6
Marketing and administrative	7,556.7	—%	8,165.4	14%	7,155.5
Research and development	4,882.8	2%	4,782.9	24%	3,848.0
Restructuring costs	327.1	*	142.3	-6%	322.2
Equity income from affiliates	(2,976.5)	30%	(2,294.4)	34%	(1,717.1)
U.S. *Vioxx* Settlement Agreement charge	4,850.0	–	–	–	–
Other (income) expense, net	46.2	*	(382.7)	*	(110.2)
	$ 20,827.0	27%	$ 16,414.6	12%	$ 14,648.0

* *100% or greater.*

Materials and Production

In 2007, materials and production costs increased primarily due to an increase in sales. This increase was partially offset by lower costs related to the global restructuring program. In 2007, $483.1 million of restructuring costs comprised of $460.6 million of accelerated depreciation associated with the planned sale or closure of certain of the Company's manufacturing facilities and $22.5 million of asset impairment charges were recorded compared with $736.4 million in 2006 representing $707.3 million of accelerated depreciation and $29.1 million of asset impairments. (See Note 3 to the consolidated financial statements.) The impact from inflation on materials and production costs in 2007 was not significant.

In 2006, materials and production costs increased 17% compared with a 3% increase in sales primarily reflecting higher global restructuring costs. Materials and production costs in 2006 also included stock option expense of $23.8 million, as a result of the adoption of Financial Accounting Standards Board ("FASB") Statement No. 123R, *Share-Based Payment* ("FAS 123R") (see Note 12 to the consolidated financial statements). Additionally, materials and production costs for 2006 included a 1% unfavorable impact from inflation.

Gross margin was 74.6% in 2007 compared with 73.5% in 2006 and 76.6% in 2005. The restructuring charges noted above had an unfavorable impact of 2.0 percentage points in 2007, 3.3 percentage points in 2006 and 0.8 percentage points in 2005. Gross margin in 2007 reflects a slight unfavorable impact from changes in product mix and the positive impact of manufacturing efficiencies. Gross margin in 2006 reflects the unfavorable impact of changes in product mix, including the decline in *Zocor* sales as a result of the loss of U.S. market exclusivity in June 2006.

Marketing and Administrative

In 2007, marketing and administrative expenses declined 7% compared with 2006 including a 2% unfavorable effect from foreign exchange and a 2% unfavorable effect from inflation. Marketing and administrative expenses in 2007 reflect the necessary support for new and anticipated product launches. Marketing and administrative expenses in 2007 and 2006 included $280 million and $673 million, respectively, of additional reserves solely for future *Vioxx* legal defense costs. In addition, marketing and administrative expenses for 2007 included a $455 million gain from an insurance arbitration award related to *Vioxx* product liability litigation coverage. (See Note 10 to the consolidated financial statements for more information on *Vioxx*–related matters). Marketing and administrative expenses in 2006 also reflected a $48 million charge for *Fosamax* legal defense costs.

In 2006, marketing and administrative expenses increased 14%, including a 3% unfavorable effect from inflation. Marketing and administrative expenses reflected $721 million of additional reserves for *Vioxx* and *Fosamax* legal defense costs, expenses associated with the launches of three new vaccines and *Januvia* in the United States, as well as stock option expense of $143.7 million.

Research and Development

Research and development expenses increased 2% in 2007 and 24% in 2006 including unfavorable effects from inflation of 2% in both 2007 and 2006. Research and development expenses in 2007 also reflected significant growth in the number of compounds entering clinical trials from internal projects as well as integration of late stage acquisitions. Research and development expenses in 2007 included $325.1 million of acquired research expense related to the NovaCardia acquisition and a $75 million initial milestone payment associated with the licensing of deforolimus (MK–8669), a Phase III compound the Company is developing with ARIAD Pharmaceuticals, Inc. ("ARIAD"). In 2006, research and development expenses included $466.2 million of acquired research related to the acquisition of Sirna, as well as $296.3 million of acquired research associated with the GlycoFi acquisition. In addition, research and development expenses for 2006 reflected accelerated depreciation costs of $56.5 million related to the closure of research facilities in connection with the global restructuring program.

During 2007, the Company continued the advancement of drug candidates through the pipeline, including the FDA approvals for *Janumet* and *Isentress*. The Company's research pipeline chart is included in Item 1. "Business — Research and Development" above.

In addition, on January 25, 2008, the FDA approved *Emend* (fosaprepitant dimeglumine) for Injection, 115mg, for the prevention of CINV. *Emend* for Injection provides a new option for day one oral *Emend* (125 mg) as part of the recommended three–day regimen that delivers five days of protection from nausea and vomiting. Prior to the FDA decision, the EU on January 11, 2008 granted marketing approval for *Emend* for Injection, known as *IVEmend* in the EU, an action that applies to all 27 EU member countries as well as Norway and Iceland.

In August 2007, the FDA accepted for standard review the NDA for *Cordaptive* (the proposed trademark for MK–0524A, ER niacin/laropiprant). *Cordaptive* is an investigational compound containing Merck's own ER niacin and laropiprant, a novel flushing pathway inhibitor designed to reduce flushing often associated with niacin treatment. Niacin is widely recognized as an effective lipid–modifying therapy; however, treatment has been limited as a result of the flushing side effect. Data included in the application support the proposed use of *Cordaptive*, either alone or with a statin, as adjunctive therapy to diet for the treatment of elevated low–density lipoprotein cholesterol ("LDL–C" or "bad" cholesterol), low high–density lipoprotein cholesterol ("HDL–C" or "good" cholesterol) and elevated triglyceride levels. All are conditions associated with increased risk of heart disease.

In September 2007, the Company announced Phase III clinical study results in which *Cordaptive* reduced LDL–C levels, increased HDL–C levels and reduced triglyceride levels compared to placebo. Patients treated with *Cordaptive* also reported significantly less flushing compared to those patients treated with ER niacin alone. *Cordaptive* was administered as 1– and 2– gram doses alone or added to ongoing statin therapy in patients with dyslipidemia. Across weeks 12 to 24 of the study, 2 grams (two 1–gram tablets) of *Cordaptive* produced significant percent changes from baseline in LDL–C levels (–18%), HDL–C levels (20%) and triglyceride levels (–26%) relative to placebo. In addition, patients treated with *Cordaptive* reported significantly less flushing both at the initiation of therapy and during maintenance therapy, compared to patients on ER niacin alone. Merck anticipates FDA action in April 2008. The Company is also moving forward with filings in countries outside the United States.

The Company currently has seven drug candidates in Phase III development and anticipates making NDA filings with respect to two of the candidates in 2008:

MK–0524B is a drug candidate that combines the novel approach to raising HDL–C and lowering triglycerides from ER niacin combined with laropiprant with the proven benefits of simvastatin in one combination product. In November 2007, the Company presented results of a study at the American Heart Association 2007 Scientific Sessions which demonstrate ER niacin/laropiprant (*Cordaptive)* coadministered with simvastatin had significant additive effects on reducing LDL–C, increasing HDL–C and reducing triglyceride levels in a Phase III study with patients with primary hypercholesterolemia or mixed dyslipidemia. In the study, 2 g (two 1–gram tablets) of *Cordaptive* coadministered with simvastatin (pooled across 20 mg or 40 mg doses) reduced LDL–C by 48%, increased HDL–C by 28%, and reduced triglyceride levels by 33% following 12 weeks of treatment. The primary study endpoint was LDL–C reduction; secondary endpoints included increased HDL–C, triglyceride reduction and effects on other lipoproteins. A 1 g tablet of *Cordaptive* contains 1 g of Merck–developed ER niacin and 20 mg of laropiprant, a novel flushing pathway inhibitor that is designed to reduce the flushing associated with niacin. The Company plans to file MK–0524B with the FDA in 2008.

MK–0364, taranabant, is an investigational highly selective cannabinoid–1 receptor inverse agonist that in early clinical studies has demonstrated dose–related weight loss versus placebo. Taranabant was generally well–tolerated, however, as reported with another cannabinoid–1 receptor inverse agonist, some dose–dependent psychiatric adverse events were observed. The Company previously announced the initiation of a targeted Phase III program in 2006. Merck anticipates filing an NDA in 2008.

MK–0974, an investigational oral calcitonin gene–related peptide receptor antagonist, utilizes a new mechanism for the treatment of migraines that has demonstrated efficacy at least comparable to triptans in early clinical studies. In June 2007, clinical results from a Phase II study were presented for the first time at the American Headache Society annual meeting which showed that MK–0974 significantly improved migraine pain relief two hours after dosing compared to placebo, and the relief was sustained through 24 hours. MK–0974 was generally well tolerated in the study. In addition to the measure of migraine pain, MK–0974 provided relief of migraine–associated symptoms, including nausea and sensitivity to light and sound, and improved functional disability two hours post dose, as well as reduced patients' need for rescue medication. The drug candidate entered Phase III development during 2007. The Company anticipates filing the NDA for MK–0974 in 2009.

MK–7418, rolofylline, is a Phase III investigational drug being evaluated for the treatment of acute heart failure. Phase III pilot study preliminary results indicated that rolofylline was generally well tolerated and that treatment resulted in a greater proportion of patients with improved dyspnea, fewer patients with worsening heart failure and greater weight loss compared to placebo. These benefits were achieved while preserving renal function compared to progressive worsening of renal function in patients treated with placebo. Merck acquired the drug candidate as part of the 2007 acquisition of NovaCardia and anticipates filing an NDA with the FDA in 2009.

MK–8669, deforolimus, is a novel mTOR (mammalian target of rapamycin) inhibitor being evaluated for the treatment of cancer. The drug candidate is being jointly developed and commercialized with ARIAD under an agreement reached in mid–2007 (as discussed below). The Company anticipates filing an NDA for a metastatic sarcoma indication in 2010.

A novel investigational hepatitis B vaccine, V270, currently is being evaluated in a Phase III clinical trial in adults and in patients undergoing dialysis treatment. Merck is jointly developing V270 with Dynavax Technologies Corporation ("Dynavax") under an agreement reached in late 2007 (as discussed below). Merck anticipates filing an NDA in 2010 for adults.

MK–0822, odanacatib, is an investigational highly selective inhibitor of the cathepsin K enzyme, which is being evaluated for the treatment of osteoporosis. The cathepsin K enzyme is believed to play a role in both osteoclastic bone resorption and in degrading the protein component of bone. The inhibition of the cathepsin K enzyme by the investigational compound odanacatib is a mechanism of action different from that of currently approved treatments such as bisphosphonates. In September 2007, twelve month results from a Phase IIB study with odanacatib demonstrated dose–dependent increases in bone mineral density ("BMD") at key fracture sites, and reduced bone turnover compared to placebo in postmenopausal women with low BMD when given at doses of 10,

25 or 50 mg. These findings were presented at the 29th Annual Meeting of the American Society for Bone and Mineral Research. BMD reflects the amount of mineralized bone tissue in a certain volume of bone, and correlates with the strength of bones and with their resistance to fracture. A BMD test is used to measure bone density and to help determine fracture risk. The Phase III program began in mid-2007. Merck anticipates filing an NDA with the FDA in 2012.

Additionally, in December 2007, the Company announced it plans to initiate a sequenced Phase III program in 2008 for MK-0859, anacetrapib, its investigational selective cholesteryl ester transfer protein ("CETP") inhibitor, to obtain additional clinical experience in patients before initiating an outcomes study. In October 2007, the Company presented results from a Phase IIb study demonstrating that MK-0859 significantly reduced LDL-C and Apolipoprotein B and increased HDL-C and Apolipoprotein A-1 both as monotherapy and in combination with atorvastatin 20 mg compared to placebo in patients with dyslipidemia. Anacetrapib produced these positive effects on lipids with no observed blood pressure changes. CETP inhibitors work by inhibiting CETP, a plasma protein that facilitates the transport of cholesteryl esters and triglycerides between the lipoproteins.

In March 2007, Merck and H. Lundbeck A/S ("Lundbeck") announced the discontinuation of their joint development program for gaboxadol, an investigational new medicine for the treatment of insomnia that was in Phase III development. Data from completed clinical studies suggested that the overall clinical profile for gaboxadol in insomnia does not support further development. As a result of this information, Merck and Lundbeck will not file an NDA for gaboxadol for the treatment of insomnia with the FDA, or other regulatory agencies worldwide, and have terminated ongoing clinical studies.

In September 2007, Merck announced that vaccination in a Phase II clinical trial of the Company's investigational HIV vaccine (V520) was discontinued because the vaccine was not effective. The trial, called STEP, was co-sponsored by Merck, the National Institutes of Health's National Institute of Allergies and Infectious Diseases ("NIAID") and the HIV Vaccine Trials Network. The independent Data Safety Monitoring Board ("DSMB") for STEP recommended discontinuation because the STEP trial would not meet its efficacy endpoints. In October 2007, the NIAID announced that a separate DSMB for a second clinical trial being conducted in South Africa of the same vaccine candidate recommended that vaccination and enrollment in the South Africa trial be permanently discontinued. The South Africa DSMB also recommended that volunteers in that trial be told whether they received the vaccine or placebo, be strongly encouraged to return to study sites for protocol-related tests, and be counseled about the possibility that those who received the vaccine might have an increased susceptibility to HIV infections. Detailed analyses of the available data are being conducted, including analyses to better understand if there may be an increased susceptibility to HIV infection among those volunteers who received the vaccine. The vaccine itself does not cause HIV infection.

In August 2006, Merck and Gilead Sciences, Inc. ("Gilead") established an agreement for the distribution of Atripla in developing countries around the world. Atripla contains 600 mg of efavirenz, a non-nucleoside reverse transcriptase inhibitor, 200 mg of emtricitabine and 300 mg of tenofovir disoproxil fumarate, both nucleoside reverse transcriptase inhibitors. Efavirenz is marketed by Merck under the tradename *Stocrin* in all territories outside of the United States, Canada and certain European countries (where it is commercialized by Bristol Myers Squibb under the tradename Sustiva). Emtricitabine and tenofovir disoproxil fumarate are commercialized by Gilead under the tradenames Emtriva and Viread, respectively. Atripla was approved in the EU in 2007.

Merck continues to remain focused on augmenting its internal efforts by capitalizing on growth opportunities, ranging from targeted acquisitions to research collaborations, preclinical and clinical compounds and technology transactions that will drive both near- and long-term growth. The Company completed 55 transactions in 2007 across a broad range of therapeutic categories, as well as early-stage technology transactions. Merck is currently evaluating other opportunities, and is actively monitoring the landscape for a range of targeted acquisitions that meet the Company's strategic criteria. Highlights from these activities for the year include:

In July 2007, Merck and ARIAD announced that they had entered into a global collaboration to jointly develop and commercialize deforolimus (MK-8669), ARIAD's novel mTOR inhibitor, for use in cancer. Each party will fund 50% of the cost of global development of MK-8669, except that Merck will fund 100% of the cost of ex-U.S. development that is specific to the development or commercialization of MK-8669 outside the U.S. that is

not currently part of the global development plan. The agreement provided for an initial payment of $75 million to ARIAD, which the Company recorded as Research and development expense, up to $452 million more in milestone payments to ARIAD based on the successful development of MK–8669 in multiple cancer indications (including $13.5 million paid for the initiation of the Phase III clinical trial in metastatic sarcomas and $114.5 million to be paid for the initiation of other Phase II and Phase III clinical trials), up to an additional $200 million based on achievement of significant sales thresholds, at least $200 million in estimated contributions by Merck to global development, up to $200 million in interest–bearing repayable development–cost advances from Merck to cover a portion of ARIAD's share of global–development costs (after ARIAD has paid $150 million in global development costs), and potential commercial returns from profit sharing in the U.S. or royalties paid by Merck outside the U.S. In the U.S., ARIAD will distribute and sell MK–8669 for all cancer indications, and ARIAD and Merck will co–promote and will each receive 50% of the income from such sales. Outside the U.S., Merck will distribute, sell and promote MK–8669; Merck will pay ARIAD tiered double–digit royalties on end–market sales of MK–8669.

In September 2007, Merck completed the acquisition of NovaCardia, a privately held clinical–stage pharmaceutical company focused on cardiovascular disease. This acquisition added rolofylline (MK–7418), NovaCardia's investigational Phase III compound for acute heart failure, to Merck's pipeline. Merck acquired all of the outstanding equity of NovaCardia for a total purchase price of $366.4 million (including $16.4 million of cash and investments on hand at closing), which was paid through the issuance of 7.3 million shares of Merck common stock to the former NovaCardia shareholders based on Merck's average closing stock price for the five days prior to closing of the acquisition. In connection with the acquisition, the Company recorded a charge of $325.1 million for acquired research associated with rolofylline as at the acquisition date, technological feasibility had not been established and no alternative future use existed (see "Acquisitions" above).

In November 2007, Merck and Dynavax announced a global license and development collaboration agreement to jointly develop V270, a novel investigational hepatitis B vaccine, which is currently being evaluated in a multi–center Phase III clinical trial involving adults and in patients on dialysis. Under the terms of the agreement, Merck receives worldwide exclusive rights to V270, will fund future vaccine development, and be responsible for commercialization. Dynavax received an initial payment of $31.5 million, which the Company recorded as Research and development expense, and will be eligible to receive up to $105 million in development and sales milestone payments, and double–digit tiered royalties on global sales of V270.

Also, in November 2007, Merck and GTx, Inc. ("GTx") announced that they had entered into an agreement providing for a research and development and global strategic collaboration for selective androgen receptor modulators ("SARMs"), a new class of drugs with the potential to treat age–related muscle loss (sarcopenia) as well as other musculoskeletal conditions. This collaboration includes GTx's lead SARM candidate, Ostarine (MK–2866), which is currently being evaluated in a Phase II clinical trial for the treatment of muscle loss in patients with cancer, and establishes a broad SARM collaboration under which GTx and Merck will pool their programs and partner to discover, develop, and commercialize current as well as future SARM molecules. As part of this global agreement, Merck will be responsible for all future costs associated with ongoing development and, if approved, commercialization of Ostarine and other investigational SARMs resulting from the collaboration. Under the terms of the collaboration agreement and related stock purchase agreement, GTx and Merck will combine their respective SARM research programs. GTx received an upfront payment of $40 million, which was recorded by Merck as Research and development expense, and will also receive $15 million in research reimbursements to be paid over the initial three years of the collaboration. In addition, Merck made an investment of $30 million in GTx common stock. GTx will also be eligible to receive up to $422 million in future milestone payments associated with the development and approval of a drug candidate if multiple indications receive regulatory approval. Additional milestones may be received for the development and approval of other collaboration drug candidates. GTx will receive royalties on any resulting worldwide product revenue.

The Company maintains a number of long–term exploratory and fundamental research programs in biology and chemistry as well as research programs directed toward product development. Merck's research and development model is designed to increase productivity and improve the probability of success by prioritizing the Company's research and development resources on disease areas such as atherosclerosis, hypertension, diabetes and obesity, novel vaccines; neurodegenerative and psychiatric diseases and targeted oncology therapies. The Company will also make focused investments in other areas of important unmet medical needs. In addition, the

Company is focused on utilizing new research technologies, building alliances with external partners and making targeted acquisitions which will complement the Company's strong internal research capabilities. A chart reflecting the Company's current research pipeline as of February 15, 2008 is set forth in Item 1. "Business."

Share–Based Compensation

On January 1, 2006, the Company adopted FAS 123R (see Note 12 to the consolidated financial statements). FAS 123R requires all share–based payments to employees be expensed over the requisite service period based on the grant–date fair value of the awards. Prior to adopting FAS 123R, the Company accounted for employee stock options using the intrinsic value method which measures share–based compensation expense as the amount by which the market price of the stock at the date of grant exceeds the exercise price. The Company elected the modified prospective transition method for adopting FAS 123R, and therefore, prior periods were not restated. Under this method, the provisions of FAS 123R applied to all awards granted or modified after January 1, 2006. Total pretax share–based compensation expense was $330.2 million in 2007, $312.5 million in 2006 and $48.0 million in 2005. In addition, the unrecognized expense of awards that had not yet vested at the date of adoption are recognized in Net income in the periods after the date of adoption. At December 31, 2007, there was $402.8 million of total pretax unrecognized compensation expense related to nonvested stock option, restricted stock unit and performance share unit awards which will be recognized over a weighted average period of 2.0 years. For segment reporting, share–based compensation costs are unallocated expenses.

Restructuring Costs

Restructuring costs were $327.1 million, $142.3 million and $322.2 million for 2007, 2006 and 2005, respectively. In 2007, 2006 and 2005, Merck incurred $251.4 million, $113.7 million and $182.4 million, respectively, in separation costs associated with actual headcount reductions, as well as headcount reductions that were probable and could be reasonably estimated related to the global restructuring program. The Company eliminated 2,400 positions in 2007; 3,700 positions in 2006 and 1,100 positions in 2005. These position eliminations are comprised of actual headcount reductions, and the elimination of contractors and vacant positions. Also included in restructuring costs are curtailment, settlement and termination charges on the Company's pension and other postretirement benefit plans and shutdown costs. In addition, in 2005, the Company recorded $116.8 million for separation costs associated with other restructuring programs. For segment reporting, restructuring costs are unallocated expenses.

Equity Income from Affiliates

Equity income from affiliates reflects the performance of the Company's joint ventures and partnerships. In 2007, 2006 and 2005, the increase in Equity income from affiliates primarily reflects the successful performance of *Vytorin* and *Zetia* through the Merck/Schering–Plough partnership. See "Selected Joint Venture and Affiliate Information" below.

U.S. Vioxx *Settlement Agreement Charge*

On November 9, 2007, Merck entered into the Settlement Agreement with the law firms that comprise the executive committee of the Plaintiffs' Steering Committee of the federal multidistrict *Vioxx* litigation as well as representatives of plaintiffs' counsel in state coordinated proceedings to resolve state and federal MI and IS claims already filed against the Company in the United States. If certain participation conditions under the Settlement Agreement are met (or waived), the Company will pay an aggregate fixed amount of $4.85 billion into two funds for qualifying claims consisting of $4.0 billion for qualifying MI claims and $850 million for qualifying IS claims that enter into the Settlement Program. As a consequence of the Settlement Agreement, the Company recorded a pretax charge of $4.85 billion in 2007. (See Note 10 to the consolidated financial statements).

Other (Income) Expense, Net

The change in Other (income) expense, net during 2007 primarily reflects a $671.1 million charge related to the resolution of certain civil governmental investigations (see Note 10 to the consolidated financial statements) partially offset by the favorable impact of gains on sales of assets and product divestitures, as well as a net gain on the settlements of certain patent disputes. The change in Other (income) expense, net, in 2006 reflects an increase in

interest income generated from the Company's investment portfolio derived from higher interest rates and higher average investment portfolio balances.

Segment Profits

($ in millions)	2007	2006	2005
Pharmaceutical segment profits	$ 14,076.7	$ 13,649.4	$ 13,157.9
Vaccines segment profits	2,605.0	892.8	767.0
Other segment profits	452.7	380.7	355.5
Other	(13,763.7)	(8,701.5)	(6,916.5)
Income before income taxes	$ 3,370.7	$ 6,221.4	$ 7,363.9

Segment profits are comprised of segment revenues less certain elements of materials and production costs and operating expenses, including components of equity income (loss) from affiliates and depreciation and amortization expenses. For internal management reporting presented to the chief operating decision maker, the Company does not allocate the vast majority of indirect production costs, research and development expenses and general and administrative expenses, as well as the cost of financing these activities. Separate divisions maintain responsibility for monitoring and managing these costs, including depreciation related to fixed assets utilized by these divisions and, therefore, they are not included in segment profits. Also excluded from the determination of segment profits are the U.S. *Vioxx* Settlement Agreement charge, taxes paid at the joint venture level and a portion of equity income. Additionally, segment profits do not reflect other expenses from corporate and manufacturing cost centers and other miscellaneous income (expense). These unallocated items are reflected in "Other" in the above table. Also included in other are miscellaneous corporate profits, operating profits related to divested products or businesses, other supply sales and adjustments to eliminate the effect of double counting certain items of income and expense.

Pharmaceutical segment profits increased 3% in 2007 and 4% in 2006 reflecting higher equity income, primarily driven by the strong performance of the Merck/Schering–Plough partnership, partially offset by the loss of U.S. market exclusivity for *Zocor* and *Proscar*.

Vaccines segment profits nearly tripled in 2007 and grew 16% in 2006 driven by the launch of three new vaccines in the latter part of 2006 and the successful performance of *Varivax*. Vaccines segment profits also reflect equity income from SPMSD.

Taxes on Income

The Company's effective income tax rate was 2.8% in 2007, 28.7% in 2006 and 37.1% in 2005. The 2007 effective tax rate reflects the reduction of domestic pretax income primarily resulting from the U.S. *Vioxx* Settlement Agreement charge and the related change in mix of domestic and foreign pretax income. The higher effective tax rate in 2005 reflects an unfavorable impact of 9.1 percentage points primarily related to the Company's decision to repatriate $15.9 billion of foreign earnings in accordance with the American Jobs Creation Act of 2004 ("AJCA").

Net Income and Earnings per Share

($ in millions except per share amounts)	2007	Change	2006	Change	2005
Net income	$ 3,275.4	'6%	$ 4,433.8	"%	$ 4,631.3
As a % of sales	13.5%		19.6%		21.0%
As a % of average total assets	7.0%		9.9%		10.6%
Earnings per common share assuming dilution	$ 1.49	'7%	$ 2.03	"%	$ 2.10

Net Income and Earnings per Common Share

Net income decreased 26% in 2007 and declined 4% in 2006. Earnings per common share assuming dilution declined 27% in 2007 compared to a decline of 3% in 2006. The declines in 2007 reflect the impact of the U.S. *Vioxx* Settlement Agreement charge and civil governmental investigations charge, partially offset by lower reserves for legal defense costs, a gain from an insurance arbitration award related to *Vioxx* product liability

litigation coverage, lower acquired research costs and the favorable impact of gains on sales of assets and product divestitures, as well as a net gain on the settlements of certain patent disputes. Net income and EPS in 2007 also reflect revenue growth of vaccines, *Singulair* and *Januvia*, as well as higher equity income from affiliates. Net income and EPS declines in 2006 primarily reflect acquired research charges, higher restructuring charges, increased reserves for legal defense costs and the incremental impact of expensing stock options, partially offset by growth in equity income from affiliates. Net income as a percentage of sales was 13.5% in 2007, 19.6% in 2006 and 21.0% in 2005. The decrease in the percentage of sales ratio in 2007 as compared to 2006 reflects the same factors discussed above. Net income as a percentage of average total assets was 7.0% in 2007, 9.9% in 2006 and 10.6% in 2005.

Selected Joint Venture and Affiliate Information

To expand its research base and realize synergies from combining capabilities, opportunities and assets, in previous years the Company formed a number of joint ventures. (See Note 8 to the consolidated financial statements.)

Merck/Schering–Plough Partnership

In 2000, the Company and Schering–Plough Corporation ("Schering–Plough") (collectively, the "Partners") entered into agreements to create separate equally–owned partnerships to develop and market in the United States new prescription medicines in the cholesterol–management and respiratory therapeutic areas. These agreements generally provide for equal sharing of development costs and for co–promotion of approved products by each company. In 2001, the cholesterol–management partnership agreements were expanded to include all the countries of the world, excluding Japan. In 2002, ezetimibe, the first in a new class of cholesterol–lowering agents, was launched in the United States as *Zetia* (marketed as *Ezetrol* outside the United States). In 2004, a combination product containing the active ingredients of both *Zetia* and *Zocor* was approved in the United States as *Vytorin* (marketed as *Inegy* outside the United States).

The cholesterol agreements provide for the sharing of operating income generated by the Merck/Schering–Plough cholesterol partnership (the "MSP Partnership") based upon percentages that vary by product, sales level and country. In the U.S. market, the Partners share profits on *Zetia* and *Vytorin* sales equally, with the exception of the first $300 million of annual *Zetia* sales, on which Schering–Plough receives a greater share of profits. Operating income includes expenses that the Partners have contractually agreed to share, such as a portion of manufacturing costs, specifically identified promotion costs (including direct–to–consumer advertising and direct and identifiable out–of–pocket promotion) and other agreed upon costs for specific services such as on–going clinical research, market support, market research, market expansion, as well as a specialty sales force and physician education programs. Expenses incurred in support of the MSP Partnership but not shared between the Partners, such as marketing and administrative expenses (including certain sales force costs), as well as certain manufacturing costs, are not included in Equity income from affiliates. However, these costs are reflected in the overall results of the Company. Certain research and development expenses are generally shared equally by the Partners, after adjusting for earned milestones.

Sales of joint venture products were as follows:

($ in millions)	2007	2006	2005
Vytorin	$ 2,779.1	$ 1,955.3	$ 1,028.3
Zetia	2,407.1	1,928.8	1,396.7
	$ 5,186.2	$ 3,884.1	$ 2,425.0

Global sales of *Vytorin* grew 42% in 2007 and 90% in 2006. *Vytorin* is the only combination tablet cholesterol treatment to provide LDL cholesterol lowering through the dual inhibition of cholesterol production and absorption. Global sales of *Zetia* increased 25% in 2007 and 38% in 2006.

On January 14, 2008, the MSP Partnership announced the primary endpoint and other results of the ENHANCE (Effect of Combination Ezetimibe and High–Dose Simvastatin vs. Simvastatin Alone on the Atherosclerotic Process in Patients with Heterozygous Familial Hypercholesterolemia) trial. The MSP Partnership

submitted an abstract on the ENHANCE trial for presentation at the American College of Cardiology meeting in March 2008 and was notified of its acceptance by the College. ENHANCE was a surrogate endpoint trial conducted in 720 patients with Heterozygous Familial Hypercholesterolemia, a rare condition that affects approximately 0.2% of the population. All analyses were conducted in accordance with the original statistical analysis plan. The primary endpoint was the mean change in the intima–media thickness measured at three sites in the carotid arteries (the right and left common carotid, internal carotid and carotid bulb) between patients treated with ezetimibe/simvastatin 10/80 mg versus patients treated with simvastatin 80 mg alone over a two year period. There was no statistically significant difference between treatment groups on the primary endpoint. There was also no statistically significant difference between the treatment groups for each of the components of the primary endpoint, including the common carotid artery. Key secondary imaging endpoints showed no statistical difference between treatment groups. The overall incidence rates of treatment–related adverse events, serious adverse events or adverse events leading to discontinuation were generally similar between treatment groups. Both medicines were generally well tolerated. Overall, the safety profiles of ezetimibe/simvastatin and simvastatin alone were similar and generally consistent with their product labels. In the trial, there was a significant difference in low–density lipoprotein ("LDL") cholesterol lowering seen between the treatment groups — 58% LDL cholesterol lowering at 24 months on ezetimibe/simvastatin as compared to 41% at 24 months on simvastatin alone. This surrogate endpoint study was not powered nor designed to assess cardiovascular clinical event outcomes. The MSP Partnership is currently conducting the IMPROVE–IT trial, a large clinical cardiovascular outcomes trial comparing *Vytorin* (ezetimibe/simvastatin) and simvastatin and including more than 10,000 patients. *Vytorin* contains two medicines: ezetimibe and simvastatin. *Vytorin* has not been shown to reduce heart attacks or strokes more than simvastatin alone.

During December 2007 and through February 26, 2008, the Company and its joint–venture partner, Schering–Plough, received several joint letters from the House Committee on Energy and Commerce and the House Subcommittee on Oversight and Investigations, and one letter from the Senate Finance Committee, collectively seeking a combination of witness interviews, documents and information on a variety of issues related to the ENHANCE clinical trial, the sale and promotion of *Vytorin*, as well as sales of stock by corporate officers. On January 25, 2008, the companies and the MSP Partnership each received two subpoenas from the New York State Attorney General's Office seeking similar information and documents. Merck and Schering–Plough have also each received a letter from the Office of the Connecticut Attorney General dated February 1, 2008, requesting documents related to the marketing and sale of *Vytorin* and *Zetia* and the timing of disclosures of the results of ENHANCE. The Company is cooperating with these investigations and working with Schering–Plough to respond to the inquiries. In addition, since mid–January 2008, the Company has become aware of or been served with approximately 85 civil class action lawsuits alleging common law and state consumer fraud claims in connection with the MSP Partnership's sale and promotion of *Vytorin* and *Zetia*.

The Company has been closely monitoring sales of *Vytorin* and *Zetia* following the release of the ENHANCE clinical trial results in the press release on January 14, 2008. To date, sales of both products in the U.S. have been below the Company's prior expectations. In addition, wholesalers in the U.S. have moderated their purchases of both products to reduce their inventory levels.

The respiratory therapeutic agreements provide for the joint development and marketing in the United States by the Partners of a once–daily, fixed–combination tablet containing the active ingredients montelukast sodium and loratadine. Montelukast sodium, a leukotriene receptor antagonist, is sold by Merck as *Singulair* and loratadine, an antihistamine, is sold by Schering–Plough as Claritin, both of which are indicated for the relief of symptoms of allergic rhinitis. In August 2007, the Partners announced that the New Drug Application filing for montelukast sodium/loratadine had been accepted by the U.S. Food and Drug Administration for standard review. The Partners are seeking U.S. marketing approval of the medicine for treatment of allergic rhinitis symptoms in patients who want relief from nasal congestion. The Company anticipates FDA action in the second quarter of 2008.

The results from the Company's interest in the MSP Partnership are recorded in Equity income from affiliates. Merck recognized equity income of $1,830.8 million in 2007, $1,218.6 million in 2006 and $570.4 million in 2005.

The financial statements of the MSP Partnership are included in Item 15. (a)(2) "Financial Statement Schedules" below.

AstraZeneca LP

In 1982, the Company entered into an agreement with Astra AB ("Astra") to develop and market Astra products in the United States. In 1994, the Company and Astra formed an equally–owned joint venture that developed and marketed most of Astra's new prescription medicines in the United States including *Prilosec*, the first in a class of medications known as proton pump inhibitors, which slows the production of acid from the cells of the stomach lining.

In 1998, the Company and Astra restructured the joint venture whereby the Company acquired Astra's interest in the joint venture, renamed KBI Inc. ("KBI"), and contributed KBI's operating assets to a new U.S. limited partnership named Astra Pharmaceuticals, L.P. (the "Partnership"), in which the Company maintains a limited partner interest. The Partnership, renamed AstraZeneca LP ("AZLP") upon Astra's 1999 merger with Zeneca Group Plc (the "AstraZeneca merger"), became the exclusive distributor of the products for which KBI retained rights.

Merck earns ongoing revenue based on sales of current and future KBI products and such revenue was $1.7 billion, $1.8 billion and $1.7 billion in 2007, 2006 and 2005, respectively, primarily relating to sales of *Nexium,* as well as *Prilosec.* In addition, Merck earns certain Partnership returns, which are recorded in Equity income from affiliates. Such returns include a priority return provided for in the Partnership Agreement, variable returns based, in part, upon sales of certain former Astra USA, Inc. products, and a preferential return representing Merck's share of undistributed AZLP GAAP earnings. These returns aggregated $820.1 million, $783.7 million and $833.5 million in 2007, 2006 and 2005, respectively. The AstraZeneca merger triggers a partial redemption of Merck's limited partnership interest in 2008. Upon this redemption, AZLP will distribute to KBI an amount based primarily on a multiple of Merck's average annual variable returns derived from sales of the former Astra USA, Inc. products for the three years prior to the redemption (the "Limited Partner Share of Agreed Value").

In conjunction with the 1998 restructuring for a payment of $443.0 million, which was recorded as deferred income, Astra purchased an option (the "Asset Option") to buy Merck's interest in the KBI products, excluding the gastrointestinal medicines *Nexium* and *Prilosec* (the "Non–PPI Products"). The Asset Option is exercisable in the first half of 2010 at an exercise price equal to the net present value as of March 31, 2008 of projected future pretax revenue to be received by the Company from the Non–PPI Products (the "Appraised Value"). Merck also had the right to require Astra to purchase such interest in 2008 at the Appraised Value. In February 2008, the Company advised AZLP that it will not exercise the Asset Option. In addition, in 1998 the Company granted Astra an option to buy Merck's common stock interest in KBI, and, therefore, Merck's interest in *Nexium* and *Prilosec*, exercisable two years after Astra's purchase of Merck's interest in the Non–PPI Products. The exercise of this option by Astra is also provided for in the year 2017 or if combined annual sales of the two products fall below a minimum amount provided, in each case, only so long as AstraZeneca's option in 2010 has been exercised. The exercise price is based on the net present value of estimated future net sales of *Nexium* and *Prilosec* as determined at the time of exercise, subject to certain true–up mechanisms.

Also, as a result of the AstraZeneca merger, in exchange for Merck's relinquishment of rights to future Astra products with no existing or pending U.S. patents at the time of the merger, Astra paid $967.4 million (the "Advance Payment"), which is subject to a true–up calculation (the "True–Up Amount") in 2008 that may require repayment of all or a portion of this amount. The True–Up Amount is directly dependent on the fair market value in 2008 of the Astra product rights retained by the Company. Accordingly, recognition of this contingent income has been deferred until the realizable amount is determinable in 2008. In 2007, the Company reclassified this amount to Accrued and other current liabilities from non–current liabilities as this true–up calculation will occur before the end of the second quarter of 2008.

The sum of the Limited Partner Share of Agreed Value, the Appraised Value and the True–Up Amount is guaranteed to be a minimum of $4.7 billion. Distribution of the Limited Partner Share of Agreed Value and payment of the True–Up Amount will occur in the first half of 2008 and such amounts are anticipated to represent a substantial portion of the $4.7 billion. These payments will result in a pretax gain estimated to be $2.1 billion to

$2.3 billion. AstraZeneca's purchase of Merck's interest in the Non–PPI Products is contingent upon the exercise of AstraZeneca's option in 2010 and, therefore, payment of the Appraised Value may or may not occur.

Merial Limited

In 1997, Merck and Rhône–Poulenc S.A. (now Sanofi–Aventis S.A.) combined their animal health and poultry genetics businesses to form Merial Limited ("Merial"), a fully integrated animal health company, which is a stand–alone joint venture, equally owned by each party. Merial provides a comprehensive range of pharmaceuticals and vaccines to enhance the health, well–being and performance of a wide range of animal species.

Sales of joint venture products were as follows:

($ in millions)	2007	2006	2005
Fipronil products	$ 1,033.3	$ 886.9	$ 757.7
Biological products	674.9	600.7	533.2
Avermectin products	478.4	468.7	467.5
Other products	262.2	238.4	228.6
	$ 2,448.8	$ 2,194.7	$ 1,987.0

Sanofi Pasteur MSD

In 1994, Merck and Pasteur Merieux Connaught (now Sanofi Pasteur S.A.) established a 50% owned joint venture to market vaccines in Europe and to collaborate in the development of combination vaccines for distribution in Europe.

In 2006, Merck launched three new vaccines that have been approved for use in the EU and are being marketed by SPMSD in certain Western European countries: *Gardasil* to help prevent cervical cancer, pre–cancerous and low–grade lesions, vulvar and vaginal pre–cancers, and genital warts caused by HPV types 6, 11, 16 and 18; *RotaTeq* to help protect against rotavirus gastroenteritis in infants and children; and *Zostavax* to help prevent shingles (herpes zoster) in individuals 60 years of age or older.

Sales of joint venture products were as follows:

($ in millions)	2007	2006	2005
Viral vaccines	$ 86.8	$ 100.1	$ 78.5
Hepatitis vaccines	72.9	70.9	81.1
Gardasil	476.0	7.5	–
Other vaccines	802.3	735.4	705.5
	$ 1,438.0	$ 913.9	$ 865.1

Johnson & Johnson°Merck Consumer Pharmaceuticals Company

In 1989, Merck formed a joint venture with Johnson & Johnson to develop and market a broad range of nonprescription medicines for U.S. consumers. This 50% owned joint venture was expanded in Europe in 1993 and into Canada in 1996. In 2004, Merck sold its 50% equity stake in its European joint venture to Johnson & Johnson. Merck will continue to benefit through royalties on certain products and also regained the rights to potential future products that switch from prescription to over–the–counter status in Europe.

Sales of joint venture products were as follows:

($ in millions)	2007	2006	2005
Gastrointestinal products	$ 218.5	$ 250.9	$ 250.8
Other products	1.2	1.7	2.5
	$ 219.7	$ 252.6	$ 253.3

Capital Expenditures

Capital expenditures were $1.0 billion in 2007, $980.2 million in 2006 and $1.4 billion in 2005. Expenditures in the United States were $788.0 million in 2007, $714.7 million in 2006 and $938.7 million in 2005. Expenditures during 2007 included $372.7 million for production facilities, $226.2 million for research and development facilities, $9.3 million for environmental projects, and $402.8 million for administrative, safety and general site projects, of which approximately 40% represents capital investments related to a multi–year initiative to standardize the Company's information systems. Capital expenditures for 2008 are estimated to be $1.6 billion.

Depreciation expense was $1.8 billion in 2007, $2.1 billion in 2006 and $1.5 billion in 2005, of which $1.4 billion, $1.5 billion and $1.1 billion, respectively, applied to locations in the United States. Total depreciation expense in 2007, 2006 and 2005 included accelerated depreciation of $460.6 million, $763.8 million and $84.6 million, respectively, associated with the global restructuring program. Additionally, depreciation expense for 2005 reflects $103.1 million associated with the closure of the Terlings Park basic research center (see Note 3 to the consolidated financial statements).

Analysis of Liquidity and Capital Resources

Merck's strong financial profile enables the Company to fully fund research and development, focus on external alliances, support in–line products and maximize upcoming launches while providing significant cash returns to shareholders.

Selected Data

($ in millions)	2007	2006	2005
Working capital	$ 2,787.2	$ 2,507.5	$ 7,806.9
Total debt to total liabilities and equity	11.9%	15.3%	18.1%
Cash provided by operations to total debt	1.2:1	1.0:1	0.9:1

Cash provided by operating activities, which was $7.0 billion in 2007, $6.8 billion in 2006 and $7.6 billion in 2005, continues to be the Company's primary source of funds to finance capital expenditures, treasury stock purchases and dividends paid to stockholders. At December 31, 2007, the total of worldwide cash and investments was $15.4 billion, including $8.2 billion of cash, cash equivalents and short–term investments, and $7.2 billion of long–term investments.

Working capital levels are more than adequate to meet the operating requirements of the Company. The ratios of total debt to total liabilities and equity and cash provided by operations to total debt reflect the strength of the Company's operating cash flows and the ability of the Company to cover its contractual obligations.

During 2006, the Company began shifting its mix of investments from short–term to long–term, resulting in a reduction of working capital in line with historical levels relative to the level at December 31, 2005. In 2005, to enable execution of the AJCA repatriation, the Company changed its mix of investments from long–term to short–term, resulting in a significant increase in working capital as of December 31, 2005. The AJCA created temporary incentives through December 31, 2005 for U.S. multinationals to repatriate accumulated income earned outside of the United States as of December 31, 2002. In connection with the AJCA, the Company repatriated $15.9 billion during 2005. As a result, the Company recorded an income tax charge of $766.5 million in Taxes on Income in 2005 related to this repatriation, $185 million of which was paid in 2005 and the remainder of which was paid in the first quarter of 2006. As of December 31, 2005, approximately $5.2 billion of the AJCA repatriation was invested in fully collateralized overnight repurchase agreements. In early 2006, the Company began reinvesting its repurchase agreement balances into other investments.

During 2008, the Company anticipates that under the U.S. *Vioxx* Settlement Agreement, if participation conditions are met or waived, the Company will make payments of up to approximately $1.6 billion pursuant to the Settlement Agreement. Also, the Company anticipates making payments of approximately $671 million related to the resolution of investigations of civil claims by federal and state authorities relating to certain past marketing and selling activities. The Company will receive payments in the first half of 2008 for certain AZLP–related activities as

discussed above in "Selected Joint Venture and Affiliate Information." Distribution of such amounts are anticipated to represent a substantial portion of the $4.7 billion minimum.

As previously disclosed, the IRS has completed its examination of the Company's tax returns for the years 1993 to 2001. As a result of the examination, the Company made an aggregate payment of $2.79 billion in February 2007. This payment was offset by (i) a tax refund of $165 million received in 2007 for amounts previously paid for these matters and (ii) a federal tax benefit of approximately $360 million related to interest included in the payment, resulting in a net cash cost to the Company of approximately $2.3 billion in 2007. The impact for years subsequent to 2001 for items reviewed as part of the examination was included in the payment although those years remain open in all other respects. The closing of the IRS examination did not have a material impact on the Company's results of operations in 2007 as these amounts had been previously provided for.

As previously disclosed, Merck's Canadian tax returns for the years 1998 through 2004 are being examined by the Canada Revenue Agency ("CRA"). In October 2006, the CRA issued the Company a notice of reassessment containing adjustments related to certain intercompany pricing matters, which result in additional Canadian and provincial tax due of approximately $1.6 billion (U.S. dollars) plus interest of approximately $810 million (U.S. dollars). In addition, in July 2007, the CRA proposed additional adjustments for 1999 relating to another intercompany pricing matter. The adjustments would increase Canadian tax due by approximately $22 million (U.S. dollars) plus $21 million (U.S. dollars) of interest. It is possible that the CRA will propose similar adjustments for later years. The Company disagrees with the positions taken by the CRA and believes they are without merit. The Company intends to contest the assessment through the CRA appeals process and the courts if necessary. In connection with the appeals process, during 2007, the Company pledged collateral to two financial institutions, one of which provided a guarantee to the CRA and the other to the Quebec Ministry of Revenue representing a portion of the tax and interest assessed. The collateral is included in Other Assets in the Consolidated Balance Sheet and totaled approximately $1.4 billion at December 31, 2007. The Company has previously established reserves for these matters. While the resolution of these matters may result in liabilities higher or lower than the reserves, management believes that resolution of these matters will not have a material effect on the Company's financial position or liquidity. However, an unfavorable resolution could have a material effect on the Company's results of operations or cash flows in the quarter in which an adjustment is recorded or tax is due.

In July 2007, the CRA notified the Company that it is in the process of proposing a penalty of $160 million (U.S. dollars) in connection with the 2006 notice. The penalty is for failing to provide information on a timely basis. The Company vigorously disagrees with the penalty and feels it is inapplicable and that appropriate information was provided on a timely basis. The Company is pursuing all appropriate remedies to avoid having the penalty assessed and was notified in early August 2007 that the CRA is holding the imposition of a penalty in abeyance pending a review of the Company's submissions as to the inapplicability of a penalty.

The IRS recently began its examination of the Company's 2002 to 2005 federal income tax returns. In addition, various state and foreign tax examinations are in progress. Tax years that remain subject to examination by major tax jurisdictions include Germany from 1999, Italy and Japan from 2000 and the United Kingdom from 2002.

The Company's contractual obligations as of December 31, 2007 are as follows:

Payments Due by Period

($ in millions)	Total	2008	2009 – 2010	2011 –2012	Thereafter
Purchase obligations	$ 776.7	$ 336.0	$ 377.3	$ 17.6	$ 45.8
Loans payable and current portion of long–term debt	1,823.6	1,823.6	–	–	–
Long–term debt	3,915.8	–	120.7	432.6	3,362.5
U.S. *Vioxx* Settlement Agreement [1]	4,850.0	1,600.0	3,250.0	–	–
Civil governmental investigations resolution	671.0	671.0	–	–	–
Unrecognized tax benefits [2]	50.0	50.0	–	–	–
Operating leases	157.6	43.1	62.6	34.9	17.0
	$ 12,244.7	$ 4,523.7	$ 3,810.6	$ 485.1	$ 3,425.3

(1) *Payments under the U.S.* Vioxx *Settlement Agreement are contingent upon participation conditions being met or waived. Also, the timing of such payments may vary depending on the timing of the claims assessment process.*

(2) *As of December 31, 2007, the Company's Consolidated Balance Sheet reflects a liability for unrecognized tax benefits of $3.69 billion, including $50.0 million reflected as a current liability. Due to the high degree of uncertainty regarding the timing of future cash outflows of liabilities for unrecognized tax benefits beyond one year, a reasonable estimate of the period of cash settlement for years beyond 2008 can not be made.*

Purchase obligations consist primarily of goods and services that are enforceable and legally binding and include obligations for minimum inventory contracts, research and development and advertising. Amounts reflected for research and development obligations do not include contingent milestone payments. Loans payable and current portion of long–term debt also reflects $331.7 million of long–dated notes that are subject to repayment at the option of the holders on an annual basis. Required funding obligations for 2008 relating to the Company's pension and other postretirement benefit plans are not expected to be material.

In December 2004, the Company increased the capacity of its shelf registration statement filed with the Securities and Exchange Commission ("SEC") to issue debt securities by an additional $3.0 billion. In February 2005, the Company issued $1.0 billion of 4.75% ten–year notes under the shelf. In November 2006, the Company issued $500 million of 5.75% twenty–year notes and $250 million of 5.125% five–year notes under the shelf. The remaining capacity under the Company's shelf registration statement is approximately $2.0 billion.

In April 2007, the Company extended the maturity date of its $1.5 billion, 5–year revolving credit facility from April 2011 to April 2012. The facility provides backup liquidity for the Company's commercial paper borrowing facility and is for general corporate purposes. The Company has not drawn funding from this facility.

The Company's long–term credit ratings assigned by Moody's Investors Service and Standard & Poor's are Aa3 with a developing outlook and AA– with a stable outlook, respectively. These ratings continue to allow access to the capital markets and flexibility in obtaining funds on competitive terms. The Company continues to maintain a conservative financial profile. Total cash and investments of $15.4 billion exceeds the sum of loans payable and long–term debt of $5.7 billion. We place our cash and investments in instruments that meet high credit quality standards, as specified in our investment policy guidelines. These guidelines also limit the amount of credit exposure to any one issuer. Despite this strong financial profile, certain contingent events, if realized, which are discussed in Note 10 to the consolidated financial statements, could have a material adverse impact on the Company's liquidity and capital resources. The Company does not participate in any off–balance sheet arrangements involving unconsolidated subsidiaries that provide financing or potentially expose the Company to unrecorded financial obligations.

In July 2002, the Board of Directors approved purchases over time of up to $10.0 billion of Merck shares. Total treasury stock purchased under this program in 2007 was $1.4 billion. As of December 31, 2007, $5.1 billion remains under the 2002 stock repurchase authorization approved by the Merck Board of Directors.

Financial Instruments Market Risk Disclosures

Foreign Currency Risk Management

While the U.S. dollar is the functional currency of the Company's foreign subsidiaries, a significant portion of the Company's revenues are denominated in foreign currencies. Merck relies on sustained cash flows generated from foreign sources to support its long-term commitment to U.S. dollar-based research and development. To the extent the dollar value of cash flows is diminished as a result of a strengthening dollar, the Company's ability to fund research and other dollar-based strategic initiatives at a consistent level may be impaired. The Company has established revenue hedging and balance sheet risk management programs to protect against volatility of future foreign currency cash flows and changes in fair value caused by volatility in foreign exchange rates.

The objective of the revenue hedging program is to reduce the potential for longer-term unfavorable changes in foreign exchange to decrease the U.S. dollar value of future cash flows derived from foreign currency denominated sales, primarily the euro and Japanese yen. To achieve this objective, the Company will partially hedge anticipated third-party sales that are expected to occur over its planning cycle, typically no more than three years into the future. The Company will layer in hedges over time, increasing the portion of sales hedged as it gets closer to the expected date of the transaction, such that it is probable the hedged transaction will occur. The portion of sales hedged is based on assessments of cost-benefit profiles that consider natural offsetting exposures, revenue and exchange rate volatilities and correlations, and the cost of hedging instruments. The hedged anticipated sales are a specified component of a portfolio of similarly denominated foreign currency-based sales transactions, each of which responds to the hedged risk in the same manner. Merck manages its anticipated transaction exposure principally with purchased local currency put options, which provide the Company with a right, but not an obligation, to sell foreign currencies in the future at a predetermined price. If the U.S. dollar strengthens relative to the currency of the hedged anticipated sales, total changes in the options' cash flows fully offset the decline in the expected future U.S. dollar cash flows of the hedged foreign currency sales. Conversely, if the U.S. dollar weakens, the options' value reduces to zero, but the Company benefits from the increase in the value of the anticipated foreign currency cash flows. While a weaker U.S. dollar would result in a net benefit, the market value of the Company's hedges would have declined by $69.5 million and $38.7 million, respectively, from a uniform 10% weakening of the U.S. dollar at December 31, 2007 and 2006. The market value was determined using a foreign exchange option pricing model and holding all factors except exchange rates constant. Because Merck principally uses purchased local currency put options, a uniform weakening of the U.S. dollar will yield the largest overall potential loss in the market value of these options. The sensitivity measurement assumes that a change in one foreign currency relative to the U.S. dollar would not affect other foreign currencies relative to the U.S. dollar. Although not predictive in nature, the Company believes that a 10% threshold reflects reasonably possible near-term changes in Merck's major foreign currency exposures relative to the U.S. dollar. The cash flows from these contracts are reported as operating activities in the Consolidated Statement of Cash Flows.

The primary objective of the balance sheet risk management program is to protect the U.S. dollar value of foreign currency denominated net monetary assets from the effects of volatility in foreign exchange that might occur prior to their conversion to U.S. dollars. Merck principally utilizes forward exchange contracts, which enable the Company to buy and sell foreign currencies in the future at fixed exchange rates and economically offset the consequences of changes in foreign exchange on the amount of U.S. dollar cash flows derived from the net assets. Merck routinely enters into contracts to fully offset the effects of exchange on exposures denominated in developed country currencies, primarily the euro and Japanese yen. For exposures in developing country currencies, the Company will enter into forward contracts on a more limited basis and only when it is deemed economical to do so based on a cost-benefit analysis that considers the magnitude of the exposure, the volatility of the exchange rate and the cost of the hedging instrument. The Company will also minimize the effect of exchange on monetary assets and liabilities by managing operating activities and net asset positions at the local level. The Company uses forward contracts to hedge the changes in fair value of certain foreign currency denominated available-for-sale securities attributable to fluctuations in foreign currency exchange rates. A sensitivity analysis to changes in the value of the U.S. dollar on foreign currency denominated derivatives, investments and monetary assets and liabilities indicated that if the U.S. dollar uniformly weakened by 10% against all currency exposures of the Company at December 31, 2007 and 2006, Income before taxes would have declined by $24.6 million and $32.7 million, respectively. Because

Merck is in a net short position relative to its major foreign currencies after consideration of forward contracts, a uniform weakening of the U.S. dollar will yield the largest overall potential net loss in earnings due to exchange. This measurement assumes that a change in one foreign currency relative to the U.S. dollar would not affect other foreign currencies relative to the U.S. dollar. Although not predictive in nature, the Company believes that a 10% threshold reflects reasonably possible near–term changes in Merck's major foreign currency exposures relative to the U.S. dollar. The cash flows from these contracts are reported as operating activities in the Consolidated Statement of Cash Flows.

Interest Rate Risk Management

In addition to the revenue hedging and balance sheet risk management programs, the Company may use interest rate swap contracts on certain investing and borrowing transactions to manage its net exposure to interest rate changes and to reduce its overall cost of borrowing. The Company does not use leveraged swaps and, in general, does not leverage any of its investment activities that would put principal capital at risk. At December 31, 2007, the Company was a party to seven pay–floating, receive–fixed interest rate swap contracts designated as fair value hedges of fixed–rate notes in which the notional amounts match the amount of the hedged fixed–rate notes. There were two swaps maturing in 2011 with notional amounts of $125 million each; one swap maturing in 2013 with a notional amount of $500 million and four swaps maturing in 2015 with notional amounts of $250 million each. The swaps effectively convert the fixed–rate obligations to floating–rate instruments. In January and February 2008, the Company terminated the four interest rate swap contracts with notional amounts of $250 million each, which effectively converted its 4.75% fixed–rate notes due 2015 to variable rate debt. As a result of the swap terminations, the Company received $96.2 million in cash, excluding accrued interest which was not material. The corresponding gains related to the basis adjustment of the debt associated with the terminated swap contracts have been deferred and will be amortized as a reduction of interest expense over the remaining term of the notes. The cash flows from these contracts are reported as operating activities in the Consolidated Statement of Cash Flows.

The Company's investment portfolio includes cash equivalents and short–term investments, the market values of which are not significantly impacted by changes in interest rates. The market value of the Company's medium– to long–term fixed–rate investments is modestly impacted by changes in U.S. interest rates. Changes in medium– to long–term U.S. interest rates have a more significant impact on the market value of the Company's fixed–rate borrowings, which generally have longer maturities. A sensitivity analysis to measure potential changes in the market value of the Company's investments, debt and related swap contracts from a change in interest rates indicated that a one percentage point increase in interest rates at December 31, 2007 and 2006 would have positively impacted the net aggregate market value of these instruments by $62.1 million and $111.0 million, respectively. A one percentage point decrease at December 31, 2007 and 2006 would have negatively impacted the net aggregate market value by $114.6 million and $171.0 million, respectively. The fair value of the Company's debt was determined using pricing models reflecting one percentage point shifts in the appropriate yield curves. The fair value of the Company's investments was determined using a combination of pricing and duration models.

Critical Accounting Policies and Other Matters

The consolidated financial statements include certain amounts that are based on management's best estimates and judgments. Estimates are used in determining such items as provisions for sales discounts and returns, depreciable and amortizable lives, recoverability of inventories produced in preparation for product launches, amounts recorded for contingencies, environmental liabilities and other reserves, pension and other postretirement benefit plan assumptions, share–based compensation assumptions, amounts recorded in connection with acquisitions, impairments of long–lived assets and investments, and taxes on income. Because of the uncertainty inherent in such estimates, actual results may differ from these estimates. Application of the following accounting policies result in accounting estimates having the potential for the most significant impact on the financial statements.

Revenue Recognition

Revenues from sales of products are recognized when title and risk of loss passes to the customer. Due to changes in terms and conditions for domestic pharmaceutical sales in the fourth quarter of 2007, revenues for these products, previously recognized at the time of shipment, were recognized at time of delivery consistent with many foreign subsidiaries and vaccine sales. There was no significant impact on revenue in the fourth quarter of 2007 as a

result of these changes. Recognition of revenue also requires reasonable assurance of collection of sales proceeds and completion of all performance obligations. Domestically, sales discounts are issued to customers as direct discounts at the point–of–sale or indirectly through an intermediary wholesale purchaser, known as chargebacks, or indirectly in the form of rebates. Additionally, sales are generally made with a limited right of return under certain conditions. Revenues are recorded net of provisions for sales discounts and returns, which are established at the time of sale.

The provision for aggregate indirect customer discounts covers chargebacks and rebates. Chargebacks are discounts that occur when a contracted customer purchases directly through an intermediary wholesale purchaser. The contracted customer generally purchases product at its contracted price plus a mark–up from the wholesaler. The wholesaler, in turn, charges the Company back for the difference between the price initially paid by the wholesaler and the contract price paid to the wholesaler by the customer. The provision for chargebacks is based on expected sell–through levels by the Company's wholesale customers to contracted customers, as well as estimated wholesaler inventory levels. Rebates are amounts owed based upon definitive contractual agreements or legal requirements with private sector and public sector (Medicaid and Medicare Part D) benefit providers, after the final dispensing of the product by a pharmacy to a benefit plan participant. The provision is based on expected payments, which are driven by patient usage and contract performance by the benefit provider customers.

The Company assumes a first–in, first–out movement of inventory within the supply chain for purposes of estimating its aggregate indirect customer discount accrual. In addition, the Company uses historical customer segment mix, adjusted for other known events, in order to estimate the expected provision. Amounts accrued for aggregate indirect customer discounts are evaluated on a quarterly basis through comparison of information provided by the wholesalers and other customers to the amounts accrued. Adjustments are recorded when trends or significant events indicate that a change in the estimated provision is appropriate.

The Company continually monitors its provision for aggregate indirect customer discounts. There were no material adjustments to estimates associated with the aggregate indirect customer discount provision in 2007, 2006 or 2005.

Summarized information about changes in the aggregate indirect customer discount accrual is as follows:

($ in millions)	2007	2006
Balance, January 1	$ 757.1	$ 1,166.5
Current provision	2,109.7	3,519.4
Adjustments to prior years	(14.1)	(29.5)
Payments	(2,153.3)	(3,899.3)
Balance, December 31	$ 699.4	$ 757.1

Accruals for chargebacks are reflected as a direct reduction to accounts receivable and accruals for rebates as current liabilities. The accrued balances relative to these provisions included in Accounts receivable and Accrued and other current liabilities were $82.5 million and $616.9 million, respectively, at December 31, 2007, and $60.4 million and $696.7 million, respectively, at December 31, 2006.

The Company maintains a returns policy that allows its customers to return product within a specified period prior to and subsequent to the expiration date (generally, six months before and twelve months after product expiration). The estimate of the provision for returns is based upon historical experience with actual returns. Additionally, the Company considers factors such as levels of inventory in the distribution channel, product dating and expiration period, whether products have been discontinued, entrance in the market of additional generic competition, changes in formularies or launch of over–the–counter products, among others. The product returns provision, as well as actual returns, were less than 1.0% of net sales in 2007, 2006 and 2005.

Through its distribution program with U.S. wholesalers, the Company encourages wholesalers to align purchases with underlying demand and maintain inventories within specified levels. The terms of the program allow the wholesalers to earn fees upon providing visibility into their inventory levels as well as by achieving certain performance parameters, such as, inventory management, customer service levels, reducing shortage claims and

reducing product returns. Information provided through the wholesaler distribution program includes items such as sales trends, inventory on-hand, on-order quantity and product returns.

Wholesalers generally provide only the above mentioned data to the Company, as there is no regulatory requirement to report lot level information to manufacturers, which is the level of information needed to determine the remaining shelf life and original sale date of inventory. Given current wholesaler inventory levels, which are generally less than a month, the Company believes that collection of order lot information across all wholesale customers would have limited use in estimating sales discounts and returns.

Inventories Produced in Preparation for Product Launches

The Company capitalizes inventories produced in preparation for product launches sufficient to support initial market demand. Typically, capitalization of such inventory does not begin until the related product candidates are in Phase III clinical trials and are considered to have a high probability of regulatory approval. The Company monitors the status of each respective product within the regulatory approval process; however, the Company generally does not disclose specific timing for regulatory approval. If the Company is aware of any specific risks or contingencies other than the normal regulatory approval process or if there are any specific issues identified during the research process relating to safety, efficacy, manufacturing, marketing or labeling, the related inventory would generally not be capitalized. Expiry dates of the inventory are impacted by the stage of completion. The Company manages the levels of inventory at each stage to optimize the shelf life of the inventory in relation to anticipated market demand in order to avoid product expiry issues. For inventories that are capitalized, anticipated future sales and shelf lives support the realization of the inventory value as the inventory shelf life is sufficient to meet initial product launch requirements. Inventories produced in preparation for product launches capitalized at December 31, 2007 and 2006 were not significant.

Contingencies and Environmental Liabilities

The Company is involved in various claims and legal proceedings of a nature considered normal to its business, including product liability, intellectual property and commercial litigation, as well as additional matters such as antitrust actions. (See Note 10 to the consolidated financial statements.) The Company records accruals for contingencies when it is probable that a liability has been incurred and the amount can be reasonably estimated. These accruals are adjusted periodically as assessments change or additional information becomes available. For product liability claims, a portion of the overall accrual is actuarially determined and considers such factors as past experience, number of claims reported and estimates of claims incurred but not yet reported. Individually significant contingent losses are accrued when probable and reasonably estimable.

Legal defense costs expected to be incurred in connection with a loss contingency are accrued when probable and reasonably estimable. As of January 1, 2006, the Company had a reserve of $685 million solely for its future legal defense costs related to the *Vioxx* Litigation (as defined below). During 2006, the Company spent $500 million in the aggregate in legal defense costs related to the *Vioxx* Litigation and recorded additional charges of $673 million. Accordingly, as of December 31, 2006, the Company had a reserve of $858 million solely for its future legal defense costs related to the *Vioxx* Litigation. During 2007, the Company spent $616 million in the aggregate in legal defense costs worldwide related to (i) the *Vioxx* Product Liability Lawsuits, (ii) the *Vioxx* Shareholder Lawsuits, (iii) the *Vioxx* Foreign Lawsuits, and (iv) the *Vioxx* Investigations (collectively, the "*Vioxx* Litigation"). In the second quarter and third quarter of 2007, the Company recorded charges of $210 million and $70 million, respectively, to increase the reserve solely for its future legal defense costs related to the *Vioxx* Litigation. In increasing the reserve, the Company considered the same factors that it considered when it previously established reserves for the *Vioxx* Litigation. On November 9, 2007, Merck entered into the Settlement Agreement with the law firms that comprise the executive committee of the Plaintiffs' Steering Committee of the federal multidistrict *Vioxx* Litigation as well as representatives of plaintiffs' counsel in the Texas, New Jersey and California state coordinated proceedings to resolve state and federal MI and IS claims filed as of that date in the United States. If certain participation conditions under the Settlement Agreement are met (or waived), Merck will pay a fixed aggregate amount into two funds for qualifying claims that enter into the Settlement Program. As a result of entering into the Settlement Agreement, the Company recorded a pretax charge of $4.85 billion which represents the fixed aggregate amount to be paid to plaintiffs qualifying for payment under the Settlement Program. In the fourth quarter of 2007, the Company spent approximately $200 million in *Vioxx* legal defense costs which resulted

in a reserve of $522 million at December 31, 2007 for its future legal defense costs related to the *Vioxx* Litigation. After entering into the Settlement Agreement, the Company reviewed its reserve for the *Vioxx* legal defense costs and allocated approximately $80 million of its reserve to Merck's anticipated future costs to administer the Settlement Program. Some of the significant factors considered in the review of the reserve were as follows: the actual costs incurred by the Company; the development of the Company's legal defense strategy and structure in light of the scope of the *Vioxx* Litigation, including the Settlement Agreement and the expectation that the Settlement Agreement will be consummated, but that certain lawsuits will continue to be pending; the number of cases being brought against the Company; the costs and outcomes of completed trials and the most current information regarding anticipated timing, progression, and related costs of pre–trial activities and trials in the *Vioxx* Product Liability Lawsuits. Events such as scheduled trials that are expected to occur throughout 2008 and 2009, and the inherent inability to predict the ultimate outcomes of such trials and the disposition of the *Vioxx* Product Liability Lawsuits not participating in or not eligible for the Settlement Program, limit the Company's ability to reasonably estimate its legal costs beyond 2009. Together with the $4.85 billion reserved for the Settlement Program, the aggregate amount of the reserve established for the *Vioxx* Litigation as of December 31, 2007 was approximately $5.372 billion. While the Company does not anticipate that it will need to increase the reserve every quarter, it will continue to monitor its legal defense costs and review the adequacy of the associated reserves and may determine to increase its reserves for legal defense costs at any time in the future if, based upon the factors set forth, it believes it would be appropriate to do so.

The Company currently anticipates that a number of *Vioxx* Product Liability Lawsuits will be tried throughout 2008. A trial in the Oregon securities case is scheduled for 2008, but the Company cannot predict whether this trial will proceed on schedule or the timing of any of the other *Vioxx* Shareholder Lawsuit trials. The Company believes that it has meritorious defenses to the *Vioxx* Lawsuits and will vigorously defend against them. In view of the inherent difficulty of predicting the outcome of litigation, particularly where there are many claimants and the claimants seek indeterminate damages, the Company is unable to predict the outcome of these matters, and at this time cannot reasonably estimate the possible loss or range of loss with respect to the *Vioxx* Lawsuits not included in the Settlement Program. The Company has not established any reserves for any potential liability relating to the *Vioxx* Lawsuits not included in the Settlement Program or the *Vioxx* Investigations, including for those cases in which verdicts or judgments have been entered against the Company, and are now in post–verdict proceedings or on appeal. In each of those cases the Company believes it has strong points to raise on appeal and therefore that unfavorable outcomes in such cases are not probable. Unfavorable outcomes in the *Vioxx* Litigation could have a material adverse effect on the Company's financial position, liquidity and results of operations.

As of December 31, 2007, the Company had a remaining reserve of approximately $27 million solely for its future legal defense costs for the *Fosamax* Litigation. Some of the significant factors considered in the establishment of the reserve for the *Fosamax* Litigation legal defense costs were as follows: the actual costs incurred by the Company thus far; the development of the Company's legal defense strategy and structure in light of the creation of the *Fosamax* multidistrict litigation; the number of cases being brought against the Company; and the anticipated timing, progression, and related costs of pre–trial activities in the *Fosamax* Litigation. The Company will continue to monitor its legal defense costs and review the adequacy of the associated reserves. Due to the uncertain nature of litigation, the Company is unable to estimate its costs beyond the end of 2009. The Company has not established any reserves for any potential liability relating to the *Fosamax* Litigation. Unfavorable outcomes in the *Fosamax* Litigation could have a material adverse effect on the Company's financial position, liquidity and results of operations.

The Company is a party to a number of proceedings brought under the Comprehensive Environmental Response, Compensation and Liability Act, commonly known as Superfund, and other federal and state equivalents. When a legitimate claim for contribution is asserted, a liability is initially accrued based upon the estimated transaction costs to manage the site. Accruals are adjusted as feasibility studies and related cost assessments of remedial techniques are completed, and as the extent to which other potentially responsible parties ("PRPs") who may be jointly and severally liable can be expected to contribute is determined.

The Company is also remediating environmental contamination resulting from past industrial activity at certain of its sites and takes an active role in identifying and providing for these costs. A worldwide survey was initially performed to assess all sites for potential contamination resulting from past industrial activities. Where

assessment indicated that physical investigation was warranted, such investigation was performed, providing a better evaluation of the need for remedial action. Where such need was identified, remedial action was then initiated. Estimates of the extent of contamination at each site were initially made at the pre–investigation stage and liabilities for the potential cost of remediation were accrued at that time. As more definitive information became available during the course of investigations and/or remedial efforts at each site, estimates were refined and accruals were adjusted accordingly. These estimates and related accruals continue to be refined annually.

The Company believes that it is in compliance in all material respects with applicable environmental laws and regulations. Expenditures for remediation and environmental liabilities were $19.5 million in 2007, and are estimated at $69.1 million for the years 2008 through 2012. In management's opinion, the liabilities for all environmental matters that are probable and reasonably estimable have been accrued and totaled $109.6 million and $129.0 million at December 31, 2007 and December 31, 2006, respectively. These liabilities are undiscounted, do not consider potential recoveries from other parties and will be paid out over the periods of remediation for the applicable sites, which are expected to occur primarily over the next 15 years. Although it is not possible to predict with certainty the outcome of these matters, or the ultimate costs of remediation, management does not believe that any reasonably possible expenditures that may be incurred in excess of the liabilities accrued should exceed $54.0 million in the aggregate. Management also does not believe that these expenditures should result in a material adverse effect on the Company's financial position, results of operations, liquidity or capital resources for any year.

Share–Based Compensation

The Company recognizes compensation cost relating to share–based payment transactions in Net income using a fair–value measurement method, in accordance with FAS 123R, which it adopted on January 1, 2006. FAS 123R requires all share–based payments to employees, including grants of stock options, to be recognized in Net income as compensation expense based on fair value over the requisite service period of the awards. The Company determines the fair value of certain share–based awards using the Black–Scholes option–pricing model which uses both historical and current market data to estimate the fair value. This method incorporates various assumptions such as the risk–free interest rate, expected volatility, expected dividend yield and expected life of the options.

Pensions and Other Postretirement Benefit Plans

Net pension and other postretirement benefit cost totaled $489.3 million in 2007 and $563.7 million in 2006. Pension and other postretirement benefit plan information for financial reporting purposes is calculated using actuarial assumptions including a discount rate for plan benefit obligations and an expected rate of return on plan assets.

The Company reassesses its benefit plan assumptions on a regular basis. For both the pension and other postretirement benefit plans, the discount rate is evaluated annually and modified to reflect the prevailing market rate at December 31 of a portfolio of high–quality fixed–income debt instruments that would provide the future cash flows needed to pay the benefits included in the benefit obligation as they come due. At December 31, 2007, the Company changed its discount rate to 6.50% from 6.00% for its U.S. pension plans and its U.S. other postretirement benefit plans.

The expected rate of return for both the pension and other postretirement benefit plans represents the average rate of return to be earned on plan assets over the period the benefits included in the benefit obligation are to be paid. In developing the expected rate of return, the Company considers long–term compound annualized returns of historical market data as well as actual returns on the Company's plan assets and applies adjustments that reflect more recent capital market experience. Using this reference information, the Company develops forward–looking return expectations for each asset category and a weighted average expected long–term rate of return for a targeted portfolio allocated across these investment categories. The expected portfolio performance reflects the contribution of active management as appropriate. As a result of this analysis, for 2008, the Company's expected rate of return of 8.75% remained unchanged from 2007 for its U.S. pension and other postretirement benefit plans.

The target investment portfolio of the Company's U.S. pension and other postretirement benefit plans is allocated 45% to 60% in U.S. equities, 20% to 30% in international equities, 15% to 25% in fixed–income investments, and up to 8% in cash and other investments. The portfolio's equity weighting is consistent with the

long–term nature of the plans' benefit obligation. The expected annual standard deviation of returns of the target portfolio, which approximates 13%, reflects both the equity allocation and the diversification benefits among the asset classes in which the portfolio invests.

Actuarial assumptions are based upon management's best estimates and judgment. A reasonably possible change of plus (minus) 25 basis points in the discount rate assumption, with other assumptions held constant, would have an estimated $42.4 million favorable (unfavorable) impact on its U.S. net pension and postretirement benefit cost. A reasonably possible change of plus (minus) 25 basis points in the expected rate of return assumption, with other assumptions held constant, would have an estimated $13.7 million favorable (unfavorable) impact on its U.S. net pension and postretirement benefit cost. The Company does not expect to have a minimum pension funding requirement under the Internal Revenue Code during 2008. The preceding hypothetical changes in the discount rate and expected rate of return assumptions would not impact the Company's funding requirements.

Net loss amounts, which reflect experience differentials primarily relating to differences between expected and actual returns on plan assets as well as the effects of changes in actuarial assumptions, are recorded as a component of Accumulated other comprehensive income. Expected returns are based on a calculated market–related value of assets. Under this methodology, asset gains/losses resulting from actual returns that differ from the Company's expected returns are recognized in the market–related value of assets ratably over a five–year period. Also, net loss amounts in Accumulated other comprehensive income in excess of certain thresholds are amortized into net pension and other postretirement benefit cost over the average remaining service life of employees. Amortization of net losses for the Company's U.S. plans at December 31, 2007 is expected to increase net pension and other postretirement benefit cost by approximately $68 million annually from 2008 through 2012.

Acquisitions

The Company accounts for acquired businesses using the purchase method of accounting in accordance with FAS 141, *Business Combinations*, which requires that the assets acquired and liabilities assumed be recorded at the date of acquisition at their respective fair values. Any excess of the purchase price over the estimated fair values of net assets acquired is recorded as goodwill. If the Company determines the acquired company is a development stage company which has not commenced its planned principal operations, the acquisition will be accounted for as an acquisition of assets rather than as a business combination and, therefore, goodwill would not be recorded. The fair value of intangible assets, including acquired research, is based on significant judgments made by management, and accordingly, for significant items, the Company typically obtains assistance from third party valuation specialists. Amounts are allocated to acquired research and expensed at the date of acquisition if technological feasibility has not been established and no alternative future use exists. For projects which can be used immediately in the research process that have alternative future uses, the Company capitalizes these intangible assets and amortizes them over an appropriate useful life. The valuations and useful life assumptions are based on information available near the acquisition date and are based on expectations and assumptions that are deemed reasonable by management. The judgments made in determining estimated fair values assigned to assets acquired and liabilities assumed, as well as asset lives, can materially impact the Company's results of operations.

For intangible assets, including acquired research, the Company typically uses the income approach, which estimates fair value based on each project's projected cash flows. Future cash flows are predominately based on a 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, if any. Expected revenues are then adjusted for the probability of technical and marketing success and the resulting cash flows are discounted at a risk–adjusted discount rate.

Impairments of Long–Lived Assets

The Company assesses changes in economic conditions and makes assumptions regarding estimated future cash flows in evaluating the value of the Company's property, plant and equipment, goodwill and other intangible assets.

The Company periodically evaluates whether current facts or circumstances indicate that the carrying values of its long–lived assets to be held and used are recoverable in accordance with FAS 144, *Accounting for the*

Impairments or Disposal of Long–Lived Assets. If such circumstances are determined to exist, an estimate of the undiscounted future cash flows of these assets, or appropriate asset groupings, is compared to the carrying value to determine whether an impairment exists. If the asset is determined to be impaired, the loss is measured based on the difference between the asset's fair value and its carrying value. If quoted market prices are not available, the Company will estimate its fair value using a discounted value of estimated future cash flows approach.

The Company tests its goodwill for impairment at least annually in accordance with FAS 142, *Goodwill and Other Intangible Assets,* using a fair value based test. Goodwill represents the excess of acquisition costs over the fair value of net assets of businesses purchased and is assigned to reporting units within the Company's segments. Other acquired intangibles are recorded at cost. When events or circumstances warrant a review, the Company will assess recoverability from future operations of other intangibles using undiscounted cash flows derived from the lowest appropriate asset groupings, generally the subsidiary level. Impairments are recognized in operating results to the extent that carrying values exceed fair value, which is determined based on the net present value of estimated cash flows.

Impairments of Investments

The Company reviews its investments for impairments based on the determination of whether the decline in market value of the investment below the carrying value is other than temporary. The Company considers available evidence in evaluating potential impairments of its investments, including the duration and extent to which fair value is less than cost and the Company's ability and intent to hold the investments.

Taxes on Income

The Company's effective tax rate is based on pretax income, statutory tax rates and tax planning opportunities available in the various jurisdictions in which the Company operates. An estimated effective tax rate for a year is applied to the Company's quarterly operating results. In the event that there is a significant unusual or one–time item recognized, or expected to be recognized, in the Company's quarterly operating results, the tax attributable to that item would be separately calculated and recorded at the same time as the unusual or one–time item. The Company considers the resolution of prior year tax matters to be such items. Significant judgment is required in determining the Company's tax provision and in evaluating its tax positions. The recognition and measurement of a tax position is based on management's best judgment given the facts, circumstances and information available at the reporting date. In accordance with FASB Interpretation No. 48, *Accounting for Uncertainty in Income Taxes — an interpretation of FASB Statement No. 109,* which Merck adopted on January 1, 2008, the Company evaluates tax positions to determine whether the benefits of tax positions are more likely than not of being sustained upon audit based on the technical merits of the tax position. For tax positions that are more likely than not of being sustained upon audit, the Company recognizes the largest amount of the benefit that is greater than 50% likely of being realized upon ultimate settlement in the financial statements. For tax positions that are not more likely than not of being sustained upon audit, the Company does not recognize any portion of the benefit in the financial statements. If the more likely than not threshold is not met in the period for which a tax position is taken, the Company may subsequently recognize the benefit of that tax position if the tax matter is effectively settled, the statute of limitations expires, or if the more likely than not threshold is met in a subsequent period. (See Note 15 to the consolidated financial statements.)

Tax regulations require items to be included in the tax return at different times than the items are reflected in the financial statements. Timing differences create deferred tax assets and liabilities. Deferred tax assets generally represent items that can be used as a tax deduction or credit in the tax return in future years for which the Company has already recorded the tax benefit in the financial statements. The Company establishes valuation allowances for its deferred tax assets when the amount of expected future taxable income is not likely to support the use of the deduction or credit. Deferred tax liabilities generally represent tax expense recognized in the financial statements for which payment has been deferred or expense for which the Company has already taken a deduction on the tax return, but has not yet recognized as expense in the financial statements.

As previously disclosed, the AJCA created a temporary incentive for U.S. multinationals to repatriate accumulated income earned outside of the United States as of December 31, 2002. In connection with the AJCA, the Company repatriated $15.9 billion during 2005 (see Note 15 to the consolidated financial statements). As a result of

this repatriation, the Company recorded an income tax charge of $766.5 million in Taxes on Income in 2005 related to this repatriation. This charge was partially offset by a $100 million benefit associated with a decision to implement certain tax planning strategies. The Company has not changed its intention to indefinitely reinvest accumulated earnings earned subsequent to December 31, 2002. At December 31, 2007, foreign earnings of $17.2 billion have been retained indefinitely by subsidiary companies for reinvestment. No provision will be made for income taxes that would be payable upon the distribution of such earnings and it is not practicable to determine the amount of the related unrecognized deferred income tax liability.

Recently Issued Accounting Standards

In September 2006, the FASB issued Statement No. 157, *Fair Value Measurements* ("FAS 157"), which clarifies the definition of fair value, establishes a framework for measuring fair value, and expands the disclosures on fair value measurements. FAS 157 was originally effective January 1, 2008. In February 2008, the FASB issued Staff Position ("FSP") 157-2 that deferred the effective date of FAS 157 for one year for nonfinancial assets and liabilities recorded at fair value on a non-recurring basis. The effect of adoption of FAS 157 and FSP 157-2 on the Company's financial position and results of operations is not expected to be material.

In February 2007, the FASB issued Statement No. FAS 159, *The Fair Value Option for Financial Assets and Financial Liabilities — including an amendment of FASB Statement No. 115* ("FAS 159"), which is effective January 1, 2008. FAS 159 permits companies to choose to measure certain financial assets and financial liabilities at fair value. Unrealized gains and losses on items for which the fair value option has been elected are reported in earnings at each subsequent reporting date. The effect of adoption of FAS 159 on the Company's financial position and results of operations is not expected to be material.

In June 2007, the FASB ratified the consensus reached by the Emerging Issues Task Force ("EITF") on Issue No. 07-3, *Accounting for Advance Payments for Goods or Services Received for Use in Future Research and Development Activities* ("Issue 07-3"), which is effective January 1, 2008 and is applied prospectively for new contracts entered into on or after the effective date. Issue 07-3 addresses nonrefundable advance payments for goods or services that will be used or rendered for future research and development activities. Issue 07-3 will require these payments be deferred and capitalized and recognized as an expense as the related goods are delivered or the related services are performed. The effect of adoption of Issue 07-3 on the Company's financial position and results of operations is not expected to be material.

In December 2007, the FASB issued Statements No. 141R, *Business Combinations* ("FAS 141R"), and No. 160, *Noncontrolling Interests in Consolidated Financial Statements — an amendment of ARB No. 51* ("FAS 160"). FAS 141R expands the scope of acquisition accounting to all transactions under which control of a business is obtained. Among other things, FAS 141R requires that contingent consideration as well as contingent assets and liabilities be recorded at fair value on the acquisition date, that acquired in-process research and development be capitalized and recorded as intangible assets at the acquisition date, and also requires transaction costs and costs to restructure the acquired company be expensed. FAS 160 requires, among other things, that noncontrolling interests be recorded as equity in the consolidated financial statements. FAS 141R and FAS 160 are both effective January 1, 2009. The Company is assessing the impacts of these standards on its financial position and results of operations.

Cautionary Factors That May Affect Future Results

This report and other written reports and oral statements made from time to time by the Company may contain so-called "forward-looking statements," all of which are based on management's current expectations and are subject to risks and uncertainties which may cause results to differ materially from those set forth in the statements. One can identify these forward-looking statements by their use of words such as "expects," "plans," "will," "estimates," "forecasts," "projects" and other words of similar meaning. One can also identify them by the fact that they do not relate strictly to historical or current facts. These statements are likely to address the Company's growth strategy, financial results, product development, product approvals, product potential and development programs. One must carefully consider any such statement and should understand that many factors could cause actual results to differ materially from the Company's forward-looking statements. These factors include inaccurate

assumptions and a broad variety of other risks and uncertainties, including some that are known and some that are not. No forward–looking statement can be guaranteed and actual future results may vary materially.

The Company does not assume the obligation to update any forward–looking statement. One should carefully evaluate such statements in light of factors, including risk factors, described in the Company's filings with the Securities and Exchange Commission, especially on Forms 10–K, 10–Q and 8–K. In Item 1A. "Risk Factors" of this annual report on Form 10–K the Company discusses in more detail various important risk factors that could cause actual results to differ from expected or historic results. The Company notes these factors for investors as permitted by the Private Securities Litigation Reform Act of 1995. One should understand that it is not possible to predict or identify all such factors. Consequently, the reader should not consider any such list to be a complete statement of all potential risks or uncertainties.

Item 7A. Quantitative and Qualitative Disclosures about Market Risk.

The information required by this Item is incorporated by reference to the discussion under "Financial Instruments Market Risk Disclosures" in Item 7. "Management's Discussion and Analysis of Financial Condition and Results of Operations."

Item 8. Financial Statements and Supplementary Data.

(a) Financial Statements

The consolidated balance sheet of Merck & Co., Inc. and subsidiaries as of December 31, 2007 and 2006, and the related consolidated statements of income, of retained earnings, of comprehensive income and of cash flows for each of the three years in the period ended December 31, 2007, the Notes to Consolidated Financial Statements, and the report dated February 27, 2008 of PricewaterhouseCoopers LLP, independent registered public accounting firm, are as follows:

Consolidated Statement of Income
Merck & Co., Inc. and Subsidiaries
Years Ended December 31
($ in millions except per share amounts)

	2007	2006	2005
Sales	$24,197.7	$22,636.0	$22,011.9
Costs, Expenses and Other			
Materials and production	6,140.7	6,001.1	5,149.6
Marketing and administrative	7,556.7	8,165.4	7,155.5
Research and development	4,882.8	4,782.9	3,848.0
Restructuring costs	327.1	142.3	322.2
Equity income from affiliates	(2,976.5)	(2,294.4)	(1,717.1)
U.S. *Vioxx* Settlement Agreement charge	4,850.0	–	–
Other (income) expense, net	46.2	(382.7)	(110.2)
	20,827.0	16,414.6	14,648.0
Income Before Taxes	3,370.7	6,221.4	7,363.9
Taxes on Income	95.3	1,787.6	2,732.6
Net Income	$3,275.4	$4,433.8	$4,631.3
Basic Earnings per Common Share	$1.51	$2.04	$2.11
Earnings per Common Share Assuming Dilution	$1.49	$2.03	$2.10

Consolidated Statement of Retained Earnings
Merck & Co., Inc. and Subsidiaries
Years Ended December 31
($ in millions)

	2007	2006	2005
Balance, January 1	$ 39,095.1	$ 37,980.0	$ 36,687.4
Cumulative Effect of Adoption of FIN 48	81.0	–	–
Net Income	3,275.4	4,433.8	4,631.3
Dividends Declared on Common Stock	(3,310.7)	(3,318.7)	(3,338.7)
Balance, December 31	$ 39,140.8	$ 39,095.1	$ 37,980.0

Consolidated Statement of Comprehensive Income
Merck & Co., Inc. and Subsidiaries
Years Ended December 31
($ in millions)

	2007	2006	2005
Net Income	$ 3,275.4	$ 4,433.8	$ 4,631.3
Other Comprehensive Income			
Net unrealized (loss) gain on derivatives, net of tax and net income realization	(4.4)	(50.9)	81.3
Net unrealized gain on investments, net of tax and net income realization	58.0	26.1	50.3
Benefit plan net gain (loss) and prior service cost (credit), net of tax and amortization	240.3	–	–
Minimum pension liability, net of tax	–	22.5	(7.0)
Cumulative translation adjustment relating to equity investees, net of tax	44.3	18.9	(26.4)
	338.2	16.6	98.2
Comprehensive Income	$ 3,613.6	$ 4,450.4	$ 4,729.5

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

Consolidated Balance Sheet
Merck & Co., Inc. and Subsidiaries
December 31
($ in millions)

	2007	2006
Assets		
Current Assets		
Cash and cash equivalents	$ 5,336.1	$ 5,914.7
Short-term investments	2,894.7	2,798.3
Accounts receivable	3,636.2	3,314.8
Inventories (excludes inventories of $345.2 in 2007 and $416.1 in 2006 classified in Other assets — see Note 6)	1,881.0	1,769.4
Prepaid expenses and taxes	1,297.4	1,433.0
Total current assets	15,045.4	15,230.2
Investments	7,159.2	7,788.2
Property, Plant and Equipment (at cost)		
Land	405.8	408.9
Buildings	10,048.0	9,745.9
Machinery, equipment and office furnishings	13,553.7	13,172.4
Construction in progress	795.6	882.3
	24,803.1	24,209.5
Less allowance for depreciation	12,457.1	11,015.4
	12,346.0	13,194.1
Goodwill	1,454.8	1,431.6
Other Intangibles, Net	713.2	943.9
Other Assets	11,632.1	5,981.8
	$ 48,350.7	$ 44,569.8
Liabilities and Stockholders' Equity		
Current Liabilities		
Loans payable and current portion of long-term debt	$ 1,823.6	$ 1,285.1
Trade accounts payable	624.5	496.6
Accrued and other current liabilities	8,534.9	6,653.3
Income taxes payable	444.1	3,460.8
Dividends payable	831.1	826.9
Total current liabilities	12,258.2	12,722.7
Long-Term Debt	3,915.8	5,551.0
Deferred Income Taxes and Noncurrent Liabilities	11,585.3	6,330.3
Minority Interests	2,406.7	2,406.1
Stockholders' Equity		
Common stock, one cent par value		
Authorized — 5,400,000,000 shares		
Issued — 2,983,508,675 shares — 2007		
— 2,976,223,337 shares — 2006	29.8	29.8
Other paid-in capital	8,014.9	7,166.5
Retained earnings	39,140.8	39,095.1
Accumulated other comprehensive loss	(826.1)	(1,164.3)
	46,359.4	45,127.1
Less treasury stock, at cost		
811,005,791 shares — 2007		

808,437,892 shares — 2006	28,174.7	27,567.4
Total stockholders' equity	18,184.7	17,559.7
	$ 48,350.7	$ 44,569.8

The accompanying notes are an integral part of this consolidated financial statement.

Consolidated Statement of Cash Flows
Merck & Co., Inc. and Subsidiaries
Years Ended December 31
($ in millions)

	2007	2006	2005
Cash Flows from Operating Activities			
Net income	$ 3,275.4	$ 4,433.8	$ 4,631.3
Adjustments to reconcile net income to net cash provided by operating activities:			
U.S. *Vioxx* Settlement Agreement charge	4,850.0	–	–
Depreciation and amortization	1,988.2	2,268.4	1,708.1
Deferred income taxes	(1,781.9)	(530.2)	9.0
Equity income from affiliates	(2,976.5)	(2,294.4)	(1,717.1)
Dividends and distributions from equity affiliates	2,485.6	1,931.9	1,101.2
Share-based compensation	330.2	312.5	48.0
Acquired research	325.1	762.5	–
Taxes paid for Internal Revenue Service settlement	(2,788.1)	–	–
Other	(64.7)	18.1	647.5
Net changes in assets and liabilities:			
Accounts receivable	(290.7)	(709.3)	345.9
Inventories	(40.7)	226.5	125.6
Trade accounts payable	117.7	16.4	63.6
Accrued and other current liabilities	451.1	461.6	238.2
Income taxes payable	987.2	(138.2)	663.2
Noncurrent liabilities	26.2	(125.6)	(412.2)
Other	105.1	131.2	156.2
Net Cash Provided by Operating Activities	6,999.2	6,765.2	7,608.5
Cash Flows from Investing Activities			
Capital expenditures	(1,011.0)	(980.2)	(1,402.7)
Purchases of securities and other investments	(10,132.7)	(19,591.3)	(125,308.4)
Acquisitions of subsidiaries, net of cash acquired	(1,135.9)	(404.9)	–
Proceeds from sales of securities and other investments	10,860.2	16,143.8	128,981.4
Increase in restricted cash	(1,401.1)	(48.1)	–
Other	10.5	(3.0)	(3.1)
Net Cash (Used) Provided by Investing Activities	(2,810.0)	(4,883.7)	2,267.2
Cash Flows from Financing Activities			
Net change in short-term borrowings	11.4	(1,522.8)	1,296.2
Proceeds from issuance of debt	–	755.1	1,000.0
Payments on debt	(1,195.3)	(506.2)	(1,014.9)
Purchases of treasury stock	(1,429.7)	(1,002.3)	(1,015.3)
Dividends paid to stockholders	(3,307.3)	(3,322.6)	(3,349.8)
Proceeds from exercise of stock options	898.6	369.9	136.5
Other	156.2	(375.3)	(93.1)
Net Cash Used by Financing Activities	(4,866.1)	(5,604.2)	(3,040.4)
Effect of Exchange Rate Changes on Cash and Cash Equivalents	98.3	52.1	(128.8)
Net (Decrease) Increase in Cash and Cash Equivalents	(578.6)	(3,670.6)	6,706.5
Cash and Cash Equivalents at Beginning of Year	5,914.7	9,585.3	2,878.8
Cash and Cash Equivalents at End of Year	$ 5,336.1	$ 5,914.7	$ 9,585.3

The accompanying notes are an integral part of this consolidated financial statement.

Notes to Consolidated Financial Statements
Merck & Co., Inc. and Subsidiaries
($ in millions except per share amounts)

1. Nature of Operations

Merck is a global research-driven pharmaceutical company that discovers, develops, manufactures and markets a broad range of innovative products to improve human and animal health. The Company's operations are principally managed on a products basis and are comprised of two reportable segments: the Pharmaceutical segment and the Vaccines segment. The Pharmaceutical segment includes human health pharmaceutical products marketed either directly or through joint ventures. These products consist of therapeutic and preventive agents, sold by prescription, for the treatment of human disorders. Merck sells these human health pharmaceutical products primarily to drug wholesalers and retailers, hospitals, government agencies and managed health care providers such as health maintenance organizations, pharmacy benefit managers and other institutions. The Vaccines segment includes human health vaccine products marketed either directly or through a joint venture. These products consist of preventive pediatric, adolescent and adult vaccines, primarily administered at physician offices. Merck sells these human health vaccines primarily to physicians, wholesalers, physician distributors and government entities. The Company's professional representatives communicate the effectiveness, safety and value of its pharmaceutical and vaccine products to health care professionals in private practice, group practices and managed care organizations.

2. Summary of Accounting Policies

Principles of Consolidation — The consolidated financial statements include the accounts of the Company and all of its subsidiaries in which a controlling interest is maintained. Controlling interest is determined by majority ownership interest and the absence of substantive third-party participating rights or, in the case of variable interest entities, by majority exposure to expected losses, residual returns or both. For those consolidated subsidiaries where Merck ownership is less than 100%, the outside stockholders' interests are shown as Minority interests. Investments in affiliates over which the Company has significant influence but not a controlling interest, such as interests in entities owned equally by the Company and a third party that are under shared control, are carried on the equity basis.

Foreign Currency Translation — The U.S. dollar is the Company's functional currency.

Cash Equivalents — Cash equivalents are comprised of certain highly liquid investments with original maturities of less than three months.

Inventories — Substantially all domestic inventories are valued at the lower of last-in, first-out ("LIFO") cost or market for both book and tax purposes. Foreign inventories are valued at the lower of first-in, first-out ("FIFO") cost or market. Inventories consist of currently marketed products and certain products awaiting regulatory approval. In evaluating the recoverability of inventories produced in preparation for product launches, the Company considers the probability that revenue will be obtained from the future sale of the related inventory together with the status of the product within the regulatory approval process.

Investments — Investments classified as available-for-sale are reported at fair value, with unrealized gains or losses, to the extent not hedged, reported net of tax in Accumulated other comprehensive income ("AOCI"). Investments in debt securities classified as held-to-maturity, consistent with management's intent, are reported at cost. Impairment losses are charged to Other (income) expense, net, for other-than-temporary declines in fair value. The Company considers available evidence in evaluating potential impairment of its investments, including the duration and extent to which fair value is less than cost and the Company's ability and intent to hold the investment.

Revenue Recognition — Revenues from sales of products are recognized when title and risk of loss passes to the customer. Due to changes in terms and conditions for domestic pharmaceutical sales in the fourth quarter of 2007, revenues for these products, previously recognized at the time of shipment, were recognized at time of delivery, consistent with many foreign subsidiaries and vaccine sales. There was no significant impact on revenue in the fourth quarter of 2007 as a result of these changes. Recognition of revenue also requires reasonable assurance of collection of sales proceeds and completion of all performance obligations. Domestically, sales discounts are issued

to customers as direct discounts at the point-of-sale or indirectly through an intermediary wholesale purchaser, known as chargebacks, or indirectly in the form of rebates. Additionally, sales are generally made with a limited right of return under certain conditions. Revenues are recorded net of provisions for sales discounts and returns, which are established at the time of sale. Accruals for chargebacks are reflected as a direct reduction to accounts receivable and accruals for rebates are recorded as accrued expenses. The accrued balances relative to these provisions included in Accounts receivable and Accrued and other current liabilities were $82.5 million and $616.9 million, respectively, at December 31, 2007 and $60.4 million and $696.7 million, respectively, at December 31, 2006.

The Company recognizes revenue from the sales of vaccines to the Federal government for placement into stockpiles related to the Pediatric Vaccine Stockpile in accordance with Securities and Exchange Commission ("SEC") Interpretation, *Commission Guidance Regarding Accounting for Sales of Vaccines and BioTerror Countermeasures to the Federal Government for Placement into the Pediatric Vaccine Stockpile or the Strategic National Stockpile.*

Depreciation — Depreciation is provided over the estimated useful lives of the assets, principally using the straight-line method. For tax purposes, accelerated methods are used. The estimated useful lives primarily range from 10 to 50 years for Buildings, and from 3 to 15 years for Machinery, equipment and office furnishings.

Software Capitalization — The Company capitalizes certain costs incurred in connection with obtaining or developing internal-use software including external direct costs of material and services, and payroll costs for employees directly involved with the software development in accordance with Statement of Position 98-1, *Accounting for the Costs of Computer Software Developed or Obtained for Internal Use*. Capitalized software costs are included in Property, plant and equipment and amortized over a period ranging from 3 to 5 years, beginning when the asset is substantially ready for use. Costs incurred during the preliminary project stage and post-implementation stage, as well as maintenance and training costs, are expensed as incurred. At December 31, 2007, the Company had approximately $200 million of unamortized capitalized software costs related to a multi-year initiative to standardize its information systems.

Acquisitions — The Company accounts for acquired businesses using the purchase method of accounting in accordance with Financial Accounting Standards Board ("FASB") Statement No. 141, *Business Combinations*, which requires that the assets acquired and liabilities assumed be recorded at the date of acquisition at their respective fair values. Any excess of the purchase price over the estimated fair values of net assets acquired is recorded as goodwill. If the Company determines the acquired company is a development stage company which has not commenced its planned principal operations, the acquisition will be accounted for as an acquisition of assets rather than as a business combination and, therefore, goodwill would not be recorded. In accordance with FASB Interpretation No. 4, *Applicability of FASB Statement No. 2 to Business Combinations Accounted for by the Purchase Method*, the Company allocates amounts to acquired research which are expensed at the date of acquisition if technological feasibility has not been established and no alternative future use exists. For projects which can be used immediately in the research process that have alternative future uses, the Company capitalizes these intangible assets and amortizes them over an appropriate useful life. The operating results of the acquired business are reflected in the Company's consolidated financial statements and results of operations as of the date of acquisition.

Goodwill and Other Intangibles — Goodwill represents the excess of acquisition costs over the fair value of net assets of businesses purchased. Goodwill is assigned to reporting units within the Company's segments and evaluated for impairment on at least an annual basis, using a fair value based test. Other acquired intangibles are recorded at cost and are amortized on a straight-line basis over their estimated useful lives ranging from 3 to 20 years (see Note 7). When events or circumstances warrant a review, the Company will assess recoverability from future operations of other intangibles using undiscounted cash flows derived from the lowest appropriate asset groupings, generally the subsidiary level. Impairments are recognized in operating results to the extent that carrying value exceeds fair value, which is determined based on the net present value of estimated future cash flows.

Research and Development — Research and development is expensed as incurred. Upfront and milestone payments made to third parties in connection with research and development collaborations prior to regulatory

approval are expensed as incurred. Payments made to third parties subsequent to regulatory approval are capitalized and amortized over the shorter of the remaining license or product patent life.

Share–Based Compensation — Effective January 1, 2006, the Company adopted FASB Statement No. 123R, *Share–Based Payment* ("FAS 123R") (see Note 12). FAS 123R requires all share–based payments to employees, including grants of stock options, to be expensed over the requisite service period based on the grant–date fair value of the awards and requires that the unvested portion of all outstanding awards upon adoption be recognized using the same fair value and attribution methodologies previously determined under FASB Statement No. 123, *Accounting for Stock–Based Compensation*. The Company uses the Black–Scholes valuation method. Prior to adoption of FAS 123R, employee share–based compensation was recognized using the intrinsic value method, which measures share–based compensation expense as the amount at which the market price of the stock at the date of grant exceeds the exercise price. Accordingly, no compensation expense was recognized for the Company's share–based compensation plans other than for its performance–based awards, restricted stock units and options granted to employees of certain equity method investees.

Restructuring Costs — The Company records restructuring activities in accordance with FASB Statement No. 146, *Accounting for Costs Associated with Exit or Disposal Activities*. Asset impairment costs are recorded in accordance with FASB Statement No. 144, *Accounting for the Impairment and Disposal of Long–Lived Assets*. Employee termination benefits covered by existing benefit arrangements are recorded in accordance with FASB Statement No. 112, *Employers' Accounting for Postemployment Benefits — an amendment of FASB Statement No. 5 and 43* and FASB Statement No. 88, *Employers' Accounting for Settlements and Curtailments of Defined Benefit Pension Plans for Termination Benefits*.

Contingencies and Legal Defense Costs — The Company records accruals for contingencies and legal defense costs expected to be incurred in connection with a loss contingency when it is probable that a liability has been incurred and the amount can be reasonably estimated in accordance with FASB Statement No. 5, *Accounting for Contingencies*.

Taxes on Income — Deferred taxes are recognized for the future tax effects of temporary differences between financial and income tax reporting based on enacted tax laws and rates. The Company evaluates tax positions to determine whether the benefits of tax positions are more likely than not of being sustained upon audit based on the technical merits of the tax position. For tax positions that are more likely than not of being sustained upon audit, the Company recognizes the largest amount of the benefit that is greater than 50% likely of being realized upon ultimate settlement in the financial statements. For tax positions that are not more likely than not of being sustained upon audit, the Company does not recognize any portion of the benefit in the financial statements.

Use of Estimates — The consolidated financial statements are prepared in conformity with accounting principles generally accepted in the United States ("GAAP") and, accordingly, include certain amounts that are based on management's best estimates and judgments. Estimates are used in determining such items as provisions for sales discounts and returns, depreciable and amortizable lives, recoverability of inventories produced in preparation for product launches, amounts recorded for contingencies, environmental liabilities and other reserves, pension and other postretirement benefit plan assumptions, share–based compensation, amounts recorded in connection with acquisitions, impairments of long–lived assets and investments, and taxes on income. Because of the uncertainty inherent in such estimates, actual results may differ from these estimates.

Reclassifications — Certain reclassifications have been made to prior year amounts to conform with the current year presentation.

Recently Issued Accounting Standards — The FASB recently issued Statement No. 157, *Fair Value Measurements* ("FAS 157"), Statement No. 159, *The Fair Value Option for Financial Assets and Financial Liabilities — including an amendment of FASB Statement No. 115* ("FAS 159"), Statement No. 141R, *Business Combinations* ("FAS 141R"), Statement No. 160, *Noncontrolling Interests in Consolidated Financial Statements — an amendment of ARB No. 51* ("FAS 160"), and ratified the consensus reached by the Emerging Issues Task Force ("EITF") on Issue No. 07–3, *Accounting for Advance Payments for Goods or Services Received for Use in Future Research and Development Activities* ("Issue 07–3").

FAS 157 clarifies the definition of fair value, establishes a framework for measuring fair value, and expands the disclosures on fair value measurements. FAS 157 was originally effective January 1, 2008. In February 2008, the FASB issued Staff Position ("FSP") 157–2, that deferred the effective date of FAS 157 for one year for nonfinancial assets and liabilities recorded at fair value on a non–recurring basis. The effect of adoption of FAS 157 and FSP 157–2 on the Company's financial position and results of operations is not expected to be material.

FAS 159, which is effective January 1, 2008, permits companies to choose to measure certain financial assets and financial liabilities at fair value. Unrealized gains and losses on items for which the fair value option has been elected are reported in earnings at each subsequent reporting date. The effect of adoption of FAS 159 on the Company's financial position and results of operations is not expected to be material.

EITF Issue 07–03, which is effective January 1, 2008 and is applied prospectively for new contracts entered into on or after the effective date, addresses nonrefundable advance payments for goods or services that will be used or rendered for future research and development activities. Issue 07–3 will require these payments be deferred and capitalized and recognized as an expense as the related goods are delivered or the related services are performed. The effect of adoption of Issue 07–3 on the Company's financial position and results of operations is not expected to be material.

FAS 141R expands the scope of acquisition accounting to all transactions under which control of a business is obtained. Among other things, FAS 141R requires that contingent consideration as well as contingent assets and liabilities be recorded at fair value on the acquisition date, that acquired in–process research and development be capitalized and recorded as intangible assets at the acquisition date, and also requires transaction costs and costs to restructure the acquired company be expensed. FAS 160 requires, among other things, that noncontrolling interests be recorded as equity in the consolidated financial statements. FAS 141R and FAS 160 are both effective January 1, 2009. The Company is assessing the impacts of these standards on its financial position and results of operations.

3. Restructuring

Global Restructuring Program

In November 2005, the Company announced the initial phase of a global restructuring program designed to reduce the Company's cost structure, increase efficiency and enhance competitiveness. The initial steps include the implementation of a new supply strategy by the Merck Manufacturing Division, which is intended to create a leaner, more cost–effective and customer–focused manufacturing model over a three–year period. As part of this program, Merck announced plans to sell or close five manufacturing sites and two preclinical sites by the end of 2008. The Company has also sold or closed certain other facilities and sold related assets in connection with the restructuring program. The pretax costs of this restructuring program were $810.1 million in 2007, $935.5 million in 2006, $401.2 million in 2005 and are expected to be approximately $100 million to $300 million in 2008. Through the end of 2008, when the initial phase of the global restructuring program is expected to be substantially complete, the cumulative pretax costs of the program are expected to be approximately $2.2 billion to $2.4 billion. Approximately 70% of the cumulative pretax costs are non–cash, relating primarily to accelerated depreciation for those facilities scheduled for closure. Since the inception of the global restructuring program through December 31, 2007, the Company has recorded total pretax accumulated costs of $2.1 billion and eliminated approximately 7,200 positions, comprised of employee separations and the elimination of contractors and vacant positions. The Company, however, continues to hire new employees as the business requires. For segment reporting, restructuring charges are unallocated expenses.

The following table summarizes the charges related to the global restructuring program by type of cost:

Year Ended December 31, 2007	Separation Costs	Accelerated Depreciation	Other	Total
Materials and production	$ –	$ 460.6	$ 22.5	$ 483.1
Research and development	–	–	(0.1)	(0.1)
Restructuring costs	251.4	–	75.7	327.1
Year Ended December 31, 2006	$ 251.4	$ 460.6	$ 98.1	$ 810.1
Materials and production	$ –	$ 707.3	$ 29.1	$ 736.4
Research and development	–	56.5	0.3	56.8
Restructuring costs	113.7	–	28.6	142.3
Year Ended December 31, 2005	$ 113.7	$ 763.8	$ 58.0	$ 935.5
Materials and production	$ –	$ 65.9	$ 111.2	$ 177.1
Research and development	–	18.7	–	18.7
Restructuring costs	182.4	–	23.0	205.4
	$ 182.4	$ 84.6	$ 134.2	$ 401.2

Separation costs are associated with actual headcount reductions, as well as those headcount reductions which were probable and could be reasonably estimated. Approximately 2,400 positions, 3,700 positions and 1,100 positions were eliminated in 2007, 2006 and 2005, respectively. These position eliminations are comprised of actual headcount reductions, and the elimination of contractors and vacant positions.

Accelerated depreciation costs primarily relate to the five Merck–owned manufacturing facilities and the two preclinical sites to be sold or closed in an effort to reduce costs and consolidate the Company's manufacturing and research facilities. Through the end of 2007, four of the manufacturing facilities had been closed, sold or had ceased operations and the two preclinical sites were closed. The remaining facility was sold in January 2008. All of the sites continued to operate up through the respective closure dates, and since future cash flows were sufficient to recover the respective book values, Merck was required to accelerate depreciation of the site assets rather than write them off immediately. The site assets include manufacturing and research facilities and equipment.

Other activity in 2007, 2006 and 2005 includes $39.4 million, $25.0 million and $111.2 million, respectively, associated with the impairment of certain fixed assets that were no longer to be used in the business as a result of these restructuring actions and were therefore written off. Additionally, other activity includes $18.9 million, $34.2 million and $23.0 million in 2007, 2006 and 2005, respectively, related to curtailment, settlement and termination charges on the Company's pension and other postretirement benefit plans (see Note 13). Other activity also includes shut–down costs, and in 2006, pretax gains of $40.7 million resulting from the sales of facilities in connection with the global restructuring program.

Other Restructuring Programs

As part of a cost–reduction program completed in 2005, the Company eliminated 900 positions and recorded restructuring costs of $116.8 million in 2005, of which $91.5 million related to employee severance benefits and $25.3 million related to curtailment, settlement and termination charges on the Company's pension and other postretirement benefit plans (see Note 13).

The following table summarizes the charges and spending relating to the global restructuring program and other programs:

	Separation Costs[1]	Accelerated Depreciation	Other	Total
Restructuring reserves as of January 1, 2006	$ 240.3	$ –	$ –	$ 240.3
Expense	113.7	763.8	58.0	935.5
(Payments) receipts, net	(176.3)	–	(9.4)[2]	(185.7)
Non–cash activity	–	(763.8)	(48.6)	(812.4)
Restructuring reserves as of December 31, 2006	$ 177.7	$ –	$ –	$ 177.7
Expense	$ 251.4	$ 460.6	$ 98.1	$ 810.1
(Payments) receipts, net	(197.6)	–	(59.9)	(257.5)
Non–cash activity	–	(460.6)	(38.2)	(498.8)
Restructuring reserves as of December 31, 2007[3]	$ 231.5	$ –	$ –	$ 231.5

(1) *Includes separation costs associated with the global restructuring program as well as amounts from other restructuring programs. The other restructuring programs were substantially complete as of the end of the first quarter of 2006.*

(2) *Includes proceeds from the sales of facilities in connection with the global restructuring program.*

(3) *The cash outlays associated with the remaining restructuring reserve are expected to be largely completed by the end of 2009.*

The Company also closed its basic research center in Terlings Park, United Kingdom in 2006. In anticipation of the closing, the Company incurred additional accelerated depreciation costs of $103.1 million recorded to Research and development expense during 2005, which reduced the assets of this research center down to their net realizable values. Subsequent to December 31, 2005, no further research and development was performed at this site.

4. Research Collaborations, Acquisitions and License Agreements

Merck continues its strategy of establishing strong external alliances to complement its substantial internal research capabilities, including research collaborations, acquisitions, licensing pre–clinical and clinical compounds and technology transfers to drive both near– and long–term growth. During 2007, Merck signed 55 such agreements.

In November 2007, Merck and GTx, Inc. ("GTx") announced that they had entered into an agreement providing for a research and development and global strategic collaboration for selective androgen receptor modulators ("SARMs"), a new class of drugs with the potential to treat age–related muscle loss (sarcopenia) as well as other musculoskeletal conditions. This collaboration includes GTx's lead SARM candidate, Ostarine (MK–2866), which is currently being evaluated in a Phase II clinical trial for the treatment of muscle loss in patients with cancer, and establishes a broad SARM collaboration under which GTx and Merck will pool their programs and partner to discover, develop, and commercialize current as well as future SARM molecules. As part of this global agreement, Merck will be responsible for all future costs associated with ongoing development and, if approved, commercialization of Ostarine and other investigational SARMs resulting from the collaboration. Under the terms of the collaboration agreement and related stock purchase agreement, GTx and Merck will combine their respective SARM research programs. GTx received an upfront payment of $40 million, which was recorded by Merck as Research and development expense, and will also receive $15 million in research reimbursements to be paid over the initial three years of the collaboration. In addition, Merck made an investment of $30 million in GTx common stock. GTx will also be eligible to receive up to $422 million in future milestone payments associated with the development and approval of a drug candidate if multiple indications receive regulatory approval. Additional milestones may be received for the development and approval of other collaboration drug candidates. GTx will receive royalties on any resulting worldwide product revenue.

Also, in November 2007, Merck and Dynavax Technologies Corporation ("Dynavax") announced a global license and development collaboration agreement to jointly develop V270, a novel investigational hepatitis B

vaccine, which is currently being evaluated in a multi-center Phase III clinical trial involving adults and in patients on dialysis. Under the terms of the agreement, Merck receives worldwide exclusive rights to V270, will fund future vaccine development, and be responsible for commercialization. Dynavax received an initial payment of $31.5 million, which the Company recorded as Research and development expense, and will be eligible to receive up to $105 million in development and sales milestone payments, and double-digit tiered royalties on global sales of V270.

In September 2007, Merck completed the acquisition of NovaCardia, Inc. ("NovaCardia"), a privately held clinical-stage pharmaceutical company focused on cardiovascular disease. This acquisition added rolofylline (MK-7418), NovaCardia's investigational Phase III compound for acute heart failure, to Merck's pipeline. Merck acquired all of the outstanding equity of NovaCardia for a total purchase price of $366.4 million (including $16.4 million of cash and investments on hand at closing), which was paid through the issuance of 7.3 million shares of Merck common stock to the former NovaCardia shareholders based on Merck's average closing stock price for the five days prior to closing of the acquisition. In connection with the acquisition, the Company recorded a charge of $325.1 million for acquired research associated with rolofylline as at the acquisition date, technological feasibility had not been established and no alternative future use existed. The charge, which is not deductible for tax purposes, was recorded in Research and development expense and was determined based upon the present value of expected future cash flows resulting from this technology adjusted for the probability of its technical and marketing success utilizing an income approach reflecting an appropriate risk-adjusted discount rate of 22.0%. The ongoing activity with respect to the future development of rolofylline is not expected to be material to the Company's research and development expenses. The remaining purchase price was allocated to cash and investments of $16.4 million, a deferred tax asset relating to a net operating loss carryforward of $23.9 million and other net assets of $1.0 million. Because NovaCardia was a development stage company that had not commenced its planned principal operations, the transaction was accounted for as an acquisition of assets rather than as a business combination and, therefore, goodwill was not recorded. NovaCardia's results of operations have been included in the Company's consolidated financial results since the acquisition date.

In July 2007, Merck and ARIAD Pharmaceuticals, Inc. ("ARIAD") announced that they had entered into a global collaboration to jointly develop and commercialize deforolimus (MK-8669), ARIAD's novel mTOR inhibitor, for use in cancer. Each party will fund 50% of the cost of global development of MK-8669, except that Merck will fund 100% of the cost of ex-U.S. development that is specific to the development or commercialization of MK-8669 outside the U.S. that is not currently part of the global development plan. The agreement provided for an initial payment of $75 million to ARIAD, which the Company recorded as Research and development expense, up to $452 million more in milestone payments to ARIAD based on the successful development of MK-8669 in multiple cancer indications (including $13.5 million paid for the initiation of the Phase III clinical trial in metastatic sarcomas and $114.5 million to be paid for the initiation of other Phase II and Phase III clinical trials), up to an additional $200 million based on achievement of significant sales thresholds, at least $200 million in estimated contributions by Merck to global development, up to $200 million in interest-bearing repayable development-cost advances from Merck to cover a portion of ARIAD's share of global-development costs (after ARIAD has paid $150 million in global development costs), and potential commercial returns from profit sharing in the U.S. or royalties paid by Merck outside the U.S. In the U.S., ARIAD will distribute and sell MK-8669 for all cancer indications, and ARIAD and Merck will co-promote and will each receive 50% of the income from such sales. Outside the U.S., Merck will distribute, sell and promote MK-8669; Merck will pay ARIAD tiered double-digit royalties on end-market sales of MK-8669.

On December 29, 2006, Merck completed the acquisition of Sirna Therapeutics, Inc. ("Sirna") for $13 per share in cash, for a total value of approximately $1.1 billion, which included the purchase of all outstanding Sirna shares, warrants and stock options. The aggregate purchase price of $1.1 billion was paid on January 3, 2007, and accordingly, is reflected as a liability within Accrued and other current liabilities in the Company's consolidated balance sheet at December 31, 2006. Sirna was a publicly-held biotechnology company that is a leader in developing a new class of medicines based on RNA interference ("RNAi") technology, which could significantly alter the treatment of disease. RNAi-based therapeutics selectively catalyze the destruction of the RNA transcribed from an individual gene. The acquisition of Sirna is expected to increase Merck's ability to use RNAi technology to turn off a targeted gene in a human cell, potentially rendering inoperative a gene responsible for triggering a specific

disease. The transaction was accounted for under the purchase method of accounting, in which the assets acquired and the liabilities assumed from Sirna at the date of acquisition were recorded at their respective fair values as of the acquisition date in the Company's consolidated financial statements. The determination of fair values requires management to make significant estimates and assumptions. The excess of the purchase price over the fair value of the acquired net assets was recorded as goodwill of $369.2 million. The goodwill was fully allocated to the Pharmaceutical segment and is not deductible for tax purposes. Also, the Company recorded a charge of $466.2 million for acquired research associated with Sirna's compounds currently under development, for which, at the acquisition date, technological feasibility had not been established and no alternative future use existed. The acquired research charge related to the development of treatments for both the hepatitis B and hepatitis C viruses, which were and currently remain in preclinical development, as well as licensing agreements held by Sirna. The charge, which is not deductible for tax purposes, was recorded in Research and development expense and was determined based upon the present value of expected future cash flows of new product candidates resulting from this technology adjusted for the probability of its technical and marketing success utilizing an income approach reflecting appropriate risk–adjusted discount rates of 27.0% to 30.0%. The ongoing activity with respect to each of these compounds under development is not expected to be material to the Company's research and development expenses. The allocation of the purchase price also resulted in the recognition of an intangible asset of $357.8 million and a related deferred tax liability of $146.3 million, as well as other assets and liabilities — net of $89.3 million. The intangible asset relates to Sirna's developed technology that can be used immediately in the research and development process and has alternative future uses. This intangible asset is being amortized to Research and development expense on a straight–line basis over a seven year useful life. Pro forma financial information is not required because Sirna's historical financial results are not significant when compared with the Company's financial results. The transaction closed on December 29, 2006, and accordingly, Sirna's operating results were included in the Company's results of operations beginning January 1, 2007.

In November 2006, the Company expanded the scope of its existing strategic collaboration with FoxHollow Technologies, Inc. ("FoxHollow") for atherosclerotic plaque analysis and acquired a stake in FoxHollow. The existing strategic collaboration, entered into in 2005, provided for FoxHollow to receive an upfront payment with the opportunity for additional payments if the collaboration continued. Under the terms of the expanded collaboration agreement, payments are made to FoxHollow over four years in exchange for FoxHollow's agreement to collaborate exclusively with Merck in specified disease areas. Merck is also providing funding to FoxHollow over the first three years of the four year collaboration program term, for research activities to be conducted by FoxHollow under Merck's direction. FoxHollow will receive milestone payments on successful development of drug products or diagnostic tests utilizing results from the collaboration, as well as royalties. In October 2007, ev3 Inc. ("ev3"), a global medical device company focused on catheter–based technologies for the endovascular treatment of vascular diseases and disorders, merged with FoxHollow, at which time FoxHollow became a wholly–owned subsidiary of ev3. In connection with the merger, the Company's shares of FoxHollow were converted into shares of ev3 common stock. The investment in ev3 is recorded as a cost method investment in the December 31, 2007 Consolidated Balance Sheet.

In June 2006, the Company acquired all of the outstanding equity of GlycoFi, Inc. ("GlycoFi") for approximately $373 million in cash ($400 million purchase price net of $25 million in shares already owned and net transaction costs). GlycoFi was a privately–held biotechnology company that is a leader in the field of yeast glycoengineering, which is the addition of specific carbohydrate modifications to the proteins in yeast, and optimization of biologic drug molecules. GlycoFi's technology platform is used in the development of glycoprotein, as well as the optimization of a glycoprotein target. In connection with the acquisition, the Company recorded a charge of $296.3 million for acquired research associated with GlycoFi's technology platform to be used in the research and development process, for which, at the acquisition date, technological feasibility had not been established and no alternative future use existed. This charge is not deductible for tax purposes. The technology is currently being utilized in Merck's pipeline of biologics. The charge was recorded in Research and development expense and was determined based upon the present value of expected future cash flows of new product candidates resulting from this technology adjusted for the probability of its technical and marketing success utilizing an income approach reflecting the appropriate risk–adjusted discount rate. The Company also recorded a $99.4 million intangible asset ($57.6 million net of deferred taxes) related to GlycoFi's developed technology that can be used immediately in the research and development process and has alternative future uses. This intangible asset is being

amortized to Research and development expense on a straight-line basis over a five year useful life. The remaining net assets acquired in this transaction were not material. Because GlycoFi was a development stage company that had not commenced its planned principal operations, the transaction was accounted for as an acquisition of assets rather than as a business combination and, therefore, goodwill was not recorded. GlycoFi's results of operations have been included with the Company's consolidated financial results since the acquisition date.

In May 2006, the Company acquired all of the equity of Abmaxis, Inc. ("Abmaxis") for approximately $80 million in cash. Abmaxis was a privately-held biopharmaceutical company dedicated to the discovery and optimization of monoclonal antibody ("MAb") products for human therapeutics and diagnostics. Abmaxis developed and validated a breakthrough antibody engineering technology platform, Abmaxis *in-silico* Immunization, which has alternative future uses to the Company with no significant technological or engineering risks at the date of acquisition. In connection with the acquisition, the Company allocated substantially all of the purchase price to Abmaxis' technology platform and recorded an intangible asset of $135.3 million ($78.5 million net of deferred taxes). This intangible asset is being amortized to Research and development expense on a straight-line basis over a five year useful life. The remaining net assets acquired in this transaction were not material. Because Abmaxis was a development stage company that had not commenced its planned principal operations, the transaction was accounted for as an acquisition of assets rather than as a business combination and, therefore, goodwill was not recorded. Abmaxis' results of operations have been included with the Company's consolidated financial results since the acquisition date.

Also in 2006, Merck and Idera Pharmaceuticals ("Idera") announced that they had formed a broad collaboration to research, develop and commercialize Idera's Toll-like Receptor agonists for use in combination with Merck's therapeutic and prophylactic vaccines under development for oncology, infectious diseases and Alzheimer's disease. Additionally in 2006, Merck and Ambrilia Biopharma Inc. ("Ambrilia"), a biopharmaceutical company developing innovative therapeutics in the fields of cancer and infectious diseases, announced they entered into an exclusive licensing agreement granting Merck the worldwide rights to Ambrilia's HIV/AIDS protease inhibitor program. Also in 2006, Neuromed Pharmaceuticals Ltd. and Merck signed a research collaboration and license agreement to research, develop and commercialize novel compounds for the treatment of pain and other neurological disorders.

In 2005, Agensys, Inc. ("Agensys"), a cancer biotechnology company, and Merck announced the formation of a global alliance to jointly develop and commercialize AGS-PSCA, Agensys' fully human MAb to Prostate Stem Cell Antigen. Also in 2005, Merck entered into an agreement with Geron Corporation to develop a cancer vaccine against telomerase, an enzyme, active in most cancer cells that maintains telomere length at the ends of chromosomes, which allows the cancer to grow and metastasize over long periods of time.

5. Financial Instruments

Foreign Currency Risk Management

While the U.S. dollar is the functional currency of the Company's foreign subsidiaries, a significant portion of the Company's revenues are denominated in foreign currencies. Merck relies on sustained cash flows generated from foreign sources to support its long-term commitment to U.S. dollar-based research and development. To the extent the dollar value of cash flows is diminished as a result of a strengthening dollar, the Company's ability to fund research and other dollar-based strategic initiatives at a consistent level may be impaired. The Company has established revenue hedging and balance sheet risk management programs to protect against volatility of future foreign currency cash flows and changes in fair value caused by volatility in foreign exchange rates.

The objective of the revenue hedging program is to reduce the potential for longer-term unfavorable changes in foreign exchange to decrease the U.S. dollar value of future cash flows derived from foreign currency denominated sales, primarily the euro and Japanese yen. To achieve this objective, the Company will partially hedge anticipated third-party sales that are expected to occur over its planning cycle, typically no more than three years into the future. The Company will layer in hedges over time, increasing the portion of sales hedged as it gets closer to the expected date of the transaction, such that it is probable that the hedged transaction will occur. The portion of sales hedged is based on assessments of cost-benefit profiles that consider natural offsetting exposures, revenue and

exchange rate volatilities and correlations, and the cost of hedging instruments. The hedged anticipated sales are a specified component of a portfolio of similarly denominated foreign currency–based sales transactions, each of which responds to the hedged risk in the same manner. Merck manages its anticipated transaction exposure principally with purchased local currency put options, which provide the Company with a right, but not an obligation, to sell foreign currencies in the future at a predetermined price. If the U.S. dollar strengthens relative to the currency of the hedged anticipated sales, total changes in the options' cash flows fully offset the decline in the expected future U.S. dollar cash flows of the hedged foreign currency sales. Conversely, if the U.S. dollar weakens, the options' value reduces to zero, but the Company benefits from the increase in the value of the anticipated foreign currency cash flows.

The designated hedge relationship is based on total changes in the options' cash flows. Accordingly, the entire fair value change in the options is deferred in AOCI and reclassified into Sales when the hedged anticipated revenue is recognized. The hedge relationship is highly effective and hedge ineffectiveness is *de minimis*. The fair values of purchased currency options are reported in Accounts receivable or Other assets. The cash flows from these contracts are reported as operating activities in the Consolidated Statement of Cash Flows.

The primary objective of the balance sheet risk management program is to protect the U.S. dollar value of foreign currency denominated net monetary assets from the effects of volatility in foreign exchange that might occur prior to their conversion to U.S. dollars. Merck principally utilizes forward exchange contracts, which enable the Company to buy and sell foreign currencies in the future at fixed exchange rates and economically offset the consequences of changes in foreign exchange on the amount of U.S. dollar cash flows derived from the net assets. Merck routinely enters into contracts to fully offset the effects of exchange on exposures denominated in developed country currencies, primarily the euro and Japanese yen. For exposures in developing country currencies, the Company will enter into forward contracts on a more limited basis, and only when it is deemed economical to do so based on a cost–benefit analysis that considers the magnitude of the exposure, the volatility of the exchange rate and the cost of the hedging instrument. The Company will also minimize the effect of exchange on monetary assets and liabilities by managing operating activities and net asset positions at the local level.

Foreign currency denominated monetary assets and liabilities are remeasured at spot rates in effect on the balance sheet date with the effects of changes in spot rates reported in Other (income) expense, net. The forward contracts are not designated as hedges and are marked to market through Other (income) expense, net. Accordingly, fair value changes in the forward contracts help mitigate the changes in the value of the remeasured assets and liabilities attributable to changes in foreign currency exchange rates, except to the extent of the spot–forward differences. These differences are not significant due to the short–term nature of the contracts, which typically have average maturities at inception of less than one year.

The Company uses forward contracts to hedge the changes in fair value of certain foreign currency denominated available–for–sale securities attributable to fluctuations in foreign currency exchange rates. Changes in the fair value of the hedged securities due to fluctuations in spot rates are offset in Other (income) expense, net, by the fair value changes in the forward contracts attributable to spot rate fluctuations. Hedge ineffectiveness was not material during 2007, 2006 or 2005. Changes in the contracts' fair value due to spot–forward differences are excluded from the designated hedge relationship and recognized in Other (income) expense, net. These amounts were not significant for the years ended December 31, 2007, 2006 or 2005.

The fair values of forward exchange contracts are reported in the following four balance sheet line items: Accounts receivable (current portion of gain position), Other assets (non–current portion of gain position), Accrued and other current liabilities (current portion of loss position), or Deferred income taxes and noncurrent liabilities (non–current portion of loss position). The cash flows from these contracts are reported as operating activities in the Consolidated Statement of Cash Flows.

Interest Rate Risk Management

The Company may use interest rate swap contracts on certain investing and borrowing transactions to manage its net exposure to interest rate changes and to reduce its overall cost of borrowing. The Company does not use leveraged swaps and, in general, does not leverage any of its investment activities that would put principal capital at risk.

At December 31, 2007, the Company was a party to seven pay–floating, receive–fixed interest rate swap contracts designated as fair value hedges of fixed–rate notes in which the notional amounts match the amount of the hedged fixed–rate notes. There are two swaps maturing in 2011 with notional amounts of $125 million each; one swap maturing in 2013 with a notional amount of $500 million and four swaps maturing in 2015 with notional amounts of $250 million each. The swaps effectively convert the fixed–rate obligations to floating–rate instruments. The fair value changes in the notes are fully offset in interest expense by the fair value changes in the swap contracts. The fair values of these contracts are reported in Accounts receivable, Other assets, Accrued and other current liabilities, or Deferred income taxes and noncurrent liabilities. The cash flows from these contracts are reported as operating activities in the Consolidated Statement of Cash Flows.

Fair Value of Financial Instruments

Summarized below are the carrying values and fair values of the Company's financial instruments at December 31, 2007 and 2006. Fair values were estimated based on market prices, where available, or dealer quotes.

	2007		2006	
	Carrying Value	Fair Value	Carrying Value	Fair Value
Assets				
Cash and cash equivalents	$ 5,336.1	$ 5,336.1	$ 5,914.7	$ 5,914.7
Short–term investments	2,894.7	2,894.7	2,798.3	2,798.3
Long–term investments	7,159.2	7,159.2	7,788.2	7,788.2
Purchased currency options	59.9	59.9	43.9	43.9
Forward exchange contracts	62.1	62.1	11.1	11.1
Interest rate swaps	108.0	108.0	26.3	26.3
Liabilities				
Loans payable and current portion of long–term debt	$ 1,823.6	$ 1,828.4	$ 1,285.1	$ 1,284.3
Long–term debt	3,915.8	3,986.7	5,551.0	5,612.7
Written currency options	8.8	8.8	–	–
Forward exchange contracts	35.8	35.8	25.5	25.5

A summary of the December 31 carrying values and fair values of the Company's investments and gross unrealized gains and losses on the Company's available–for–sale investments recorded, net of tax, in AOCI is as follows:

	2007			
	Carrying Value	Fair Value	Gross Unrealized Gains	Gross Unrealized Losses
Corporate notes and bonds	$ 5,465.0	$ 5,465.0	$ 28.4	$ (20.7)
U.S. Government and agency securities	1,748.4	1,748.4	32.2	(0.1)
Mortgage–backed securities	760.0	760.0	8.9	–
Municipal securities	744.6	744.6	13.3	(0.2)
Asset–backed securities	313.2	313.2	1.8	(1.4)
Foreign government bonds	269.9	269.9	0.7	(0.6)
Commercial paper	258.1	258.1	–	–
Other debt securities	343.9	343.9	14.5	–
Equity securities	150.8	150.8	97.0	(5.5)
	$ 10,053.9	$ 10,053.9	$ 196.8	$ (28.5)

The amount of gross unrealized losses that were in a continuous loss position for more than 12 months was *de minimis*.

	2006			
	Carrying Value	Fair Value	Gross Unrealized Gains	Gross Unrealized Losses
Corporate notes and bonds	$ 5,189.5	$ 5,189.5	$ 7.2	$ (5.0)
U.S. Government and agency securities	2,028.2	2,028.2	2.3	(3.7)
Commercial paper	1,110.2	1,110.2	–	–
Municipal securities	708.5	708.5	4.3	(1.3)
Mortgage–backed securities	615.4	615.4	1.8	(0.7)
Asset–backed securities	456.5	456.5	0.8	(0.4)
Foreign government bonds	191.2	191.2	–	(0.7)
Repurchase agreements	81.5	81.5	–	–
Other debt securities	47.1	47.1	8.8	–
Equity securities	158.4	158.4	85.5	(0.7)
	$ 10,586.5	$ 10,586.5	$ 110.7	$ (12.5)

Available–for–sale debt securities maturing within one year totaled $2.9 billion at December 31, 2007. Of the remaining debt securities, $5.8 billion mature within five years.

Available–for–sale investments at December 31, 2007 and December 31, 2006 included $760.0 million and $615.4 million, respectively, of AAA–rated mortgage–backed securities issued or unconditionally guaranteed as to payment of principal and interest by U.S. government agencies, and $313.2 million and $456.5 million, respectively, of asset–backed securities, substantially all of which are highly–rated (Standard & Poor's rating of AAA or Moody's Investors Service rating of Aaa), secured primarily by credit card, auto loan, and home equity receivables, with weighted–average lives of primarily 5 years or less.

Concentrations of Credit Risk

As part of its ongoing control procedures, the Company monitors concentrations of credit risk associated with corporate issuers of securities and financial institutions with which it conducts business. We place our cash and investments in instruments that meet high credit quality standards, as specified in our investment policy guidelines. Credit risk is minimal as credit exposure limits are established to avoid a concentration with any single issuer or institution.

Four U.S. customers represented, in aggregate, approximately one–sixth of the Company's accounts receivable at December 31, 2007. The Company monitors the creditworthiness of its customers to which it grants credit terms in the normal course of business. Bad debts have been minimal. The Company does not normally require collateral or other security to support credit sales.

6. Inventories

Inventories at December 31 consisted of:

	2007	2006
Finished goods	$ 382.9	$ 403.8
Raw materials and work in process	1,732.2	1,688.9
Supplies	111.1	92.8
Total (approximates current cost)	2,226.2	2,185.5
Reduction to LIFO costs	–	–
Recognized as:	$ 2,226.2	$ 2,185.5
Inventories	$ 1,881.0	$ 1,769.4
Other assets	$ 345.2	$ 416.1

Inventories valued under the LIFO method comprised approximately 57% and 62% of inventories at December 31, 2007 and 2006, respectively. Amounts recognized as Other assets are comprised entirely of raw materials and work in process inventories, representing inventories for products not expected to be sold within one year, the majority of which are vaccines.

7. Other Intangibles

Other intangibles at December 31 consisted of:

	2007	2006
Patents and product rights	$ 1,656.3	$ 1,656.3
Other	781.0	775.9
Total acquired cost	$ 2,437.3	$ 2,432.2
Patents and product rights	$ 1,449.4	$ 1,321.5
Other	274.7	166.8
Total accumulated amortization	$ 1,724.1	$ 1,488.3

Other reflects intangibles recorded in connection with the acquisitions of Sirna, GlycoFi and Abmaxis (see Note 4). Aggregate amortization expense was $235.8 million in 2007, $170.3 million in 2006 and $163.9 million in 2005. The estimated aggregate amortization expense for each of the next five years is as follows: 2008, $185.0 million; 2009, $134.6 million; 2010, $132.6 million; 2011, $105.2 million; 2012, $85.6 million.

8. Joint Ventures and Other Equity Method Affiliates

Equity income from affiliates reflects the performance of the Company's joint ventures and other equity method affiliates and was comprised of the following:

Years Ended December 31	2007	2006	2005
Merck/Schering–Plough	$ 1,830.8	$ 1,218.6	$ 570.4
AstraZeneca LP	820.1	783.7	833.5
Other [1]	325.6	292.1	313.2
	$ 2,976.5	$ 2,294.4	$ 1,717.1

[1] *Primarily reflects results from Merial Limited, Sanofi Pasteur MSD and Johnson & Johnson°Merck Consumer Pharmaceuticals Company.*

Merck/Schering–Plough

In 2000, the Company and Schering–Plough Corporation ("Schering–Plough") (collectively the "Partners") entered into agreements to create separate equally–owned partnerships to develop and market in the

United States new prescription medicines in the cholesterol–management and respiratory therapeutic areas. These agreements generally provide for equal sharing of development costs and for co–promotion of approved products by each company. In 2001, the cholesterol–management partnership agreements were expanded to include all the countries of the world, excluding Japan. In 2002, ezetimibe, the first in a new class of cholesterol–lowering agents, was launched in the United States as *Zetia* (marketed as *Ezetrol* outside the United States). In 2004, a combination product containing the active ingredients of both *Zetia* and *Zocor*, was approved in the United States as *Vytorin* (marketed as *Inegy* outside of the United States).

The cholesterol agreements provide for the sharing of operating income generated by the Merck/Schering–Plough cholesterol partnership (the "MSP Partnership") based upon percentages that vary by product, sales level and country. In the U.S. market, the Partners share profits on *Zetia* and *Vytorin* sales equally, with the exception of the first $300 million of annual *Zetia* sales on which Schering–Plough receives a greater share of profits. Operating income includes expenses that the Partners have contractually agreed to share, such as a portion of manufacturing costs, specifically identified promotion costs (including direct–to–consumer advertising and direct and identifiable out–of–pocket promotion) and other agreed upon costs for specific services such as on–going clinical research, market support, market research, market expansion, as well as a specialty sales force and physician education programs. Expenses incurred in support of the MSP Partnership but not shared between the Partners, such as marketing and administrative expenses (including certain sales force costs), as well as certain manufacturing costs, are not included in Equity income from affiliates. However, these costs are reflected in the overall results of the Company. Certain research and development expenses are generally shared equally by the Partners, after adjusting for earned milestones.

See Note 10 for information with respect to litigation involving the MSP Partnership and the Partners related to the sale and promotion of *Zetia* and *Vytorin*.

The respiratory therapeutic agreements provide for the joint development and marketing in the United States by the Partners of a once–daily, fixed–combination tablet containing the active ingredients montelukast sodium and loratadine. Montelukast sodium, a leukotriene receptor antagonist, is sold by Merck as *Singulair* and loratadine, an antihistamine, is sold by Schering–Plough as Claritin, both of which are indicated for the relief of symptoms of allergic rhinitis. In August 2007, the Partners announced that the New Drug Application filing for montelukast sodium/loratadine had been accepted by the U.S. Food and Drug Administration ("FDA") for standard review. The Partners are seeking U.S. marketing approval of the medicine for treatment of allergic rhinitis symptoms in patients who want relief from nasal congestion.

Summarized financial information for the MSP Partnership is as follows:

Years Ended December 31	2007	2006	2005
Sales	$ 5,186.2	$ 3,884.1	$ 2,425.0
Vytorin	2,779.1	1,955.3	1,028.3
Zetia	2,407.1	1,928.8	1,396.7
Materials and production costs	216.0	179.0	93.0
Other expense, net	1,307.2	1,217.1	1,079.0
Income before taxes	$ 3,663.0	$ 2,488.0	$ 1,253.0
Merck's share of income before taxes [1]	$ 1,832.5	$ 1,214.5	$ 564.5

December 31	2007	2006
Total assets [2]	$ 1,014.0	$430.0
Total liabilities [2]	656.0	511.0

(1) *Merck's share of the MSP Partnership's income before taxes differs from the equity income recognized from the MSP Partnership primarily due to the timing of recognition of certain transactions between the Company and the MSP Partnership.*

(2) *Amounts are comprised almost entirely of current balances.*

AstraZeneca LP

In 1982, Merck entered into an agreement with Astra AB ("Astra") to develop and market Astra's products under a royalty–bearing license. In 1993, the Company's total sales of Astra products reached a level that triggered the first step in the establishment of a joint venture business carried on by Astra Merck Inc. ("AMI"), in which Merck and Astra each owned a 50% share. This joint venture, formed in 1994, developed and marketed most of Astra's new prescription medicines in the United States including *Prilosec*, the first of a class of medications known as proton pump inhibitors, which slows the production of acid from the cells of the stomach lining.

In 1998, Merck and Astra completed the restructuring of the ownership and operations of the joint venture whereby the Company acquired Astra's interest in AMI, renamed KBI Inc. ("KBI"), and contributed KBI's operating assets to a new U.S. limited partnership, Astra Pharmaceuticals L.P. (the "Partnership"), in exchange for a 1% limited partner interest. Astra contributed the net assets of its wholly owned subsidiary, Astra USA, Inc., to the Partnership in exchange for a 99% general partner interest. The Partnership, renamed AstraZeneca LP ("AZLP") upon Astra's 1999 merger with Zeneca Group Plc (the "AstraZeneca merger"), became the exclusive distributor of the products for which KBI retained rights.

While maintaining a 1% limited partner interest in AZLP, Merck has consent and protective rights intended to preserve its business and economic interests, including restrictions on the power of the general partner to make certain distributions or dispositions. Furthermore, in limited events of default, additional rights will be granted to the Company, including powers to direct the actions of, or remove and replace, the Partnership's chief executive officer and chief financial officer. Merck earns ongoing revenue based on sales of current and future KBI products and such revenue was $1.7 billion, $1.8 billion and $1.7 billion in 2007, 2006 and 2005, respectively, primarily relating to sales of *Nexium*, as well as *Prilosec*. In addition, Merck earns certain Partnership returns which are recorded in Equity income from affiliates as reflected in the table above. Such returns include a priority return provided for in the Partnership Agreement, variable returns based, in part, upon sales of certain former Astra USA, Inc. products, and a preferential return representing Merck's share of undistributed AZLP GAAP earnings. The AstraZeneca merger triggers a partial redemption of Merck's limited partnership interest in 2008. Upon this redemption, AZLP will distribute to KBI an amount based primarily on a multiple of Merck's average annual variable returns derived from sales of the former Astra USA, Inc. products for the three years prior to the redemption (the "Limited Partner Share of Agreed Value").

In conjunction with the 1998 restructuring, for a payment of $443.0 million, which was recorded as deferred income, Astra purchased an option (the "Asset Option") to buy Merck's interest in the KBI products, excluding the gastrointestinal medicines *Nexium* and *Prilosec* (the "Non–PPI Products"). The Asset Option is exercisable in the first half of 2010 at an exercise price equal to the net present value as of March 31, 2008 of projected future pretax revenue to be received by the Company from the KBI products (the "Appraised Value"). Merck also had the right to require Astra to purchase such interest in 2008 at the Appraised Value. In February 2008, the Company advised AZLP that it will not exercise the Asset Option. In addition, in 1998 the Company granted Astra an option to buy Merck's common stock interest in KBI, and, therefore, Merck's interest in *Nexium* and *Prilosec*, exercisable two years after Astra's purchase of Merck's interest in the Non–PPI Products. The exercise of this option by Astra is also provided for in the year 2017 or if combined annual sales of the two products fall below a minimum amount provided, in each case, only so long as AstraZeneca's option in 2010 has been exercised. The exercise price is based on the net present value of estimated future net sales of *Nexium* and *Prilosec* as determined at the time of exercise, subject to certain true–up mechanisms.

The 1999 AstraZeneca merger constituted a Trigger Event under the KBI restructuring agreements. As a result of the merger, in exchange for Merck's relinquishment of rights to future Astra products with no existing or pending U.S. patents at the time of the merger, Astra paid $967.4 million (the "Advance Payment"), which is subject to a true–up calculation in 2008 that may require repayment of all or a portion of this amount. The amount determined by the true–up calculation (the "True–Up Amount") is directly dependent on the fair market value in 2008 of the Astra product rights retained by the Company. Accordingly, recognition of this contingent income has been deferred until the realizable amount is determinable in 2008. In 2007, the Company reclassified this amount to Accrued and other current liabilities from non–current liabilities as this true–up calculation will occur before the end of the second quarter of 2008.

Under the provisions of the KBI restructuring agreements, because a Trigger Event has occurred, the sum of the Limited Partner Share of Agreed Value, the Appraised Value and the True-Up Amount is guaranteed to be a minimum of $4.7 billion. Distribution of the Limited Partner Share of Agreed Value and payment of the True-Up Amount will occur in the first half of 2008 and such amounts are anticipated to represent a substantial portion of the $4.7 billion. These payments will result in a pretax gain estimated to be $2.1 billion to $2.3 billion. AstraZeneca's purchase of Merck's interest in the Non-PPI Products is contingent upon the exercise of AstraZeneca's option in 2010 and, therefore, payment of the Appraised Value may or may not occur.

In connection with the 1998 restructuring of AMI, the Company assumed a $2.4 billion par value preferred stock obligation with a dividend rate of 5% per annum, which is carried by KBI and included in Minority interests. While a small portion of the preferred stock carried by KBI is convertible into KBI common shares, none of the preferred securities are convertible into the Company's common shares and, therefore, they are not included as common shares issuable for purposes of computing Earnings per common share assuming dilution (see Note 16).

Merial Limited

In 1997, Merck and Rhône-Poulenc S.A. (now Sanofi-Aventis S.A.) combined their animal health and poultry genetics businesses to form Merial Limited ("Merial"), a fully integrated animal health company, which is a stand-alone joint venture, equally owned by each party. Merial provides a comprehensive range of pharmaceuticals and vaccines to enhance the health, well-being and performance of a wide range of animal species. Merial sales were $2.4 billion for 2007, $2.2 billion for 2006 and $2.0 billion for 2005.

Sanofi Pasteur MSD

In 1994, Merck and Pasteur Mérieux Connaught (now Sanofi Pasteur S.A.) established an equally-owned joint venture to market vaccines in Europe and to collaborate in the development of combination vaccines for distribution in Europe. Joint venture vaccine sales were $1.4 billion for 2007, $913.9 million for 2006 and $865.1 million for 2005.

Johnson & Johnson°Merck Consumer Pharmaceuticals Company

In 1989, Merck formed a joint venture with Johnson & Johnson to develop and market a broad range of nonprescription medicines for U.S. consumers. This 50% owned venture was expanded into Europe in 1993 and into Canada in 1996. In 2004, Merck sold its 50% equity stake in its European joint venture to Johnson & Johnson. Merck will continue to benefit through royalties on certain products and also regained the rights to potential future products that switch from prescription to over-the-counter status in Europe. Sales of products marketed by the joint venture were $219.7 million for 2007, $252.6 million for 2006 and $253.3 million for 2005.

Investments in affiliates accounted for using the equity method, including the above joint ventures, totaled $3.9 billion at December 31, 2007 and $3.5 billion at December 31, 2006. These amounts are reported in Other assets.

Summarized information for those affiliates (excluding the MSP Partnership disclosed separately above) is as follows:

Years Ended December 31	2007	2006	2005
Sales	$ 10,564.0	$ 10,393.7	$ 9,379.6
Materials and production costs	4,710.9	5,129.7	4,534.4
Other expense, net	3,085.4	2,824.9	2,839.0
Income before taxes	2,767.7	2,439.1	2,006.2

December 31	2007	2006
Current assets	$ 7,431.5	$7,342.7
Noncurrent assets	1,576.5	1,483.6
Current liabilities	3,484.5	3,562.9
Noncurrent liabilities	280.8	215.6

9. Loans Payable, Long–Term Debt and Other Commitments

During 2007, the Company reclassified the $1.38 billion Astra Note due in 2008 from Long–term debt to Loans payable and current portion of long–term debt. Loans payable at December 31, 2007 and 2006 included $331.7 million and $336.2 million, respectively, of long–dated notes that are subject to repayment at the option of the holders on an annual basis. Loans payable at December 31, 2006 also included $500.0 million of notes with annual interest rate resets which were redeemed by the Company in 2007, upon notification from the remarketing agent that, due to an overall rise in interest rates, it would not exercise its annual option to remarket the notes. Additionally, Loans payable at December 31, 2006, included $349.8 million of fixed rate notes, which matured in 2007. In December 2006, a foreign subsidiary of the Company entered into an 18–month, $100 million line of credit with a financial institution. At December 31, 2007 and 2006, borrowings under the line of credit were $100 million and $90 million, respectively, and are included in Loans payable. The weighted average interest rate for all of these borrowings included in Loans payable was 5.8% and 4.9% at December 31, 2007 and 2006, respectively.

Long–term debt at December 31 consisted of:

	2007	2006
4.75% notes due 2015	$ 1,068.1	$ 1,017.0
4.375% notes due 2013	524.4	503.0
6.4% debentures due 2028	499.3	499.2
5.75% notes due 2036	497.7	497.6
5.95% debentures due 2028	497.1	497.0
5.125% notes due 2011	258.8	249.1
6.3% debentures due 2026	247.9	247.8
6.0% Astra note due 2008	–	1,380.0
Variable–rate borrowing due 2009	–	300.0
Other	322.5	360.3
	$ 3,915.8	$ 5,551.0

The Company was a party to interest rate swap contracts which effectively convert the 4.75%, 4.375%, and 5.125% fixed–rate notes to floating–rate instruments (see Note 5).

In September 2007, the Company redeemed its $300 million variable–rate borrowings that were due in 2009.

Other (as presented in the table above) at December 31, 2007 and 2006 consisted primarily of $292.7 million and $328.6 million, respectively, of borrowings at variable rates averaging 4.4% and 4.7%, respectively. Of these borrowings, $158.7 million are subject to repayment at the option of the holders beginning in 2011 and $106.0 million are subject to repayment at the option of the holders beginning in 2010. In both years, Other also included foreign borrowings at varying rates up to 7.5%.

The aggregate maturities of long–term debt for each of the next five years are as follows: 2008, $1.4 billion; 2009, $8.0 million; 2010, $6.7 million; 2011, $269.4 million; 2012, $4.5 million.

Rental expense under the Company's operating leases, net of sublease income, was $197.5 million in 2007. The minimum aggregate rental commitments under noncancellable leases are as follows: 2008, $43.1 million; 2009, $36.4 million; 2010, $26.2 million; 2011, $20.9 million; 2012, $14.0 million and thereafter, $17.0 million. The Company has no significant capital leases.

10. Contingencies and Environmental Liabilities

The Company is involved in various claims and legal proceedings of a nature considered normal to its business, including product liability, intellectual property and commercial litigation, as well as additional matters such as antitrust actions. The Company records accruals for contingencies when it is probable that a liability has been incurred and the amount can be reasonably estimated. These accruals are adjusted periodically as assessments

change or additional information becomes available. For product liability claims, a portion of the overall accrual is actuarially determined and considers such factors as past experience, number of claims reported and estimates of claims incurred but not yet reported. Individually significant contingent losses are accrued when probable and reasonably estimable. Legal defense costs expected to be incurred in connection with a loss contingency are accrued when probable and reasonably estimable.

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 a number of factors, product liability insurance has become less available while the cost has increased significantly. The Company has evaluated its risks and has determined that the cost of obtaining product liability insurance outweighs the likely benefits of the coverage that is available and as such, has no insurance for certain product liabilities effective August 1, 2004, including liability for products first sold after that date. The Company will continue to evaluate its insurance needs and the costs, availability and benefits of product liability insurance in the future.

***Vioxx* Litigation**

Product Liability Lawsuits

As previously disclosed, individual and putative class actions have been filed against the Company in state and federal courts alleging personal injury and/or economic loss with respect to the purchase or use of *Vioxx*. All such actions filed in federal court are coordinated in a multidistrict litigation in the U.S. District Court for the Eastern District of Louisiana (the "MDL") before District Judge Eldon E. Fallon. A number of such actions filed in state court are coordinated in separate coordinated proceedings in state courts in New Jersey, California and Texas, and the counties of Philadelphia, Pennsylvania and Washoe and Clark Counties, Nevada. As of December 31, 2007, the Company had been served or was aware that it had been named as a defendant in approximately 26,500 lawsuits, which include approximately 47,275 plaintiff groups, alleging personal injuries resulting from the use of *Vioxx*, and in approximately 262 putative class actions alleging personal injuries and/or economic loss. (All of the actions discussed in this paragraph are collectively referred to as the "*Vioxx* Product Liability Lawsuits".) Of these lawsuits, approximately 9,025 lawsuits representing approximately 26,275 plaintiff groups are or are slated to be in the federal MDL and approximately 15,575 lawsuits representing approximately 15,575 plaintiff groups are included in a coordinated proceeding in New Jersey Superior Court before Judge Carol E. Higbee.

In addition to the *Vioxx* Product Liability Lawsuits discussed above, the claims of over 6,350 plaintiffs had been dismissed as of December 31, 2007. Of these, there have been over 1,850 plaintiffs whose claims were dismissed with prejudice (i.e., they cannot be brought again) either by plaintiffs themselves or by the courts. Over 4,500 additional plaintiffs have had their claims dismissed without prejudice (i.e., subject to the applicable statute of limitations, they can be brought again).

Merck entered into a tolling agreement (the "Tolling Agreement") with the MDL Plaintiffs' Steering Committee ("PSC") that established a procedure to halt the running of the statute of limitations (tolling) as to certain categories of claims allegedly arising from the use of *Vioxx* by non-New Jersey citizens. The Tolling Agreement applied to individuals who have not filed lawsuits and may or may not eventually file lawsuits and only to those claimants who seek to toll claims alleging injuries resulting from a thrombotic cardiovascular event that results in a myocardial infarction ("MI") or ischemic stroke ("IS"). The Tolling Agreement provided counsel additional time to evaluate potential claims. The Tolling Agreement required any tolled claims to be filed in federal court. As of December 31, 2007, approximately 13,230 claimants had entered into Tolling Agreements. The parties agreed that April 9, 2007 was the deadline for filing Tolling Agreements and no additional Tolling Agreements are being accepted.

On November 9, 2007, Merck announced that it had entered into an agreement (the "Settlement Agreement") with the law firms that comprise the executive committee of the PSC of the federal *Vioxx* MDL as well as representatives of plaintiffs' counsel in the Texas, New Jersey and California state coordinated proceedings to resolve state and federal MI and IS claims filed as of that date in the United States. The Settlement Agreement, which also applies to tolled claims, was signed by the parties after several meetings with three of the four judges overseeing the coordination of more than 95 percent of the current claims in the *Vioxx* Litigation (as defined below). The Settlement Agreement applies only to U.S. legal residents and those who allege that their MI or IS occurred in the United States.

If certain participation conditions under the Settlement Agreement are met, which conditions may be waived by Merck, Merck will pay a fixed aggregate amount of $4.85 billion into two funds for qualifying claims that enter into the resolution process (the "Settlement Program"). Individual claimants will be examined by administrators of the Settlement Program to determine qualification based on objective, documented facts provided by claimants, including records sufficient for a scientific evaluation of independent risk factors. The conditions in the Settlement Agreement also require claimants to pass three gates: an injury gate requiring objective, medical proof of an MI or IS (each as defined in the Settlement Agreement), a duration gate based on documented receipt of at least 30 *Vioxx* pills, and a proximity gate requiring receipt of pills in sufficient number and proximity to the event to support a presumption of ingestion of *Vioxx* within 14 days before the claimed injury.

The Settlement Agreement provides that Merck does not admit causation or fault. Merck's payment obligations under the Settlement Agreement will be triggered only if, among other conditions, (1) law firms on the federal and state PSCs and firms that have tried cases in the coordinated proceedings elect to recommend enrollment in the program to 100 percent of their clients who allege either MI or IS and (2) by March 1, 2008 (subject to extension), plaintiffs enroll in the Settlement Program at least 85 percent of each of all currently pending and tolled (i) MI claims, (ii) IS claims, (iii) eligible MI and IS claims together which involve death, and (iv) eligible MI and IS claims together which allege more than 12 months of use. The Company has the right to waive these participation conditions.

Under the Settlement Agreement, Merck will create separate funds in the amount of $4.0 billion for MI claims and $850 million for IS claims. Once triggered, Merck's total payment for both funds of $4.85 billion is a fixed amount to be allocated among qualifying claimants based on their individual evaluation. While at this time the exact number of claimants covered by the Settlement Agreement is unknown, the total dollar amount is fixed. Payments to individual qualifying claimants could begin as early as August 2008 and then will be paid over a period of time. Merck retains its right to terminate this process without any payment to any claimant, and to defend each claim individually at trial if any of the aforementioned participation conditions in the Settlement Agreement are not met.

After the Settlement Agreement was announced on November 9, 2007, judges in the Federal MDL, California, Texas and New Jersey State Coordinated Proceedings entered a series of orders. The orders: (1) temporarily stayed their respective litigations; (2) required plaintiffs to register their claims by January 15, 2008; (3) require plaintiffs with cases pending as of November 9, 2007 to preserve and produce records and serve expert reports; and (4) require plaintiffs who file thereafter to make similar productions on an accelerated schedule. The Clark County, Nevada coordinated proceeding was also generally stayed.

As of February 26, 2008, more than 57,000 plaintiffs had submitted registration materials, including more than 47,000 plaintiffs who allege an MI or IS. In addition, as of February 26, 2008, more than 33,000 claimants have started submitting enrollment materials. The registration and enrollment materials currently are being evaluated for eligibility, accuracy and completeness. The claims administrator continues to receive new materials from plaintiffs.

The Company has previously disclosed the outcomes of several *Vioxx* Product Liability Lawsuits that were tried prior to September 30, 2007 (see chart below).

The following sets forth the results of trials and certain significant rulings that occurred in or after the fourth quarter of 2007 with respect to the *Vioxx* Product Liability Lawsuits.

On October 5, 2007, the jury in Kozic v. Merck, a case tried in state court in Tampa, Florida found unanimously in favor of Merck on all counts, rejecting a claim that the Company was liable for plaintiff's heart attack. In December 2007, plaintiff filed an appeal but agreed to an order staying all other post-trial activity pending his entry into the Settlement Program.

On January 18, 2007, Judge Victoria Chaney declared a mistrial in a consolidated trial of two cases, Appell v. Merck and Arrigale v. Merck, which had commenced on October 31, 2006 in California state court in Los Angeles, after the jury indicated that it could not reach a verdict. Judge Chaney had rescheduled the re-trial of the combined trial of Appell and Arrigale for January 8, 2008, but both of these cases are now stayed.

In April 2006, in a trial involving two plaintiffs, Thomas Cona and John McDarby, in Superior Court of New Jersey, Law Division, Atlantic County, the jury returned a split verdict. The jury determined that *Vioxx* did not substantially contribute to the heart attack of Mr. Cona, but did substantially contribute to the heart attack of

Mr. McDarby. The jury also concluded that, in each case, Merck violated New Jersey's consumer fraud statute, which allows plaintiffs to receive their expenses for purchasing the drug, trebled, as well as reasonable attorneys' fees. The jury awarded $4.5 million in compensatory damages to Mr. McDarby and his wife, who also was a plaintiff in that case, as well as punitive damages of $9 million. On June 8, 2007, Judge Higbee denied Merck's motion for a new trial. On June 15, 2007, Judge Higbee awarded approximately $4 million in the aggregate in attorneys' fees and costs. The Company has appealed the judgments in both cases and the Appellate Division held oral argument on both cases on January 16, 2008.

On March 27, 2007, a jury found for Merck on all counts in Schwaller v. Merck, which was tried in state court in Madison County, Illinois. The plaintiff moved for a new trial on May 25, 2007. The plaintiff filed a supplemental motion for a new trial on September 5, 2007. On December 11, 2007, Judge Stack signed a consent order staying all post-trial activity in the case until March 2008.

On December 15, 2006, the jury in Albright v. Merck, a case tried in state court in Birmingham, Alabama, returned a verdict for Merck on all counts. Plaintiff appealed in July 2007 to the Alabama Supreme Court, but in December 2007, plaintiff agreed to stay his appeal pending his entry into the Settlement Program.

On April 19, 2007, Judge Randy Wilson, who presides over the Texas *Vioxx* coordinated proceeding, dismissed the failure to warn claim of plaintiff Ruby Ledbetter, whose case was scheduled to be tried on May 14, 2007. Judge Wilson relied on a Texas statute enacted in 2003 that provides that there can be no failure to warn regarding a prescription medicine if the medicine is distributed with FDA-approved labeling. There is an exception in the statute if required, material, and relevant information was withheld from the FDA that would have led to a different decision regarding the approved labeling, but Judge Wilson found that the exception is preempted by federal law unless the FDA finds that such information was withheld. Judge Wilson is currently presiding over approximately 1,000 *Vioxx* suits in Texas in which a principal allegation is failure to warn. Judge Wilson certified the decision for an expedited appeal to the Texas Court of Civil Appeals. Plaintiffs have appealed the decision. On October 11, 2007, Merck filed a motion to abate the hearing of the appeal until after the U.S. Supreme Court's decision in Warner Lambert v. Kent, which is to be decided in 2008. On October 25, 2007, the Texas Court of Appeals denied Merck's motion to abate. The parties are currently briefing the appeal. The Company expects oral argument to be set sometime in the spring of 2008.

In July 2006, in Doherty v. Merck, in Superior Court of New Jersey, Law Division, Atlantic County, a jury returned a verdict in favor of the Company on all counts. The jury rejected a claim by the plaintiff that her nearly three years of *Vioxx* use caused her heart attack. The jury also found in Merck's favor on the plaintiff's consumer fraud claim. Plaintiff filed a motion for a new trial in August 2006. On December 21, 2007, Judge Higbee denied plaintiff's motion for a new trial without prejudice in light of plaintiff's expressed intention to participate in the Settlement Program.

A consolidated trial, Hermans v. Merck and the retrial of Humeston v. Merck, began on January 17, 2007, in the coordinated proceeding in New Jersey Superior Court before Judge Higbee. Humeston v. Merck was first tried in 2005, resulting in a jury verdict in favor of Merck on November 3, 2005. However, on August 17, 2006, Judge Higbee set aside the November 2005 jury verdict and ordered a new trial on the grounds of newly discovered evidence.

The Hermans/Humeston trial was separated into two phases: a general phase regarding Merck's conduct and a plaintiff-specific phase. On March 2, 2007, the jury found for Merck in the general phase on the Hermans failure to warn claim, and the consumer fraud claim was subsequently submitted to Judge Higbee for decision. On March 12, 2007, the jury found for plaintiffs in the Humeston case, awarding compensatory damages to Mr. Humeston in the amount of $18 million and to Mrs. Humeston in the amount of $2 million. The jury also awarded $27.5 million in punitive damages. Merck has moved for a judgment notwithstanding the verdict, a new trial, or reduction of the award. These and other post-trial motions are currently pending. On December 11, 2007, the Court dismissed the motion for new trial without prejudice in Hermans.

On July 31, 2007, the New Jersey Appellate Division unanimously upheld Judge Higbee's dismissal of *Vioxx* Product Liability Lawsuits brought by residents of the United Kingdom. Plaintiffs had asked the New Jersey Supreme Court to review the decision. On November 15, 2007, the New Jersey Supreme Court declined to review the decision.

Merck voluntarily withdrew *Vioxx* from the market on September 30, 2004. Most states have statutes of limitations for product liability claims of no more than three years, which require that claims must be filed within no more than three years after the plaintiffs learned or could have learned of their potential cause of action. As a result, some may view September 30, 2007 as a significant deadline for filing *Vioxx* cases. It is important to note, however, that the law regarding statutes of limitations can be complex and variable, depending on the facts and applicable law. Some states have longer statutes of limitations. There are also arguments that the statutes of limitations began running before September 30, 2004. New Jersey Superior Court Judge Higbee and Federal District Court Judge Fallon have issued orders in cases from New Jersey and eight other jurisdictions ruling that the statutory period for making *Vioxx* personal injury claims has passed. Judge Higbee's order was issued on October 15, 2007 and Judge Fallon's was issued on November 8, 2007.

The following chart sets forth the results of all U.S. *Vioxx* Product Liability trials to date. Juries have now decided in favor of the Company 12 times and in plaintiffs' favor five times. One Merck verdict was set aside by the court and has not been retried. Another Merck verdict was set aside and retried, leading to one of the five plaintiff verdicts. There have been two unresolved mistrials. With respect to the five plaintiffs' verdicts, Merck has filed an appeal or sought judicial review in each of those cases, and in one of those five, a federal judge reduced the damage award after trial. Certain of the plaintiffs in the trials listed below may be eligible for the Settlement Program.

Verdict Date	Plaintiff	State or Federal Court	Result	Comments
Aug. 19, 2005	Ernst	Texas	Verdict for Plaintiff	Jury awarded Plaintiff $253.4 million; the Court reduced amount to approximately $26.1 million plus interest. The judgment is now on appeal.
Nov. 3, 2005 and March 12, 2007	Humeston	New Jersey	Verdict for Merck, then judge set aside the verdict, ordering a new trial, which resulted in a verdict for Plaintiff.	In the 2005 trial, the jury found for Merck. In August 2006, the Court set aside the verdict, and ordered a new trial for January 2007. At the conclusion of the 2007 trial, the jury awarded Plaintiff a total of $47.5 million in damages. The jury also awarded Plaintiff the nominal sum of $36.00 on their Consumer Fraud Act claim. Merck has moved for a judgment notwithstanding the verdict, a reduced verdict amount, and for a new trial. These motions are still pending.
Dec. 12, 2005 and Feb. 17, 2006	Plunkett	Federal	Verdict for Merck, judge then set aside the verdict	Merck prevailed in the February 2006 retrial. The Court set aside the February 2006 verdict in May 2007. No date has been set for a new trial.
April 5, 2006	McDarby	N.J.	Verdict for Plaintiff	Plaintiff was awarded $13.5 million in damages. In June 2007, the Court awarded Plaintiffs in this and the Cona claim tried with it approximately $4 million in attorneys' fees and costs. Merck has appealed the judgment including the award of attorney's fees and costs.

Verdict Date	Plaintiff	State or Federal Court	Result	Comments
April 5, 2006	Cona	N.J.	Verdict for Merck on failure to warn claim	The jury found for Merck on the failure to warn claim. The jury awarded Plaintiff the nominal sum of $135.00 for his Consumer Fraud Act claim. In June 2007, the Court awarded Plaintiffs in this and the McDarby claim tried with it approximately $4 million in attorneys' fees and costs. Merck has appealed the judgment including the award of attorney's fees and costs.
April 21, 2006	Garza	Texas	Verdict for Plaintiff	Judge reduced $32 million jury award to $8.7 million plus interest. Merck filed an appeal on March 20, 2007.
July 13, 2006	Doherty	N.J.	Verdict for Merck	The Court denied the motion for new trial without prejudice pending Plaintiff's entry into the Settlement Program.
Aug. 2, 2006	Grossberg	California	Verdict for Merck	Plaintiff's motion for a new trial was denied, and his subsequent appeal was dismissed.
Aug. 17, 2006	Barnett	Federal	Verdict for Plaintiff	Jury awarded Plaintiff $51 million in damages. The judge ruled the award was "grossly excessive," and reduced the award to $1.6 million. Merck has appealed the Judgment to the Court of Appeals.
Sept. 26, 2006	Smith	Federal	Verdict for Merck	
Nov. 15, 2006	Mason	Federal	Verdict for Merck	
Dec. 13, 2006	Dedrick	Federal	Verdict for Merck	Plaintiff's motion for a new trial was denied in May 2007.
Dec. 15, 2006	Albright	Alabama	Verdict for Merck	Plaintiff appealed in July 2007 to the Alabama Supreme Court, but in December 2007, Plaintiff agreed to stay his appeal pending his entry into the Settlement Program.
Jan. 18, 2007	Arrigale/Appell	California	Mistrial declared after the jury deadlocked	Jury failed to return verdicts in cases filed by two Plaintiffs who alleged *Vioxx* contributed to their heart attacks. These cases are now stayed.
March 2, 2007	Hermans	New Jersey	Verdict for Merck on the failure to warn claim	The jury found for Merck on the failure to warn claim. The parties submitted the Consumer Fraud Act claim to the Court for resolution. This remains pending but subject to the stay.
March 27, 2007	Schwaller	Illinois	Verdict for Merck	Plaintiff moved for a new trial. On December 11, 2007, Judge Stack signed a consent order staying all post-trial activity in the case until March 2008.
Oct. 5, 2007	Kozic	Florida	Verdict for Merck	In December 2007, Plaintiff filed an appeal but agreed to an order staying all other post-trial activity pending his entry into the Settlement Program.

Other Lawsuits

As previously disclosed, on July 29, 2005, a New Jersey state trial court certified a nationwide class of third-party payors (such as unions and health insurance plans) that paid in whole or in part for the *Vioxx* used by their plan members or insureds. The named plaintiff in that case sought recovery of certain *Vioxx* purchase costs (plus penalties) based on allegations that the purported class members paid more for *Vioxx* than they would have had they known of the product's alleged risks. On March 31, 2006, the New Jersey Superior Court, Appellate Division, affirmed the class certification order. On September 6, 2007, the New Jersey Supreme Court reversed the certification of a nationwide class action of third-party payors, finding that the suit does not meet the requirements for a class action. Claims of certain individual third-party payors remain pending in the New Jersey court, and counsel purporting to represent a large number of third-party payors has threatened to file numerous additional such actions. Activity in the pending cases is currently stayed.

There are also pending in various U.S. courts putative class actions purportedly brought on behalf of individual purchasers or users of *Vioxx* and claiming either reimbursement of alleged economic loss or an entitlement to medical monitoring. All of these cases are at early procedural stages, and no class has been certified. In New Jersey, the trial court dismissed the complaint in the case of Sinclair, a purported statewide medical monitoring class. The Appellate Division reversed the dismissal, and the issue is now on appeal to the New Jersey Supreme Court. That court heard argument on October 22, 2007.

As previously reported, the Company has also been named as a defendant in separate lawsuits brought by the Attorneys General of seven states, and the City of New York. A Colorado taxpayer has also filed a derivative suit, on behalf of the State of Colorado, naming the Company. These actions allege that the Company misrepresented the safety of *Vioxx* and seek (i) recovery of the cost of *Vioxx* purchased or reimbursed by the state and its agencies; (ii) reimbursement of all sums paid by the state and its agencies for medical services for the treatment of persons injured by *Vioxx*; (iii) damages under various common law theories; and/or (iv) remedies under various state statutory theories, including state consumer fraud and/or fair business practices or Medicaid fraud statutes, including civil penalties. In addition, the Company has been named in two other lawsuits containing similar allegations filed by governmental entities seeking the reimbursement of alleged Medicaid expenditures for *Vioxx*. Those lawsuits are (1) a class action filed by Santa Clara County, California on behalf of all similarly situated California counties, and (2) an action filed by Erie County, New York. With the exception of the case filed by Texas (which remains in Texas state court and is currently scheduled for trial in September 2008) and the New York Attorney General and Erie County cases (which are pending transfer), the rest of the actions described in this paragraph have been transferred to the federal MDL and have not experienced significant activity to date.

Shareholder Lawsuits

As previously disclosed, in addition to the *Vioxx* Product Liability Lawsuits, the Company and various current and former officers and directors are defendants in various putative class actions and individual lawsuits under the federal securities laws and state securities laws (the "*Vioxx* Securities Lawsuits"). All of the *Vioxx* Securities Lawsuits pending in federal court have been transferred by the Judicial Panel on Multidistrict Litigation (the "JPML") to the United States District Court for the District of New Jersey before District Judge Stanley R. Chesler for inclusion in a nationwide MDL (the "Shareholder MDL"). Judge Chesler has consolidated the *Vioxx* Securities Lawsuits for all purposes. The putative class action, which requested damages on behalf of purchasers of Company stock between May 21, 1999 and October 29, 2004, alleged that the defendants made false and misleading statements regarding *Vioxx* in violation of Sections 10(b) and 20(a) of the Securities Exchange Act of 1934, and sought unspecified compensatory damages and the costs of suit, including attorneys' fees. The complaint also asserted claims under Section 20A of the Securities and Exchange Act against certain defendants relating to their sales of Merck stock and under Sections 11, 12 and 15 of the Securities Act of 1933 against certain defendants based on statements in a registration statement and certain prospectuses filed in connection with the Merck Stock Investment Plan, a dividend reinvestment plan. On April 12, 2007, Judge Chesler granted defendants' motion to dismiss the complaint with prejudice. Plaintiffs have appealed Judge Chesler's decision to the United States Court of Appeals for the Third Circuit.

In October 2005, a Dutch pension fund filed a complaint in the District of New Jersey alleging violations of federal securities laws as well as violations of state law against the Company and certain officers. Pursuant to the

Case Management Order governing the Shareholder MDL, the case, which is based on the same allegations as the *Vioxx* Securities Lawsuits, was consolidated with the *Vioxx* Securities Lawsuits. Defendants' motion to dismiss the pension fund's complaint was filed on August 3, 2007. In September 2007, the Dutch pension fund filed an amended complaint rather than responding to defendants' motion to dismiss. In addition in 2007, six new complaints were filed in the District of New Jersey on behalf of various foreign institutional investors also alleging violations of federal securities laws as well as violations of state law against the Company and certain officers. Defendants are not required to respond to these complaints until after the Third Circuit issues a decision on the securities lawsuit currently on appeal.

As previously disclosed, on August 15, 2005, a complaint was filed in Oregon state court by the State of Oregon through the Oregon state treasurer on behalf of the Oregon Public Employee Retirement Fund against the Company and certain current and former officers and directors under Oregon securities law. A trial date has been set for October 2008.

As previously disclosed, various shareholder derivative actions filed in federal court were transferred to the Shareholder MDL and consolidated for all purposes by Judge Chesler (the "*Vioxx* Derivative Lawsuits"). On May 5, 2006, Judge Chesler granted defendants' motion to dismiss and denied plaintiffs' request for leave to amend their complaint. Plaintiffs appealed, arguing that Judge Chesler erred in denying plaintiffs' leave to amend their complaint with materials acquired during discovery. On July 18, 2007, the United States Court of Appeals for the Third Circuit reversed the District Court's decision on the grounds that Judge Chesler should have allowed plaintiffs to make use of the discovery material to try to establish demand futility, and remanded the case for the District Court's consideration of whether, even with the additional materials, plaintiffs' request to amend their complaint would still be futile. Plaintiffs filed their brief in support of their request for leave to amend their complaint in November 2007. That motion is pending.

In addition, as previously disclosed, various putative class actions filed in federal court under the Employee Retirement Income Security Act ("ERISA") against the Company and certain current and former officers and directors (the "*Vioxx* ERISA Lawsuits" and, together with the *Vioxx* Securities Lawsuits and the *Vioxx* Derivative Lawsuits, the "*Vioxx* Shareholder Lawsuits") have been transferred to the Shareholder MDL and consolidated for all purposes. The consolidated complaint asserts claims on behalf of certain of the Company's current and former employees who are participants in certain of the Company's retirement plans for breach of fiduciary duty. The lawsuits make similar allegations to the allegations contained in the *Vioxx* Securities Lawsuits. On July 11, 2006, Judge Chesler granted in part and denied in part defendants' motion to dismiss the ERISA complaint. In October 2007, plaintiffs moved for certification of a class of individuals who were participants in and beneficiaries of the Company's retirement savings plans at any time between October 1, 1998 and September 30, 2004 and whose plan accounts included investments in the Merck Common Stock Fund and/or Merck common stock. That motion is pending.

As previously disclosed, on October 29, 2004, two individual shareholders made a demand on the Company's Board to take legal action against Mr. Raymond Gilmartin, former Chairman, President and Chief Executive Officer and other individuals for allegedly causing damage to the Company with respect to the allegedly improper marketing of *Vioxx*. In December 2004, the Special Committee of the Board of Directors retained the Honorable John S. Martin, Jr. of Debevoise & Plimpton LLP to conduct an independent investigation of, among other things, the allegations set forth in the demand. Judge Martin's report was made public in September 2006. Based on the Special Committee's recommendation made after careful consideration of the Martin report and the impact that derivative litigation would have on the Company, the Board rejected the demand. On October 11, 2007, the shareholders filed a lawsuit in state court in Atlantic County, NJ against current and former executives and directors of the Company alleging that the Board's rejection of their demand was unreasonable and improper, and that the defendants breached various duties to the Company in allowing *Vioxx* to be marketed.

International Lawsuits

As previously disclosed, in addition to the lawsuits discussed above, the Company has been named as a defendant in litigation relating to *Vioxx* in various countries (collectively, the "*Vioxx* Foreign Lawsuits") in Europe, as well as Canada, Brazil, Argentina, Australia, Turkey, and Israel.

Additional Lawsuits

Based on media reports and other sources, the Company anticipates that additional *Vioxx* Product Liability Lawsuits, *Vioxx* Shareholder Lawsuits and *Vioxx* Foreign Lawsuits (collectively, the "*Vioxx* Lawsuits") will be filed against it and/or certain of its current and former officers and directors in the future.

Insurance

As previously disclosed, the Company has product liability insurance for claims brought in the *Vioxx* Product Liability Lawsuits with stated upper limits of approximately $630 million after deductibles and co-insurance. This insurance provides coverage for legal defense costs and potential damage amounts in connection with the *Vioxx* Product Liability Lawsuits. The Company's insurance coverage with respect to the *Vioxx* Lawsuits will not be adequate to cover its defense costs and losses.

As previously disclosed, the Company's upper level excess insurers (which provide excess insurance potentially applicable to all of the *Vioxx* Lawsuits) had commenced an arbitration seeking, among other things, to cancel those policies, to void all of their obligations under those policies and to raise other coverage issues with respect to the *Vioxx* Lawsuits. As previously disclosed, in November 2007, the tribunal in the arbitration ruled in the Company's favor ordering the upper level excess insurers to comply with their obligations under the policies. The Company recorded a $455 million gain in the fourth quarter as a result of certain other settlements and the tribunal's decision. In addition, prior to recording the gain in the fourth quarter of 2007, as a result of settlements with, and payments made by, certain of its insurers, the Company had previously received insurance proceeds of approximately $145 million. The Company still has claims that have not yet been resolved against lower level excess insurers to obtain reimbursement for amounts paid in connection with *Vioxx* Product Liability Lawsuits. As a result of settlements that have already been made, the Company will not recover the full amount of the limits discussed in the first paragraph of this section. The resolution of claims against lower level insurers will also affect the total amount of insurance that is recovered for these claims. Other than the remaining coverage of approximately $15 million from the lower level excess insurers, the Company has no additional insurance for the *Vioxx* Product Liability Lawsuits.

The Company has Directors and Officers insurance coverage applicable to the *Vioxx* Securities Lawsuits and *Vioxx* Derivative Lawsuits with stated upper limits of approximately $190 million. The Company has Fiduciary and other insurance for the *Vioxx* ERISA Lawsuits with stated upper limits of approximately $275 million. As a result of the arbitration, additional insurance coverage for these claims should also be available, if needed, under upper-level excess policies that provide coverage for a variety of risks. There are disputes with the insurers about the availability of some or all of the Company's insurance coverage for these claims and there are likely to be additional disputes. The amounts actually recovered under the policies discussed in this paragraph may be less than the stated upper limits.

Investigations

As previously disclosed, in November 2004, the Company was advised by the staff of the SEC that it was commencing an informal inquiry concerning *Vioxx*. On January 28, 2005, the Company announced that it received notice that the SEC issued a formal notice of investigation. Also, the Company has received subpoenas from the U.S. Department of Justice (the "DOJ") requesting information related to the Company's research, marketing and selling activities with respect to *Vioxx* in a federal health care investigation under criminal statutes. In addition, as previously disclosed, investigations are being conducted by local authorities in certain cities in Europe in order to determine whether any criminal charges should be brought concerning *Vioxx*. The Company is cooperating with these governmental entities in their respective investigations (the "*Vioxx* Investigations"). The Company cannot predict the outcome of these inquiries; however, they could result in potential civil and/or criminal dispositions.

As previously disclosed, the Company has received a number of Civil Investigative Demands ("CID") from a group of Attorneys General from 31 states and the District of Columbia who are investigating whether the Company violated state consumer protection laws when marketing *Vioxx*. The Company is cooperating with the Attorneys General in responding to the CIDs.

In addition, the Company received a subpoena in September 2006 from the State of California Attorney General seeking documents and information related to the placement of *Vioxx* on California's Medi–Cal formulary. The Company is cooperating with the Attorney General in responding to the subpoena.

Reserves

As discussed above, on November 9, 2007, Merck entered into the Settlement Agreement with the law firms that comprise the executive committee of the PSC of the federal *Vioxx* MDL as well as representatives of plaintiffs' counsel in the Texas, New Jersey and California state coordinated proceedings to resolve state and federal MI and IS claims filed as of that date in the United States. The Settlement Agreement, which also applies to tolled claims, was signed by the parties after several meetings with three of the four judges overseeing the coordination of more than 95 percent of the current claims in the *Vioxx* Litigation. The Settlement Agreement applies only to U.S. legal residents and those who allege that their MI or IS occurred in the United States. As a result of entering into the Settlement Agreement, the Company recorded a pretax charge of $4.85 billion which represents the fixed aggregate amount to be paid to plaintiffs qualifying for payment under the Settlement Program.

The Company currently anticipates that a number of *Vioxx* Product Liability Lawsuits will be tried throughout 2008. A trial in the Oregon securities case is scheduled for 2008, but the Company cannot predict whether this trial will proceed on schedule or the timing of any of the other *Vioxx* Shareholder Lawsuit trials. The Company believes that it has meritorious defenses to the *Vioxx* Lawsuits and will vigorously defend against them. In view of the inherent difficulty of predicting the outcome of litigation, particularly where there are many claimants and the claimants seek indeterminate damages, the Company is unable to predict the outcome of these matters, and at this time cannot reasonably estimate the possible loss or range of loss with respect to the *Vioxx* Lawsuits not included in the Settlement Program. The Company has not established any reserves for any potential liability relating to the *Vioxx* Lawsuits not included in the Settlement Program or the *Vioxx* Investigations, including for those cases in which verdicts or judgments have been entered against the Company, and are now in post–verdict proceedings or on appeal. In each of those cases the Company believes it has strong points to raise on appeal and therefore that unfavorable outcomes in such cases are not probable. Unfavorable outcomes in the *Vioxx* Litigation could have a material adverse effect on the Company's financial position, liquidity and results of operations.

Legal defense costs expected to be incurred in connection with a loss contingency are accrued when probable and reasonably estimable. As of December 31, 2005, the Company had a reserve of $685 million solely for its future legal defense costs related to the *Vioxx* Litigation. During 2006, the Company spent $500 million in the aggregate in legal defense costs related to the *Vioxx* Litigation and recorded additional charges of $673 million. Thus, as of December 31, 2006, the Company had a reserve of $858 million solely for its future legal defense costs related to the *Vioxx* Litigation.

During 2007, the Company spent approximately $616 million in the aggregate, in legal defense costs worldwide related to (i) the *Vioxx* Product Liability Lawsuits, (ii) the *Vioxx* Shareholder Lawsuits, (iii) the *Vioxx* Foreign Lawsuits, and (iv) the *Vioxx* Investigations (collectively, the "*Vioxx* Litigation"). In the second quarter and third quarter of 2007, the Company recorded charges of $210 million and $70 million, respectively, to increase the reserve solely for its future legal defense costs related to the *Vioxx* Litigation. In increasing the reserve, the Company considered the same factors that it considered when it previously established reserves for the *Vioxx* Litigation. In the fourth quarter, the Company spent approximately $200 million in *Vioxx* legal defense costs which resulted in a reserve of $522 million at December 31, 2007 for its future legal defense costs related to the *Vioxx* Litigation. After entering into the Settlement Agreement, the Company reviewed its reserve for the *Vioxx* legal defense costs and allocated approximately $80 million of its reserve to Merck's anticipated future costs to administer the Settlement Program. Some of the significant factors considered in the review of the reserve were as follows: the actual costs incurred by the Company; the development of the Company's legal defense strategy and structure in light of the scope of the *Vioxx* Litigation, including the Settlement Agreement and the expectation that the Settlement Agreement will be consummated, but that certain lawsuits will continue to be pending; the number of cases being brought against the Company; the costs and outcomes of completed trials and the most current information regarding anticipated timing, progression, and related costs of pre–trial activities and trials in the *Vioxx* Product Liability Lawsuits. Events such as scheduled trials, that are expected to occur throughout 2008 and 2009, and the inherent inability to predict the ultimate outcomes of such trials and the disposition of *Vioxx* Product

Liability Lawsuits not participating in or not eligible for the Settlement Program, limit the Company's ability to reasonably estimate its legal costs beyond 2009. Together with the $4.85 billion reserved for the Settlement Program, the aggregate amount of the reserve established for the *Vioxx* Litigation as of December 31, 2007 is approximately $5.372 billion (the "*Vioxx* Reserve"). As of December 31, 2007, $2.122 billion of the *Vioxx* Reserve is included in Accrued and other current liabilities in the Consolidated Balance Sheet.

While the Company does not anticipate that it will need to increase the reserve every quarter, it will continue to monitor its legal defense costs and review the adequacy of the associated reserves and may determine to increase its reserves for legal defense costs at any time in the future if, based upon the factors set forth, it believes it would be appropriate to do so.

Other Product Liability Litigation

As previously disclosed, the Company is a defendant in product liability lawsuits in the United States involving *Fosamax* (the "*Fosamax* Litigation"). As of December 31, 2007, approximately 403 cases, which include approximately 911 plaintiff groups had been filed and were pending against Merck in either federal or state court, including 7 cases which seek class action certification, as well as damages and medical monitoring. In these actions, plaintiffs allege, among other things, that they have suffered osteonecrosis of the jaw, generally subsequent to invasive dental procedures such as tooth extraction or dental implants, and/or delayed healing, in association with the use of *Fosamax*. On August 16, 2006, the JPML ordered that the *Fosamax* product liability cases pending in federal courts nationwide should be transferred and consolidated into one multidistrict litigation (the "*Fosamax* MDL") for coordinated pre–trial proceedings. The *Fosamax* MDL has been transferred to Judge John Keenan in the United States District Court for the Southern District of New York. As a result of the JPML order, approximately 350 of the cases are before Judge Keenan. Judge Keenan has issued a Case Management Order setting forth a schedule governing the proceedings which focuses primarily upon resolving the class action certification motions in 2007 and completing fact discovery in an initial group of 25 cases by August 1, 2008. Briefing and argument on plaintiffs' motions for certification of medical monitoring classes were completed in 2007 and Judge Keenan issued an order denying the motions on January 3, 2008. On January 28, 2008, Judge Keenan issued a further order dismissing with prejudice all class claims asserted in the first four class action lawsuits filed against Merck that sought personal injury damages and/or medical monitoring relief on a class wide basis. Discovery is ongoing in both the *Fosamax* MDL litigation as well as in various state court cases. The Company intends to defend against these lawsuits.

As of December 31, 2007, the Company had a remaining reserve of approximately $27 million solely for its future legal defense costs for the *Fosamax* Litigation. Some of the significant factors considered in the establishment of the reserve for the *Fosamax* Litigation legal defense costs were as follows: the actual costs incurred by the Company thus far; the development of the Company's legal defense strategy and structure in light of the creation of the *Fosamax* MDL; the number of cases being brought against the Company; and the anticipated timing, progression, and related costs of pre–trial activities in the *Fosamax* Litigation. The Company will continue to monitor its legal defense costs and review the adequacy of the associated reserves. Due to the uncertain nature of litigation, the Company is unable to estimate its costs beyond 2009. The Company has not established any reserves for any potential liability relating to the *Fosamax* Litigation. Unfavorable outcomes in the *Fosamax* Litigation could have a material adverse effect on the Company's financial position, liquidity and results of operations.

Commercial Litigation

As previously disclosed, the Company was joined in ongoing litigation alleging manipulation by pharmaceutical manufacturers of Average Wholesale Prices ("AWP"), which are sometimes used in calculations that determine public and private sector reimbursement levels. In 2002, the JPML ordered the transfer and consolidation of all pending federal AWP cases to federal court in Boston, Massachusetts. Plaintiffs filed one consolidated class action complaint, which aggregated the claims previously filed in various federal district court actions and also expanded the number of manufacturers to include some which, like the Company, had not been defendants in any prior pending case. In May 2003, the court granted the Company's motion to dismiss the consolidated class action and dismissed the Company from the class action case. Subsequent to the Company's dismissal, the plaintiffs filed an amended consolidated class action complaint, which did not name the Company as

a defendant. The Company and many other pharmaceutical manufacturers are defendants in similar complaints pending in federal and state court brought individually by a number of counties in the State of New York. Forty of the county cases have been consolidated. The Company was dismissed from the Suffolk County case, which was the first of the New York county cases to be filed. In addition, as of December 31, 2007, the Company was a defendant in state cases brought by the Attorneys General of eleven states, all of which are being defended.

As previously disclosed, in January 2003, the DOJ notified the federal court in New Orleans, Louisiana that it was not going to intervene at that time in a pending Federal False Claims Act case that was filed under seal in December 1999 against the Company. The court issued an order unsealing the complaint, which was filed by a physician in Louisiana, and ordered that the complaint be served. The complaint, which alleged that the Company's discounting of *Pepcid* in certain Louisiana hospitals led to increases in costs to Medicaid, was dismissed. An amended complaint was filed under seal and the case has been administratively closed by the Court until the seal is lifted. The State of Louisiana has filed its own amended complaint, incorporating the allegations contained in the sealed amended complaint. As part of the resolution of the government investigations discussed below, the seal in this case was lifted and the cases were dismissed.

In April 2005, the Company was named in a qui tam lawsuit under the Nevada False Claims Act. The suit, in which the Nevada Attorney General has intervened, alleges that the Company inappropriately offered nominal pricing and other marketing and pricing inducements to certain customers and also failed to comply with its obligations under the Medicaid Best Price scheme related to such arrangements. In May 2006, the Company's motion to dismiss this action was denied by the district court. This matter has also been dismissed as part of the resolution of the government investigations.

During December 2007 and through February 26, 2008, the Company and its joint-venture partner, Schering-Plough, received several joint letters from the House Committee on Energy and Commerce and the House Subcommittee on Oversight and Investigations, and one letter from the Senate Finance Committee, collectively seeking a combination of witness interviews, documents and information on a variety of issues related to the ENHANCE clinical trial, the sale and promotion of *Vytorin*, as well as sales of stock by corporate officers. On January 25, 2008, the companies and the MSP Partnership each received two subpoenas from the New York State Attorney General's Office seeking similar information and documents. Merck and Schering-Plough have also each received a letter from the Office of the Connecticut Attorney General dated February 1, 2008 requesting documents related to the marketing and sale of *Vytorin* and *Zetia* and the timing of disclosures of the results of ENHANCE. The Company is cooperating with these investigations and working with Schering-Plough to respond to the inquiries. In addition, since mid-January 2008, the Company has become aware of or been served with approximately 85 civil class action lawsuits alleging common law and state consumer fraud claims in connection with the MSP Partnership's sale and promotion of *Vytorin* and *Zetia*. Unfavorable outcomes resulting from the government investigations or the consumer fraud litigation could have a material adverse effect on the Company's financial position, liquidity and results of operations.

Governmental Proceedings

As previously disclosed, the Company had received a subpoena from the DOJ in connection with its investigation of the Company's marketing and selling activities, including nominal pricing programs and samples. The Company had also reported that it has received a CID from the Attorney General of Texas regarding the Company's marketing and selling activities relating to Texas. As previously disclosed, the Company received another CID from the Attorney General of Texas asking for additional information regarding the Company's marketing and selling activities related to Texas, including with respect to certain of its nominal pricing programs and samples. In April 2004, the Company received a subpoena from the office of the Inspector General for the District of Columbia in connection with an investigation of the Company's interactions with physicians in the District of Columbia, Maryland, and Virginia. In November 2004, the Company received a letter request from the DOJ in connection with its investigation of the Company's pricing of *Pepcid*.

On February 7, 2008, the Company announced that it entered into agreements with the government to settle federal and state civil cases alleging violations of the Medicaid Rebate Statute, as well as federal and state False Claims Acts in connection with certain nominal pricing programs and sales and marketing activities between

1994 and 2001. To resolve these matters, the Company agreed to pay approximately $649 million, plus interest and reasonable fees and expenses to the federal government, 49 states participating in the Medicaid program and the District of Columbia. In the fourth quarter of 2007, the Company recorded a pretax charge of $671 million in connection with the anticipated resolution of these investigations. Each of the investigations described in the preceding paragraph has been resolved as part of these settlement agreements.

The settlements described above arose out of civil actions filed under seal in the U.S. District Courts located in Philadelphia and New Orleans. Both actions contained allegations involving past pricing programs. The Philadelphia settlement relates to past programs in which the Company offered hospitals significantly discounted prices on certain medications, including *Mevacor*, *Vioxx* and *Zocor*. In the Philadelphia matter, the government alleged that the Company improperly excluded certain discounts — those which were nominal in amount — from its best price reported to Medicaid under the Medicaid Rebate Agreement. The Philadelphia action also related to certain marketing and sales programs conducted between 1997 and 2001. The Philadelphia settlement accounts for $399 million plus interest of the total settlement amount.

The New Orleans settlement resolves a civil action containing allegations involving pricing discounts offered to hospitals for *Pepcid*. The original pricing program, known as the Flex Program, was launched in 1994 and continued to operate as the Flex-NP Program until its termination in April 2001. The New Orleans settlement accounts for $250 million plus interest of the total settlement amount.

In connection with these settlements, the Company entered into a corporate integrity agreement with the Department of Health and Human Services, which incorporates the Company's existing, comprehensive compliance program governing its pharmaceutical sales and marketing activities in the United States.

As previously disclosed, the Company had received a letter from DOJ advising it of the existence of a civil complaint brought under the qui tam provisions of the False Claims Act alleging that the Company violated certain rules related to its calculations of best price and other federal pricing benchmark calculations, certain of which may affect the Company's Medicaid rebate obligation. DOJ has informed the Company that it does not intend to intervene in this action and has closed its investigation. The lawsuit has now been dismissed.

The Company has cooperated with all of these investigations. In addition to these investigations, from time to time, other federal, state or foreign regulators or authorities may seek information about practices in the pharmaceutical industry or the Company's business practices in inquiries other than the investigations discussed in this section. It is not feasible to predict the outcome of any such inquiries.

Vaccine Litigation

As previously disclosed, the Company was a party in claims brought under the Consumer Protection Act of 1987 in the United Kingdom, which allege that certain children suffer from a variety of conditions as a result of being vaccinated with various bivalent vaccines for measles and rubella and/or trivalent vaccines for measles, mumps and rubella, including the Company's *M-M-R* II. The conditions include autism, with or without inflammatory bowel disease, epilepsy, encephalitis, encephalopathy, Guillain-Barre syndrome and transverse myelitis. All of the remaining cases have been discontinued or struck out by the Court and the group litigation has concluded. There are no claims outstanding against Merck. As previously disclosed, the Company is also a party to individual and class action product liability lawsuits and claims in the United States involving pediatric vaccines (e.g., hepatitis B vaccine) that contained thimerosal, a preservative used in vaccines. Merck has not distributed thimerosal-containing pediatric vaccines in the United States since the fall of 2001. As of December 31, 2007, there were approximately 234 active thimerosal related lawsuits with approximately 425 plaintiffs. Other defendants include other vaccine manufacturers who produced pediatric vaccines containing thimerosal as well as manufacturers of thimerosal. In these actions, the plaintiffs allege, among other things, that they have suffered neurological injuries as a result of exposure to thimerosal from pediatric vaccines. There are no cases currently scheduled for trial. The Company will defend against these lawsuits; however, it is possible that unfavorable outcomes could have a material adverse effect on the Company's financial position, liquidity and results of operations.

The Company has been successful in having cases of this type either dismissed or stayed on the ground that the action is prohibited under the National Childhood Vaccine Injury Act (the "Vaccine Act"). The Vaccine Act prohibits any person from filing or maintaining a civil action (in state or federal court) seeking damages against a vaccine manufacturer for vaccine-related injuries unless a petition is first filed in the United States Court of Federal Claims (hereinafter the "Vaccine Court"). Under the Vaccine Act, before filing a civil action against a vaccine manufacturer, the petitioner must either (a) pursue his or her petition to conclusion in Vaccine Court and then timely file an election to proceed with a civil action in lieu of accepting the Vaccine Court's adjudication of the petition or (b) timely exercise a right to withdraw the petition prior to Vaccine Court adjudication in accordance with certain statutorily prescribed time periods. The Company is not a party to Vaccine Court proceedings because the petitions are brought against the United States Department of Health and Human Services.

The Company is aware that there are approximately 900 cases pending in the Vaccine Court involving allegations that thimerosal-containing vaccines and/or the *M-M-R* II vaccine cause autism spectrum disorders. Not all of the thimerosal-containing vaccines involved in the Vaccine Court proceeding are Company vaccines. The Company is the sole source of the *M-M-R* II vaccine domestically. In June 2007, the Special Masters presiding over the Vaccine Court proceedings held a two and a half week hearing in which both petitioners and the government presented evidence on the issue of whether the combination of *M-M-R* II vaccine and thimerosal in vaccines can cause autism spectrum disorders and whether it did cause autism spectrum disorder in the petitioner in that case. Two shorter additional evidentiary hearings of that type addressing that issue were held in the fall of 2007. Rulings in these three cases are expected in 2008. According to the Vaccine Court, it expects to hold evidentiary hearings in six additional so-called "test cases" by September 2008, addressing the issue of whether thimerosal in vaccines, or the *M-M-R-* II vaccine alone, can cause autism spectrum disorders, and did cause such disorders in those six petitioners. The Vaccine Court has indicated that it intends to use the evidence presented at these test case hearings to guide the adjudication of the remaining autism spectrum disorder cases.

Patent Litigation

From time to time, generic manufacturers of pharmaceutical products file Abbreviated New Drug Applications ("ANDA's") with the FDA seeking to market generic forms of the Company's products prior to the expiration of relevant patents owned by the Company. Generic pharmaceutical manufacturers have submitted ANDA's to the FDA seeking to market in the United States a generic form of *Fosamax, Propecia, Prilosec, Nexium, Singulair, Trusopt, Cosopt* and *Primaxin* prior to the expiration of the Company's (and AstraZeneca's in the case of *Prilosec* and *Nexium*) patents concerning these products. In addition, an ANDA has been submitted to the FDA seeking to market in the United States a generic form of *Zetia* prior to the expiration of Schering-Plough's patent concerning that product. The generic companies' ANDA's generally include allegations of non-infringement, invalidity and unenforceability of the patents. Generic manufacturers have received FDA approval to market a generic form of *Prilosec.* The Company has filed patent infringement suits in federal court against companies filing ANDA's for generic alendronate (*Fosamax*), finasteride (*Propecia*), dorzolamide (*Trusopt*), montelukast (*Singulair*), dorzolamide/timolol (*Cosopt*), imipenem/cilastatin (*Primaxin*) and AstraZeneca and the Company have filed patent infringement suits in federal court against companies filing ANDA's for generic omeprazole (*Prilosec*) and esomeprazole (*Nexium*). Also, the Company and Schering-Plough have filed a patent infringement suit in federal court against companies filing ANDA's for generic ezetimibe (*Zetia*). Similar patent challenges exist in certain foreign jurisdictions. The Company intends to vigorously defend its patents, which it believes are valid, against infringement by generic companies attempting to market products prior to the expiration dates of such patents. As with any litigation, there can be no assurance of the outcomes, which, if adverse, could result in significantly shortened periods of exclusivity for these products.

In February 2007, Schering-Plough received a notice from a generic company indicating that it had filed an ANDA for *Zetia* and that it is challenging the U.S. patents that are listed for *Zetia.* Merck and Schering Plough market *Zetia* through a joint venture, MSP Singapore Company LLC. On March 22, 2007, Schering-Plough and MSP Singapore Company LLC filed a patent infringement suit against Glenmark Pharmaceuticals Inc., USA and its parent corporation ("Glenmark"). The lawsuit automatically stays FDA approval of Glenmark's ANDA for 30 months or until an adverse court decision, if any, whichever may occur earlier.

As previously disclosed, in January 2007, the Company received a letter from Ranbaxy Laboratories Ltd. ("Ranbaxy") stating that it had filed an ANDA seeking approval of a generic version of Merck's *Primaxin*. In April 2007, the Company filed a patent infringement suit against Ranbaxy.

As previously disclosed, in February 2007, the Company received a notice from Teva Pharmaceuticals ("Teva"), a generic company, indicating that it had filed an ANDA for montelukast and that it is challenging the U.S. patent that is listed for *Singulair*. On April 2, 2007, the Company filed a patent infringement action against Teva. The lawsuit automatically stays FDA approval of Teva's ANDA for 30 months or until an adverse court decision, if any, whichever may occur earlier.

As previously disclosed, on January 28, 2005, the U.S. Court of Appeals for the Federal Circuit in Washington, D.C. found the Company's patent claims for once–weekly administration of *Fosamax* to be invalid. The Company exhausted all options to appeal this decision in 2005. Based on the Court of Appeals' decision, *Fosamax* lost market exclusivity in the United States in February 2008. *Fosamax Plus D* will lose marketing exclusivity in the United States in April 2008. As a result of these events, the Company expects significant declines in U.S. *Fosamax* and *Fosamax Plus D* sales.

In May 2005, the Federal Court of Canada Trial Division issued a decision refusing to bar the approval of generic alendronate on the grounds that Merck's patent for weekly alendronate was likely invalid. This decision cannot be appealed and generic alendronate was launched in Canada in June 2005. In July 2005, Merck was sued in the Federal Court of Canada by Apotex Corp. ("Apotex") seeking damages for lost sales of generic weekly alendronate due to the patent proceeding.

As previously disclosed, in September 2004, the Company appealed a decision of the Opposition Division of the European Patent Office ("EPO") that revoked the Company's patent in Europe that covers the once–weekly administration of alendronate. On March 14, 2006, the Board of Appeal of the EPO upheld the decision of the Opposition Division revoking the patent. On March 28, 2007, the EPO issued another patent in Europe to the Company that covers the once–weekly administration of alendronate. Under its terms, this new patent is effective until July 2018. Oppositions have been filed in the EPO against this patent. Additionally, Merck has brought patent infringement suits in various European jurisdictions based upon this patent. Merck's basic patent covering the use of alendronate has been challenged in several European countries. The Company has received adverse decisions in Germany, Holland and the United Kingdom. The decision in the United Kingdom was upheld on appeal. The Company has appealed the decisions in Germany and Holland.

In addition, as previously disclosed, in Japan after a proceeding was filed challenging the validity of the Company's Japanese patent for the once–weekly administration of alendronate, the patent office invalidated the patent. The decision is under appeal.

On January 18, 2006, the Company sued Hi–Tech Pharmacal Co., Inc. ("Hi–Tech") of Amityville, New York for patent infringement in response to Hi–Tech's application to the FDA seeking approval of a generic version of Merck's ophthalmic drugs *Trusopt* and *Cosopt*, which are used for treating elevated intraocular pressure in patients with open–angle glaucoma or ocular hypertension. In the lawsuit, Merck sued to enforce a patent covering an active ingredient dorzolamide, which is present in both *Trusopt* and *Cosopt*, and the District Court entered judgment in Merck's favor which was upheld on appeal. The patent covering dorzolamide provides exclusivity for *Trusopt* and *Cosopt* until October 2008 (including six months of pediatric exclusivity). After such time, the Company expects significant declines in U.S. sales of these products. Merck has elected not to enforce two other U.S. patents listed with the FDA which cover the combination of dorzolamide and timolol, the two active ingredients in *Cosopt*.

In the case of omeprazole, on May 31, 2007, the trial court issued a decision with respect to four generic companies selling generic omeprazole. The court found that the Impax Laboratories Inc. and Apotex products infringed AstraZeneca's formulation patents, while products made by Mylan Laboratories and Lek Pharmaceutical and Chemical Co., d.d. did not infringe. The companies found to have infringed were ordered off the market until October 20, 2007, which was the expiration of the pediatric exclusivity period.

The Company and AstraZeneca received notice in October 2005 that Ranbaxy had filed an ANDA for esomeprazole magnesium. The ANDA contains Paragraph IV challenges to patents on *Nexium*. On November 21,

2005, the Company and AstraZeneca sued Ranbaxy in the United States District Court in New Jersey. Accordingly, FDA approval of Ranbaxy's ANDA is stayed for 30 months until April 2008 or until an adverse court decision, if any, whichever may occur earlier. The Company and AstraZeneca received notice in January 2006 that IVAX Pharmaceuticals, Inc., subsequently acquired by Teva, had filed an ANDA for esomeprazole magnesium. The ANDA contains Paragraph IV challenges to patents on *Nexium*. On March 8, 2006, the Company and AstraZeneca sued Teva in the United States District Court in New Jersey. Accordingly, FDA approval of Teva's ANDA is stayed for 30 months until September 2008 or until an adverse court decision, if any, whichever may occur earlier. In January 2008, the Company and AstraZeneca sued Dr. Reddy's in the District Court in New Jersey based on Dr. Reddy's filing of an ANDA for esomeprazole magnesium. Accordingly, FDA approval of Dr. Reddy's ANDA is stayed for 30 months until July 2010 or until an adverse court decision, if any, whichever may occur earlier.

In Europe, the Company is aware of various companies seeking registration for generic losartan (the active ingredient for *Cozaar*). The Company has patent rights to losartan via license from E.I. du Pont de Nemours and Company ("du Pont"). The Company and du Pont have filed patent infringement proceedings against various companies in Portugal, Spain, Norway and Austria.

As previously disclosed, in the third quarter of 2007, the Company resolved certain patent disputes which resulted in a net gain to the Company.

Other Litigation

In November 2005, an individual shareholder delivered a letter to the Company's Board alleging that the Company had sustained damages through the Company's adoption of its Change in Control Separation Benefits Plan (the "CIC Plan") in November 2004. The shareholder made a demand on the Board to take legal action against the Board's current or former members for allegedly causing damage to the Company with respect to the adoption of the CIC Plan. In response to that demand letter, the independent members of the Board determined at the November 22, 2005 Board meeting that the Board would take the shareholder's request under consideration. After careful consideration by the Board, the shareholder was advised that the Board had determined not to take legal action.

In February 2008, an individual shareholder delivered a letter to the Company's Board of Directors demanding that the Board take legal action against the responsible individuals to recover the amounts paid by the Company to resolve the governmental investigations referred to above.

As previously disclosed, on August 20, 2004, the United States District Court for the District of New Jersey granted a motion by the Company, Medco Health Solutions, Inc. ("Medco Health") and certain officers and directors to dismiss a shareholder derivative action involving claims related to the Company's revenue recognition practice for retail co-payments paid by individuals to whom Medco Health provides pharmaceutical benefits as well as other allegations. The complaint was dismissed with prejudice. Plaintiffs appealed the decision. On December 15, 2005, the U.S. Court of Appeals for the Third Circuit upheld most of the District Court's decision dismissing the suit, and sent the issue of whether the Company's Board of Directors properly refused the shareholder demand relating to the Company's treatment of retail co-payments back to the District Court for reconsideration under a different legal standard. Plaintiffs moved to remand their action to state court on August 18, 2006, and the District Court granted that motion on February 1, 2007. The shareholder derivative suit was pending before the Superior Court of New Jersey, Chancery Division, Hunterdon County. All of the remaining issues were dismissed with prejudice in favor of Medco Health, Merck and the individual defendants on July 31, 2007.

As previously disclosed, prior to the spin-off of Medco Health, the Company and Medco Health agreed to settle, on a class action basis, a series of lawsuits asserting violations of ERISA (the "Gruer Cases"). The Company, Medco Health and certain plaintiffs' counsel filed the settlement agreement with the federal District Court in New York, where cases commenced by a number of plaintiffs, including participants in a number of pharmaceutical benefit plans for which Medco Health is the pharmacy benefit manager, as well as trustees of such plans, have been consolidated. Medco Health and the Company agreed to the proposed settlement in order to avoid the significant cost and distraction of prolonged litigation. The proposed class settlement has been agreed to by plaintiffs in five of the cases filed against Medco Health and the Company. Under the proposed settlement, the Company and Medco

Health have agreed to pay a total of $42.5 million, and Medco Health has agreed to modify certain business practices or to continue certain specified business practices for a period of five years. The financial compensation is intended to benefit members of the settlement class, which includes ERISA plans for which Medco Health administered a pharmacy benefit at any time since December 17, 1994. The District Court held hearings to hear objections to the fairness of the proposed settlement and approved the settlement in 2004, but has not yet determined the number of class member plans that have properly elected not to participate in the settlement. The settlement becomes final only if and when all appeals have been resolved. Certain class member plans have indicated that they will not participate in the settlement. Cases initiated by three such plans and two individuals remain pending in the Southern District of New York. Plaintiffs in these cases have asserted claims based on ERISA as well as other federal and state laws that are the same as or similar to the claims that had been asserted by settling class members in the Gruer Cases. The Company and Medco Health are named as defendants in these cases.

Three notices of appeal were filed and the appellate court heard oral argument in May 2005. On December 8, 2005, the appellate court issued a decision vacating the District Court's judgment and remanding the cases to the District Court to allow the District Court to resolve certain jurisdictional issues. A hearing was held to address such issues on February 24, 2006. The District Court issued a ruling on August 10, 2006 resolving such jurisdictional issues in favor of the settling plaintiffs. The class members and the other party that had previously appealed the District Court's judgment renewed their appeals. On October 4, 2007, the renewed appeals were affirmed in part and vacated in part by the federal court of appeals. The appeals court remanded the class settlement for further proceedings in the District Court.

After the spin–off of Medco Health, Medco Health assumed substantially all of the liability exposure for the matters discussed in the foregoing two paragraphs. These cases are being defended by Medco Health.

There are various other legal proceedings, principally product liability and intellectual property suits involving the Company, which are pending. While it is not feasible to predict the outcome of such proceedings or the proceedings discussed in this Note, in the opinion of the Company, all such proceedings are either adequately covered by insurance or, if not so covered, should not ultimately result in any liability that would have a material adverse effect on the financial position, liquidity or results of operations of the Company, other than proceedings for which a separate assessment is provided in this Note.

Environmental Matters

The Company is a party to a number of proceedings brought under the Comprehensive Environmental Response, Compensation and Liability Act, commonly known as Superfund, and other federal and state equivalents. These proceedings seek to require the operators of hazardous waste disposal facilities, transporters of waste to the sites and generators of hazardous waste disposed of at the sites to clean up the sites or to reimburse the government for cleanup costs. The Company has been made a party to these proceedings as an alleged generator of waste disposed of at the sites. In each case, the government alleges that the defendants are jointly and severally liable for the cleanup costs. Although joint and several liability is alleged, these proceedings are frequently resolved so that the allocation of cleanup costs among the parties more nearly reflects the relative contributions of the parties to the site situation. The Company's potential liability varies greatly from site to site. For some sites the potential liability is *de minimis* and for others the costs of cleanup have not yet been determined. While it is not feasible to predict the outcome of many of these proceedings brought by federal or state agencies or private litigants, in the opinion of the Company, such proceedings should not ultimately result in any liability which would have a material adverse effect on the financial position, results of operations, liquidity or capital resources of the Company. The Company has taken an active role in identifying and providing for these costs and such amounts do not include any reduction for anticipated recoveries of cleanup costs from former site owners or operators or other recalcitrant potentially responsible parties.

Merck has entered into a Consent Decree (the "Decree") with the United States of America, the Pennsylvania Department of Environmental Protection and the Pennsylvania Fish and Boat Commission resolving the government's claims asserted in an enforcement action, United States of America and Commonwealth of Pennsylvania v. Merck & Co., Inc., in response to the previously disclosed accidental release of 25 gallons of potassium thiocyanate from the site in June 2006 that resulted in a fish kill in the Wissahickon Creek as well as the

discharge of materials on August 8, 9, and 16, 2006 that caused foaming in the creek. Pursuant to the terms of the Decree, Merck will pay civil penalties in the amount of $1.575 million; fund supplemental environmental projects in the amount of $9 million; and implement on–site remedial measures in the amount of $10 million. A motion to enter the Decree is pending with the court.

As previously disclosed on September 13, 2007, approximately 1,400 plaintiffs filed an amended complaint against Merck and 12 other defendants in United States District Court, Eastern District of California asserting claims under the Clean Water Act, the Resource Conservation and Recovery Act, as well as negligence and nuisance. The suit seeks damages for diminution of property value, medical monitoring and other alleged real and personal property damage associated with groundwater and soil contamination found at the site of a former Merck subsidiary in Merced, California. The Company intends to defend itself against these claims.

In management's opinion, the liabilities for all environmental matters that are probable and reasonably estimable have been accrued and totaled $109.6 million and $129.0 million at December 31, 2007 and 2006, respectively. These liabilities are undiscounted, do not consider potential recoveries from other parties and will be paid out over the periods of remediation for the applicable sites, which are expected to occur primarily over the next 15 years. Although it is not possible to predict with certainty the outcome of these matters, or the ultimate costs of remediation, management does not believe that any reasonably possible expenditures that may be incurred in excess of the liabilities accrued should exceed $54.0 million in the aggregate. Management also does not believe that these expenditures should result in a material adverse effect on the Company's financial position, results of operations, liquidity or capital resources for any year.

11. Stockholders' Equity

Other paid–in capital increased by $848.4 million in 2007, $266.5 million in 2006 and $30.2 million in 2005. The increase in 2007 reflects the issuance of shares related to the acquisition of NovaCardia (see Note 4). The increases in all periods also reflect the impact of shares issued upon exercise of stock options and related income tax benefits, as well as the issuance of restricted shares. In addition, the increase in 2006 reflects the impact of recognizing share–based compensation expense as a result of the adoption of FAS 123R (see Note 12).

A summary of treasury stock transactions (shares in millions) is as follows:

	2007		2006		2005	
	Shares	Cost	Shares	Cost	Shares	Cost
Balance as of January 1	808.4	$ 27,567.4	794.3	$ 26,984.4	767.6	$ 26,191.8
Purchases	26.5	1,429.7	26.4	1,002.3	33.2	1,015.3
Issuances (1)	(23.9)	(822.4)	(12.3)	(419.3)	(6.5)	(222.7)
Balance as of December 31	811.0	$ 28,174.7	808.4	$ 27,567.4	794.3	$ 26,984.4

(1) Issued primarily under stock option plans.

At December 31, 2007 and 2006, 10 million shares of preferred stock, without par value, were authorized; none were issued.

12. Share–Based Compensation Plans

The Company has share–based compensation plans under which employees, non–employee directors and employees of certain of the Company's equity method investees may be granted options to purchase shares of Company common stock at the fair market value at the time of grant. In addition to stock options, the Company grants performance share units ("PSUs") and restricted stock units ("RSUs") to certain management level employees. These plans were approved by the Company's shareholders. At December 31, 2007, 149.8 million shares were authorized for future grants under the Company's share–based compensation plans. The Company settles employee share–based compensation awards primarily with treasury shares.

Employee stock options are granted to purchase shares of Company stock at the fair market value at the time of grant. These awards generally vest one–third each year over a three–year period, with a contractual term of

10 years. RSUs are stock awards that are granted to employees and entitle the holder to shares of common stock as the awards vest, as well as non-forfeitable dividend equivalents. The fair value of the awards is determined and fixed on the grant date based on the Company's stock price. PSUs are stock awards where the ultimate number of shares issued will be contingent on the Company's performance against a pre-set objective or set of objectives. The fair value of each PSU is determined on the date of grant based on the Company's stock price. Over the performance period, the number of shares of stock that are expected to be issued will be adjusted based on the probability of achievement of a performance target and final compensation expense will be recognized based on the ultimate number of shares issued. The Company did not recognize compensation expense in connection with PSUs in 2006 or 2005. Both PSU and RSU payouts will be in shares of Company stock after the end of the vesting or performance period, generally three years, subject to the terms applicable to such awards.

Effective January 1, 2006, the Company adopted FAS 123R. Employee share-based compensation expense was previously recognized using the intrinsic value method which measures share-based compensation expense as the amount at which the market price of the stock at the date of grant exceeds the exercise price. FAS 123R requires the recognition of the fair value of share-based compensation in net income, which the Company recognizes on a straight-line basis over the requisite service period. Additionally, the Company elected the modified prospective transition method for adopting FAS 123R, and therefore, prior periods were not retrospectively adjusted. Under this method, the provisions for FAS 123R apply to all awards granted or modified after January 1, 2006. In addition, the unrecognized expense of awards that have not yet vested at the date of adoption are recognized in net income in the relevant period after the date of adoption. Also effective January 1, 2006, the Company adopted FASB Staff Position 123R-3, *Transition Election Related to Accounting for the Tax Effects of Share-Based Payment Awards*, which provides the Company an optional short-cut method for calculating the historical pool of windfall tax benefits upon adopting FAS 123R.

The following table provides amounts of share-based compensation cost recorded in the Consolidated Statement of Income (substantially all of the 2005 amounts were related to RSUs):

Years Ended December 31	2007	2006	2005
Pretax share-based compensation expense	$ 330.2	$ 312.5	$ 48.0
Income tax benefits	(104.1)	(98.5)	(16.8)
Total share-based compensation expense, net of tax	$ 226.1	$ 214.0	$ 31.2

FAS 123R requires the Company to present pro forma information for periods prior to the adoption as if the Company had accounted for employee share-based compensation under the fair value method of that Statement. For purposes of pro forma disclosure, the estimated fair value of awards at the date of grant, including those granted to retirement-eligible employees, is amortized to expense over the requisite service period. The following table illustrates the effect on net income and earnings per common share if the Company had applied the fair value method for recognizing employee share-based compensation for the year ended December 31, 2005:

Year Ended December 31	2005
Net income, as reported	$ 4,631.3
Compensation expense, net of tax:	
Reported	31.2
Fair value method	(357.1)
Pro forma net income	$ 4,305.4
Earnings per common share:	
Basic – as reported	$2.11
Basic – pro forma	$1.96
Assuming dilution – as reported	$2.10
Assuming dilution – pro forma	$1.96

The pro forma amounts and the fair value of each option grant were estimated on the date of grant using the Black–Scholes option pricing model. Upon the adoption of FAS 123R, compensation expense is being recognized immediately for awards granted to retirement–eligible employees or over the period from the grant date to the date retirement eligibility is achieved. This approach is known as the non–substantive vesting period approach. If the Company had been applying this approach for stock options granted to retirement–eligible employees, the effect on pro forma earnings per share assuming dilution for the year ended December 31, 2005, as provided in the above table, would not have been significant.

In 2005, pro forma compensation expense was calculated using the Black–Scholes model utilizing assumptions based on historical data, such that expense was determined using separate expected term assumptions for each vesting tranche. As a result, pro forma compensation expense for any stock options granted after January 1, 2004 but prior to January 1, 2006 was calculated using the accelerated amortization method prescribed in FASB Interpretation No. 28, *Accounting for Stock Appreciation Rights and Other Variable Stock Option or Award Plans*. Upon adoption of FAS 123R, effective January 1, 2006, the Company recognizes compensation expense using the straight–line method.

The Company continues to use the Black–Scholes option pricing model for option grants after adoption of FAS 123R. In applying this model, the Company uses both historical data and current market data to estimate the fair value of its options. The Black–Scholes model requires several assumptions including expected term of the options, risk–free rate, volatility, and dividend yield. The expected term represents the expected amount of time that options granted are expected to be outstanding, based on historical and forecasted exercise behavior. The risk–free rate is based on the rate at grant date of zero–coupon U.S. Treasury Notes with a term equal to the expected term of the option. Expected volatility is estimated using a blend of historical and implied volatility. The historical component is based on historical monthly price changes. The implied volatility is obtained from market data on the Company's traded options.

The weighted average fair value of options granted in 2007, 2006 and 2005 was $9.51, $7.25 and $6.66 per option, respectively, and were determined using the following assumptions:

Years Ended December 31	2007	2006	2005
Expected dividend yield	3.4%	4.2%	4.8%
Risk–free interest rate	4.4%	4.6%	4.0%
Expected volatility	24.6%	26.5%	31.7%
Expected life (years)	5.7	5.7	5.7

Summarized information relative to the Company's stock option plans (options in thousands) is as follows:

	Number of Options	Weighted Average Exercise Price	Weighted Average Remaining Contractual Term	Aggregate Intrinsic Value
Balance at December 31, 2006	255,336.7	$ 53.13		
Granted	35,551.4	45.42		
Exercised	(22,430.5)	40.06		
Forfeited	(25,443.5)	50.58		
Outstanding at December 31, 2007	**243,014.1**	**$ 53.47**	**5.05**	**$ 2,102.2**
Exercisable at December 31, 2007	**177,558.8**	**$ 58.14**	**3.77**	**$ 967.0**

Additional information pertaining to the Company's stock option plans is provided in the table below:

Years Ended December 31	2007	2006	2005
Total intrinsic value of stock options exercised	$ 301.2	$ 67.3	$ 58.8
Fair value of stock options vested	$ 251.1	$ 857.4	$ 949.3
Cash received from the exercise of stock options	$ 898.6	$ 369.9	$ 136.5

A summary of the Company's nonvested RSUs and PSUs (shares in thousands) at December 31, 2007, is as follows:

	RSUs		PSUs	
	Number of Shares	Weighted Average Grant Date Fair Value	Number of Shares	Weighted Average Grant Date Fair Value
Nonvested at December 31, 2006	6,000.6	$ 35.85	1,376.8	$ 38.59
Granted	**1,906.5**	**45.66**	**588.7**	**44.19**
Vested	**(2,212.8)**	**40.96**	**—**	**—**
Forfeited	**(271.0)**	**34.96**	**(558.7)**	**46.62**
Nonvested at December 31, 2007	**5,423.3**	**$ 37.26**	**1,406.8**	**$ 37.75**

At December 31, 2007, there was $402.8 million of total pretax unrecognized compensation expense related to nonvested stock options, RSU and PSU awards which will be recognized over a weighted average period of 2.0 years. For segment reporting, share-based compensation costs are unallocated expenses.

13. Pension and Other Postretirement Benefit Plans

The Company has defined benefit pension plans covering eligible employees in the United States and in certain of its international subsidiaries. Pension benefits in the United States are based on a formula that considers final average pay and years of credited service. In addition, the Company provides medical, dental and life insurance benefits, principally to its eligible U.S. retirees and similar benefits to their dependents, through its other postretirement benefit plans. The Company uses a December 31 measurement date for substantially all of its pension plans and for all of its other postretirement benefit plans.

The net cost for the Company's pension and other postretirement benefit plans consisted of the following components:

Years Ended December 31	Pension Benefits			Other Postretirement Benefits		
	2007	2006	2005	2007	2006	2005
Service cost	$ 377.2	$ 363.7	$ 338.8	$ 90.8	$ 91.3	$ 87.9
Interest cost	379.9	341.3	310.6	107.7	100.1	106.0
Expected return on plan assets	(491.4)	(436.8)	(400.7)	(130.5)	(112.6)	(103.0)
Net amortization	149.4	169.4	156.1	(16.8)	1.9	22.0
Termination benefits	25.6	29.7	32.0	7.7	3.6	6.5
Curtailments	1.1	–	9.1	(16.8)	(2.6)	0.7
Settlements	5.4	14.7	(4.2)	–	–	–
Net pension and postretirement cost	$ 447.2	$ 482.0	$ 441.7	$ 42.1	$ 81.7	$ 120.1

The net pension cost attributable to U.S. plans included in the above table was $302.2 million in 2007, $327.2 million in 2006 and $295.3 million in 2005.

The cost of health care and life insurance benefits for active employees was $312.0 million in 2007, $311.6 million in 2006 and $324.6 million in 2005.

In connection with the Company's restructuring actions (see Note 3), Merck recorded termination charges in 2007, 2006 and 2005 on its pension and other postretirement benefit plans related to expanded eligibility for certain employees exiting the Company. Also, in connection with these restructuring activities, the Company recorded curtailment losses in 2007 on its pension plans, curtailment gains in 2007 and 2006 on its other postretirement benefit plans and curtailment losses in 2005 on its pension and other postretirement benefit plans.

In 2006, amendments that changed participant contributions for other postretirement benefit plans generated curtailment gains.

In addition, the Company recorded settlement losses in 2007 and 2006 and a settlement gain in 2005 on certain of its domestic pension plans resulting from employees electing to receive their pension benefits as lump sum payments.

Effective December 31, 2006, the Company adopted FASB Statement No. 158, *Employers' Accounting for Defined Benefit Pension and Other Postretirement Plans, an amendment of FASB Statements No. 87, 106 and 132R* ("FAS 158"), except for the requirement to measure plan assets and benefit obligations as of the Company's fiscal year end, which is effective as of December 31, 2008. FAS 158 required the Company to fully recognize the funded status of its benefit plans. Each overfunded plan is recognized as an asset and each underfunded plan is recognized as a liability. Previously unrecognized net losses and unrecognized plan changes are recognized as a component of AOCI (see Note 17).

Summarized information about the changes in plan assets and benefit obligation, the funded status and the amounts recorded at December 31, 2007 and 2006 is as follows:

	Pension Benefits		Other Postretirement Benefits	
	2007	2006	**2007**	2006
Fair value of plan assets at January 1	**$ 7,056.7**	$ 6,070.6	**$ 1,484.2**	$ 1,277.4
Actual return on plan assets	**498.4**	955.7	**95.0**	209.9
Company contributions	**185.3**	494.4	**44.8**	36.5
Benefits paid from plan assets	**(362.5)**	(468.8)	**(46.4)**	(39.6)
Other	**7.5**	4.8	**–**	–
Fair value of plan assets at December 31	**$ 7,385.4**	$ 7,056.7	**$ 1,577.6**	$ 1,484.2
Benefit obligation at January 1	**$ 6,926.8**	$ 6,523.5	**$ 1,821.8**	$ 1,816.6
Service cost	**377.2**	363.7	**90.8**	91.3
Interest cost	**379.9**	341.3	**107.7**	100.1
Actuarial (gains) losses	**(242.9)**	150.7	**(12.7)**	(16.0)
Benefits paid	**(391.8)**	(502.1)	**(80.1)**	(62.0)
Plan amendments	**(20.9)**	11.3	**(8.0)**	(111.8)
Curtailments	**(5.6)**	(22.7)	**9.6**	–
Termination benefits	**25.6**	29.7	**7.7**	3.6
Other	**1.1**	31.4	**–**	–
Benefit obligation at December 31	**$ 7,049.4**	$ 6,926.8	**$ 1,936.8**	$ 1,821.8
Funded status at December 31	**$ 336.0**	$ 129.9	**$ (359.2)**	$ (337.6)
Recognized as:				
Other assets	**$ 1,132.3**	$ 915.7	**$ 387.9**	$ 376.5
Accrued and other current liabilities	**(37.3)**	(20.0)	**(3.8)**	(24.6)
Deferred income taxes and noncurrent liabilities	**(759.0)**	(765.8)	**(743.3)**	(689.5)

The fair value of U.S. pension plan assets included in the preceding table was $4.4 billion in 2007 and 2006. The pension benefit obligation of U.S. plans included in this table was $4.3 billion in 2007 and $4.2 billion in 2006.

The weighted average asset allocations of the investment portfolio for the pension and other postretirement benefit plans at December 31 are as follows:

	Pension Benefits			Other Postretirement Benefits		
	Target	2007	2006	Target	2007	2006
U.S. equities	40%	38%	39%	55%	55%	56%
International equities	30%	34%	34%	26%	29%	28%
Fixed-income investments	25%	24%	22%	17%	16%	15%
Real estate and other investments	4%	3%	4%	0%	0%	0%
Cash and cash equivalents	1%	1%	1%	2%	0%	1%
	100%	100%	100%	100%	100%	100%

The target investment portfolios for the Company's pension plans are determined by country based on the nature of the liabilities and considering the demographic composition of the plan participants (average age, years of service and active versus retiree status) and in accordance with local regulations. Other investments include insurance contracts for certain international pension plans. The target investment portfolio asset allocation for the Company's other postretirement benefit plans is consistent with the long-term nature of the plans' benefit obligation, and is well diversified among the asset classes in which the portfolio invests.

Contributions to the pension plans and other postretirement benefit plans during 2008 are expected to be $450.0 million and $101.9 million, respectively.

Expected benefit payments are as follows:

	Pension Benefits	Other Postretirement Benefits
2008	$ 287.2	$ 82.0
2009	300.0	88.8
2010	318.7	95.9
2011	347.2	103.3
2012	385.2	109.2
2013 – 2017	2,446.9	667.8

Expected benefit payments are based on the same assumptions used to measure the benefit obligations and include estimated future employee service.

At December 31, 2007 and 2006, the accumulated benefit obligation was $5.6 billion and $5.4 billion, respectively, for all pension plans. At December 31, 2007 and 2006, the accumulated benefit obligation for U.S. pension plans was $3.2 billion. The Company recorded a minimum pension liability, representing the extent to which the accumulated benefit obligation exceeded plan assets for certain of the Company's pension plans, of $29.9 million prior to the adoption of FAS 158 at December 31, 2006.

For pension plans with benefit obligations in excess of plan assets at December 31, 2007 and 2006, the fair value of plan assets was $558.3 million and $785.3 million, respectively, and the benefit obligation was $1.4 billion and $1.6 billion, respectively. For those plans with accumulated benefit obligations in excess of plan assets at

December 31, 2007 and 2006, the fair value of plan assets was $4.4 million and $187.1 million, respectively, and the accumulated benefit obligation was $405.0 million and $535.2 million, respectively.

Net loss amounts, which reflect experience differentials primarily relating to differences between expected and actual returns on plan assets as well as the effects of changes in actuarial assumptions, are recorded as a component of AOCI. Net loss amounts in excess of certain thresholds are amortized into net pension and other postretirement benefit cost over the average remaining service life of employees. The estimated net loss and prior service cost (credit) amounts that will be amortized from AOCI into net pension and postretirement benefit cost during 2008 are $77.9 million and $8.6 million, respectively, for pension plans and are $23.7 million and $(38.9) million, respectively, for other postretirement benefit plans.

The Company reassesses its benefit plan assumptions on a regular basis. The weighted average assumptions used in determining pension plan and U.S. pension and other postretirement benefit plan information are as follows:

	Pension Plans			U.S. Pension and Other Postretirement Benefit Plans		
December 31	**2007**	2006	2005	**2007**	2006	2005
Net cost						
Discount rate	**5.35%**	5.15%	5.40%	**6.00%**	5.75%	6.00%[1]
Expected rate of return on plan assets	**7.65%**	7.65%	7.65%	**8.75%**	8.75%	8.75%
Salary growth rate	**4.20%**	4.20%	4.10%	**4.50%**	4.50%	4.50%
Benefit obligation						
Discount rate	**5.90%**	5.35%	5.15%	**6.50%**	6.00%	5.75%
Salary growth rate	**4.30%**	4.20%	4.20%	**4.50%**	4.50%	4.50%

(1) *5.75% used for other postretirement benefit plans.*

The expected rate of return for both the pension and other postretirement benefit plans represents the average rate of return to be earned on plan assets over the period the benefits included in the benefit obligation are to be paid and is determined on a country basis. In developing the expected rate of return within each country, the long-term historical returns data is considered as well as actual returns on the plan assets and other capital markets experience. Using this reference information, the long-term return expectations for each asset category and a weighted average expected return for each country's target portfolio is developed, according to the allocation among those investment categories. The expected portfolio performance reflects the contribution of active management as appropriate. For 2008, the Company's expected rate of return of 8.75% will remain unchanged from 2007 for its U.S. pension and other postretirement benefit plans.

The health care cost trend rate assumptions for other postretirement benefit plans are as follows:

December 31	**2007**	2006
Health care cost trend rate assumed for next year	**9.0%**	9.0%
Rate to which the cost trend rate is assumed to decline	**5.0%**	5.0%
Year that the trend rate reaches the ultimate trend rate	**2015**	2014

A one percentage point change in the health care cost trend rate would have had the following effects:

	One Percentage Point	
	Increase	Decrease
Effect on total service and interest cost components	**$ 35.4**	**$ (28.2)**
Effect on benefit obligation	**$ 280.3**	**$ (229.3)**

14. Other (Income) Expense, Net

Years Ended December 31	2007	2006	2005
Interest income	$ (741.1)	$ (764.3)	$ (480.9)
Interest expense	384.3	375.1	385.5
Exchange gains	(54.3)	(25.0)	(16.1)
Minority interests	121.4	120.5	121.8
Other, net	335.9	(89.0)	(120.5)
	$ 46.2	$ (382.7)	$ (110.2)

The change in Other, net during 2007 primarily reflects a charge related to the resolution of certain civil governmental investigations (see Note 10), partially offset by the favorable impact of gains on sales of assets and product divestitures, as well as a net gain on the settlements of certain patent disputes. The increase in interest income in 2006 reflects interest income generated from the Company's investment portfolio derived from higher interest rates and higher average investment portfolio balances. Interest paid was $406.4 million in 2007, $387.5 million in 2006 and $354.1 million in 2005.

15. Taxes on Income

A reconciliation between the Company's effective tax rate and the U.S. statutory rate is as follows:

	2007		2006		2005	
	Amount	Tax Rate	Amount	Tax Rate	Amount	Tax Rate
U.S. statutory rate applied to income before taxes	$ 1,179.8	35.0%	$ 2,177.5	35.0%	$ 2,577.4	35.0%
Differential arising from:						
Foreign earnings	(1,196.0)	(35.5)	(1,024.1)	(16.5)	(945.1)	(12.8)
Tax exemption for Puerto Rico operations	–	–	(87.6)	(1.4)	(98.0)	(1.3)
State taxes	11.6	0.3	129.6	2.1	188.6	2.5
Acquired research	113.8	3.4	266.9	4.3	–	–
American Jobs Creation Act of 2004	–	–	–	–	766.5	10.4
Other[1]	(13.9)	(0.4)	325.3	5.2	243.2	3.3
	$ 95.3	2.8%	$ 1,787.6	28.7%	$ 2,732.6	37.1%

(1) *Other includes the tax effect of minority interests, contingency reserves, research credits, export incentives and miscellaneous items.*

The 2007 tax rate reconciliation percentage of (35.5)% for foreign earnings reflects the change in mix of foreign and domestic earnings primarily resulting from the $4.85 billion U.S. *Vioxx* Settlement Agreement charge. Pretax (loss) income consisted of:

Years Ended December 31	2007	2006	2005
Pretax (Loss) Income			
Domestic	$ (2,647.2)	$ 2,124.4	$ 3,196.1
Foreign	6,017.9	4,097.0	4,167.8
	$ 3,370.7	$ 6,221.4	$ 7,363.9

Taxes on income consisted of:

Years Ended December 31	2007	2006	2005
Current provision			
Federal	$ 988.1	$ 1,618.4	$ 1,688.1
Foreign	687.0	458.3	739.6
State	202.2	241.1	295.9
	1,877.3	2,317.8	2,723.6
Deferred provision			
Federal	(1,671.5)	(374.1)	97.0
Foreign	157.2	(130.3)	(134.0)
State	(267.7)	(25.8)	46.0
	(1,782.0)	(530.2)	9.0
	$ 95.3	$ 1,787.6	$ 2,732.6

Deferred income taxes at December 31 consisted of:

	2007		2006	
	Assets	Liabilities	Assets	Liabilities
Other intangibles	$ 22.6	$ 252.3	$ 27.3	$ 344.1
Inventory related	369.9	111.6	455.2	177.7
Accelerated depreciation	–	1,096.3	–	1,262.2
Advance payment	338.6	–	338.6	–
Equity investments	247.8	938.0	142.4	863.8
Pensions and other postretirement benefits	323.3	268.0	281.9	188.9
Compensation related	374.8	–	249.1	–
Vioxx Litigation reserve	2,130.0	–	306.8	–
Unrecognized tax benefits	980.8	–	–	–
Net operating losses	339.5	–	448.4	–
Other	1,272.7	382.2	1,404.0	269.2
Subtotal	6,400.0	3,048.4	3,653.7	3,105.9
Valuation allowance	(94.0)	–	(101.8)	–
Total deferred taxes	$ 6,306.0	$ 3,048.4	$ 3,551.9	$ 3,105.9
Net deferred income taxes	$ 3,257.6		$ 446.0	
Recognized as:				
Prepaid expenses and taxes	$ 829.5		$ 1,177.7	
Other assets	2,823.7		183.7	
Income taxes payable		$ —		$ 62.8
Deferred income taxes and noncurrent liabilities		395.6		852.6

The Company has net operating loss ("NOL") carryforwards in a number of jurisdictions, the most significant of which is the United Kingdom with NOL carryforwards of $144.7 million which have no expiration date. The valuation allowance in both years primarily relates to certain Canadian NOL carryforwards resulting from a legal entity reorganization.

Income taxes paid in 2007, 2006 and 2005 were $3.5 billion, $2.4 billion and $1.7 billion, respectively. Stock option exercises reduced income taxes paid by $138.4 million in 2007. Stock option exercises did not have a significant impact on taxes paid in 2006 or 2005.

On January 1, 2007, the Company adopted the provisions of FASB Interpretation No. 48, *Accounting for Uncertainty in Income Taxes — an interpretation of FASB Statement No. 109*, ("FIN 48"). FIN 48 prescribes 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. FIN 48 requires that the Company determine whether the benefits of tax positions are more likely than not of being sustained upon audit based on the technical merits of the tax position. For tax positions that are more likely than not of being sustained upon audit, the Company recognizes the largest amount of the benefit that is greater than 50% likely of being realized upon ultimate settlement in the financial statements. For tax positions that are not more likely than not of being sustained upon audit, the Company does not recognize any portion of the benefit in the financial statements. As a result of the implementation of FIN 48, the Company recognized an $81 million decrease in its existing liability for unrecognized tax benefits, with a corresponding increase to the January 1, 2007 Retained earnings balance.

As of January 1, 2007, after the implementation of FIN 48, the Company's liability for unrecognized tax benefits was $5.01 billion, excluding liabilities for interest and penalties. If the Company were to recognize these benefits, the income tax provision would reflect a favorable net impact of $3.95 billion. In addition, at January 1, 2007, liabilities for accrued interest and penalties relating to the unrecognized tax benefits totaled $2.40 billion. As of December 31, 2007, the Company's Consolidated Balance Sheet reflects a liability for unrecognized tax benefits of $3.69 billion. If the Company were to recognize these benefits, the income tax provision would reflect a favorable net impact of $2.60 billion. Accrued interest and penalties included in the Consolidated Balance Sheet were $1.60 billion as of December 31, 2007. The declines from January 1, 2007 were primarily due to the settlement with the Internal Revenue Service ("IRS") discussed below.

A reconciliation of the beginning and ending amount of unrecognized tax benefits is as follows:

	2007
Balance as of January 1	$ 5,008.4
Additions related to prior year positions	187.8
Reductions for tax positions of prior years	(87.0)
Additions related to current year positions	284.5
Settlements	(1,703.5)
Lapse of statute of limitations	(0.7)
Balance as of December 31	$ 3,689.5

The Company recognizes interest and penalties associated with uncertain tax positions as a component of Taxes on Income in the Consolidated Statement of Income which amounted to $270 million in 2007.

As previously disclosed, the IRS has completed its examination of the Company's tax returns for the years 1993 to 2001. As a result of the examination, the Company made an aggregate payment of $2.79 billion in February 2007. This payment was offset by (i) a tax refund of $165 million received in 2007 for amounts previously paid for these matters and (ii) a federal tax benefit of approximately $360 million related to interest included in the payment, resulting in a net cash cost to the Company of approximately $2.3 billion in 2007. The impact for years subsequent to 2001 for items reviewed as part of the examination was included in the payment although those years remain open in all other respects. The closing of the IRS examination did not have a material impact on the Company's results of operations in 2007 as these amounts had been previously provided for.

The Company is in the process of reporting the results of the IRS adjustments for the years 1993 through 2001 to various state tax authorities. This resulted in additional tax and interest payments of $57 million and $67 million, respectively, in 2007, and an equivalent reduction in the balances of unrecognized tax benefits and accrued interest.

It is anticipated that the amount of unrecognized tax benefits will change in the next 12 months; however these changes are not expected to have a significant impact on the results of operations, cash flows or the financial position of the Company.

As previously disclosed, Merck's Canadian tax returns for the years 1998 through 2004 are being examined by the Canada Revenue Agency ("CRA"). In October 2006, the CRA issued the Company a notice of

reassessment containing adjustments related to certain intercompany pricing matters, which result in additional Canadian and provincial tax due of approximately $1.6 billion (U.S. dollars) plus interest of approximately $810 million (U.S. dollars). In addition, in July 2007, the CRA proposed additional adjustments for 1999 relating to another intercompany pricing matter. The adjustments would increase Canadian tax due by approximately $22 million (U.S. dollars) plus $21 million (U.S. dollars) of interest. It is possible that the CRA will propose similar adjustments for later years. The Company disagrees with the positions taken by the CRA and believes they are without merit. The Company intends to contest the assessment through the CRA appeals process and the courts if necessary. In connection with the appeals process, during 2007, the Company pledged collateral to two financial institutions, one of which provided a guarantee to the CRA and the other to the Quebec Ministry of Revenue representing a portion of the tax and interest assessed. The collateral is included in Other Assets in the Consolidated Balance Sheet and totaled approximately $1.4 billion at December 31, 2007. The Company has previously established reserves for these matters. While the resolution of these matters may result in liabilities higher or lower than the reserves, management believes that resolution of these matters will not have a material effect on the Company's financial position or liquidity. However, an unfavorable resolution could have a material effect on the Company's results of operations or cash flows in the quarter in which an adjustment is recorded or tax is due.

In July 2007, the CRA notified the Company that it is in the process of proposing a penalty of $160 million (U.S. dollars) in connection with the 2006 notice. The penalty is for failing to provide information on a timely basis. The Company vigorously disagrees with the penalty and feels it is inapplicable and that appropriate information was provided on a timely basis. The Company is pursuing all appropriate remedies to avoid having the penalty assessed and was notified in early August 2007 that the CRA is holding the imposition of a penalty in abeyance pending a review of the Company's submissions as to the inapplicability of a penalty.

The IRS recently began its examination of the Company's 2002 to 2005 federal income tax returns. In connection with the examination, the Company is considering the possibility of a Pre Filing Agreement with the IRS to assure certainty with respect to the timing and deductibility of certain legal settlements accrued in 2007. In addition, various state and foreign tax examinations are in progress. Tax years that remain subject to examination by major tax jurisdictions include Germany from 1999, Italy and Japan from 2000 and the United Kingdom from 2002.

At December 31, 2007, foreign earnings of $17.2 billion have been retained indefinitely by subsidiary companies for reinvestment. No provision will be made for income taxes that would be payable upon the distributions of such earnings and it is not practicable to determine the amount of the related unrecognized deferred income tax liability. In addition, the Company has subsidiaries operating in Puerto Rico and Singapore under tax incentive grants that expire in 2015 and 2026, respectively. The American Jobs Creation Act of 2004 ("AJCA") created temporary incentives for U.S. multinationals to repatriate accumulated income earned outside the United States as of December 31, 2002. In accordance with the AJCA, the Company repatriated $15.9 billion during 2005. The Company recorded an income tax charge of $766.5 million in Taxes on Income in 2005 related to this repatriation, $185 million of which was paid in 2005 and the remainder was paid in the first quarter of 2006. The Company has not changed its intention to indefinitely reinvest accumulated earnings earned subsequent to December 31, 2002.

16. Earnings per Share

The weighted average common shares used in the computations of basic earnings per common share and earnings per common share assuming dilution (shares in millions) are as follows:

Years Ended December 31	**2007**	2006	2005
Average common shares outstanding	**2,170.5**	2,177.6	2,197.0
Common shares issuable [1]	**22.4**	10.1	3.4
Average common shares outstanding assuming dilution	**2,192.9**	2,187.7	2,200.4

[1] *Issuable primarily under share–based compensation plans.*

In 2007, 2006 and 2005, 123.7 million, 222.5 million and 242.4 million, respectively, of common shares issuable under the Company's share–based compensation plans were excluded from the computation of earnings per common share assuming dilution because the effect would have been antidilutive.

17. Comprehensive Income

The components of Other comprehensive income are as follows:

	Pretax[1]	Tax	After Tax
Year Ended December 31, 2007			
Net unrealized loss on derivatives	**$ (50.5)**	**$ 20.7**	**$ (29.8)**
Net loss realization	**43.0**	**(17.6)**	**25.4**
Derivatives	**(7.5)**	**3.1**	**(4.4)**
Net unrealized gain on investments	**106.2**	**(24.5)**	**81.7**
Net gain realization	**(36.1)**	**12.4**	**(23.7)**
Investments	**70.1**	**(12.1)**	**58.0**
Benefit plan net gain (loss) and prior service cost (credit) arising during the period	**252.8[2]**	**(95.9)**	**156.9**
Net loss and prior service cost (credit) amortization included in net periodic benefit cost	**134.6[3]**	**(51.2)**	**83.4**
Benefit plans	**387.4**	**(147.1)**	**240.3**
Cumulative translation adjustment related to equity investees	**34.4**	**9.9**	**44.3**
	$ 484.4	**$ (146.2)**	**$ 338.2**
Year Ended December 31, 2006			
Net unrealized loss on derivatives	$ (111.2)	$ 45.2	$ (66.0)
Net loss realization	25.5	(10.4)	15.1
Derivatives	(85.7)	34.8	(50.9)
Net unrealized gain on investments	33.9	(7.8)	26.1
Net loss realization	0.2	(0.2)	–
Investments	34.1	(8.0)	26.1
Minimum pension liability	34.8	(12.3)	22.5
Cumulative translation adjustment related to equity investees	29.0	(10.1)	18.9
	$ 12.2	$ 4.4	$ 16.6
Year Ended December 31, 2005			
Net unrealized gain on derivatives	$ 93.6	$ (38.3)	$ 55.3
Net loss realization	44.0	(18.0)	26.0
Derivatives	137.6	(56.3)	81.3
Net unrealized loss on investments	(23.5)	1.6	(21.9)
Net loss realization	71.1	1.1	72.2
Investments	47.6	2.7	50.3
Minimum pension liability	(11.9)	4.9	(7.0)
Cumulative translation adjustment related to equity investees	(40.6)	14.2	(26.4)

	$ 132.7	$ (34.5)	$ 98.2

(1) *Net of applicable minority interest.*

(2) *Pretax net gain (loss) and prior service cost (credit) arising during the period were $269.1 million and $21.4 million, respectively, for pension plans and were $(16.5) million and $(21.2) million, respectively, for other postretirement benefit plans.*

(3) *Pretax amortization of net loss and prior service cost (credit) was $139.3 million and $12.1 million, respectively, relating to pension plans and $26.6 million and $(43.4) million, respectively, relating to other postretirement benefit plans.*

The components of Accumulated other comprehensive loss are as follows:

December 31	2007	2006
Net unrealized loss on derivatives	$ (39.7)	$ (35.3)
Net unrealized gain on investments	143.6	85.6
Pension plan net loss	(853.6)	(1,103.7)
Other postretirement benefit plan net loss	(305.4)	(315.1)
Pension plan prior service cost	(38.0)	(57.8)
Other postretirement benefit plan prior service cost	204.1	243.4
Cumulative translation adjustment related to equity investees	62.9	18.6
	$ (826.1)	$ (1,164.3)

At December 31, 2007, $28.2 million of the net unrealized loss on derivatives is associated with options maturing in the next 12 months, which hedge anticipated foreign currency denominated sales over that same period.

18. Segment Reporting

The Company's operations are principally managed on a products basis and are comprised of two reportable segments: the Pharmaceutical segment and the Vaccines segment.

The Pharmaceutical segment includes human health pharmaceutical products marketed either directly or through joint ventures. These products consist of therapeutic and preventive agents, sold by prescription, for the treatment of human disorders. Merck sells these human health pharmaceutical products primarily to drug wholesalers and retailers, hospitals, government agencies and managed health care providers such as health maintenance organizations, pharmacy benefit managers and other institutions. The Vaccines segment includes human health vaccine products marketed either directly or through a joint venture. These products consist of preventive pediatric, adolescent and adult vaccines, primarily administered at physician offices. Merck sells these human health vaccines primarily to physicians, wholesalers, physician distributors and government entities. The Vaccines segment includes the vast majority of the Company's vaccine sales, but excludes certain sales of vaccines by non–U.S. subsidiaries managed by and included in the Pharmaceutical segment. A large component of pediatric and adolescent vaccines is sold to the U.S. Centers for Disease Control and Prevention Vaccines for Children program, which is funded by the U.S. government.

All Other includes other non-reportable human and animal health segments. The accounting policies for the segments described above are the same as those described in Note 2. Revenues and profits for these segments are as follows:

	Pharmaceutical	Vaccines[1]	All Other	Total
Year Ended December 31, 2007				
Segment revenues	**$ 20,101.5**	**$ 3,837.6**	**$ 162.0**	**$ 24,101.1**
Segment profits	**14,076.7**	**2,605.0**	**452.7**	**17,134.4**
Included in segment profits:				
Equity income from affiliates	**2,260.0**	**65.8**	**390.1**	**2,715.9**
Depreciation and amortization	**(131.0)**	**(6.1)**	**–**	**(137.1)**
Year Ended December 31, 2006				
Segment revenues	$ 20,374.8	$ 1,705.5	$ 162.1	$ 22,242.4
Segment profits	13,649.4	892.8	380.7	14,922.9
Included in segment profits:				
Equity income from affiliates	1,673.1	72.4	315.2	2,060.7
Depreciation and amortization	(153.0)	(5.0)	–	(158.0)
Year Ended December 31, 2005				
Segment revenues	$ 20,678.8	$ 984.2	$ 161.8	$ 21,824.8
Segment profits	13,157.9	767.0	355.5	14,280.4
Included in segment profits:				
Equity income from affiliates	1,006.5	108.9	290.1	1,405.5
Depreciation and amortization	(148.8)	(4.2)	–	(153.0)

(1) *In accordance with segment reporting requirements, Vaccines segment revenues exclude $440.6 million, $153.9 million and $119.1 million in 2007, 2006 and 2005, respectively, of vaccine sales by certain non-U.S. subsidiaries managed by and included in the Pharmaceutical segment.*

Segment profits are comprised of segment revenues less certain elements of materials and production costs and operating expenses, including components of equity income (loss) from affiliates and depreciation and amortization expenses. For internal management reporting presented to the chief operating decision maker, the Company does not allocate the vast majority of indirect production costs, research and development expenses and general and administrative expenses, as well as the cost of financing these activities. Separate divisions maintain responsibility for monitoring and managing these costs, including depreciation related to fixed assets utilized by these divisions and, therefore, they are not included in segment profits.

A reconciliation of total segment revenues to consolidated Sales is as follows:

Years Ended December 31	**2007**	2006	2005
Segment revenues	**$ 24,101.1**	$ 22,242.4	$ 21,824.8
Other revenues	**96.6**	393.6	187.1
	$ 24,197.7	$ 22,636.0	$ 22,011.9

Other revenues are primarily comprised of miscellaneous corporate revenues, sales related to divested products or businesses and other supply sales not included in segment results.

Sales[1] of the Company's products were as follows:

(Years Ended December 31)	2007	2006	2005
Singulair	$ 4,266.3	$ 3,579.0	$ 2,975.6
Cozaar/Hyzaar	3,350.1	3,163.1	3,037.2
Fosamax	3,049.0	3,134.4	3,191.2
Zocor	876.5	2,802.7	4,381.7
Cosopt/Trusopt	786.8	697.1	617.2
Primaxin	763.5	704.8	739.6
Januvia	667.5	42.9	–
Cancidas	536.9	529.8	570.0
Vasotec/Vaseretic	494.6	547.2	623.1
Maxalt	467.3	406.4	348.4
Proscar	411.0	618.5	741.4
Propecia	405.4	351.8	291.9
Arcoxia	329.1	265.4	218.2
Crixivan/Stocrin	310.2	327.3	348.4
Emend	204.2	130.8	87.0
Invanz	190.2	139.2	93.7
Janumet	86.4	–	–
Other pharmaceutical [2]	2,465.9	2,780.5	2,295.1
	19,660.9	20,220.9	20,559.7
Vaccines: [3]			
Gardasil	1,480.6	234.8	–
RotaTeq	524.7	163.4	–
Zostavax	236.0	38.6	–
ProQuad/M-M-R II/Varivax	1,347.1	820.1	597.4
Hepatitis vaccines	279.9	248.5	194.5
Other vaccines	409.9	354.0	311.4
	4,278.2	1,859.4	1,103.3
Other [4]	258.6	555.7	348.9
	$ 24,197.7	$ 22,636.0	$ 22,011.9

(1) *Presented net of discounts and returns.*

(2) *Other pharmaceutical primarily includes sales of other human pharmaceutical products and revenue from the Company's relationship with AstraZeneca LP primarily relating to sales of* Nexium, *as well as* Prilosec. *Revenue from AstraZeneca LP was $1.7 billion, $1.8 billion and $1.7 billion in 2007, 2006 and 2005, respectively. In 2006, other pharmaceutical also reflects certain supply sales, including supply sales associated with the Company's arrangement with Dr. Reddy's Laboratories for the sale of generic simvastatin.*

(3) *These amounts do not reflect sales of vaccines sold in most major European markets through the Company's joint venture, Sanofi Pasteur MSD, the results of which are reflected in Equity income from affiliates.*

(4) *Other primarily includes other human and animal health joint venture supply sales and other miscellaneous revenues.*

Consolidated revenues by geographic area where derived are as follows:

Years Ended December 31	2007	2006	2005
United States	$ 14,690.9	$ 13,776.8	$ 12,766.6
Europe, Middle East and Africa	5,159.0	4,977.1	5,203.5
Japan	1,533.2	1,479.0	1,637.9
Other	2,814.6	2,403.1	2,403.9
	$ 24,197.7	$ 22,636.0	$ 22,011.9

A reconciliation of total segment profits to consolidated Income before taxes is as follows:

Years Ended December 31	2007	2006	2005
Segment profits	$ 17,134.4	$ 14,922.9	$ 14,280.4
Other profits	21.8	256.7	175.3
Adjustments	367.7	516.3	615.3
Unallocated:			
Interest income	741.1	764.3	480.9
Interest expense	(384.3)	(375.1)	(385.5)
Equity income from affiliates	260.6	233.7	311.6
Depreciation and amortization	(1,851.0)	(2,110.4)	(1,555.1)
Research and development	(4,882.8)	(4,782.9)	(3,848.0)
U.S. *Vioxx* Settlement Agreement charge	(4,850.0)	–	–
Other expenses, net	(3,186.8)	(3,204.1)	(2,711.0)
	$ 3,370.7	$ 6,221.4	$ 7,363.9

Other profits are primarily comprised of miscellaneous corporate profits as well as operating profits related to divested products or businesses and other supply sales. Adjustments represent the elimination of the effect of double counting certain items of income and expense. Equity income from affiliates includes taxes paid at the joint venture level and a portion of equity income that is not reported in segment profits. Other expenses, net, include expenses from corporate and manufacturing cost centers and other miscellaneous income (expense), net.

Long–lived assets [(1)] by geographic area where located is as follows:

Years Ended December 31	2007	2006	2005
United States	$ 10,943.0	$ 11,542.7	$ 11,525.6
Europe, Middle East and Africa	1,650.3	1,730.7	1,991.2
Japan	885.3	942.4	1,074.7
Other	1,035.4	1,353.8	1,411.1
	$ 14,514.0	$ 15,569.6	$ 16,002.6

(1) *Long–lived assets are comprised of property, plant and equipment, net; goodwill and intangible assets, net.*

The Company does not disaggregate assets on a products and services basis for internal management reporting and, therefore, such information is not presented.

Report of Independent Registered Public Accounting Firm

To the Board of Directors and
Shareholders of Merck & Co., Inc.:

In our opinion, the accompanying consolidated balance sheets and the related consolidated statements of income, of retained earnings, of comprehensive income and of cash flows present fairly, in all material respects, the financial position of Merck & Co., Inc. and its subsidiaries at December 31, 2007 and December 31, 2006, and the results of their operations and their cash flows for each of the three years in the period ended December 31, 2007 in conformity with accounting principles generally accepted in the United States of America. Also in our opinion, the Company maintained, in all material respects, effective internal control over financial reporting as of December 31, 2007, based on criteria established in *Internal Control — Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO). The Company's management is responsible for these financial statements, for maintaining effective internal control over financial reporting and for its assessment of the effectiveness of internal control over financial reporting, included in Management's Report under Item 9A. Our responsibility is to express opinions on these financial statements and on the Company's internal control over financial reporting based on our integrated audits. We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audits to obtain reasonable assurance about whether the financial statements are free of material misstatement and whether effective internal control over financial reporting was maintained in all material respects. Our audits of the financial statements included 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. Our audit of internal control over financial reporting included obtaining an understanding of internal control over financial reporting, assessing the risk that a material weakness exists, and testing and evaluating the design and operating effectiveness of internal control based on the assessed risk. Our audits also included performing such other procedures as we considered necessary in the circumstances. We believe that our audits provide a reasonable basis for our opinions.

As discussed in Note 12 to the consolidated financial statements, the Company changed the manner in which it accounts for share–based compensation in 2006.

As discussed in Note 13 to the consolidated financial statements, the Company changed the manner in which it accounts for defined benefit pension and other post–retirement plans in 2006.

As discussed in Note 15 to the consolidated financial statements, the Company changed the manner in which it accounts for unrecognized tax benefits in 2007.

A company's internal control over financial reporting is a process designed 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 (i) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the company; (ii) 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 (iii) 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 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.

PricewaterhouseCoopers LLP

PricewaterhouseCoopers LLP
Florham Park, New Jersey
February 27, 2008

(b) Supplementary Data

Selected quarterly financial data for 2007 and 2006 are contained in the Condensed Interim Financial Data table below.

Condensed Interim Financial Data (Unaudited)

($ in millions except per share amounts)	4th Q[(1),(2),(3)]	3rd Q[(2),(3),(4)]	2nd Q[(2),(3)]	1st Q[(5)]
2007[(6)]				
Sales	**$6,242.8**	**$6,074.1**	**$6,111.4**	**$5,769.4**
Materials and production costs	**1,544.8**	**1,517.7**	**1,552.3**	**1,525.8**
Marketing and administrative expenses	**1,719.5**	**1,951.4**	**2,083.7**	**1,802.0**
Research and development expenses	**1,381.7**	**1,440.5**	**1,030.5**	**1,030.0**
Restructuring costs	**156.2**	**49.3**	**55.8**	**65.8**
Equity income from affiliates	**(796.3)**	**(768.5)**	**(759.1)**	**(652.6)**
U.S. Vioxx product liability settlement charge	**4,850.0**	**–**	**–**	**–**
Other (income) expense, net	**567.4**	**(180.9)**	**(84.0)**	**(256.0)**
(Loss) income before taxes	**(3,180.5)**	**2,064.6**	**2,232.2**	**2,254.4**
Net (loss) income	**(1,630.9)**	**1,525.5**	**1,676.4**	**1,704.3**
Basic (loss) earnings per common share	**$(0.75)**	**$0.70**	**$0.77**	**$0.79**
(Loss) earnings per common share assuming dilution	**$(0.75)**	**$0.70**	**$0.77**	**$0.78**
2006[(6)]				
Sales	$6,044.2	$5,410.4	$5,771.7	$5,409.8
Materials and production costs	1,669.1	1,544.1	1,445.2	1,342.7
Marketing and administrative expenses	2,345.8	2,370.6	1,734.0	1,715.0
Research and development expenses	1,722.9	945.4	1,172.5	942.0
Restructuring costs	55.8	49.6	(6.9)	43.7
Equity income from affiliates	(584.2)	(595.4)	(611.3)	(503.4)
Other (income) expense, net	(77.1)	(134.7)	(70.1)	(100.6)
Income before taxes	911.9	1,230.8	2,108.3	1,970.4
Net income	473.9	940.6	1,499.3	1,520.0
Basic earnings per common share	$0.22	$0.43	$0.69	$0.70
Earnings per common share assuming dilution	$0.22	$0.43	$0.69	$0.69

(1) *Amounts for 2007 include the impact of the U.S.* Vioxx *Settlement Agreement charge, a civil governmental investigations charge and an insurance arbitration gain (see Note 10). The fourth quarter tax provision, in addition to these items, also reflects the favorable impacts of adjustments relating to certain federal and state tax items.*

(2) *Amounts for third and second quarter 2007 and fourth and third quarter 2006 include the impact of additional* Vioxx *legal defense reserves (see Note 10). Amounts for fourth quarter 2006 include the impact of* Fosamax *legal defense reserves (see Note 10).*

(3) *Amounts for third quarter 2007 and fourth and second quarter 2006 include acquired research expenses associated with acquisitions (see Note 4).*

(4) *Amounts for 2007 include a net gain on the settlements of certain patent disputes.*

(5) *Amounts for 2007 include gains on sales of assets and product divestitures.*

(6) *Amounts for 2007 and 2006 include the impact of restructuring actions (see Note 3).*

Item 9. Changes in and Disagreements with Accountants on Accounting and Financial Disclosure.

Not applicable.

Item 9A. Controls and Procedures.

Management of the Company, with the participation of its Chief Executive Officer and Chief Financial Officer, evaluated the effectiveness of the Company's disclosure controls and procedures. Based on their evaluation, as of the end of the period covered by this Form 10–K, the Company's Chief Executive Officer and Chief Financial Officer have concluded that the Company's disclosure controls and procedures (as defined in Rules 13a–15(e) or 15d–15(e) under the Securities Exchange Act of 1934, as amended (the "Act")) are effective.

Management is responsible for establishing and maintaining adequate internal control over financial reporting, as such term is defined in Rule 13a–15(f) of the Act. Management conducted an evaluation of the effectiveness of internal control over financial reporting based on the framework in *Internal Control — Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission ("COSO"). Based on this evaluation, management concluded that internal control over financial reporting was effective as of December 31, 2007 based on criteria in *Internal Control — Integrated Framework* issued by COSO. PricewaterhouseCoopers LLP, an independent registered public accounting firm, has performed its own assessment of the effectiveness of the Company's internal control over financial reporting and its attestation report is included in this Form 10–K filing.

There have been no changes in internal control over financial reporting for the period covered by this report that have materially affected, or are reasonably likely to materially affect, the Company's internal control over financial reporting. As previously disclosed, the Company is undergoing a multi–year initiative to standardize a number of its information systems. On October 1, 2007, the Company implemented an SAP environment for selected business processes at a limited number of its non–U.S. locations. This initiative, as well as the Company's plan to move certain transaction processing activities into shared service environments, will support efforts to create a leaner organization.

Management's Report

Management's Responsibility for Financial Statements

Responsibility for the integrity and objectivity of the Company's financial statements rests with management. The financial statements report on management's stewardship of Company assets. These statements are prepared in conformity with generally accepted accounting principles and, accordingly, include amounts that are based on management's best estimates and judgments. Nonfinancial information included in the Annual Report on Form 10–K has also been prepared by management and is consistent with the financial statements.

To assure that financial information is reliable and assets are safeguarded, management maintains an effective system of internal controls and procedures, important elements of which include: careful selection, training and development of operating and financial managers; an organization that provides appropriate division of responsibility; and communications aimed at assuring that Company policies and procedures are understood throughout the organization. A staff of internal auditors regularly monitors the adequacy and application of internal controls on a worldwide basis.

To ensure that personnel continue to understand the system of internal controls and procedures, and policies concerning good and prudent business practices, the Company periodically conducts the Management's Stewardship Program for key management and financial personnel. This program reinforces the importance and understanding of internal controls by reviewing key corporate policies, procedures and systems. In addition, the Company has compliance programs, including an ethical business practices program to reinforce the Company's long–standing commitment to high ethical standards in the conduct of its business.

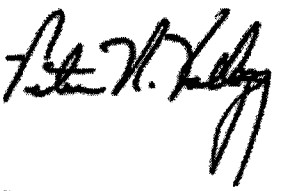
The financial statements and other financial information included in the Annual Report on Form 10–K fairly present, in all material respects, the Company's financial condition, results of operations and cash flows. Our formal certification to the Securities and Exchange Commission is included in this Form 10–K filing. In addition, in

May 2007, the Company submitted to the New York Stock Exchange ("NYSE") a certificate of the CEO certifying that he was not aware of any violation by the Company of NYSE Corporate Governance Listing Standards.

Management's Report on Internal Control Over Financial Reporting

Management is responsible for establishing and maintaining adequate internal control over financial reporting, as such term is defined in Exchange Act Rule 13a–15(f). Management conducted an evaluation of the effectiveness of internal control over financial reporting based on the framework in *Internal Control — Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission ("COSO"). Based on this evaluation, management concluded that internal control over financial reporting was effective as of December 31, 2007 based on criteria in *Internal Control — Integrated Framework* issued by COSO. PricewaterhouseCoopers LLP, an independent registered public accounting firm, has performed its own assessment of the effectiveness of the Company's internal control over financial reporting and its attestation report is included in this Form 10–K filing.

Richard T. Clark
Chairman, President
and Chief Executive Officer



Peter N. Kellogg
Executive Vice President
and Chief Financial Officer

Item 9B. Other Information.

None.

PART III

Item 10. Directors, Executive Officers and Corporate Governance.

The required information on directors and nominees is incorporated by reference from the discussion under Item 1. Election of Directors of the Company's Proxy Statement for the Annual Meeting of Stockholders to be held April 22, 2008. Information on executive officers is set forth in Part I of this document on pages 41 through 44.

The required information on compliance with Section 16(a) of the Securities Exchange Act of 1934 is incorporated by reference from the discussion under the heading "Section 16(a) Beneficial Ownership Reporting Compliance" of the Company's Proxy Statement for the Annual Meeting of Stockholders to be held April 22, 2008.

The Company has adopted a Code of Conduct — *Our Values and Standards* applicable to all employees, including the principal executive officer, principal financial officer, and principal accounting officer. The Code of Conduct is available on the Company's website at www.merck.com/about/corporategovernance. The Company intends to post on this website any amendments to, or waivers from, its Code of Conduct. A printed copy will be sent, without charge, to any stockholder who requests it by writing to the Chief Ethics Officer of Merck & Co., Inc., One Merck Drive, Whitehouse Station, NJ 08889–0100.

The required information on the identification of the audit committee and the audit committee financial expert is incorporated by reference from the discussion under the heading "Board Committees" of the Company's Proxy Statement for the Annual Meeting of Stockholders to be held April 22, 2008.

Item 11. Executive Compensation.

The information required on executive compensation is incorporated by reference from the discussion under the headings "Compensation Discussion and Analysis", "Summary Compensation Table", "All Other Compensation" table, "Grants of Plan–Based Awards Table", "Outstanding Equity Awards at Fiscal Year–End Table", "Option Exercises and Stock Vested Table", Retirement Plan Benefits and related "Pension Benefits" table,

Nonqualified Deferred Compensation and related tables, Potential Payments on Termination or Change in Control, including the discussion under the subheadings "Separation", "Separation Plan Payment and Benefit Estimates" table, "Individual Agreements", "Change in Control" and "Change in Control Payment and Benefit Estimates" table, as well as all footnote information to the various tables, of the Company's Proxy Statement for the Annual Meeting of Stockholders to be held April 22, 2008.

The required information on director compensation is incorporated by reference from the discussion under the heading "Director Compensation" and related "Director Compensation" table and "Schedule of Director Fees" table of the Company's Proxy Statement for the Annual Meeting of Stockholders to be held April 22, 2008.

The required information under the headings "Compensation Committee Interlocks and Insider Participation" and "Compensation and Benefits Committee Report" is incorporated by reference from the Company's Proxy Statement for the Annual Meeting of Stockholders to be held April 22, 2008.

Item 12. Security Ownership of Certain Beneficial Owners and Management and Related Stockholder Matters.

Information with respect to securities authorized for issuance under equity compensation plans is incorporated by reference from the discussion under the heading "Equity Compensation Plan Information" of the Company's Proxy Statement for the Annual Meeting of Stockholders to be held April 22, 2008. Information with respect to security ownership of certain beneficial owners and management is incorporated by reference from the discussion under the heading "Security Ownership of Certain Beneficial Owners and Management" of the Company's Proxy Statement for the Annual Meeting of Stockholders to be held April 22, 2008.

Item 13. Certain Relationships and Related Transactions, and Director Independence.

The required information on transactions with related persons is incorporated by reference from the discussion under the heading "Related Person Transactions" of the Company's Proxy Statement for the Annual Meeting of Stockholders to be held April 22, 2008.

The required information on director independence is incorporated by reference from the discussion under the heading "Independence of Directors" of the Company's Proxy Statement for the Annual Meeting of Stockholders to be held April 22, 2008.

Item 14. Principal Accountant Fees and Services.

The information required for this item is incorporated by reference from the discussion under "Audit Committee" beginning with the caption "Pre–Approval Policy for Services of Independent Registered Public Accounting Firm" through "All Other Fees" of the Company's Proxy Statement for the Annual Meeting of Stockholders to be held April 22, 2008.

PART IV

Item 15. Exhibits and Financial Statement Schedules.

(a) The following documents are filed as part of this Form 10–K

1. Financial Statements

Consolidated statement of income for the years ended December 31, 2007, 2006 and 2005

Consolidated statement of retained earnings for the years ended December 31, 2007, 2006 and 2005

Consolidated statement of comprehensive income for the years ended December 31, 2007, 2006 and 2005

Consolidated balance sheet as of December 31, 2007 and 2006

Consolidated statement of cash flows for the years ended December 31, 2007, 2006 and 2005

Notes to consolidated financial statements

Report of PricewaterhouseCoopers LLP, independent registered public accounting firm

2. Financial Statement Schedules

Merck/Schering-Plough Cholesterol Partnership Combined Financial Statements

Merck/Schering-Plough Cholesterol Partnership
Combined Statements of Net Sales and Contractual Expenses
Years Ended December 31,
($ in millions)

	2007	2006	2005
Net sales	$5,186	$3,884	$2,425
Cost of sales	216	179	93
Selling, general and administrative	1,151	1,056	945
Research and development	156	161	134
	1,523	1,396	1,172
Income from operations	$3,663	$2,488	$1,253

Merck/Schering-Plough Cholesterol Partnership
Combined Balance Sheets
December 31,
($ in millions)

	2007	2006
Assets		
Cash and cash equivalents	$ 491	$ 36
Accounts receivable, net	402	293
Inventories	105	87
Prepaid expenses and other assets	16	14
Total assets	$ 1,014	$ 430
Liabilities and Partners' Capital (Deficit)		
Rebates payable		
Payable to Merck, net	$ 377	$ 271
Payable to Schering-Plough, net	119	64
Accrued expenses and other liabilities	115	169
	45	7
Total liabilities	656	511
Commitments and contingent liabilities (notes 3 and 5)		
Partners' capital (deficit)	358	(81)
Total liabilities and Partners' capital (deficit)	$ 1,014	$ 430

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

Merck/Schering-Plough Cholesterol Partnership
Combined Statements of Cash Flows
Years Ended December 31,
($ in millions)

	2007	2006	2005
Operating Activities:			
Income from operations	$ 3,663	$ 2,488	$ 1,253
Adjustments to reconcile income from operations to net cash provided by operating activities:			
Accounts receivable, net	(109)	(63)	(46)
Inventories	(18)	(21)	(2)
Prepaid expenses and other assets	(2)	(1)	(12)
Rebates payable	106	151	85
Payable to Merck and Schering-Plough, net	1	(130)	36
Accrued expenses and other liabilities	38	5	2
Non-cash charges	60	52	–
Net cash provided by operating activities	3,739	2,481	1,316
Financing Activities:			
Contributions from Partners	722	721	710
Distributions to Partners	(4,006)	(3,206)	(2,033)
Net cash used for financing activities	(3,284)	(2,485)	(1,323)
Net increase/(decrease) in cash and cash equivalents	455	(4)	(7)
Cash and cash equivalents, beginning of period	36	40	47
Cash and cash equivalents, end of period	$ 491	$ 36	$ 40

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

Merck/Schering-Plough Cholesterol Partnership
Combined Statements of Partners' Capital (Deficit)
($ in millions)

	Schering-Plough	Merck	Total
Balance, January 1, 2005	$ 56	$ (122)	$ (66)
Contributions from Partners	330	380	710
Income from operations	689	564	1,253
Distributions to Partners	(1,042)	(991)	(2,033)
Balance, December 31, 2005	33	(169)	(136)
Contributions from Partners	344	429	773
Income from operations	1,273	1,215	2,488
Distributions to Partners	(1,648)	(1,558)	(3,206)
Balance, December 31, 2006	2	(83)	(81)
Contributions from Partners	276	506	782
Income from operations	1,831	1,832	3,663
Distributions to Partners	(1,944)	(2,062)	(4,006)
Balance, December 31, 2007	$ 165	$ 193	$ 358

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

Merck/Schering–Plough Cholesterol Partnership
Notes to Combined Financial Statements

1. Description of Business and Basis of Presentation

Description of Business

In May 2000, Merck & Co., Inc. ("Merck") and Schering–Plough Corporation ("Schering–Plough") (collectively "Management" or the "Partners") entered into agreements (the "Agreements") to jointly develop and market in the United States, Schering–Plough's then investigational cholesterol absorption inhibitor ("CAI") ezetimibe (marketed today in the United States as ZETIA and as EZETROL in most other countries) (the "Cholesterol Collaboration") and a fixed–combination tablet containing the active ingredients montelukast sodium and loratadine (the "Respiratory Collaboration"). Montelukast sodium, a leukotriene receptor antagonist, is sold by Merck as SINGULAIR and loratadine, an antihistamine, is sold by Schering–Plough as CLARITIN, both of which are indicated for the relief of symptoms of allergic rhinitis.

The Cholesterol Collaboration is formally referred to as the Merck/Schering–Plough Cholesterol Partnership (the "Partnership"). In December 2001, the Cholesterol Collaboration Agreements were expanded to include all countries of the world, except Japan. The Cholesterol Collaboration Agreements provide for ezetimibe to be developed and marketed in the following forms:

- Ezetimibe, a once daily CAI, non–statin cholesterol reducing medicine used alone or co–administered with any statin drug, and
- Ezetimibe and simvastatin (Merck's existing ZOCOR statin cholesterol modifying medicine) combined into one tablet (marketed today in the United States as VYTORIN and as INEGY in most other countries).

VYTORIN and ZETIA were approved by the U.S. Food and Drug Administration in July 2004 and October 2002, respectively. Together, these products, whether marketed as VYTORIN, ZETIA or under other trademarks locally, are referred to as the "Cholesterol Products."

Under the Cholesterol Collaboration Agreements, the Partners established jointly–owned, limited purpose legal entities based in Canada, Puerto Rico, and the United States through which to carry out the contractual activities of the Partnership in these countries. An additional jointly–owned, limited purpose legal entity based in Singapore was established to own the rights to the intellectual property and to fund and oversee research and development and manufacturing activities of the Cholesterol and Respiratory Collaborations. In all other markets except Latin America, subsidiaries of Merck or Schering–Plough perform marketing activities for Cholesterol Products under contract with the Partnership. These legal entity and subsidiary operations are collectively referred to as the "Combined Companies." In Latin America, the Partnership sells directly to Schering–Plough and Merck's Latin American subsidiaries and Schering–Plough and Merck compete against one another in the cholesterol market. Consequently, selling, promotion and distribution activities for the Cholesterol Products within Latin America are not included in the Combined Companies.

The Partnership is substantially reliant on the infrastructures of Merck and Schering–Plough. There are a limited number of employees of the legal entities of the Partnership and most activities are performed by employees of either Merck or Schering–Plough under service agreements with the Partnership. Profits, which are shared by the Partners under differing arrangements in countries around the world, are generally defined as net sales minus (1) agreed upon manufacturing costs and expenses incurred by the Partners and invoiced to the Partnership, (2) direct promotion expenses incurred by the Partners and invoiced to the Partnership, (3) expenses for a limited specialty sales force in the United States incurred by the Partners and invoiced to the Partnership, and certain amounts for sales force physician detailing of the Cholesterol Products in the United States, Puerto Rico, Canada and Italy, (4) administration expenses based on a percentage of Cholesterol Product net sales, which are invoiced by one of the Partners, and (5) other costs and expenses incurred by the Partners that were not contemplated when the Cholesterol Collaboration Agreements were entered into but that were subsequently agreed to by both Partners. Agreed upon research and development expenses incurred by the Partners and invoiced to the Partnership are shared equally by the Partners, after adjusting for special allocations in the nature of milestones due to one of the Partners.

The Partnership's future results of operations, financial position, and cash flows may differ materially from the historical results presented herein because of the risks and uncertainties related to the Partnership's business. The Partnership's future operating results and cash flows are dependent on the Cholesterol Products. Any events that adversely affect the market for those products could have a significant impact on the Partnership's results of operations and cash flows. These events could include loss of patent protection, increased costs associated with manufacturing, increased competition from the introduction of new, more effective treatments, exclusion from government reimbursement programs, discontinuation or removal from the market of a product for safety or other reason, and the results of future clinical or outcomes studies. (Note 5)

Basis of Presentation

The accompanying combined balance sheets and combined statements of net sales and contractual expenses, cash flows and partners' capital (deficit) include the Cholesterol and Respiratory Collaboration activities of the Combined Companies. The Respiratory Collaboration activities primarily pertain to clinical development work and pre–launch marketing activities. Spending on respiratory–related activities is not material to the income from operations in any of the years presented. In August 2007, the Partners announced that the New Drug Application filing for montelukast sodium/loratadine had been accepted by the U.S. Food and Drug Administration for standard review. The Partners are seeking U.S. marketing approval of the medicine for treatment of allergic rhinitis symptoms in patients who want relief from nasal congestion.

Net sales include the net sales of the Cholesterol Products sold by the Combined Companies. Expenses include amounts that Merck and Schering–Plough have contractually agreed to directly invoice to the Partnership, or are shared through the contractual profit sharing arrangements between the Partners, as described above.

The accompanying combined financial statements were prepared for the purpose of complying with certain rules and regulations of the Securities and Exchange Commission and reflect the activities of the Partnership based on the contractual agreements between the Partners. Such combined financial statements include only the expenses agreed by the Partners to be shared or included in the calculation of profits under the contractual agreements of the Partnership, and are not intended to be a complete presentation of all of the costs and expenses that would be incurred by a stand–alone pharmaceutical company for the discovery, development, manufacture, distribution and marketing of pharmaceutical products.

Under the Cholesterol Collaboration Agreements, certain activities are charged to the Partnership by the Partners based on contractually agreed upon allocations of Partner–incurred expenses as described below. In the opinion of Management, any allocations of expenses described below are made on a basis that reasonably reflects the actual level of support provided. All other expenses are expenses of the Partners and accordingly, are reflected in each Partner's respective expense line items in their separate consolidated financial statements.

As described above, the profit sharing arrangements under the Cholesterol Collaboration Agreements provide that only certain Partner–incurred costs and expenses be invoiced to the Partnership by the Partners and therefore become part of the profit sharing calculation. The following paragraphs list the typical categories of costs and expenses that are generally incurred in the discovery, development, manufacture, distribution and marketing of the Cholesterol Products and provide a description of how such costs and expenses are treated in the accompanying combined statements of net sales and contractual expenses, and in determining profits under the contractual agreements.

- Manufacturing costs and expenses — All contractually agreed upon manufacturing plant costs and expenses incurred by the Partners related to the manufacture of the Partnership products are included as "Cost of sales" in the accompanying combined statements of net sales and contractual expenses, including direct production costs, certain production variances, expenses for plant services and administration, warehousing, distribution, materials management, technical services, quality control, and asset utilization. All other manufacturing costs and expenses incurred by the Partners not agreed to be included in the determination of profits under the contractual agreements are not invoiced to the Partnership and, therefore, are excluded from the accompanying combined financial statements. These costs and expenses include but are not limited to yield gains and losses in excess of jointly agreed upon yield rates and excess/idle capacity of manufacturing plant assets.

- Direct promotion expenses — Direct promotion represents direct and identifiable out–of–pocket expenses incurred by the Partners on behalf of the Partnership, including but not limited to contractually agreed upon expenses related to market research, detailing aids, agency fees, direct–to–consumer advertising, meetings and symposia, trade programs, launch meetings, special sales force incentive programs and product samples. All such contractually agreed upon expenses are included in "Selling, general and administrative" in the accompanying combined statements of net sales and contractual expenses. All other promotion expenses incurred by the Partners not agreed to be included in the determination of profits under the contractual agreements are excluded from the accompanying combined financial statements.

- Selling expenses — In the United States, Canada, Puerto Rico and other markets outside the United States (primarily Italy), the general sales forces of the Partners provide a majority of the physician detail activity at an agreed upon cost which is included in "Selling, general and administrative" in the accompanying combined statements of net sales and contractual expenses. In addition, the agreed upon costs of a limited specialty sales force for the United States market that calls on opinion leaders in the field of cholesterol medicine are also included in "Selling, general and administrative." All other selling expenses incurred by the Partners not agreed to be included in the determination of profits under the contractual agreements are excluded from the accompanying combined financial statements. These expenses include the total costs of the general sales forces of the Partners detailing the Cholesterol Products in most countries other than the United States, Canada, Puerto Rico and Italy.

- Administrative expenses — Administrative support is primarily provided by one of the Partners. The contractually agreed upon expenses for support are determined based on a percentage of Cholesterol Product net sales. Such amounts are included in "Selling, general and administrative" in the accompanying combined statements of net sales and contractual expenses. Selected contractually agreed upon direct costs of employees of the Partners for support services and out–of–pocket expenses incurred by the Partners on behalf of the Partnership are also included in "Selling, general and administrative." All other expenses incurred by the Partners not agreed to be included in the determination of profits under the contractual agreements are excluded from the accompanying combined financial statements. These expenses include, but are not limited to, certain U.S. managed care services, Partners' subsidiary management in most international markets, and other indirect expenses such as corporate overhead and interest.

- Research and development ("R&D") expenses — R&D activities are performed by the Partners and agreed upon costs and expenses are invoiced to the Partnership. These agreed upon expenses generally represent an allocation of each Partner's estimate of full time equivalents devoted to the research and development of the cholesterol and respiratory products and include grants and other third–party expenses. These contractually agreed upon allocated costs are included in "Research and development" in the accompanying combined statements of net sales and contractual expenses. All other R&D costs that are incurred by the Partners but not jointly agreed upon, are excluded from the accompanying combined financial statements.

2. Summary of Significant Accounting Policies

Principles of Combination

The accompanying combined balance sheets and combined statements of net sales and contractual expenses, cash flows and partners' capital (deficit) include the Cholesterol and Respiratory Collaboration activities of the Combined Companies. Interpartnership balances and profits are eliminated.

Use of Estimates

The combined financial statements are prepared based on contractual agreements between the Partners, as described above, and include certain amounts that are based on Management's best estimates and judgments. Estimates are used in determining such items as provisions for sales discounts and returns and government and managed care rebates. Because of the uncertainty inherent in such estimates, actual results may differ from these estimates.

Foreign Currency Translation

The net assets of the Partnership's foreign operations are translated into U.S. dollars at current exchange rates. The U.S. dollar effects arising from translating the net assets of these operations are included in Partners' capital (deficit), and are not significant.

Cash and Cash Equivalents

Cash and cash equivalents primarily consist of highly liquid money market instruments with original maturities of less than three months. In 2007, the Partnership changed certain cash management practices, increasing the amount of cash held by the Partnership. The Partnership's cash, which is primarily invested in highly liquid money market instruments, is used to fund trade obligations coming due in the month and for distributions to the Partners. Interest income earned on cash and cash equivalents is reported in "Selling, general and administrative" in the accompanying combined statements of net sales and contractual expenses and amounted to $8 million, $5 million and $2 million in 2007, 2006 and 2005, respectively.

Inventories

Substantially all inventories are valued at the lower of first in, first out cost or market.

Intangible Assets

Intangible assets consist of licenses, trademarks and trade names owned by the Partnership. These intangible assets were recorded at the Partners' historical cost at the date of contribution, at a nominal value.

Revenue Recognition, Rebates, Returns and Allowances

Revenue from sales of Cholesterol Products are recognized when title and risk of loss pass to the customer. Recognition of revenue also requires reasonable assurance of collection of sales proceeds and completion of all performance obligations. Net sales of VYTORIN/INEGY are $2,779 million, $1,955 million and $1,028 million in 2007, 2006 and 2005, respectively. Net sales of ZETIA/EZETROL are $2,407 million, $1,929 million and $1,397 million in 2007, 2006 and 2005, respectively.

In the United States, sales discounts are issued to customers as direct discounts at the point–of–sale or indirectly through an intermediary wholesale purchaser, known as chargebacks, or indirectly in the form of rebates. Additionally, sales are generally made with a limited right of return under certain conditions. Revenues are recorded net of provisions for sales discounts and returns for which reliable estimates can be made at the time of sale. Reserves for chargebacks, discounts and returns and allowances are reflected as a direct reduction to accounts receivable and amounted to $44 million and $37 million at December 31, 2007 and 2006, respectively. Accruals for rebates are reflected as "Rebates payable," shown separately in the combined balance sheets.

Income Taxes

Generally, taxable income or losses of the Partnership are allocated to the Partners and included in each Partner's income tax return. In some state jurisdictions, the Partnership is subject to an income tax, which is included in the combined financial statements and shared between the Partners. Except for these state income taxes, which are not significant to the combined financial statements, no provision has been made for federal, foreign or state income taxes. In January 2007, the Partnership adopted Financial Accounting Standards Board Interpretation No. 48, *Accounting for Uncertainty in Income Taxes* (FIN 48). Adoption of FIN 48 had no impact on the Partnership's financial statements.

Concentrations of Credit Risk

The Partnership's concentrations of credit risk consist primarily of accounts receivable. At December 31, 2007, three customers each represented 28%, 27% and 15% of "Accounts receivable, net." These same three customers accounted for more than 70% of net sales in 2007. Bad debts for the years ended December 31, 2007, 2006 and 2005 have been minimal. The Partnership does not normally require collateral or other security to support credit sales. In 2007, 2006 and 2005, the Partnership derived approximately 75%, 80% and 81%, respectively, of its combined net sales from the United States.

3. Inventories

Inventories at December 31 consisted of:

(Dollars in Millions)	2007	2006
Finished goods	$ 37	$ 25
Raw materials and work in process	68	62
	$ 105	$ 87

The Partnership has entered into long–term agreements with the Partners for the supply of active pharmaceutical ingredients (API) and for the formulation and packaging of the Cholesterol Products at an agreed upon cost. In connection with these supply agreements, the Partnership has entered into capacity agreements under which the Partnership has committed to take a specified annual minimum supply of API and formulated tablets or pay a penalty. These capacity agreements are in effect for a period of seven years following the first full year of production by one of the Partners and expire beginning in 2011. The Partnership has met its commitments under the capacity agreements through December 31, 2007.

4. Related Party Transactions

The Partnership receives substantially all of its goods and services, including pharmaceutical product, manufacturing services, sales force services, administrative services and R&D services, from its Partners. Summarized information about related party balances is as follows:

	December 31, 2007			December 31, 2006		
(Dollars in Millions)	Merck	Schering–Plough	Total	Merck	Schering–Plough	Total
Receivables	$ 128	$ 6	$ 134	$ 399	$ 11	$ 410
Payables	247	121	368	463	180	643
Payables, net	$ 119	$ 115	$ 234	$ 64	$ 169	$ 233

Selling, general and administrative expense includes contractually defined costs for physician detailing provided by Schering–Plough and Merck of $242 million and $197 million, respectively, in 2007; $204 million and $203 million, respectively, in 2006; and $196 million and $181 million, respectively, in 2005. These expenses are not necessarily reflective of the actual cost of the Partners' sales efforts in the countries in which the amounts are contractually defined. Included in the 2007 and 2006 amounts are $60 million and $52 million, respectively, relating to contractually defined costs of physician detailing in Italy. These amounts were not paid by the Partnership to the Partners, but are a component of the profit sharing calculation.

Cost of sales and selling, general and administrative expense also includes contractually defined costs for distribution and administrative services provided by Merck and Schering–Plough of $34 million, $27 million, and $21 million in 2007, 2006 and 2005, respectively. These amounts are not necessarily reflective of the actual costs for such distribution and administrative services.

The Partnership sells Cholesterol Products directly to the Partners, principally to Merck and Schering–Plough affiliates in Latin America. In Latin America, where the Partners compete with one another in the cholesterol market, Merck and Schering–Plough purchase Cholesterol Products from the Partnership and sell directly to third parties. Sales to Partners are included in "Net sales" at their invoiced price in the accompanying combined statements of net sales and contractual expenses and are $82 million, $61 million, and $36 million in 2007, 2006, and 2005, respectively.

5. Legal and Other Matters

The Partnership may become party to claims and legal proceedings of a nature considered normal to its business, including product liability and intellectual property. The Partnership records a liability in connection with

such matters when it is probable a liability has been incurred and an amount can be reasonably estimated. Legal costs associated with litigation and investigation activities are expensed as incurred.

In February 2007, Schering–Plough received a notice from Glenmark Pharmaceuticals, a generic company, indicating that it had filed an Abbreviated New Drug Application for a generic form of ZETIA and that it is challenging the U.S. patents that are listed for ZETIA. Schering–Plough and the Partnership intend to vigorously defend its patents, which they believe are valid, against infringement by generic companies attempting to market products prior to the expiration dates of such patents. As with any litigation, there can be no assurances of the outcomes which, if adverse, could result in significantly shortened periods of exclusivity.

On January 14, 2008, the Partnership announced the primary endpoint and other results of the ENHANCE trial (Effect of Combination Ezetimibe and High–Dose Simvastatin vs. Simvastatin Alone on the Atherosclerotic Process in Patients with Heterozygous Familial Hypercholesterolemia). ENHANCE was a surrogate endpoint trial conducted in 720 patients with Heterozygous Familial Hypercholesterolemia, a rare condition that affects approximately 0.2% of the population. The primary endpoint was the mean change in the intima–media thickness measured at three sites in the carotid arteries (the right and left common carotid, internal carotid and carotid bulb) between patients treated with ezetimibe/simvastatin 10/80 mg versus patients treated with simvastatin 80 mg alone over a two year period. There was no statistically significant difference between treatment groups on the primary endpoint. There was also no statistically significant difference between the treatment groups for each of the components of the primary endpoint, including the common carotid artery. The Partnership has been closely monitoring sales of the Cholesterol Products following release of the ENHANCE clinical trial results. To date, 2008 net sales of the Cholesterol Products have been below the Partnership's prior expectations.

During December 2007 and through February 26, 2008, Merck and Schering–Plough received joint letters from the House Committee on Energy and Commerce and the House Subcommittee on Oversight and Investigations and one letter from the Senate Finance Committee collectively seeking a combination of witness interviews, documents and information on a variety of issues related to the ENHANCE clinical trial, the sale and promotion of VYTORIN, as well as sales of stock by corporate officers of Merck and Schering–Plough. On January 25, 2008, Merck, Schering–Plough and the Partnership each received two subpoenas from the New York State Attorney General's Office seeking similar information and documents. Merck and Schering–Plough have also each received a letter from the Office of the Connecticut Attorney General dated February 1, 2008, requesting documents related to the marketing and sale of the Cholesterol Products and the timing of disclosures of the results of ENHANCE. The Partners and the Partnership are cooperating with these investigations and are working to respond to the inquiries. In addition, since mid–January 2008, the Partners and the Partnership have become aware of or been served with approximately 85 civil class action lawsuits alleging common law and state consumer fraud claims in connection with the sale and promotion of the Cholesterol Products. While it is not feasible to predict the outcome of the investigations or lawsuits arising from the ENHANCE trial, unfavorable outcomes could have a significant adverse effect on the Partnership's financial position, results of operations and cash flows.

The Partnership maintains insurance coverage with deductibles and self–insurance as Management believes is cost beneficial. The Partnership self–insures all of its risk as it relates to product liability and accrues an estimate of product liability claims incurred but not reported.

INDEPENDENT AUDITORS' REPORT

The Partners of the Merck/Schering–Plough Cholesterol Partnership

We have audited the accompanying combined balance sheets of the Merck/Schering–Plough Cholesterol Partnership (the "Partnership") as of December 31, 2007 and 2006, as described in Note 1, and the related combined statements of net sales and contractual expenses, partners' capital (deficit) and cash flows, as described in Note 1, for each of the three years in the period ended December 31, 2007. These financial statements are the responsibility of the management of the Partnership, Merck & Co., Inc., and Schering–Plough Corporation. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with generally accepted auditing standards as established by the Auditing Standards Board (United States) and in accordance with the auditing 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. The Partnership is not required to have, nor were we engaged to perform, an audit of its internal control over financial reporting. Our audits included consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Partnership's internal control over financial reporting. Accordingly, we express no such opinion. An audit also 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, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

The accompanying statements were prepared for the purpose of complying with certain rules and regulations of the Securities and Exchange Commission and, as described in Note 1, are not intended to be a complete presentation of the financial position, results of operations or cash flows of all the activities of a stand–alone pharmaceutical company involved in the discovery, development, manufacture, distribution and marketing of pharmaceutical products.

In our opinion, the financial statements referred to above present fairly, in all material respects, the combined financial position of the Merck/Schering–Plough Cholesterol Partnership, as described in Note 1, as of December 31, 2007 and 2006, and the combined results of its net sales and contractual expenses and its combined cash flows, as described in Note 1, for each of the three years in the period ended December 31, 2007, in conformity with accounting principles generally accepted in the United States of America.

Deloitte & Touche LLP

Deloitte & Touche LLP

Parsippany, New Jersey

February 27, 2008

Schedules other than those listed above have been omitted because they are either not required or not applicable.

Financial statements of other affiliates carried on the equity basis have been omitted because, considered individually or in the aggregate, such affiliates do not constitute a significant subsidiary.

3. Exhibits

Exhibit Number	Description
2.1	— Master Restructuring Agreement dated as of June 19, 1998 between Astra AB, Merck & Co., Inc., Astra Merck Inc., Astra USA, Inc., KB USA, L.P., Astra Merck Enterprises, Inc., KBI Sub Inc., Merck Holdings, Inc. and Astra Pharmaceuticals, L.P. (Portions of this Exhibit are subject to a request for confidential treatment filed with the Commission) — Incorporated by reference to Form 10–Q Quarterly Report for the period ended June 30, 1998
2.2	— Agreement and Plan of Merger by and among Merck & Co., Inc., Spinnaker Acquisition Corp., a wholly owned subsidiary of Merck & Co., Inc. and Sirna Therapeutics, Inc., dated as of October 30, 2006 — Incorporated by reference to Current Report on Form 8–K dated October 30, 2006
3.1	— Restated Certificate of Incorporation of Merck & Co., Inc. (May 17, 2007) — Incorporated by reference to Current Report on Form 8–K dated May 17, 2007
3.2	— By–Laws of Merck & Co., Inc. (as amended effective May 31, 2007) — Incorporated by reference to Current Report on Form 8–K dated May 31, 2007
4.1	— Indenture, dated as of April 1, 1991, between Merck & Co., Inc. and Morgan Guaranty Trust Company of New York, as Trustee — Incorporated by reference to Exhibit 4 to Registration Statement on Form S–3 (No. 33–39349)
4.2	— First Supplemental Indenture between Merck & Co., Inc. and First Trust of New York, National Association, as Trustee — Incorporated by reference to Exhibit 4(b) to Registration Statement on Form S–3 (No. 333–36383)
*10.1	— Executive Incentive Plan (as amended effective February 27, 1996) — Incorporated by reference to Form 10–K Annual Report for the fiscal year ended December 31, 1995
*10.2	— Base Salary Deferral Plan (as adopted on October 22, 1996, effective January 1, 1997) — Incorporated by reference to Form 10–K Annual Report for the fiscal year ended December 31, 1996
*10.3	— Merck & Co., Inc. Deferral Program (amended and restated as of September 28, 2006) — Incorporated by reference to Current Report on Form 8–K dated September 26, 2006
*10.4	— 1996 Incentive Stock Plan (amended and restated as of December 19, 2006) — Incorporated by reference to Form 10–K Annual Report for the fiscal year ended December 31, 2006
*10.5	— 2001 Incentive Stock Plan (amended and restated as of December 19, 2006) — Incorporated by reference to Form 10–K Annual Report for the fiscal year ended December 31, 2006
*10.6	— 2004 Incentive Stock Plan (amended and restated as of December 19, 2006) — Incorporated by reference to Form 10–K Annual Report for the fiscal year ended December 31, 2006
*10.7	— 2007 Incentive Stock Plan (as amended effective December 19, 2006) — Incorporated by reference to Form 10–K Annual Report for the fiscal year ended December 31, 2006
*10.8	— Merck & Co., Inc. Change in Control Separation Benefits Plan — Incorporated by reference to Current Report on Form 8–K dated November 23, 2004
*10.9	— Merck & Co., Inc. Separation Benefits Plan for Nonunion Employees (amended and restated effective as of July 11, 2006) — Incorporated by reference to Current Report on Form 8–K dated July 11, 2006
*10.10	— Merck & Co., Inc. Special Separation Program for "Separated" Employees (effective as of January 2, 2008)
*10.11	— Merck & Co., Inc. Special Separation Program for "Bridged" Employees (effective as of January 2, 2008)

Exhibit Number	Description
*10.12	— Merck & Co., Inc. Special Separation Program for "Separated Retirement Eligible" Employees (effective as of January 2, 2008)
*10.13	— Non–Employee Directors Stock Option Plan (as amended and restated February 24, 1998) — Incorporated by reference to Form 10–K Annual Report for the fiscal year ended December 31, 1997
*10.14	— 1996 Non–Employee Directors Stock Option Plan (as amended April 27, 1999) — Incorporated by reference to Form 10–Q Quarterly Report for the period ended June 30, 1999
*10.15	— 2001 Non–Employee Directors Stock Option Plan (as amended April 19, 2002) — Incorporated by reference to Form 10–Q Quarterly Report for the period ended June 30, 2002
*10.16	— 2006 Non–Employee Directors Stock Option Plan (effective April 25, 2006; as amended and restated February 27, 2007) — Incorporated by reference to Form 10–K Annual Report for the fiscal year ended December 31, 2006
*10.17	— Supplemental Retirement Plan (as amended effective January 1, 1995) — Incorporated by reference to Form 10–K Annual Report for the fiscal year ended December 31, 1994
*10.18	— Retirement Plan for the Directors of Merck & Co., Inc. (amended and restated June 21, 1996) — Incorporated by reference to Form 10–Q Quarterly Report for the period ended June 30, 1996
*10.19	— Plan for Deferred Payment of Directors' Compensation (amended and restated as of October 1, 2006) — Incorporated by reference to Current Report on Form 8–K dated September 26, 2006
*10.20	— Offer Letter between Merck & Co., Inc. and Peter S. Kim, dated December 15, 2000 — Incorporated by reference to Form 10–K Annual Report for the fiscal year ended December 31, 2003
*10.21	— Letter Agreement between Merck & Co., Inc. and David W. Anstice, dated December 15, 2006 — Incorporated by reference to Form 10–K Annual Report for the fiscal year ended December 31, 2006
*10.22	— Offer Letter between Merck & Co., Inc. and Peter N. Kellogg, dated June 18, 2007 — Incorporated by reference to Current Report on Form 8–K dated June 28, 2007
10.23	— Amended and Restated License and Option Agreement dated as of July 1, 1998 between Astra AB and Astra Merck Inc. — Incorporated by reference to Form 10–Q Quarterly Report for the period ended June 30, 1998
10.24	— KBI Shares Option Agreement dated as of July 1, 1998 by and among Astra AB, Merck & Co., Inc. and Merck Holdings, Inc. — Incorporated by reference to Form 10–Q Quarterly Report for the period ended June 30, 1998
10.25	— KBI–E Asset Option Agreement dated as of July 1, 1998 by and among Astra AB, Merck & Co., Inc., Astra Merck Inc. and Astra Merck Enterprises Inc. — Incorporated by reference to Form 10–Q Quarterly Report for the period ended June 30, 1998
10.26	— KBI Supply Agreement dated as of July 1, 1998 between Astra Merck Inc. and Astra Pharmaceuticals, L.P. (Portions of this Exhibit are subject to a request for confidential treatment filed with the Commission). — Incorporated by reference to Form 10–Q Quarterly Report for the period ended June 30, 1998
10.27	— Second Amended and Restated Manufacturing Agreement dated as of July 1, 1998 among Merck & Co., Inc., Astra AB, Astra Merck Inc. and Astra USA, Inc. — Incorporated by reference to Form 10–Q Quarterly Report for the period ended June 30, 1998
10.28	— Limited Partnership Agreement dated as of July 1, 1998 between KB USA, L.P. and KBI Sub Inc. — Incorporated by reference to Form 10–Q Quarterly Report for the period ended June 30, 1998
10.29	— Distribution Agreement dated as of July 1, 1998 between Astra Merck Enterprises Inc. and Astra Pharmaceuticals, L.P. — Incorporated by reference to Form 10–Q Quarterly Report for the period ended June 30, 1998

Exhibit Number	Description
10.30	— Agreement to Incorporate Defined Terms dated as of June 19, 1998 between Astra AB, Merck & Co., Inc., Astra Merck Inc., Astra USA, Inc., KB USA, L.P., Astra Merck Enterprises Inc., KBI Sub Inc., Merck Holdings, Inc. and Astra Pharmaceuticals, L.P. — Incorporated by reference to Form 10–Q Quarterly Report for the period ended June 30, 1998
10.31	— Form of Voting Agreement made and entered into as of October 30, 2006 by and between Merck & Co., Inc. and Sirna Therapeutics, Inc. — Incorporated by reference to Current Report on Form 8–K dated October 30, 2006
10.32	— Settlement Agreement, dated November 9, 2007, by and between Merck & Co., Inc. and The Counsel Listed on the Signature Pages Hereto, including the exhibits thereto — Incorporated by reference to Current Report on Form 8–K dated November 9, 2007
12	— Computation of Ratios of Earnings to Fixed Charges
21	— Subsidiaries of Merck & Co., Inc.
23.1	— Consent of Independent Registered Public Accounting Firm — Contained on page 155 of this Report
23.2	— Independent Auditor's Consent — Contained on page 156 of this Report
24.1	— Power of Attorney
24.2	— Certified Resolution of Board of Directors
31.1	— Rule 13a–14(a)/15d–14(a) Certification of Chief Executive Officer
31.2	— Rule 13a–14(a)/15d–14(a) Certification of Chief Financial Officer
32.1	— Section 1350 Certification of Chief Executive Officer
32.2	— Section 1350 Certification of Chief Financial Officer

* *Management contract or compensatory plan or arrangement.*

Copies of the exhibits may be obtained by stockholders upon written request directed to the Stockholder Services Department, Merck & Co., Inc., P.O. Box 100 — WS 3AB–40, Whitehouse Station, New Jersey 08889–0100.

SIGNATURES

Pursuant to the requirements of Section 13 or 15(d) of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

Dated: February 28, 2008

MERCK & CO., INC.

By RICHARD T. CLARK
(Chairman, President and Chief Executive Officer)

By CELIA A. COLBERT
Celia A. Colbert
(Attorney–in–Fact)

Pursuant to the requirements of the Securities Exchange Act of 1934, this report has been signed below by the following persons on behalf of the registrant and in the capacities and on the dates indicated.

Signatures	Title	Date
RICHARD T. CLARK	Chairman, President and Chief Executive Officer; Principal Executive Officer; Director	February 28, 2008
PETER N. KELLOGG	Executive Vice President and Chief Financial Officer; Principal Financial Officer	February 28, 2008
JOHN CANAN	Senior Vice President and Controller; Principal Accounting Officer	February 28, 2008
JOHNNETTA B. COLE	Director	February 28, 2008
STEVEN F. GOLDSTONE	Director	February 28, 2008
THOMAS H. GLOCER	Director	February 28, 2008
WILLIAM B. HARRISON, JR.	Director	February 28, 2008
HARRY R. JACOBSON	Director	February 28, 2008
WILLIAM N. KELLEY	Director	February 28, 2008
ROCHELLE B. LAZARUS	Director	February 28, 2008
THOMAS E. SHENK	Director	February 28, 2008
ANNE M. TATLOCK	Director	February 28, 2008
SAMUEL O. THIER	Director	February 28, 2008
WENDELL P. WEEKS	Director	February 28, 2008
PETER C. WENDELL	Director	February 28, 2008

Celia A. Colbert, by signing her name hereto, does hereby sign this document pursuant to powers of attorney duly executed by the persons named, filed with the Securities and Exchange Commission as an exhibit to this document, on behalf of such persons, all in the capacities and on the date stated, such persons including a majority of the directors of the Company.

By CELIA A. COLBERT
Celia A. Colbert
(Attorney–in–Fact)

Exhibit 23.1

CONSENT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

We hereby consent to the incorporation by reference in the Registration Statements on Form S-3 (Nos. 33-39349, 33-60322, 33-57421, 333-17045, 333-36383, 333-77569, 333-72546, 333-87034, 333-118186 and 333-146356) and on Form S-8 (Nos. 33-21087, 33-21088, 33-51235, 33-53463, 33-64273, 33-64665, 333-91769, 333-30526, 333-31762, 333-53246, 333-56696, 333-72206, 333-65796, 333-101519, 333-109296, 333-117737, 333-117738, 333-139561 and 333-139562) of Merck & Co., Inc. of our report dated February 27, 2008 relating to the financial statements and the effectiveness of internal control over financial reporting, which appears in this Form 10-K.

PricewaterhouseCoopers LLP

PricewaterhouseCoopers LLP

Florham Park, New Jersey
February 27, 2008

Exhibit 23.2

INDEPENDENT AUDITORS' CONSENT

We consent to the incorporation by reference in Registration Statement Nos. 33–39349, 33–60322, 33–57421, 333–17045, 333–36383, 333–77569, 333–72546, 333–87034, 333–118186 and 333–146356 on Form S–3 and Registration Statement Nos. 33–21087, 33–21088, 33–51235, 33–53463, 33–64273, 33–64665, 333–91769, 333–30526, 333–31762, 333–53246, 333–56696, 333–72206, 333–65796, 333–101519, 333–109296, 333–117737, 333–117738, 333–139561 and 333–139562 on Form S–8 of Merck & Co., Inc. of our report dated February 27, 2008, relating to the combined financial statements of the Merck/Schering–Plough Cholesterol Partnership appearing in this Annual Report on Form 10–K of Merck & Co., Inc. for the year ended December 31, 2007.

Deloitte & Touche LLP

Deloitte & Touche LLP

Parsippany, New Jersey
February 27, 2008

EXHIBIT INDEX

Exhibit Number		Description
2.1	—	Master Restructuring Agreement dated as of June 19, 1998 between Astra AB, Merck & Co., Inc., Astra Merck Inc., Astra USA, Inc., KB USA, L.P., Astra Merck Enterprises, Inc., KBI Sub Inc., Merck Holdings, Inc. and Astra Pharmaceuticals, L.P. (Portions of this Exhibit are subject to a request for confidential treatment filed with the Commission) — Incorporated by reference to Form 10–Q Quarterly Report for the period ended June 30, 1998
2.2	—	Agreement and Plan of Merger by and among Merck & Co., Inc., Spinnaker Acquisition Corp., a wholly owned subsidiary of Merck & Co., Inc. and Sirna Therapeutics, Inc., dated as of October 30, 2006 — Incorporated by reference to Current Report on Form 8–K dated October 30, 2006
3.1	—	Restated Certificate of Incorporation of Merck & Co., Inc. (May 17, 2007) — Incorporated by reference to Current Report on Form 8–K dated May 17, 2007
3.2	—	By–Laws of Merck & Co., Inc. (as amended effective May 31, 2007) — Incorporated by reference to Current Report on Form 8–K dated May 31, 2007
4.1	—	Indenture, dated as of April 1, 1991, between Merck & Co., Inc. and Morgan Guaranty Trust Company of New York, as Trustee — Incorporated by reference to Exhibit 4 to Registration Statement on Form S–3 (No. 33–39349)
4.2	—	First Supplemental Indenture between Merck & Co., Inc. and First Trust of New York, National Association, as Trustee — Incorporated by reference to Exhibit 4(b) to Registration Statement on Form S–3 (No. 333–36383)
*10.1	—	Executive Incentive Plan (as amended effective February 27, 1996) — Incorporated by reference to Form 10–K Annual Report for the fiscal year ended December 31, 1995
*10.2	—	Base Salary Deferral Plan (as adopted on October 22, 1996, effective January 1, 1997) — Incorporated by reference to Form 10–K Annual Report for the fiscal year ended December 31, 1996
*10.3	—	Merck & Co., Inc. Deferral Program (amended and restated as of September 28, 2006) — Incorporated by reference to Current Report on Form 8–K dated September 26, 2006
*10.4	—	1996 Incentive Stock Plan (amended and restated as of December 19, 2006) — Incorporated by reference to Form 10–K Annual Report for the fiscal year ended December 31, 2006
*10.5	—	2001 Incentive Stock Plan (amended and restated as of December 19, 2006) — Incorporated by reference to Form 10–K Annual Report for the fiscal year ended December 31, 2006
*10.6	—	2004 Incentive Stock Plan (amended and restated as of December 19, 2006) — Incorporated by reference to Form 10–K Annual Report for the fiscal year ended December 31, 2006
*10.7	—	2007 Incentive Stock Plan (as amended effective December 19, 2006) — Incorporated by reference to Form 10–K Annual Report for the fiscal year ended December 31, 2006
*10.8	—	Merck & Co., Inc. Change in Control Separation Benefits Plan — Incorporated by reference to Current Report on Form 8–K dated November 23, 2004
*10.9	—	Merck & Co., Inc. Separation Benefits Plan for Nonunion Employees (amended and restated effective as of July 11, 2006) — Incorporated by reference to Current Report on Form 8–K dated July 11, 2006
*10.10	—	Merck & Co., Inc. Special Separation Program for "Separated" Employees (effective as of January 2, 2008)
*10.11	—	Merck & Co., Inc. Special Separation Program for "Bridged" Employees (effective as of January 2, 2008)
*10.12	—	Merck & Co., Inc. Special Separation Program for "Separated Retirement Eligible" Employees (effective as of January 2, 2008)

Exhibit Number		Description
*10.13	—	Non–Employee Directors Stock Option Plan (as amended and restated February 24, 1998) — Incorporated by reference to Form 10–K Annual Report for the fiscal year ended December 31, 1997
*10.14	—	1996 Non–Employee Directors Stock Option Plan (as amended April 27, 1999) — Incorporated by reference to Form 10–Q Quarterly Report for the period ended June 30, 1999
*10.15	—	2001 Non–Employee Directors Stock Option Plan (as amended April 19, 2002) — Incorporated by reference to Form 10–Q Quarterly Report for the period ended June 30, 2002
*10.16	—	2006 Non–Employee Directors Stock Option Plan (effective April 25, 2006; as amended and restated February 27, 2007) — Incorporated by reference to Form 10–K Annual Report for the fiscal year ended December 31, 2006
*10.17	—	Supplemental Retirement Plan (as amended effective January 1, 1995) — Incorporated by reference to Form 10–K Annual Report for the fiscal year ended December 31, 1994
*10.18	—	Retirement Plan for the Directors of Merck & Co., Inc. (amended and restated June 21, 1996) — Incorporated by reference to Form 10–Q Quarterly Report for the period ended June 30, 1996
*10.19	—	Plan for Deferred Payment of Directors' Compensation (amended and restated as of October 1, 2006) — Incorporated by reference to Current Report on Form 8–K dated September 26, 2006
*10.20	—	Offer Letter between Merck & Co., Inc. and Peter S. Kim, dated December 15, 2000 — Incorporated by reference to Form 10–K Annual Report for the fiscal year ended December 31, 2003
*10.21	—	Letter Agreement between Merck & Co., Inc. and David W. Anstice, dated December 15, 2006 — Incorporated by reference to Form 10–K Annual Report for the fiscal year ended December 31, 2006
*10.22	—	Offer Letter between Merck & Co., Inc. and Peter N. Kellogg, dated June 18, 2007 — Incorporated by reference to Current Report on Form 8–K dated June 28, 2007
10.23	—	Amended and Restated License and Option Agreement dated as of July 1, 1998 between Astra AB and Astra Merck Inc. — Incorporated by reference to Form 10–Q Quarterly Report for the period ended June 30, 1998
10.24	—	KBI Shares Option Agreement dated as of July 1, 1998 by and among Astra AB, Merck & Co., Inc. and Merck Holdings, Inc. — Incorporated by reference to Form 10–Q Quarterly Report for the period ended June 30, 1998
10.25	—	KBI–E Asset Option Agreement dated as of July 1, 1998 by and among Astra AB, Merck & Co., Inc., Astra Merck Inc. and Astra Merck Enterprises Inc. — Incorporated by reference to Form 10–Q Quarterly Report for the period ended June 30, 1998
10.26	—	KBI Supply Agreement dated as of July 1, 1998 between Astra Merck Inc. and Astra Pharmaceuticals, L.P. (Portions of this Exhibit are subject to a request for confidential treatment filed with the Commission) — Incorporated by reference to Form 10–Q Quarterly Report for the period ended June 30, 1998
10.27	—	Second Amended and Restated Manufacturing Agreement dated as of July 1, 1998 among Merck & Co., Inc., Astra AB, Astra Merck Inc. and Astra USA, Inc. — Incorporated by reference to Form 10–Q Quarterly Report for the period ended June 30, 1998
10.28	—	Limited Partnership Agreement dated as of July 1, 1998 between KB USA, L.P. and KBI Sub Inc. — Incorporated by reference to Form 10–Q Quarterly Report for the period ended June 30, 1998
10.29	—	Distribution Agreement dated as of July 1, 1998 between Astra Merck Enterprises Inc. and Astra Pharmaceuticals, L.P. — Incorporated by reference to Form 10–Q Quarterly Report for the period ended June 30, 1998
10.30	—	Agreement to Incorporate Defined Terms dated as of June 19, 1998 between Astra AB, Merck & Co., Inc., Astra Merck Inc., Astra USA, Inc., KB USA, L.P., Astra Merck Enterprises Inc., KBI Sub Inc., Merck Holdings, Inc. and Astra Pharmaceuticals, L.P. — Incorporated by reference to Form 10–Q Quarterly Report for the period ended June 30, 1998

Exhibit Number		Description
10.31	—	Form of Voting Agreement made and entered into as of October 30, 2006 by and between Merck & Co., Inc. and Sirna Therapeutics, Inc. — Incorporated by reference to Current Report on Form 8–K dated October 30, 2006
10.32		Settlement Agreement, dated November 9, 2007, by and between Merck & Co., Inc. and The Counsel Listed on the Signature Pages Hereto, including the exhibits thereto — Incorporated by reference to Current Report on Form 8–K dated November 9, 2007
12	—	Computation of Ratios of Earnings to Fixed Charges
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32.1	—	Section 1350 Certification of Chief Executive Officer
32.2	—	Section 1350 Certification of Chief Financial Officer

* Management contract or compensatory plan or arrangement.

PFIZER INC (PFE)

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NEW YORK, NY 10017
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http://www.pfizer.com

10-K

Filed on 02/29/2008 - Period: 12/31/2007
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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM 10 – K

(Mark One)

☒ ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the fiscal year ended December 31, 2007

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

For the transition period from to
Commission file number 1–3619

PFIZER INC.

(Exact name of registrant as specified in its charter)

Delaware	13–5315170
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification Number)
235 East 42nd Street New York, New York (Address of principal executive offices)	10017–5755 (Zip Code)

(212) 573–2323
(Registrant's telephone number, including area code)
Securities registered pursuant to Section 12(b) of the Act:

Title of each class	Name of each exchange on which registered
Common Stock, $.05 par value	New York Stock Exchange

Securities registered pursuant to Section 12(g) of the Act:
None

Indicate by check mark if the registrant is a well–known seasoned issuer, as defined in Rule 405 of the Securities Act. Yes No Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act.

Yes ☒ No c

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.

Yes c No ☒

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S–K is not contained herein, and will not be contained, to the best of registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10–K or any amendment to this Form 10–K.

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

Large accelerated filer ☒ Accelerated filer c Non–accelerated filer c Smaller reporting company c

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b–2 of the Exchange Act).

Yes c No ☒

The aggregate market value of the voting stock held by non–affiliates of the registrant, computed by reference to the closing price as of the last business day of the registrant's most recently completed second fiscal quarter, July 1, 2007, was approximately $125 billion. The registrant has no non–voting common stock.

The number of shares outstanding of each of the registrant's classes of common stock as of February 15, 2008 was 6,760,988,882 shares of common stock, all of one class.

DOCUMENTS INCORPORATED BY REFERENCE

Portions of the 2007 Annual Report to Shareholders	Parts I, II and IV

Portions of the Proxy Statement for the 2008 Annual Meeting of Shareholders	Parts I and III

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PART I

ITEM 1. BUSINESS

General

Pfizer Inc. (which may be referred to as *Pfizer, the Company, we, us or our*) is a research-based, global pharmaceutical company. We discover, develop, manufacture and market leading prescription medicines for humans and animals.

The Company was incorporated under the laws of the State of Delaware on June 2, 1942.

We acquired Pharmacia Corporation (Pharmacia) in April 2003. The acquisition was accounted for as a purchase. In accordance with GAAP, we did not restate our results of operations and financial position to reflect the historical results of operations and financial position of Pharmacia.

We acquired Esperion Therapeutics, Inc. (Esperion) in February 2004. The acquisition was accounted for as a purchase. Esperion is a biopharmaceutical company focused on the development of high density lipoprotein (HDL)-targeted ("good cholesterol") therapies for the treatment of cardiovascular disease.

In September 2005, we acquired Vicuron Pharmaceuticals, Inc., a biopharmaceutical company focused on the development of novel anti-infectives. The acquisition was also accounted for as a purchase.

In February 2006, we acquired from sanofi-aventis the worldwide rights to *Exubera* (inhaled insulation therapy) and the insulin product business and facilities located in Frankfurt, Germany, which were previously jointly owned by the Company and sanofi-aventis. In the third quarter of 2007, the Company decided to exit *Exubera* and recorded charges totaling $2.8 billion ($2.1 billion, net of tax).

We completed the sale of our Consumer Healthcare business to Johnson & Johnson for $16.6 billion in December 2006. Revenues from our Consumer Healthcare business were $4.0 billion for full-year 2006.

In January 2008, we completed the acquisition of Coley Pharmaceutical Group, Inc., a company

whose area of expertise is immunotherapy with specific emphasis on Toll-like receptor research and development. The acquisition was accounted for as a purchase.

In January 2008, we completed the acquisition of CovX Research LLC, a privately-held biotherapeutics company focused on preclinical oncology and metabolic research and a developer of a technology platform. The acquisition was accounted for as a purchase.

Pfizer Website

Our Annual Report on Form 10-K, Quarterly Reports on Form 10-Q, Current Reports on Form 8-K and amendments to those reports filed or furnished pursuant to Section 13(a) or 15(d) of the Securities Exchange Act of 1934 are available on our website (www.pfizer.com) as soon as reasonably practicable after we electronically file such material with, or furnish it to, the Securities and Exchange Commission (SEC).

Throughout this 2007 Form 10-K, we "incorporate by reference" certain information from parts of other documents filed with the SEC, including our Annual Report to Shareholders for 2007 and our Proxy Statement for the 2008 Annual Meeting of Shareholders (2008 Proxy Statement). The SEC allows us to disclose important information by referring to it in that manner. Please refer to such information. Our Annual Report to Shareholders consists of: the 2007 Annual Review (2007 Annual Review); and the 2007 Financial Report (2007 Financial Report), which is contained in Appendix A to our 2008 Proxy Statement. Portions of our 2007 Financial Report are filed as Exhibit 13 to this 2007 Form 10-K. On or about March 14, 2008, our 2007 Annual Review, our 2007 Financial Report and our 2008 Proxy Statement will be available on our website (www.pfizer.com).

Information relating to corporate governance at Pfizer, including our Corporate Governance Principles; Director Qualification Standards; Chief

Executive Officer and Chief Financial Officer certifications; Pfizer Policies on Business Conduct (for all of our employees, including our Chief Executive Officer, Chief Financial Officer and Principal Accounting Officer); Code of Business Conduct and Ethics for our Directors; as well as information concerning our Directors; e-mail

communication with our Directors; Board Committees; Committee charters and the Lead Independent Director Charter; and transactions in Pfizer securities by Directors and officers, is available on our website (www.pfizer.com). We will provide any of the foregoing information without charge upon written request to Margaret M. Foran, Senior Vice President–Corporate Governance, Associate General Counsel and Corporate Secretary, Pfizer Inc., 235 East 42nd Street, New York, NY 10017–5755. Information relating to shareholder services, including our Shareholder Investment Program, book–entry share ownership and direct deposit of dividends, is also available on our website (www.pfizer.com).

Business Segments

We operate in two business segments: Pharmaceutical and Animal Health.

We also operate several other businesses, including the manufacture of gelatin capsules, contract manufacturing and bulk pharmaceutical chemicals. Due to the size of these small businesses, they are grouped into the "Corporate/Other" category of our segment information.

Comparative segment revenues and related financial information for 2007, 2006, and 2005 are presented in the tables captioned *Segment* and *Revenues by Therapeutic Area* in Note 21 to our consolidated financial statements, *Segment, Geographic and Revenue Information,* in our 2007 Financial Report. The information from those sections of our 2007 Financial Report is incorporated by reference in this 2007 Form 10–K.

Our businesses are heavily regulated in most of the countries where we operate. In the U.S., the principal authority regulating our operations is the Food and Drug Administration (FDA). The FDA regulates the safety and efficacy of the products we offer and our research quality, manufacturing processes, product promotion, advertising and product labeling. Similar regulations exist in most other countries, and in many countries the government also regulates our prices. See *Government Regulation and Price Constraints* below.

Pharmaceutical

Our Pharmaceutical business is the largest pharmaceutical business in the world. Each year, Pfizer pharmaceuticals help over 150 million people throughout the world live longer, healthier lives. With medicines across 11 therapeutic areas, we help to treat and prevent many of the most common and most challenging conditions of our time. Our products are in Cardiovascular and Metabolic Diseases; Central Nervous System Disorders; Arthritis and Pain; Infectious and Respiratory Diseases; Urology; Oncology; Ophthalmology; and Endocrine Disorders. As of October 2007, our portfolio of medicines included seven medicines that led their therapeutic areas based on revenues.

In 2007, Pharmaceutical revenues declined 1%, to $44.4 billion primarily resulting from the earlier–than–expected loss of U.S. exclusivity for *Norvasc* in March 2007 and the loss of U.S. exclusivity for *Zoloft* in August 2006. Solid performance from products launched in the U.S. since 2005 such as Lyrica, Sutent and Chantix and several in–line products, as well as the favorable impact of foreign exchange, were able to partially offset these declines. Revenues from this segment contributed 91.8% of our total revenues in 2007, 93.2% of our total revenues in 2006, and 93.4% in 2005. In 2007, *Lipitor, Norvasc,* and *Celebrex* each delivered at least $2 billion in revenues while *Lyrica, Viagra, Detrol/Detrol LA, Xalatan/Xalacom* and *Zyrtec/Zyrtec D* each surpassed $1 billion. A table captioned *Revenues — Major Pharmaceutical Products,* in our 2007 Financial Report, is incorporated by reference.

Our major pharmaceutical products and certain recently approved products are as follows:

Cardiovascular and Metabolic Diseases

- *Lipitor,* for the treatment of elevated LDL– cholesterol levels in the blood, is the most widely used treatment for lowering cholesterol and the best–selling pharmaceutical product of any kind in the world.
- *Norvasc,* for treating hypertension, lost exclusivity in the U.S. in March 2007 and has also experienced patent expirations in most other major markets with the exception of Japan and Canada. *Norvasc* is covered by a compound patent in Japan that will expire in March 2008.

- *Caduet* is a single pill therapy combining *Lipitor* and *Norvasc* for prevention of cardiovascular events.
- *Chantix/Champix*, the first new prescription treatment to aid smoking cessation in nearly a decade, became available to patients in the U.S. in August 2006. It also is currently available in over 20 European markets as well as Canada, Australia, Korea, Brazil and Mexico. *For further information on Chantix/Champix, including a recent label change in the U.S., see the discussion under the heading Pharmaceutical–Selected Product Description, Chantix/Champix in the Financial Review section of our 2007 Financial Report, which is incorporated by reference.*

Central Nervous System Disorders

- *Lyrica* was approved by the FDA in June 2005 for adjuctive therapy for adults with partial onset epileptic seizures. This indication built on an earlier FDA approval of *Lyrica* for the treatment of two of the most common forms of neuropathic pain—painful diabetic peripheral neuropathy and post–herpetic neuralgia. In June 2007, Lyrica was approved in the U.S. for the management of fibromyalgia, one of the most common chronic pain conditions. This approval represents a breakthrough for the more than six million Americans who suffer from this debilitating condition who previously had no FDA–approved treatment.
- *Geodon/Zeldox*, a psychotropic agent, is a dopamine and serotonin receptor antagonist indicated for the treatment of schizophrenia and acute manic or mixed episodes associated with bipolar disorder. It is available in both an oral capsule and rapid–acting intramuscular formulation.
- *Aricept*, discovered and developed by Eisai Co., Ltd., is the world's leading medicine to treat symptoms of Alzheimer's disease. We co– promote *Aricept* with Eisai in the U.S. and several other countries and have an exclusive license to sell this medicine in certain other countries.
- *Zoloft*, lost exclusivity in the U.S. in August 2006 and earlier in many European markets. It

is indicated for the treatment of major depressive disorder, panic disorder, obsessive–compulsive disorder (OCD) in adults and children, post–traumatic stress disorder (PTSD), premenstrual dysphoric disorder (PMDD) and social anxiety disorder (SAD). *Zoloft* is approved for acute and long–term use in all of these indications, with the exception of PMDD. *Zoloft* was launched in Japan in July 2006 for the indications of depression/depressed state and panic disorder.

Arthritis and Pain

- *Celebrex* is for the treatment of arthritis pain and inflammation and acute pain. It also was approved by the FDA in July 2005 and in Europe in February 2007 for the treatment of ankylosing spondylitis, a form of spinal arthritis, and in December 2006, for the treatment of juvenile rheumatoid arthritis.

Infectious and Respiratory Diseases

- *Vfend* is a treatment that can be administered orally or intravenously for certain serious and potentially fatal fungal infections, for the treatment of esophageal candidiasis and for the treatment of certain blood stream infections in non–neutropenic patients (those without low white blood cell counts). It is also available in an oral–suspension formulation suitable for patients unable to swallow the tablet form.
- *Zyvox* is for the treatment of bacterial infections, which increasingly are caused by drug–resistant bacteria, and the treatment of diabetic foot infections. *Zyvox* is available in intravenous, tablet and oral–suspension formulations.
- *Selzentry/Celsentri* is the first in a new class of oral HIV medicines in more than a decade known as CCR5 antagonists. CCR5 antagonists work by blocking the CCR5 co–receptor, the virus' predominant entry route into T–cells. *Selzentry/Celsentri*

stops the R5 virus on the outside surface of the cells before it enters, rather than fighting the virus inside, as do all other classes of oral HIV medicines. *Selzentry/Celsentri* was approved in the U.S. in August 2007 and in Europe in September 2007, and is indicated for combination anti–

retroviral treatment of treatment-experienced adults infected with only CCR5-tropic HIV-1 detectable, who have evidence of viral replication and have HIV-1 strains resistant to multiple anti-retroviral agents.

Urology

- *Viagra* remains the leading treatment for erectile dysfunction (ED), and one of the world's most recognized pharmaceutical brands.
- *Detrol* is the world's leading product for the treatment of overactive bladder. *Detrol LA* is an extended-release formulation of this medicine, taken once a day.

Oncology

- *Camptosar*, which is marketed under the name *Campto* in many countries outside the U.S., is indicated as first-line therapy for metastatic colorectal cancer in combination with 5-fluorouracil and leucovorin. The U.S. basic patent for *Camptosar* expired in February 2008.
- *Sutent* is an oral multi-kinase inhibitor that combines anti-angiogenic and anti-tumor activity to inhibit the blood supply to tumors. *Sutent* was approved by the FDA and launched in the U.S. in January 2006 for advanced renal cell carcinoma, including metastatic renal cell carcinoma, and gastrointestinal stromal tumors (GIST) after disease progression on or intolerance to imatinib mesylate. In January 2007, *Sutent* received full marketing authorization and extension of the indication to first-line treatment of advanced and/or metastatic renal cell carcinoma, as well as approval as a second-line treatment of GIST in the EU.

Ophthalmology

- *Xalatan/Xalacom* is one of the world's leading branded glaucoma medicines. It is used to treat open-angle glaucoma and ocular hypertension. *Xalacom*, the only fixed combination prostaglandin (*Xalatan*) in combination with a beta blocker, is available primarily in European markets.

Endocrine Disorders

- *Genotropin* is the world's leading human recombinant growth hormone. It is used for the treatment of various growth disorders in children and adults. Novo Nordisk has granted us a non-exclusive license to sell *Genotropin* in the U.S.

Other

- *Zyrtec/Zyrtec D* is for the treatment of year- round indoor and seasonal outdoor allergies and hives in adults and children. We lost U.S. exclusivity for *Zyrtec* in January 2008. Since we sold our rights to market *Zyrtec* over-the- counter in connection with the sale of our Consumer Healthcare business, we ceased selling this product in late January 2008.

Animal Health

Our Animal Health business is one of the largest in the world. We discover, develop and sell products for the prevention and treatment of diseases in livestock and companion animals. In 2007, Animal Health revenues increased 14%, to $2.6 billion, primarily due to the continued performance of *Revolution/Stronghold, Rimadyl*, and other products, and the launches of important new products such as *Convenia* (single dose antibiotic for dogs and cats), *Slentrol* (anti-obesity treatment for dogs), *Cerenia* (prevention and treatment of emesis for dogs), and *Improvac* (boar taint vaccine for pigs).

Among the products we market are parasiticides, anti-inflammatories, antibiotics, vaccines, antiemetics, and anti-obesity agents, including the products discussed below.

Parasiticides constitute the largest segment of the animal health market for companion animals, consisting mainly of medicines for the control of parasites such as fleas and heartworm. Our product, *Revolution/Stronghold,* is our largest-selling parasiticide for dogs and cats.

Rimadyl relieves pain and inflammation associated with canine osteoarthritis and soft tissue orthopedic surgery. *Rimadyl* is the only arthritis pain medication prescribed by veterinarians available in chewable tablets, regular caplets and in an injectable formulation.

Clavamox/Synulox is an antibiotic for skin and soft tissue infections in dogs and cats.

Our vaccine portfolio for livestock is extensive and includes *RespiSureOne/StellamuneOne,* a single-dose vaccine used to prevent pneumonia in swine, and *Bovi-Shield Gold,* a cattle vaccine for reproductive and respiratory protection.

Dectomax injectable and pour-on formulations remove and control internal and external parasites in beef cattle.

Draxxin is an effective and convenient single dose antibiotic used to treat infections in cattle and swine.

Excede is an effective and convenient single-dose antibiotic used to treat infections in dairy cows, beef cattle and swine.

Research and Product Development

Innovation by our research and development operations is very important to the Company's success. Our goal is to discover, develop and bring to market innovative products that address major unmet medical needs. This goal has been supported by our substantial research and development investments. We spent $8.1 billion in 2007, $7.6 billion in 2006 and $7.3 billion in 2005 on research and development in support of Pfizer's Pharmaceutical and Animal Health businesses.

We conduct research internally and also through contracts with third parties, through collaborations with universities and biotechnology companies and in cooperation with other pharmaceutical firms. We also seek out promising compounds and innovative technologies developed by third parties to incorporate into our discovery or development processes or projects, as well as our product lines, through acquisition, licensing or other arrangements.

Drug discovery and development is time consuming, expensive and unpredictable. On average, only one out of many thousands of chemical compounds discovered by researchers proves to be both medically effective and safe enough to become an approved medicine. The process from early discovery to development to regulatory approval can take more than ten years. Drug candidates can fail at any stage of the process. Candidates may not receive regulatory approval even after many years of research.

We believe that our investments in research have been rewarded by the number of pharmaceutical compounds we have in all stages of development. We currently are working on 213 projects in development, including 151 new molecular entities and 62 product-line extensions. In addition, we have more than 300 projects in discovery research. In recent years, our discovery scientists have delivered over 100 new chemical compounds to early development. While these new candidates may or may not eventually receive regulatory approval, new drug candidates entering development are the foundation for future products.

In addition to discovering and developing new products, our research operations add value to our existing products by improving their effectiveness and by discovering new uses for them.

Information concerning several of our drug candidates in development, as well as supplemental filings for existing products, is set forth under the heading *Product Developments* in our 2007 Financial Report. That information is incorporated by reference.

Pfizer provides a detailed update of its pipeline twice a year, which is available at www.pfizer.com/pipeline for tracking development compounds across Pfizer's robust pipeline.

Our competitors also devote substantial funds and resources to research and development. In addition, the consolidation that has occurred in our industry has created companies with substantial research and development resources. We also compete against numerous small biotechnology companies in developing potential drug candidates. The extent to which our competitors are successful in their research could result in erosion of the sales of our products and unanticipated product obsolescence.

International Operations

We have significant operations outside the United States. They are managed through the same business segments as our U.S. operations —Pharmaceutical and Animal Health.

Revenues from operations outside the U.S. of $25.3 billion accounted for 52.2% of our total revenues in 2007. Revenues exceeded $500 million in each of 12 countries outside the U.S. in

2007. The U.S. was the only country to contribute more than 10% of our total revenues, comprising 47.8% of total revenues in 2007, 53.4% of total revenues in 2006 and 52.2% of total revenues in 2005. Japan is our second-largest national market, with 7.0% of our total revenues in 2007, 6.7% in 2006 and 7.3% in 2005.

For a geographic breakdown of revenues and changes in revenues, see the table captioned *Geographic* in Note 21 to our consolidated financial statements, *Segment, Geographic and Revenue Information,* in our 2007 Financial Report and the table captioned *Change in Revenues by Segment and Geographic Area* in our 2007 Financial Report. Those tables are incorporated by reference.

Our international businesses are subject, in varying degrees, to a number of risks inherent in carrying on business in other countries. These include currency fluctuations, capital and exchange control regulations, expropriation and other restrictive government actions. Our international businesses are also subject to government-imposed constraints, including laws on pricing, reimbursement and access to our products.

See *Government Regulation and Price Constraints* below for discussion of these matters.

Depending on the direction of change relative to the U.S. dollar, foreign currency values can increase or decrease the reported dollar value of our net assets and results of operations. In 2007, both revenues and net income were favorably impacted by foreign exchange, as foreign currency movements relative to the U.S. dollar increased our revenues and net income in many countries. While we cannot predict with certainty future changes in foreign exchange rates or the effect they will have on us, we attempt to mitigate their impact through operational means and by using various financial instruments. See the discussion under Note 10-D to our consolidated financial statements, *Financial Instruments: Derivative Financial Instruments and Hedging Activities* in our 2007 Financial Report. That discussion is incorporated by reference. Related information about valuation and risks associated with such financial instruments in parts E and F of that Note is also incorporated by reference.

Marketing

In our global Pharmaceutical business, we promote our products to healthcare providers and patients. Through our marketing organizations, we explain the approved uses, benefits and risks of our products to healthcare providers, such as doctors, nurse practitioners, physician assistants, pharmacists, hospitals, Pharmacy Benefit Managers (PBMs), Managed Care Organizations (MCOs), employers and government agencies. We also market directly to consumers in the U.S., through direct-to-consumer advertising that communicates the approved uses, benefits, and risks of our products while continuing to motivate people to have meaningful conversations with their doctors. In addition, we sponsor general advertising to educate the public on disease awareness, important public health issues, and our patient assistance programs.

Our operations include several pharmaceutical sales organizations. Our structure aligns the sales, marketing, and medical functions to work closely in tandem along the same therapeutic groups of products, reinforcing common coordination, focus, and accountability across the organizations.

Our prescription pharmaceutical products are sold principally to wholesalers, but we also sell directly to retailers, hospitals, clinics, government agencies and pharmacies. We seek to gain access to health authority, PBM and MCO formularies (lists of recommended, approved, and/or reimbursed medicines and other products). We also work with MCOs, PBMs, employers and other appropriate healthcare providers to assist them with disease management, patient education and other tools that help their medical treatment routines.

Our Animal Health business also uses its own sales organization to promote its products. Its advertising and promotion are generally targeted to health professionals, directly and through veterinary journals. Animal health products are sold through veterinarians, distributors and retail outlets as well as directly to users. Where appropriate, these products are also marketed through print and television advertising.

During 2007, sales to our three largest wholesalers were as follows:

- McKesson, Inc.—18% of our total revenues;
- Cardinal Health, Inc.—12% of our total revenues; and
- AmerisourceBergen Corporation—10% of our total revenues.

Sales to these wholesalers were concentrated in the Pharmaceutical segment. Apart from these instances, neither of our business segments is dependent on any one customer or group of related customers.

Patents and Intellectual Property Rights

Our products are sold around the world under brand-name, logo and certain product design trademarks that we consider in the aggregate to be of material importance. Trademark protection continues in some countries for as long as the mark is used and, in other countries, for as long as it is registered. Registrations generally are for fixed, but renewable, terms.

We own or license a number of U.S. and foreign patents. These patents cover pharmaceutical and other products and their uses, pharmaceutical formulations, product manufacturing processes and intermediate chemical compounds used in manufacturing.

Patents for individual products extend for varying periods according to the date of patent filing or grant and the legal term of patents in the various countries where patent protection is obtained. The actual protection afforded by a patent, which can vary from country to country, depends upon the type of patent, the scope of its coverage and the availability of legal remedies in the country.

In the aggregate, our patent and related rights are of material importance to our businesses in the U.S. and most other countries. Based on current product sales, and considering the vigorous competition with products sold by others, the patent rights we consider most significant in relation to our business as a whole, together with the year in which the U.S. basic product patent expires (including, where applicable, the additional six-month pediatric exclusivity period), are those for the drugs set forth in the table below. The table

also includes patent expiration information relating to certain recently approved drugs.

Drug	U.S. Basic Product Patent Expiration Year
Aricept	2010
Lipitor	2010
Xalatan	2011
Viagra	2012
Detrol	2012
Celebrex	2014
Zyvox	2015
Chantix	2018
Lyrica	2018
Sutent	2021

In some instances, there are later-expiring patents relating to our products directed to particular forms or compositions of the drug or to methods of manufacturing or using the drug in the treatment of particular diseases or conditions. However, in some cases, such patents may not protect the Company's drug from generic competition after the expiration of the basic patent.

The U.S. basic patents expired for *Zyrtec/Zyrtec D* and *Norvasc* in 2007 and for *Camptosar* in February 2008.

Aricept is patented by Eisai Co., Ltd. We co-promote *Aricept* with Eisai in the U.S. and several other countries and have an exclusive license to sell the drug in certain other countries.

In addition to our U.S. basic product patent for *Lipitor,* which (including the pediatric exclusivity period) expires in March 2010, we have a patent covering specifically the enantiomeric form of the drug,

which (including the pediatric exclusivity period) expires in June 2011. See Note 20 to our consolidated financial statements, *Legal Proceedings and Contingencies,* in our 2007 Financial Report regarding pending legal challenges to our *Lipitor* patents in the U.S. and Canada.

We market *Genotropin* in the U.S. under a non–exclusive license from Novo–Nordisk.

Companies have filed applications with the FDA seeking approval of products that we believe infringe our patents covering, among other products, *Lipitor, Celebrex, Detrol/Detrol LA and Caduet.* In addition, a company has filed an application with the FDA seeking approval to market a generic version of *Aricept,* which is patented by Eisai Co., Ltd.

We also have other patent rights covering additional products that have lesser revenues than most of the products set forth in the table above.

The expiration of a basic product patent or loss of patent protection resulting from a legal challenge normally results in significant competition from generic products against the originally patented product and can result in a significant reduction in sales of that product in a very short period. In some cases, however, we can continue to obtain commercial benefits from product manufacturing trade secrets; patents on uses for products; patents on processes and intermediates for the economical manufacture of the active ingredients; patents for special formulations of the product or delivery mechanisms; and conversion of the active ingredient to over-the-counter products.

One of the main limitations on our operations in some countries outside the U.S. is the lack of effective intellectual property protection for our products. Under international agreements in recent years, global protection of intellectual property rights is improving. The General Agreement on Tariffs and Trade requires participant countries to amend their intellectual property laws to provide patent protection for pharmaceutical products by the end of a ten-year transition period. A number of countries are doing this. We have experienced significant growth in our businesses in some of those nations, and our continued business expansion in those countries depends to a large degree on further patent protection improvement.

Competition

Our businesses are conducted in intensely competitive and often highly regulated markets. Many of our human pharmaceutical products face competition in the form of branded drugs or generic drugs that treat similar diseases or indications. The principal forms of competition include efficacy, safety, ease of use, and cost effectiveness. Though the means of competition vary among product categories and business groups, demonstrating the value of our products is a critical factor for success in all of our principal businesses.

Our Pharmaceutical business is the largest in the world. Our competitors include other worldwide research-based drug companies, smaller research companies with more limited therapeutic focus, and generic drug manufacturers. We compete with other companies that manufacture and sell products that treat similar diseases or indications as our major products.

Such competition affects our core product business, focused on applying innovative science to discover and market products that satisfy unmet medical needs and provide therapeutic improvements. Our emphasis on innovation is underscored by our multi-billion-dollar investment in research and development over the past decade, resulting in one of the strongest product pipelines in the industry. Our investment in research does not stop with a drug approval; we continue to invest in further understanding the value of our products for the conditions they treat as well as potentially new conditions. We protect the health and well being of patients by ensuring that medically sound knowledge of the benefits and risks of our medicines is understood and communicated to patients, physicians and global health authorities. We also continue to enhance the organizational effectiveness of our pharmaceutical sales and marketing functions, coordinating support for our salespeople's efforts to launch and promote our products to our customers.

Operating conditions have become more challenging under the mounting global pressures of competition, industry regulation and cost containment. We recently have taken and continue to take measures to evaluate, adapt, and improve our organization and business practices to better meet customer and public needs.

For instance, we have taken an industry-leading role in evolving our approaches to U.S. direct-to-consumer advertising, interactions with healthcare professionals and medical education grants. We also continue to sponsor programs to address patient affordability and access barriers, as we strive to advance fundamental health system change through support for better healthcare solutions.

While our Animal Health business is one of the largest in the world, many other companies offer competitive products. Altogether, there are hundreds of producers of animal health products throughout the world. The principal methods of competition vary somewhat depending on the particular product. They include product

innovation, quality, price, service and effective promotion to veterinary professionals and consumers.

Managed Care Organizations

The growth of MCOs in the U.S. has been a major factor in the competitive makeup of the healthcare marketplace. Approximately 180 million people in the U.S. now participate in some version of managed care. Because of the size of the patient population covered by MCOs, marketing of prescription drugs to them and the PBMs that serve many of those organizations continues to grow in importance.

MCOs can include medical insurance companies, medical plan administrators, health–maintenance organizations, alliances of hospitals and physicians and other physician organizations. The purchasing power of MCOs has been increasing in recent years due to their growing numbers of enrolled patients. At the same time, those organizations have been consolidating into fewer, even larger entities. This enhances their purchasing strength and importance to us.

The growth of MCOs has increased pressure on drug prices. One objective of MCOs is to contain and, where possible, reduce healthcare expenditures. They typically use formularies, volume purchases and long–term contracts to negotiate discounts from pharmaceutical providers. They use their purchasing power to bargain for lower supplier prices. They also emphasize primary and preventive care, out–patient treatment and procedures performed at doctors' offices and clinics. Hospitalization and surgery, typically the most expensive forms of treatment, are carefully managed. Since the use of certain drugs can prevent the need for hospitalization, professional therapy or even surgery, such drugs can become favored first–line treatments for certain diseases.

As discussed above in *Marketing*, MCOs and PBMs typically develop formularies. Formularies can be based on the prices and therapeutic benefits of the available products. Due to their generally lower cost, generic medicines are often favored. The breadth of the products covered by formularies can vary considerably from one MCO to another and many formularies include alternative and competitive products for treatment of particular medical problems. MCOs use a variety of means to encourage patients' use of products listed on their formularies.

Exclusion of a product from a formulary or other restrictions, such as requiring prior authorizations, can lead to its sharply reduced usage in the MCO patient population. Consequently, pharmaceutical companies compete aggressively to have their products included. Where possible, companies compete for inclusion based upon unique features of their products, such as greater efficacy, better patient ease of use or fewer side effects. A lower overall cost of therapy is also an important factor. Products that demonstrate fewer therapeutic advantages must compete for inclusion based primarily on price. We have been generally, although not universally, successful in having our major products included on most MCO formularies.

The impact of MCOs on drug prices and volumes has increased as the result of their role in negotiating on behalf of Medicare beneficiaries in connection with the Medicare out–patient Prescription Drug Benefit, Medicare Part D that took effect January 1, 2006. MCOs and PBMs negotiate on behalf of the federal government as Prescription Drug Plans (PDPs). We have been generally, although not universally, successful in having our major products that are used by the senior population included on the formularies of the new Medicare PDPs for 2006, 2007 and 2008.

Generic Products

One of the biggest competitive challenges that we face is from generic pharmaceutical manufacturers. Upon the expiration or loss of patent protection for a product, we can lose the major portion of sales of that product in a very short period. Several such competitors make a regular practice of challenging our product patents before their expiry. Generic competitors operate without our large research and development expenses and our costs of conveying medical information about our products to the medical community. In addition, the FDA approval process exempts generics from costly and time–consuming clinical trials to demonstrate their safety and efficacy, allowing generic manufacturers to rely on the safety and efficacy data of the innovator product. Generic products need only demonstrate a level of availability in the bloodstream equivalent

to that of the innovator product. This means that generic competitors can market a competing version of our product after the expiration or loss of our patent and charge much less.

In addition, our patent–protected products can face competition in the form of generic versions of branded products of competitors that lose their market exclusivity. For example, *Lipitor* began to face competition from generic pravastatin (Pravachol) and generic simvastatin (Zocor) during 2006.

As noted above, MCOs that focus primarily on the immediate cost of drugs often favor generics over brand–name drugs. Many governments also encourage the use of generics as alternatives to brand–name drugs in their healthcare programs, including Medicaid in the U.S. Laws in the U.S. generally allow, and in some cases require, pharmacists to substitute generic drugs that have been rated under government procedures to be therapeutically equivalent to brand–name drugs. The substitution must be made unless the prescribing physician expressly forbids it. In the U.S., Pfizer's Greenstone subsidiary sells generic versions of Pfizer's pharmaceutical products upon loss of exclusivity, as appropriate.

Raw Materials

Raw materials essential to our businesses are purchased worldwide in the ordinary course of business from numerous suppliers. In general, these materials are available from multiple sources. No serious shortages or delays were encountered in 2007, and none are expected in 2008. The rise in the price of crude oil has resulted in pricing pressures on raw materials that are derived from petroleum and used in our businesses.

Government Regulation and Price Constraints

In the United States

General. Pharmaceutical companies are subject to extensive regulation by national, state and local agencies in the countries in which they do business. Of particular importance is the FDA in the U.S. It has jurisdiction over our human pharmaceutical business and administers

requirements covering the testing, safety, effectiveness, manufacturing, labeling, marketing, advertising and post–marketing surveillance of our pharmaceutical products. The FDA also regulates our animal health products, along with the U.S. Department of Agriculture and the U.S. Environmental Protection Agency.

In addition, many of our activities are subject to the jurisdiction of various other federal regulatory and enforcement departments and agencies, such as the Department of Health and Human Services, the Federal Trade Commission and the Department of Justice. Individual states, acting through their attorneys general, have become active as well, seeking to regulate the marketing of prescription drugs under state consumer protection and false advertising laws.

We are subject to possible administrative and legal proceedings and actions by these various regulatory bodies (see Note 20 to our consolidated financial statements, *Legal Proceedings and Contingencies,* in our 2007 Financial Report). Such actions may include product recalls, seizures and other civil and criminal sanctions.

The U.S. Congress and the FDA are considering proposals to change how the FDA assesses "follow–on biological" products. Depending on the specific provisions, legislative or regulatory changes that would facilitate the approval of such products could have an adverse impact on the Company's business.

Medicare. In December 2003, the Medicare Prescription Drug Improvement and Modernization Act of 2003 (the 2003 Medicare Act) was enacted. Medicare beneficiaries are now eligible to obtain subsidized prescription drug coverage from a choice of private sector plans. Over 90 percent of Medicare beneficiaries now have coverage for prescription medicines. It remains difficult to predict the long–term impact of the 2003 Medicare Act on pharmaceutical companies. The use of pharmaceuticals has increased slightly among some patients as the result of the expanded access to medicines afforded by coverage under Medicare. However, such expanded utilization has been largely offset by increased pricing pressure and competition due to the enhanced purchasing power of the private sector plans that negotiate on behalf of Medicare beneficiaries and by an increase in the use of

generic medicines in this population. In addition, effective January 1, 2007, Medicare ended reimbursement for ED medicines, including *Viagra.*

Pfizer is committed to helping ensure that all Americans without coverage for prescription medicines have access to Pfizer products. To that end, in 2004, we implemented our Helpful Answers program, an umbrella program that brings together Pfizer's long-standing patient assistance programs with Pfizer Pfriends, a prescription discount card offering savings on Pfizer prescription medicines for all Americans without prescription drug coverage, regardless of age or income. In addition, in January 2005, we joined Together Rx Access with nine other pharmaceutical companies to offer savings on over 275 medicines to Medicare-ineligible, uninsured individuals under 65 who fall below certain income thresholds. Pfizer also participates in the Partnership for Prescription Assistance, a single point of access to more than 475 public and private patient assistance programs.

Importation of Drugs. There continue to be legislative proposals to amend U.S. law to allow the importation into the U.S. of prescription drugs from outside the U.S., which can be sold at prices that are regulated by the governments of various foreign countries. In addition to well documented safety concerns, such importation could impact pharmaceutical prices in the U.S. While the 2003 Medicare Act maintains the current prohibition on such imports, it would allow importation from Canada if the Secretary of Health and Human Services certifies that such importation is safe and would result in savings to consumers. Before the 2003 Medicare Act, federal law would have permitted importation of medicines into the U.S. from a considerably larger group of developed countries, provided the Secretary of Health and Human Services made the same safety and cost-savings certifications. In December 2004, the Department of Health and Human Services (HHS) and the Department of Commerce issued reports on drug importation and foreign price controls. The HHS report noted that it would be "extraordinarily difficult to ensure that drugs personally imported by individual consumers" could meet the standards of safety that would support certifying such importation as safe. While the report also concluded that the U.S. could establish a feasible basis for commercial drug importation, such a change in the law would require "new legal authorities, substantial additional resources and significant restrictions on the types of drugs that could be imported." The report also noted that the total savings to be expected from such a commercial importation regime would be relatively small — 1% or 2% of total drug spending in the U.S. The Commerce Department report confirmed that the lower prices in many countries result from governmental price controls, and these price controls adversely affect the amount of funding that is available for the discovery of new drugs.

Medicaid and Related Matters. Federal law requires us to give rebates to state Medicaid agencies based on each state's reimbursement of pharmaceutical products under the Medicaid program. In recent years, various proposals have been offered at the federal and state levels that would bring about major changes in the Medicaid program. In the short term, driven by budget concerns, many states have implemented restrictive drug lists and state supplemental rebate programs under the Medicaid program. These programs increased our required rebate payments in 2007. Nonetheless, Pfizer enjoys relatively broad formulary access in state Medicaid fee-for-service programs, although restrictions exist for some products in certain states. Access in the Medicaid managed care program is typically determined by the health plans providing coverage for Medicaid recipients contracting for the provision of services in the state. Access may vary by plan.

Since January 1, 2006, federal funds have not been used for reimbursement of erectile dysfunction medications, including *Viagra,* in the Medicaid program. In addition, effective January 1, 2007, changes to the treatment of authorized generics for purposes of calculating Medicaid rebates increased the amount of rebates we are required to pay on brand name drug sales after loss of exclusivity and on authorized generic sales to the Medicaid program. In addition, a number of states are considering expansion of eligibility for their Medicaid programs that would result in increased exposure to Medicaid rebates.

Some states are considering price-control regimes that would apply to broader segments of their populations that are not Medicaid eligible, as

well as various approaches to controlling pharmaceutical marketing activities. If many states were to require increased rebate payments in discount programs for the uninsured and link Medicaid beneficiaries' access to our products to such discount programs, the impact on patients' access to medicines and on Pfizer could be significant.

We also must give discounts or rebates on purchases or reimbursements of pharmaceutical products by certain other federal and state agencies and programs. See the discussion regarding rebates in the *Revenues* section of our 2007 Financial Report and in Note 1–G to our consolidated financial statements, *Significant Accounting Policies, Revenues,* in our 2007 Financial Report, which discussions are incorporated by reference.

Health Reform. Massachusetts is currently implementing its program for health reform. Part of the ongoing implementation discussion is whether minimal coverage requires access to brand–name medications or only to generic medications. The latter approach has the potential to have a negative impact on the sale of brand–name medications. This impact would be more significant if generics–only programs were implemented by other states considering their own approaches to health reform.

Outside the United States

We encounter similar regulatory and legislative issues in most other countries. In Europe and some other international markets, the government provides healthcare at low direct cost to consumers and regulates pharmaceutical prices or patient reimbursement levels to control costs for the government–sponsored healthcare system. This international patchwork of price regulation has led to different prices and some third–party trade in our products from markets with lower prices. Such trade exploiting price differences between countries can undermine our sales in markets with higher prices.

The approval of new drugs across the EU may only be achieved using the Mutual Recognition Procedure/Decentralized Procedure or EU Commission/European Medicines Agency (EMEA) Central Approval Process, which applies in the 27 EU member states, plus Norway and Iceland, which are full participants in these registration processes. The use of these procedures provides a more rapid and consistent approval across the member states than was the case when the approval processes were operating independently within each country.

Since the EU does not have jurisdiction over patient reimbursement or pricing matters in its member states, we continue to deal with individual countries on such matters across the region.

During 2004, a comprehensive package of reforms was adopted (called New Medicines Legislation) amending EU law on the regulation of medicinal products in many areas, including approval procedures and safety reporting. Of particular note, the data exclusivity periods during which innovative companies' regulatory data are protected are required to be harmonized in all member states. Implementation is complete or underway in most member states, which will facilitate the approval and launch of generic medicines. In addition, these reforms introduced a clear legal basis for the approval of "biosimilar" or "follow–on biological" products in the EU. Following the effectiveness of these new regulations (in November 2005), the first such products, including a biosimilar version of *Genotropin*, were approved in the EU in 2006. The new regulations also shortened certain approval timelines and introduced fast–track and conditional centralized authorizations. Pfizer's *Sutent* was the first product to be conditionally approved under the new law in 2006 (although its status subsequently was converted to full authorization).

On January 26, 2007, the new EU Regulation on Medicines for Pediatric Use became effective. This introduced new obligations on pharmaceutical companies to conduct research on their medicines in children and, subject to various conditions, offers the possibility of incentives for so doing, including exclusivity extensions. The aim of this new regulation is to improve the health of children in the EU through high quality research, stimulating the development of new medicines, creating infrastructure to enable authorized use and improving the information on medicines for children. A Pediatric Committee (PDCO) was created within the EMEA to provide scientific opinions and input on development plans for medicines for use with children.

On November 28, 2007, the EU Commission hosted the Transatlantic Administrative Simplification Workshop co-chaired by the EU Commission and the FDA, in co-operation with the EMEA and the Heads of European Medicines Agencies, to identify opportunities for administrative simplification between the U.S. and the EU in the field of pharmaceutical regulation. These opportunities include possible harmonization of administrative practices and guidelines, not necessitating changes in regulations, while maintaining or increasing the current levels of Public Health protection. By freeing up resources, this cooperation will allow the industry to focus more of its resources on developing and supplying medicines to meet the needs of patients.

Environmental Law Compliance

Most of our operations are affected by federal, state and/or local environmental laws. We have made, and intend to continue to make, necessary expenditures for compliance with applicable laws. We also are cleaning up environmental contamination from past industrial activity at certain sites (see Note 20 to our consolidated financial statements, *Legal Proceedings and Contingencies,* in our 2007 Financial Report).

As a result, we incurred capital and operational expenditures in 2007 for environmental compliance purposes and for the clean-up of certain past industrial activity as follows:

- environment-related capital expenditures — $64 million
- other environment-related expenses — $178 million

While we cannot predict with certainty future capital expenditures or operating costs for environmental compliance, we do not believe they will have a material effect on our capital expenditures or competitive position.

Tax Matters

The discussion of tax-related matters in Note 8 to our consolidated financial statements, *Taxes on Income,* in our 2007 Financial Report, is incorporated by reference.

Employees

In our innovation-intensive business, our employees are vital to our success. We believe we have good relationships with our employees. As of December 31, 2007, we employed approximately 86,600 people in our operations throughout the world.

ITEM 1A. RISK FACTORS AND CAUTIONARY FACTORS THAT MAY AFFECT FUTURE RESULTS

The statements in this Section describe the major risks to our business and should be considered carefully. In addition, these statements constitute our cautionary statements under the Private Securities Litigation Reform Act of 1995.

Our disclosure and analysis in this 2007 Form 10-K and in our 2007 Annual Report to Shareholders contain some forward-looking statements that set forth anticipated results based on management's plans and assumptions. From time to time, we also provide forward-looking statements in other materials we release to the public, as well as oral forward-looking statements. Such statements give our current expectations or forecasts of future events; they do not relate strictly to historical or current facts. We have tried, wherever possible, to identify such statements by using words such as "anticipate," "estimate," "expect," "project," "intend," "plan," "believe," "will," "target", "forecast" and similar expressions in connection with any discussion of future operating or financial performance or business plans or prospects. In particular, these include statements relating to future actions, business plans and prospects, prospective products or product approvals, future performance or results of current and anticipated products, sales efforts, expenses, interest rates, foreign exchange rates, the outcome of contingencies, such as legal proceedings, and financial results.

We cannot guarantee that any forward-looking statement will be realized, although we believe we have been prudent in our plans and assumptions. Achievement of future results is subject to risks, uncertainties and potentially inaccurate assumptions. Should known or unknown risks or uncertainties materialize, or should underlying assumptions prove

differ materially from past results and those anticipated, estimated or projected. You should bear this in mind as you consider forward-looking statements.

We undertake no obligation to publicly update forward-looking statements, whether as a result of new information, future events or otherwise. You are advised, however, to consult any further disclosures we make on related subjects in our 10-Q and 8-K reports to the SEC. Also note that we provide the following cautionary discussion of risks, uncertainties and possibly inaccurate assumptions relevant to our businesses. These are factors that, individually or in the aggregate, we think could cause our actual results to differ materially from expected and historical results. We note these factors for investors as permitted by the Private Securities Litigation Reform Act of 1995. You should understand that it is not possible to predict or identify all such factors. Consequently, you should not consider the following to be a complete discussion of all potential risks or uncertainties.

Government Regulation and Managed Care Trends

U.S. and foreign governmental regulations mandating price controls and limitations on patient access to our products impact our business, and our future results could be adversely affected by changes in such regulations. In the U.S., many of our pharmaceutical products are subject to increasing pricing pressures. Such pressures have increased as the result of the 2003 Medicare Act due to the enhanced purchasing power of the private sector plans that negotiate on behalf of Medicare beneficiaries. In addition, if the 2003 Medicare Act were amended to impose direct governmental price controls and access restrictions, it would have a significant adverse impact on our business. In addition, MCOs, as well as Medicaid and other government agencies, continue to seek price discounts. Some states have implemented and other states are considering price controls or patient-access constraints under the Medicaid program and some states are considering price-control regimes that would apply to broader segments of their populations that are not Medicaid eligible. Other matters also could be the subject of U.S. federal or state legislative or regulatory action that could adversely affect our business, including changes in patent laws, the importation of prescription drugs from outside the U.S. at prices that are regulated by the governments of various foreign countries and restrictions on U.S. direct-to- consumer advertising or limitations on interactions with healthcare professionals.

The prohibition on the use of federal funds for reimbursement of ED medications by the Medicaid program, which became effective January 1, 2006, and the similar federal funding prohibition for the Medicare program, which became effective January 1, 2007, has had an adverse effect on our business. Any prohibitions on the use of federal funds for reimbursement of other classes of drugs in the future may also have an adverse effect.

We encounter similar regulatory and legislative issues in most other countries. In Europe and some other international markets, the government provides healthcare at low direct cost to consumers and regulates pharmaceutical prices or patient reimbursement levels to control costs for the government-sponsored healthcare system. This international patchwork of price regulation has led to different prices and some third-party trade in our products from markets with lower prices. Such trade exploiting price differences between countries can undermine our sales in markets with higher prices. As a result, it is expected that pressures on the pricing component of operating results will continue.

Generic Competition

Competition from manufacturers of generic drugs is a major challenge for us around the world. Upon the expiration or loss of patent protection for one of our products, or upon the "at-risk" launch (despite pending patent infringement litigation against the generic product) by a generic manufacturer of a generic version of one of our products, we can lose the major portion of sales of that product in a very short period, which can adversely affect our business. The U.S. basic patent for *Norvasc* expired in 2007 and a generic version was launched promptly. The U.S. basic patent for *Zyrtec/Zyrtec D* expired in December 2007 and an over-the-counter version was launched in late January 2008 by the purchaser of

our Consumer Healthcare business. The U.S. basic patent for *Camptosar* expired in February 2008. Also, the patents covering several of our most important medicines, including *Lipitor, Celebrex, Detrol/Detrol LA, Caduet* and *Aricept,* are being challenged by generic manufacturers. In addition, our patent-protected products may face competition in the form of generic versions of branded products of competitors that lose their market exclusivity. For example, *Lipitor* began to face competition from generic pravastatin (Pravachol) and generic simvastatin (Zocor) during 2006.

Competitive Products

We cannot predict with accuracy the timing or impact of the introduction of competitive products or their possible effect on our sales. Products that compete with our drugs, including some of our best-selling medicines, are launched from time to time. Launches of a number of competitive products have occurred in recent years, and certain potentially competitive products are in various stages of development, some of which have been filed for approval with the FDA and with regulatory authorities in other countries.

Dependence on Key In-Line and New Products

We recorded product sales of more than $1 billion for each of eight pharmaceutical products in 2007: *Lipitor, Norvasc, Lyrica, Celebrex, Viagra, Detrol/Detrol LA, Xalatan/Xalacom* and *Zyrtec/Zyrtec D*. Those products accounted for 58.0% of our total Pharmaceutical revenues in 2007. *Lipitor* sales in 2007 were approximately $12.7 billion, accounting for 28.4% of our total 2007 Pharmaceutical revenues. The U.S. basic patents for *Norvasc* and *Zyrtec/Zyrtec D* expired in 2007. If the other six products or any of our other major products were to become subject to problems such as loss of patent protection, changes in prescription growth rates, material product liability litigation, unexpected side effects, regulatory proceedings, publicity affecting doctor or patient confidence or pressure from existing competitive products, or if a new, more effective treatment should be introduced, the adverse impact on our revenues could be significant. As noted, patents covering several of our best-selling

medicines have recently expired or will expire in the next few years, and patents covering a number of our best-selling medicines are the subject of pending legal challenges. In addition, our revenues could be significantly impacted by the timing and rate of commercial acceptance of key new products, including *Lyrica, Sutent, Chantix/Champix* and *Selzentry/Celsentri.*

Uncertainty Relating to COX-2 Medicines

Our ability to further increase *Celebrex* sales may be limited by the continuing concern about the safety of non-steroidal anti-inflammatory pain relievers.

Research and Development Investment

The discovery and development of new products as well as the development of additional uses for existing products is very important to the success of the Company. However, balancing current growth and investment for the future remains a major challenge. Our ongoing investments in new product introductions and in research and development for new products and existing product extensions could exceed corresponding sales growth. This could produce higher costs without a proportional increase in revenues.

Development, Regulatory Approval and Marketing of Products

Risks and uncertainties apply particularly with respect to product-related, forward-looking statements. The outcome of the lengthy and complex process of identifying new compounds and developing new products is inherently uncertain. There can be no assurance as to whether or when we will receive regulatory approval for new products or for new indications or dosage forms for existing products. Decisions by regulatory authorities regarding labeling and other matters could adversely affect the availability or commercial potential of our products. There also are many considerations that can affect marketing of pharmaceutical products around the world. Regulatory delays, the inability to successfully complete clinical trials, claims and concerns about safety and efficacy, new discoveries, patent disputes and claims about adverse side effects are

a few of the factors that could adversely affect the realization of research and development and product-related, forward-looking statements.

Research Studies

Decisions about research studies made early in the development process of a drug candidate can have a substantial impact on the marketing strategy once the drug receives approval. More detailed studies may demonstrate additional benefits that can help in the marketing, but they consume time and resources and can delay submitting the drug candidate for initial approval. We try to plan clinical trials prudently, but there is no guarantee that a proper balance of speed and testing will be made in each case. The quality of our decisions in this area could affect our future results.

Interest Rate and Foreign Exchange Risk

52.2% of our total 2007 revenues were derived from international operations, including 32.9% from the Europe/Canada region and 13.4% from the Japan/Asia region. These international-based revenues as well as our substantial international net assets expose our revenues and earnings to foreign currency exchange rate changes. In addition, our interest-bearing investments, loans and borrowings are subject to risk from changes in interest rates. These risks and the measures we have taken to help contain them are discussed in the section entitled Financial Risk Management in our 2007 Financial Report. For additional details, see Note 10-D to our consolidated financial statements, *Financial Instruments: Derivative Financial Instruments and Hedging Activities,* in our 2007 Financial Report. Those sections of our 2007 Financial Report are incorporated by reference.

Notwithstanding our efforts to foresee and mitigate the effects of changes in fiscal circumstances, we cannot predict with certainty changes in currency and interest rates, inflation or other related factors affecting our businesses.

Risks Affecting International Operations

Our international operations also could be affected by changes in intellectual property legal protections and remedies, trade regulations and procedures and actions affecting approval, production, pricing, reimbursement and marketing of products, as well as by unstable governments and legal systems and inter-governmental disputes. Any of these changes could adversely affect our business.

Product Manufacturing and Marketing Risks

Difficulties or delays in product manufacturing or marketing, including, but not limited to, the inability to increase production capacity commensurate with demand or the failure to predict market demand for, or to gain market acceptance of, approved products, could affect future results.

Cost and Expense Control/Unusual Events

Growth in costs and expenses, changes in product, segment and geographic mix and the impact of acquisitions, divestitures, restructurings, product withdrawals and other unusual events that could result from evolving business strategies, evaluation of asset realization and organizational restructuring could adversely affect future results. Such risks and uncertainties include, in particular, our ability to realize the projected benefits of our cost-reduction initiatives.

Changes in Laws and Accounting Standards

Our future results could be adversely affected by changes in laws and regulations, including changes in accounting standards, taxation requirements (including tax-rate changes, new tax laws and revised tax law interpretations), competition laws and environmental laws in the U.S. and other countries.

Terrorist Activity

Our future results could be adversely affected by changes in business, political and economic conditions, including the cost and availability of insurance, due to the threat of terrorist activity in the U.S. and other parts

of the world and related U.S. military action overseas.

Legal Proceedings

We and certain of our subsidiaries are involved in various patent, product liability, consumer, commercial, securities, environmental and tax litigations and claims, government investigations, and other legal proceedings that arise from time to time in the ordinary course of our business. Litigation is inherently unpredictable, and excessive verdicts do occur. Although we believe we have substantial defenses in these matters, we could in the future incur judgments or enter into settlements of claims that could have a material adverse effect on our results of operations in any particular period.

Patent claims include challenges to the coverage and/or validity of our patents on various products or processes. Although we believe we have substantial defenses to these challenges with respect to all our material patents, there can be no assurance as to the outcome of these matters, and a loss in any of these cases could result in a loss of patent protection for the drug at issue, which could lead to a significant loss of sales of that drug and could materially affect future results of operations.

Business Development Activities

We plan to enhance our product pipeline through acquisitions, licensing and alliances (see *Regulatory Environment and Pipeline Productivity* under *Our Operating Environment and Response to Key Opportunities and Challenges* in our 2007 Financial Report, which section is incorporated by reference). However, these enhancement plans are subject to the availability and cost of appropriate opportunities and competition from other pharmaceutical companies that are seeking similar opportunities.

Information Technology

We rely to a large extent upon sophisticated information technology systems and infrastructure. The size and complexity of our computer systems make them potentially vulnerable to breakdown, malicious intrusion and random attack. Likewise, data privacy breaches by employees and others with permitted access to our systems may pose a risk that sensitive data may be exposed to unauthorized persons or to the public. While we have invested heavily in protection of data and information technology, there can be no assurance that our efforts will prevent breakdowns or breaches in our systems that could adversely affect our business.

ITEM 1B. UNRESOLVED STAFF COMMENTS

Not applicable.

ITEM 2. PROPERTIES

Our corporate headquarters and the headquarters of our Worldwide Pharmaceuticals and Animal Health businesses are located at our world headquarters, which includes several owned and leased buildings in New York City.

For our Worldwide Pharmaceuticals business, we own and lease space around the world for sales and marketing, administrative support and customer service functions.

Our Global Research and Development and Biotechnology and Bioinnovation Center divisions are headquartered in owned and leased facilities in New London, Connecticut and South San Francisco, California, respectively. We operate both divisions in 17 locations around the world. More efficient use of our R&D facilities is a component of Pfizer's cost-reduction initiatives and the expansion of those initiatives was announced on January 22, 2007. Since that time, the majority of R&D activities in Ann Arbor, Plymouth Township and several buildings in Kalamazoo, Michigan have been concluded, and disposition efforts are underway for those sites. R&D operations will continue, as noted below, in other retained buildings in Kalamazoo. Disposition alternatives, subject to consultation with works councils and local labor laws, are also being pursued in Amboise, France and Nagoya, Japan.

We have veterinary medicine research and development operations in owned facilities in Henrietta, Kalamazoo and Richland Township, Michigan, and Sandwich, England. Additionally, these operations occupy leased facilities in Melbourne, Australia.

Our Global Manufacturing (PGM) division is headquartered in New York, NY and in Peapack, NJ and operates plants in 57 locations around the world that manufacture products for our

Pharmaceutical and Animal Health businesses. Major facilities are located in Belgium, Brazil, China, France, Germany, Ireland, Italy, Japan, Mexico, Puerto Rico, Singapore, Sweden, the United Kingdom and the United States. The Global Manufacturing division also operates distribution facilities in major markets around the world. As part of Pfizer's Transformation and Plant Network Strategy productivity initiatives, 12 of the manufacturing facilities are scheduled to be sold or closed within the next several years as Global Manufacturing continues to optimize its plant network. This includes a number of plants that were announced for closure in early 2007 as part of Pfizer's streamlining initiatives. Studies are underway to further consolidate the distribution network.

In general, our properties are well maintained, adequate and suitable for their purposes. See Note 12 to our consolidated financial statements, *Property, Plant and Equipment*, in our 2007 Financial Report, which discloses amounts invested in land, buildings and equipment, which is incorporated by reference. See also the discussion

under Note 18 to our consolidated financial statements, *Lease Commitments*, in our 2007 Financial Report, which is also incorporated by reference.

ITEM 3. LEGAL PROCEEDINGS

Certain legal proceedings in which we are involved are discussed in Note 20 to our consolidated financial statements, *Legal Proceedings and Contingencies*, in our 2007 Financial Report, which is incorporated by reference.

ITEM 4. SUBMISSION OF MATTERS TO A VOTE OF SECURITY HOLDERS

Not applicable.

EXECUTIVE OFFICERS OF THE COMPANY

The executive officers of the Company are set forth in this table. Each holds the offices indicated until his or her successor is chosen and qualified at the regular meeting of the Board of Directors to be held immediately following the 2008 Annual Meeting of Shareholders. Each of the executive officers is a member of the Pfizer Executive Leadership Team.

Name	Age	Position
Jeffrey B. Kindler	52	Chairman of the Board and Chief Executive Officer
Richard H. Bagger	47	Senior Vice President, Worldwide Public Affairs and Policy, since August 2006. Since joining Pfizer in 1993, Mr. Bagger has held various positions of increasing responsibility in Pfizer's Corporate Affairs Division. He was promoted to Vice President, Government Relations in 2002 and to Senior Vice President, Government Relations in 2003. He assumed additional responsibility for Public Affairs and Policy in 2005. Prior to joining Pfizer, he was Assistant General Counsel of Blue Cross and Blue Shield of New Jersey and previously practiced law with the firm of McCarter and English. Mr. Bagger also served in both houses of the New Jersey legislature.
Frank A. D'Amelio	50	Senior Vice President & Chief Financial Officer
Joseph M. Feczko	58	Senior Vice President and Chief Medical Officer, since August 2006. Dr. Feczko has held various positions of increasing responsibility in research and development and medical and regulatory operations. After four years as Medical Director at Glaxo's Research & Development headquarters in London, Dr. Feczko returned to Pfizer in 1996 and was promoted to the position of Senior Vice President, Medical and Regulatory Operations for Global Pharmaceuticals. He was promoted to his position as Chief Medical Officer in 2002. Dr. Feczko, who is board–certified in Internal Medicine and a specialist in infectious diseases, joined us in 1982.
Corey S. Goodman	56	Senior Vice President; President of Pfizer's Biotherapeutics and Bioinnovation Center, since October 2007. Dr. Goodman has advised numerous biotechnology companies and co–founded two companies, Exelixis and Renovis, Inc. He served as President and Chief Executive Officer of Renovis from 2001 until 2007. Dr. Goodman was a professor at the University of California, Berkeley from 1987 to 2001, and, while on faculty, served as the Evan Rauch Professor of Neuroscience, the Director of the Wills Neuroscience Institute and an Investigator with the Howard Hughes Medical Institute. Dr. Goodman is an Adjunct Professor at the University of California San Francisco and an elected member of the U.S. National Academy of Sciences. He is a Director of Renovis, Inc.
John L. LaMattina (retired at year–end 2007)	57	Senior Vice President; President, Pfizer Research and Development

Martin Mackay	51	Senior Vice President; President of Pfizer Global Research & Development
Mary McLeod	51	Senior Vice President of Pfizer's Worldwide Human Resources, since April 2007. She served in this role on an interim basis from January to April 2007 while she was a consultant at Korn Consulting Group. Prior to that, she led Human Resources for Symbol Technologies from 2005 to 2006 and was the head of Human Resources for Charles Schwab, from 2001 to 2004. From 1999 to 2001, she was Vice President–Human Resources for Cisco Systems and prior to that, Vice President of Human Resources for General Electric Company from 1992 to 1997. On February 28, 2008, she was appointed a Director of Belden Inc.
Ian C. Read	54	Senior Vice President; President, Worldwide Pharmaceutical Operations
Natale S. Ricciardi	59	Senior Vice President; President – Pfizer Global Manufacturing since October 2004. He held a number of positions of increasing responsibility in manufacturing before being named U.S. Area Vice President/Team Leader for Pfizer Global Manufacturing in 1999. Mr. Ricciardi joined us in 1972. He is a Director of Mediacom Communications Corp.
David L. Shedlarz (retired at year–end 2007)	60	Vice Chairman
Sally Susman	46	Senior Vice President – Chief Communications Officer since February 2008. Prior to joining Pfizer, Ms. Susman held senior level positions at The Estee Lauder Companies, including Executive Vice President from December 2004 to January 2008 and Senior Vice President – Global Communications from September 2000 through November 2004. Earlier in her career, Ms. Susman was responsible for all of American Express International's internal and external communications and governmental affairs and spent eight years in government service focused on international trade issues.
Allen P. Waxman	45	Senior Vice President and General Counsel, since August 2006. Mr. Waxman joined Pfizer in 2003 as Senior Assistant General Counsel and Chief of Litigation. He was promoted to Associate General Counsel in 2005 and to General Counsel in 2006. Prior to joining Pfizer, Mr. Waxman was a partner at the law firm of Williams & Connolly, LLP in Washington D.C., since 1995, and during that same period was an adjunct professor of law at Georgetown University Law Center.

Information concerning Mr. Kindler, Dr. LaMattina and Messrs. D'Amelio, Mackay, Read and Shedlarz is incorporated by reference from the discussion under the headings *Nominees For Directors* and *Named Executive Officers Who Are Not Directors* in our 2008 Proxy Statement.

PART II

ITEM 5. MARKET FOR THE COMPANY'S COMMON EQUITY, RELATED STOCKHOLDER MATTERS AND ISSUER PURCHASES OF EQUITY SECURITIES

The principal market for our Common Stock is the New York Stock Exchange. Our stock is also listed on the London, Euronext and Swiss Stock Exchanges and is traded on various United States regional stock exchanges. Additional information required by this item is incorporated by reference from the table captioned *Quarterly Consolidated Financial Data (Unaudited)* in our 2007 Financial Report.

This table provides certain information with respect to our purchases of shares of the Company's Common Stock during the fiscal fourth quarter of 2007:

Issuer Purchases of Equity Securities(a)

Period	Total Number of Shares Purchased(b)	Average Price Paid per Share(b)	Total Number of Shares Purchased as Part of Publicly Announced Plan(a)	Approximate Dollar Value of Shares that May Yet Be Purchased Under the Plan(a)
October 1, 2007 through October 31, 2007	34,714,454	$24.84	34,698,342	$ 2,171,856,156
November 1, 2007 through November 30, 2007	36,715,341	$23.47	36,713,085	$ 1,310,037,414
December 1, 2007 through December 31, 2007	32,868,267	$23.71	32,737,540	$ 533,679,153
Total	104,298,062	$24.00	104,148,967	

(a) On June 23, 2005, Pfizer announced that the Board of Directors had authorized a $5 billion share–purchase plan (the "2005 Stock Purchase Plan"). On June 26, 2006, Pfizer announced that the Board of Directors increased the 2005 Stock Purchase Plan authorization from $5 billion to $18 billion. On January 23, 2008, Pfizer announced that the Board of Directors had authorized a new $5 billion share–purchase plan to be utilized from time to time.

(b) In addition to purchases under the 2005 Stock Purchase Plan, this column reflects the following transactions during the fiscal fourth quarter of 2007: (i) the deemed surrender to Pfizer of nil shares of common stock to pay the exercise price and to satisfy tax withholding obligations in connection with the exercise of employee stock options; (ii) the open–market purchase by the trustee of 102,985 shares of common stock in connection with the reinvestment of dividends paid on common stock held in trust for employees who were granted performance–contingent share awards and who deferred receipt of such awards and (iii) the surrender to Pfizer of 46,110 shares of common stock to satisfy tax withholding obligations in connection with the vesting of restricted stock issued to employees.

ITEM 6. SELECTED FINANCIAL DATA

Information required by this item is incorporated by reference from the *Financial Summary* in our 2007 Financial Report.

ITEM 7. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

Information required by this item is incorporated by reference from the Financial Review section of our 2007 Financial Report.

ITEM 7A. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

Information required by this item is incorporated by reference from the discussion under the heading *Financial Risk Management* in our 2007 Financial Report.

ITEM 8. FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA

Information required by this item is incorporated by reference from the *Report of Independent Registered Public Accounting Firm on the Consolidated Financial Statements* in our 2007 Financial Report and from the consolidated financial statements, related notes and supplementary data in our 2007 Financial Report.

ITEM 9. CHANGES IN AND DISAGREEMENTS WITH ACCOUNTANTS ON ACCOUNTING AND FINANCIAL DISCLOSURE

Not applicable.

ITEM 9A. CONTROLS AND PROCEDURES

Disclosure Controls

As of the end of the period covered by this 2007 Form 10–K, we carried out an evaluation,

under the supervision and with the participation of our principal executive officer and principal financial officer, of the effectiveness of the design and operation of our disclosure controls and procedures (as such term is defined in Rules 13a–15(e) and 15d–15(e) under the Securities Exchange Act of 1934 (the "Exchange Act")). Based on this evaluation, our principal executive officer and principal financial officer concluded that our disclosure controls and procedures are effective in alerting them in a timely manner to material information required to be disclosed in our periodic reports filed with the SEC.

Internal Control over Financial Reporting

Management's report on the Company's internal control over financial reporting (as such term is defined in Rules 13a–15(f) and 15d–15(f) under the Exchange Act), and the related report of our independent public accounting firm, are included in our 2007 Financial Report under the headings *Management's Report on Internal Control Over Financial Reporting* and *Report of Independent Registered Public Accounting Firm on Internal Control Over Financial Reporting*, respectively, and are incorporated by reference.

Changes in Internal Controls

During our most recent fiscal quarter, there has not occurred any change in our internal control over financial reporting (as such term is defined in Rules 13a–15(f) and 15d–15(f) under the Exchange Act) that has materially affected, or is reasonably likely to materially affect, our internal control over financial reporting. However, we do wish to highlight some changes which, taken together, are expected to have a favorable impact on our controls over a multi–year period. We continue to pursue a multi–year initiative to outsource some transaction–processing activities within certain accounting processes and are migrating to a consistent enterprise resource planning system across the organization. These are

enhancements of ongoing activities to support the growth of our financial shared service capabilities and standardize our financial systems. None of these initiatives is in response to any identified deficiency or weakness in our internal control over financial reporting.

ITEM 9B. OTHER INFORMATION

Not applicable.

PART III

ITEM 10. DIRECTORS, EXECUTIVE OFFICERS AND CORPORATE GOVERNANCE

Information about our Directors is incorporated by reference from the discussion under Item 1 of our 2008 Proxy Statement. Information about compliance with Section 16(a) of the Exchange Act is incorporated by reference from the discussion under the heading *Section 16(a) Beneficial Ownership Reporting Compliance* in our 2008 Proxy Statement. Information about the Pfizer Policies on Business Conduct governing our employees, including our Chief Executive Officer, Chief Financial Officer and Principal Accounting Officer, and the Code of Business Conduct and Ethics governing our Directors, is incorporated by reference from the discussion under the heading *Pfizer Policies on Business Ethics and Conduct* in our 2008 Proxy Statement. Information regarding the procedures by which our stockholders may recommend nominees to our board of directors is incorporated by reference from the discussion under the heading *Requirements, Including Deadlines, for Submission of Proxy Proposals, Nomination of Directors and Other Business of Shareholders* in our 2008 Proxy Statement. Information about our Audit Committee, including the members of the Committee, and our Audit Committee financial experts, is incorporated by reference from the discussion under the headings *The Audit Committee and Audit Committee Financial Experts* in our 2008 Proxy Statement. The balance of the information required by this item is contained in the discussion entitled *Executive Officers of the Company* in Part I of this 2007 Form 10–K.

ITEM 11. EXECUTIVE COMPENSATION

Information about Director and executive compensation is incorporated by reference from the discussion under the headings: *2007 Compensation of Non–Employee Directors, Executive Compensation, Compensation Committee Interlocks and Insider Participation* in our 2008 Proxy Statement.

ITEM 12. SECURITY OWNERSHIP OF CERTAIN BENEFICIAL OWNERS AND MANAGEMENT AND RELATED STOCKHOLDER MATTERS

Information required by this item is incorporated by reference from the discussion under the headings *Securities Ownership of Management* and *Equity Compensation Plan Information* in our 2008 Proxy Statement.

ITEM 13. CERTAIN RELATIONSHIPS AND RELATED TRANSACTIONS AND DIRECTOR INDEPENDENCE

Information about certain relationships and transactions with related parties is incorporated by reference from the discussion under the headings *Review of Related Person Transactions* and *Transactions with Related Persons* in our 2008 Proxy Statement. Information about director independence is incorporated by reference from the discussion under the heading *Director Independence* in our 2008 Proxy Statement.

ITEM 14. PRINCIPAL ACCOUNTANT FEES AND SERVICES

Information about the fees for professional services rendered by our independent auditors in 2007 and 2006 is incorporated by reference from the discussion under the heading *Audit and Non–Audit Fees* in Item 2 of our 2008 Proxy Statement. Our Audit Committee's policy on pre–approval of audit and permissible non–audit services of our independent auditors is incorporated by reference from the section captioned *Policy on Audit Committee Pre–Approval of Audit and Permissible Non–Audit Services of Independent Registered Public Accounting Firm* in Item 2 of our 2008 Proxy Statement.

PART IV

ITEM 15. EXHIBITS AND FINANCIAL STATEMENT SCHEDULES

15(a)(1) Financial Statements. The following consolidated financial statements, related notes, report of independent registered public accounting firm and supplementary data from our 2007 Financial Report are incorporated by reference into Item 8 of Part II of this 2007 Form 10–K:

- Report of Independent Registered Public Accounting Firm on the Consolidated Financial Statements
- Consolidated Statements of Income
- Consolidated Balance Sheets
- Consolidated Statements of Shareholders' Equity
- Consolidated Statements of Cash Flows
- Notes to Consolidated Financial Statements
- Quarterly Consolidated Financial Data (Unaudited)

15(a)(2) Financial Statement Schedules. Schedules are omitted because they are not required or because the information is provided elsewhere in the financial statements. The financial statements of unconsolidated subsidiaries are omitted because, considered in the aggregate, they would not constitute a significant subsidiary.

15(a)(3) Exhibits. These exhibits are available upon request. Requests should be directed to Margaret M. Foran, Senior Vice President–Corporate Governance, Associate General Counsel and Corporate Secretary, Pfizer Inc., 235 East 42nd Street, New York, NY 10017–5755. The exhibit numbers preceded by an asterisk (*) indicate exhibits physically filed with this 2007 Form 10–K. All other exhibit numbers indicate exhibits filed by incorporation by reference. Exhibit numbers 10(1) through 10(30) are management contracts or compensatory plans or arrangements.

2	Agreement and Plan of Merger dated as of July 13, 2002 among Pfizer Inc., Pilsner Acquisition Sub Corp. and Pharmacia Corporation is incorporated by reference from Amendment No. 2 to our Registration Statement on Form S–4 as filed with the SEC on October 17, 2002.[1]
3(1)	Our Restated Certificate of Incorporation dated April 12, 2004, is incorporated by reference from our 10–Q report for the period ended March 28, 2004.
3(2)	Amendment dated May 1, 2006 to Restated Certificate of Incorporation dated April 12, 2004, is incorporated by reference from our 10–Q report for the period ended July 2, 2006.
3(3)	Our By–laws as amended October 25, 2007 are incorporated by reference from our 8–K report filed on October 30, 2007.
4(1)	Indenture, dated as of January 30, 2001, between us and The Chase Manhattan Bank, is incorporated by reference from our 8–K report filed on January 30, 2001.
4(2)	Except as set forth in Exhibit 4(1) above, the instruments defining the rights of holders of long–term debt securities of the Company and its subsidiaries have been omitted.[2]
10(1)	2001 Stock and Incentive Plan is incorporated by reference from our Proxy Statement for the 2001 Annual Meeting of Shareholders.

[1] We agree to furnish to the SEC, upon request, a copy of each exhibit to this Agreement and Plan of Merger.

[2] We agree to furnish to the SEC, upon request, a copy of each instrument with respect to issuances of long–term debt of the Company and its subsidiaries.

10(2)	Pfizer Inc. 2004 Stock Plan is incorporated by reference from our Proxy Statement for the 2004 Annual Meeting of Shareholders.
10(3)	Form of Stock Option Grant Notice and Summary of Key Terms is incorporated by reference from our 10–Q report for the period ended September 26, 2004.
10(4)	Form of Restricted Stock Grant Notice is incorporated by reference from our 10–Q report for the period ended September 26, 2004.
10(5)	Form of Performance–Contingent Share Award Grant Notice is incorporated by reference from our 10–Q report for the period ended September 26, 2004.
10(6)	Stock and Incentive Plan, as amended through July 1, 1999, is incorporated by reference from our 1999 10–K report.
10(7)	Pfizer Retirement Annuity Plan, as amended through November 6, 1997, is incorporated by reference from our 1997 10–K report.
10(8)	Nonfunded Supplemental Retirement Plan is incorporated by reference from our 1996 10–K report.
10(9)	Nonfunded Deferred Compensation and Supplemental Savings Plan, as amended and restated as of February 1, 2002, is incorporated by reference from our 2002 10–K report.
10(10)	Executive Annual Incentive Plan is incorporated by reference from our Proxy Statement for the 1997 Annual Meeting of Shareholders.
10(11)	Summary of Annual Incentive Plan is incorporated by reference from our 2000 10–K report.
10(12)	2001 Performance–Contingent Share Award Plan is incorporated by reference from our Proxy Statement for the 2001 Annual Meeting of Shareholders.
10(13)	Performance–Contingent Share Award Program is incorporated by reference from our 10–Q report for the period ended September 29, 1996.
10(14)	Deferred Compensation Plan is incorporated by reference from our 1997 10–K report.
10(15)	Non–Employee Directors' Retirement Plan (frozen as of October 1996) is incorporated by reference from our 1996 10–K report.
10(16)	Annual Retainer Unit Award Plan (for Non–Employee Directors) (frozen as of March 1, 2006) is incorporated by reference from our 10–Q report for the period ended September 29, 1996.
10(17)	Nonfunded Deferred Compensation and Unit Award Plan for Non–Employee Directors, as amended effective March 1, 2006, is incorporated by reference from our 2005 10–K report.
10(18)	Restricted Stock Plan for Non–Employee Directors is incorporated by reference from our 1996 10–K report.
10(19)	The form of change–of–control/severance agreement with each of the Named Executive Officers identified in our 2008 Proxy Statement is incorporated by reference from our 1994 10–K report.
10(20)	The form of Amendment, dated as of February 23, 2006, to change of control/severance agreements with Messrs. Kindler, LaMattina and Shedlarz is incorporated by reference from our 2005 10–K report.
10(21)	The form of Amendment, dated as of February 22, 2007, to change of control/severance agreements with Messrs. Kindler, LaMattina and Shedlarz is incorporated by reference from our 2006 Form 10–K report.
10(22)	The form of Amendment, dated as of February 22, 2007, to change of control/severance agreements with Messrs. Levin and Read is incorporated by reference from our 2006 Form 10–K report.
10(23)	The form of Indemnification Agreement with each of our non–employee Directors is incorporated by reference from our 1996 10–K report.
10(24)	The form of Indemnification Agreement with each of the Named Executive Officers identified in our 2008 Proxy Statement is incorporated by reference from our 1997 10–K report.
10(25)	Post–Retirement Consulting Agreement, dated as of April 20, 2000, between us and William C. Steere, Jr., is incorporated by reference from our 10–Q report for the period ended April 2, 2000.

10(26)	Employment Agreement, dated as of January 1, 2001, between us and Henry A. McKinnell is incorporated by reference from our 8–K report filed on February 2, 2001.
10(27)	Agreement, dated as of December 18, 2006, between us and Henry A. McKinnell is incorporated by reference from our 8–K report filed on December 21, 2006.
10(28)	Severance Agreement, dated August 22, 2007, between us and Frank A. D'Amelio and letter to Frank A. D'Amelio regarding replacement pension benefit dated August 22, 2007, are incorporated by reference from our 8–K report filed on August 22, 2007.
10(29)	Agreement dated November 1, 2007 between us and Alan G. Levin, is incorporated by reference from our 10–Q report for the period ended September 30, 2007.
10(30)	Agreement dated November 2, 2007 between us and John L. LaMattina, is incorporated by reference from our 10–Q report for the period ended September 30, 2007.
*12	Computation of Ratio of Earnings to Fixed Charges.
*13	Portions of the 2007 Financial Report, which, except for those sections incorporated by reference, are furnished solely for the information of the SEC and are not to be deemed "filed."
*21	Subsidiaries of the Company.
*23	Consent of KPMG LLP, Independent Registered Public Accounting Firm.
*24	Power of Attorney (included as part of signature page).
*31.1	Certification by the Chief Executive Officer Pursuant to Section 302 of the Sarbanes–Oxley Act of 2002.
*31.2	Certification by the Chief Financial Officer Pursuant to Section 302 of the Sarbanes–Oxley Act of 2002.
*32.1	Certification by the Chief Executive Officer Pursuant to 18 U.S.C. Section 1350, as Adopted Pursuant to Section 906 of the Sarbanes–Oxley Act of 2002.
*32.2	Certification by the Chief Financial Officer Pursuant to 18 U.S.C. Section 1350, as Adopted Pursuant to Section 906 of the Sarbanes–Oxley Act of 2002.

SIGNATURES

Under the requirements of Section 13 or 15(d) of the Securities Exchange Act of 1934, this report was signed on behalf of the Registrant by the authorized person named below.

Dated: February 29, 2008

Pfizer Inc.
By: /s/ Margaret M. Foran
Margaret M. Foran,
Senior Vice President–Corporate
Governance, Associate General Counsel
and Corporate Secretary

We, the undersigned directors and officers of Pfizer Inc., hereby severally constitute Margaret M. Foran and Allen P. Waxman, and each of them singly, our true and lawful attorneys with full power to them and each of them to sign for us, in our names in the capacities indicated below, any and all amendments to this Annual Report on Form 10–K filed with the Securities and Exchange Commission.

Under the requirements of the Securities Exchange Act of 1934, this report was signed by the following persons on behalf of the Registrant and in the capacities and on the date indicated.

Signature	Title	Date
/s/ Jeffrey B. Kindler Jeffrey B. Kindler	Chairman of the Board and Chief Executive Officer and Director (Principal Executive Officer)	February 29, 2008
/s/ Frank A. D'Amelio Frank A. D'Amelio	Senior Vice President and Chief Financial Officer (Principal Financial Officer)	February 29, 2008
/s/ Loretta . Cangialosi Loretta V. Cangialosi	Vice President – Controller (Principal Accounting Officer)	February 29, 2008
/s/ Dennis A. Ausiello Dennis A. Ausiello	Director	February 29, 2008
/s/ Michael S. Brown Michael S. Brown	Director	February 29, 2008
/s/ M. Anthony Burns M. Anthony Burns	Director	February 29, 2008
/s/ Robert N. Burt Robert N. Burt	Director	February 29, 2008
/s/ W. Don Cornwell W. Don Cornwell	Director	February 29, 2008
/s/ William H. Gray III William H. Gray III	Director	February 29, 2008
/s/ Constance J. Horner Constance J. Horner	Director	February 29, 2008

Signature	Title	Date
/s/ William R. Howell William R. Howell	Director	February 29, 2008
/s/ Suzanne Nora Johnson Suzanne Nora Johnson	Director	February 29, 2008
/s/ James M. Kilts James M. Kilts	Director	February 29, 2008
/s/George A. Lorch George A. Lorch	Director	February 29, 2008
/s/Dana G. Mead Dana G. Mead	Director	February 29, 2008
/s/ William C. Steere, Jr. William C. Steere, Jr.	Director	February 29, 2008