SERONO S A
Form 20-F
March 16, 2005

As filed with the Securities and Exchange Commission on March 16, 2005.

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

FORM 20-F

(Mark One)

o **REGISTRATION STATEMENT PURSUANT TO SECTION 12(b) OR 12(g) OF THE SECURITIES EXCHANGE ACT OF 1934**

or

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

For the fiscal year ended December 31, 2004

or

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

Commission File Number: 1-15096

SERONO S.A.
(Exact name of Registrant as specified in its charter)

Not Applicable	**Switzerland**
(Translation of Registrant's name into English)	(Jurisdiction of incorporation or organization)

15 bis, Chemin des Mines
Case Postale 54
CH-1211 Geneva 20
Switzerland
(Address of principal executive offices)

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

Title of each class:	**Name of each exchange on which registered:**
Bearer Shares, nominal value CHF25 per share	New York Stock Exchange*
American Depositary Shares (as evidenced by American Depositary Receipts), each representing one fortieth of a Bearer Share	New York Stock Exchange

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*Not for trading, but only in connection with the registration of American Depositary Shares, pursuant to the requirements of the Securities and Exchange Commission.

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

None

Securities for which there is a reporting obligation pursuant to Section 15(d) of the Act:

None

Indicate the number of outstanding shares of each of the issuer's classes of capital or common stock as of December 31, 2004.

Bearer Shares, nominal value CHF 25 per share:	10,126,741 outstanding
Registered Shares, nominal value CHF 10 per share:	11,013,040 outstanding

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.

x Yes ¨ No

Indicate by check mark which financial statement item the registrant has elected to follow.

¨ Item 17 x Item 18

Serono S.A.
Annual Report on Form 20-F
for the year ended
December 31, 2004

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The registered (®) and the filed (^{TM}) trademarks and the filed service marks (^{SM}) Canvaxin^{TM}, Cetrotide®, click.easy®, cool.click®, Crinone®, EasyJect®, Fertility LifeLines^{TM}, Ferti.net®, Fertinex®, Geref®, Gonal-f®, GHMonitor^{SM}, Howkidsgrow^{SM}, Learning for life^{TM}, Luveris®, Metrodin HP®, MSLifelines^{SM}, Mylinax ®, Novantrone®, one.click®, Ovidrel®, Ovitrelle®, Pergogreen®, Pergonal®, Profasi®, Raptiva®, Rebif®, Rebiject®, Rebiject II®, Rebiject mini®, Reliser®, Saizen®, SeroJet^{TM}, Serono®, Serophene®, Serostim®, Stilamin® and Zorbtive^{TM}, as well as the filed trademarks (^{TM}) for the "S" symbol, used alone or with the words "Serono" or "Serono biotech and beyond," are trademarks of, or are licensed to a subsidiary of, Serono S.A. Trade names and trademarks of other companies appearing in this report are the property of their respective owners.

PART I

Item 1. IDENTITY OF DIRECTORS, SENIOR MANAGEMENT AND ADVISERS

Not applicable.

Item 2. OFFER STATISTICS AND EXPECTED TIMETABLE

Not applicable.

Item 3. KEY INFORMATION

Selected Consolidated Historical Financial Data

We have derived our selected consolidated historical financial data from our consolidated financial statements. We prepare and present our consolidated financial statements in accordance with International Financial Reporting Standards or IFRS. IFRS differ in significant respects from United States Generally Accepted Accounting Principles, or U.S. GAAP. You can find a reconciliation of our audited consolidated financial statements to U.S. GAAP in Note 35 to our audited consolidated financial statements included in this Annual Report. Since the information we present below is only a summary and does not provide all of the information contained in our consolidated financial statements, you should read our consolidated financial statements and the notes to the consolidated financial statements included in this Annual Report.

	Year ended December 31,				
	2004	2003	2002	2001	2000
	(U.S. dollars in thousands, except per share data)				
Income Statement Data:					
Product sales	$ 2,177,949	$ 1,858,009	$ 1,423,130	$ 1,249,405	$ 1,146,998
Royalty and license income	280,101	160,608	114,705	127,065	92,656
Total revenues	2,458,050	2,018,617	1,537,835	1,376,470	1,239,654
Operating expenses:					
Cost of product sales	304,111	279,619	223,751	213,160	229,907
Selling, general and administrative	807,940	636,823	504,248	446,945	393,716
Research and development,	594,802	467,779	358,099	308,561	263,152
Restructuring	—	—	16,303	—	—
Other operating expense, net	227,096	199,476	85,811	70,152	31,147
Total operating expenses	1,933,949	1,583,697	1,188,212	1,038,818	917,922
Operating income	524,101	434,920	349,623	337,652	321,732
Financial income, net	63,281	44,018	36,476	51,381	52,277
Other expense, net	629	19,743	1,658	2,548	2,411
Total non-operating income, net	62,652	24,275	34,818	48,833	49,866
Income before taxes and minority interests	586,753	459,195	384,441	386,485	371,598
Taxes	90,947	68,905	63,127	69,816	70,384
Income before minority interests	495,806	390,290	321,314	316,669	301,214
Minority interests	1,653	327	536	(52)	174
Net income	$ 494,153	$ 389,963	$ 320,778	$ 316,721	$ 301,040

Per Share Data:					
Basic income per share (1)(2):					
Bearer shares	$ 32.35	$ 24.63	$ 20.07	$ 19.72	$ 19.50
Registered shares	12.94	9.85	8.03	7.89	7.80
American depositary shares (3)	0.81	0.62	0.50	0.49	0.49
Diluted income per share (1)(2):					
Bearer shares	32.29	24.59	20.04	19.68	19.46
Registered shares	12.92	9.84	8.02	7.87	7.78
American depositary shares (3)	0.81	0.61	0.50	0.49	0.49
Cash dividends paid (1)(4):					
Bearer shares	6.54	5.42	4.02	3.35	1.15
Registered shares	2.57	2.17	1.61	1.34	0.46
American depositary shares (3)	0.16	0.14	0.10	0.08	0.03
Supplemental Per Equivalent Bearer Share Data:					
Net income, basic (1)(5)	$ 32.35	$ 24.63	$ 20.07	$ 19.72	$ 19.50
Net income, diluted (1)(5)	32.29	24.59	20.04	19.68	19.46

	As of December 31,				
	2004	**2003**	**2002**	**2001**	**2000**
	(U.S. dollars in thousands, except per share data)				
Balance Sheet Data:					
Cash, cash equivalents and short- term investments	$ 1,060,978	$ 1,438,782	$ 1,064,898	$ 1,475,504	$ 1,438,485
Working capital (6)	1,183,852	1,543,933	1,139,848	1,527,359	1,505,534
Tangible fixed assets	799,878	701,453	554,509	460,767	462,425
Total assets	4,404,290	4,571,603	3,484,278	3,018,769	2,794,777
Outstanding share capital(4)	254,420	253,895	253,416	253,137	253,072
Short-term financial debts	34,527	51,224	93,598	173,254	238,585
Long-term financial debts	640,892	532,022	25,857	37,325	56,626
Shareholders' equity	2,447,878	2,880,190	2,461,198	2,218,914	2,006,416
Amounts in Accordance with U.S. GAAP:					
Net income	471,024	398,346	280,176	291,470	304,389
Basic income per share (1)(7):					
Bearer shares	30.83	25.16	17.53	18.15	19.72
Registered shares	12.33	10.06	7.01	7.26	7.89
Diluted income per share (1)(7):					
Bearer shares	30.78	25.12	17.51	18.11	19.68
Registered shares	12.31	10.05	7.00	7.24	7.87
Total shareholders' equity	2,398,311	2,855,473	2,456,683	2,239,711	2,015,860
Total assets	4,367,211	4,561,583	3,483,295	3,069,873	2,794,465
Margins and Other Data:					
Gross margin (8)(9)	86.0%	85.0%	84.3%	82.9%	80.0%
Operating margin (8)(10)	21.3%	21.5%	22.7%	24.5%	26.0%
Net margin (8)(11)	20.1%	19.3%	20.9%	23.0%	24.3%
Cash dividends paid (4)	$ 99,354	$ 85,709	$ 64,238	$ 53,759	$ 17,755
Net cash flow from operating activities	$ 471,709	$ 542,859	$ 531,982	$ 404,950	$ 255,443
Depreciation and amortization	$ 145,221	$ 135,607	$ 100,552	$ 98,906	$ 86,266
Additions to tangible fixed assets	$ 151,504	$ 185,045	$ 125,324	$ 97,131	$ 67,080
Average number of employees	4,740	4,597	4,559	4,384	4,117

	Year ended December 31,					
	2004		2003		2002	
	Sales	% Total	Sales	% Total	Sales	% Total
	(U.S. dollars in millions)					
Product sales by Region:						
Europe	$ 895.2	41.1%	$ 796.8	42.9%	$ 620.4	43.6%
North America	837.9	38.5	694.3	37.4	479.6	33.7
Middle East, Africa and Eastern Europe	196.3	9.0	151.2	8.1	107.6	7.6
Asia-Pacific, Oceania and Japan	137.5	6.3	116.9	6.3	106.3	7.4
Latin America	111.0	5.1	98.8	5.3	109.2	7.7
Total product sales	$ 2,177.9	100.0%	$ 1,858.0	100.0%	$ 1,423.1	100.0%

	Year ended December 31,					
	2004		2003		2002	
	Sales	% Total	Sales	% Total	Sales	% Total
	(U.S. dollars in millions)					
Product sales by Therapeutic Area:						
Neurology:						
Rebif	$ 1,090.6	50.1%	$ 819.3	44.1%	$ 548.8	38.6%
Novantrone	32.4	1.5	30.9	1.7	0.3	0.0
Total Neurology	1,123.0	51.6	850.2	45.8	549.1	38.6
Reproductive Health:						
Gonal-f	572.7	26.3	526.1	28.3	450.4	31.6
Cetrotide	24.8	1.1	24.8	1.3	18.4	1.3
Crinone	19.8	0.9	20.8	1.1	10.9	0.8
Ovidrel	17.7	0.8	12.4	0.7	5.7	0.4
Luveris	10.6	0.5	10.0	0.6	6.6	0.5
Core Infertility Portfolio	645.6	29.6	594.9	32.0	492.0	34.6
Metrodin HP	15.9	0.7	24.8	1.3	50.1	3.5
Pergonal	11.5	0.5	45.8	2.5	46.0	3.2
Profasi	6.7	0.3	15.4	0.9	19.8	1.4
Other products	12.6	0.7	12.0	0.6	14.0	1.0
Total Reproductive Health	692.3	31.8	692.9	37.3	621.9	43.7
Growth and Metabolism:						
Saizen	182.1	8.4	151.5	8.1	124.0	8.7
Serostim	86.8	4.0	88.7	4.8	95.1	6.7
Zorbtive	0.9	0.0	0.0	0.0	0.0	0.0
Total Growth and Metabolism	269.8	12.4	240.2	12.9	219.1	15.4
Dermatology						
Raptiva	4.9	0.2	0.0	0.0	0.0	0.0
Total Dermatology	4.9	0.2	0.0	0.0	0.0	0.0
Other products	87.9	4.0	74.7	4.0	33.0	2.3

Total product sales	$ 2,177.9	100.0%	$ 1,858.0	100.0%	$ 1,423.1	100.0%

(1) Basic and diluted per share data have been calculated net of treasury shares held on the following basis:

	Year ended December 31,				
	2004	2003	2002	2001	2000
Basic per share:					
Bearer shares	10,871,187	11,427,194	11,580,611	11,658,108	11,032,835
Registered shares	11,013,040	11,013,040	11,013,040	11,013,040	11,013,040
Equivalent bearer shares	15,276,403	15,832,410	15,985,827	16,063,324	15,438,051
Diluted per share:					
Bearer shares	10,896,618	11,452,890	11,598,155	11,687,609	11,063,889
Registered shares	11,013,040	11,013,040	11,013,040	11,013,040	11,013,040
Equivalent bearer shares	15,301,834	15,858,106	16,003,371	16,092,825	15,469,105

(2) The portion of net income allocated to bearer and registered shares was $351,655 and $142,498, respectively, for the year ended December 31, 2004, $281,459 and $108,504, respectively for the year ended December 31, 2003, and $232,381 and $88,397, respectively, for the year ended December 31, 2002. On a diluted basis, the portion of net income allocated to bearer shares and registered shares was $351,892 and $142,261, respectively, for the year ended December 31, 2004, $281,635 and $108,328, respectively for the year ended December 31, 2003, and $232,478 and $88,300, respectively, for the year ended December 31, 2002.

(3) Per share data for American depositary shares is equal to one-fortieth of the amount shown for bearer shares.

(4) Dividends for any fiscal year are generally declared and paid in the following year, after approval at the annual shareholders' meeting.

(5) Supplemental per equivalent bearer share data have been calculated on the basis of the number of total equivalent bearer shares outstanding during the applicable period, as set forth in footnote (1) above. Per equivalent bearer share information assumes the conversion of all of our outstanding registered shares into bearer shares. We believe the per equivalent bearer share information may be useful to investors in analyzing our financial results on a per share basis. Because our bearer shares and registered shares have different dividend rights, we believe that per equivalent bearer share information should be considered in conjunction with our other reported per share data in order to obtain a clear understanding of our consolidated historical per share information.

(6) Working capital means current assets less current liabilities.

(7) The portion of net income in accordance with U.S. GAAP allocated to bearer shares and registered shares was $335,196 and $135,828 respectively, for the year ended December 31, 2004, $287,510 and $110,836, respectively, for the year ended December 31, 2003, and $202,968 and $77,208, respectively, for the year ended December 31, 2002. On a diluted basis, the portion of net income allocated to bearer shares and registered shares was $335,422 and $135,602, respectively, for the year ended December 31, 2004, $287,689 and $110,657, respectively, for the year ended December 31, 2003, and $203,053 and $77,123, respectively, for the year ended December 31, 2002.

(8) These measures are not defined in IFRS or U.S. GAAP and should not be considered as an alternative to any IFRS and U.S. GAAP data. The method of calculating these measures may be different from methods used by other companies.

(9) Gross margin means gross profit divided by product sales. Gross profit means product sales less cost of product sales.

(10) Operating margin means operating income divided by total revenues.

(11) Net margin means net income divided by total revenues.

Risk Factors

We operate in a rapidly changing environment that involves a number of risks, some of which are beyond our control. You should carefully consider each of the risks and uncertainties we describe below and all of the other information in this Annual Report before deciding to invest in our bearer shares or ADSs. The risks and uncertainties we describe below are not the only ones facing our company. Additional risks and uncertainties that we do not currently know or that we currently believe to be immaterial may also adversely affect our business.

Risks Related to Technological Change and Research and Development

If technological change makes our products obsolete, we will no longer be able to sell our products and our revenues will decline

Pharmaceutical and biotechnology development is characterized by significant and rapid technological change. Research and discoveries by others, including possible developments of which we are not currently aware, may make our products and those from which we derive royalty income obsolete. If technological changes make our products obsolete, doctors will be less likely to prescribe our products, and sales of our products will be reduced. If sales of our products are reduced, our results of operations could be adversely affected.

If we are not able to develop and realize the full market potential of our current and new products, we may not be able to maintain our current level of sales growth and our stock price could decline

Our long-term growth will depend on our ability to realize the full market potential of our current products and to develop and commercialize new products. Successful biotechnology product development is highly uncertain and depends on numerous factors, many of which are beyond our control. We currently have approximately 30 post-discovery projects in preclinical or clinical development. Products that appear promising in the early phases of development may fail to reach the market for numerous reasons, including, but not limited to:

- development of products may be stopped due to a variety of reasons, such as lack of efficacy, harmful side effects and evolution of the competitive environment. For example, in July 2004, the development of emfilermin in embryo implantation failure was stopped due to inadequate efficacy in a Phase II clinical trial;

- we may not successfully complete clinical trials for our products within any specific time period, or at all, for a variety of reasons, such as our inability to attract a sufficient number of investigators, our inability to enroll and maintain a sufficient number of patients in the clinical trials and suspension of the trials by regulatory authorities;

- products may fail to receive necessary regulatory approvals. For example, in April 2003 the Committee for Proprietary Medicinal Products recommended not granting marketing authorization for our high-dose recombinant human growth hormone product, Serostim, for the treatment of AIDS Wasting in the European Union;

- products may turn out to be uneconomical to commercialize because of manufacturing costs or other factors.

These factors are important, not only with respect to new drugs, but also with respect to new indications for existing drugs, because we must obtain regulatory approval for each indication and market acceptance for various indications may vary. These factors may also lead to gaps in the product development pipeline and delays between the approval of one product and approval of the next new product.

Risks Related to Our Products and Markets

If we encounter problems with any of our key suppliers or service providers, we could experience higher costs of sales, delays in our manufacturing or loss of revenues

Other companies produce raw materials necessary for the manufacture of some of our products, as well as some of our products themselves. As a result, we are subject to the risk that some of the products we sell may have manufacturing defects that we cannot control. For example, we obtain Crinone exclusively from Columbia Laboratories. In April 2001, we announced a voluntary recall of batches of Crinone due to a manufacturing defect and suspended sales for the remainder of 2001 and the first part of 2002.

In some cases, we cite our third party sources specifically in our drug applications with regulatory authorities and accordingly we must obtain those materials or products as specified. We also use subcontractors for certain services, and in some cases the subcontracts are with sole- or limited-source suppliers. For example, Owen Mumford is the exclusive provider of the injection device Rebiject for use with Rebif, our largest product. Our subcontractors may also be registered with the regulatory authorities, so we would have to obtain regulatory approval in order to use a different subcontractor. If such services were no longer available at a reasonable cost from those suppliers, we would need to find new subcontractors.

If our suppliers experience manufacturing defects or if we have to find and register alternative raw material, product or service suppliers, we may experience significant delays in our ability to manufacture or sell our products and incur significant expense or fail to realize significant revenues.

We may encounter unexpected difficulties in the design and construction of production facilities and the scale-up of production to viable commercial levels

In order to manufacture a product candidate commercially, we require access to large-scale production facilities. We may encounter unexpected difficulties in the design and construction or adaptation of production facilities and the scale-up of production to viable commercial levels. These difficulties could result in substantial additional costs or affect the commercial viability of a product candidate. We are particularly at risk of encountering these difficulties in the manufacture of biological products, which are inherently more difficult to produce than chemical compounds.

We face growing and new competition that may reduce our likelihood of market success

We operate in a highly competitive environment. This competition may become more intense as commercial applications for biotechnology products increase. Our principal competitors are pharmaceutical companies, pharmaceutical divisions of chemical companies and biotechnology companies. Some of our competitors have greater clinical, research, regulatory, financial and marketing resources than we do and may be able to market competing products earlier than we do or market products with greater efficacy, fewer side effects or lower cost than ours. For example, the approval and launch of natalizumab (Tysabri) in the United States by Biogen Idec and its partner Elan in November 2004 is an indication of increasing competition in the field of multiple sclerosis.

Small biotechnology companies, academic institutions, governmental agencies and other public and private research organizations conduct a significant amount of research and development in the biotechnology field. These entities may seek patent protection and enter into licensing arrangements to collect royalties for the use of technology they have developed. We face competition in licensing activities from pharmaceutical companies, pharmaceutical divisions of chemical companies and biotechnology companies that also seek to acquire technologies from the same entities. If we are not able to compete effectively with these entities to acquire the technology we need to develop new products, we may not be able to maintain our current level of sales growth and our stock price could decline.

We may be required to revise the labeling for our products from time to time

We may be required to change the labeling for our products for a variety of reasons, such as to include new safety or efficacy data from clinical trials or post-marketing surveillance, to reflect experiential use following a period of commercialization, or to be in keeping with evolving regulatory or clinical environments. Prescribers of our products may interpret such changes in various ways that could influence their decisions on initiation, further use or discontinuance of these products. If prescribers interpret changes in the labeling of our products in ways that cause them to decrease or cease prescribing those products, we may not be able to continue our current level of sales growth and our stock price could decline.

Resale of our biotechnology products within the European Union may cause our sales and gross profit margin to decline

In an effort to create a single economic sphere and reduce barriers to the mobility of commercial products, the European Union has interpreted its competition and patent laws to permit the resale of various products, including biotechnology products. In 2004, $895.2 million (41.1%) of our product sales were in Europe. Once we place our products in the stream of commerce in the European Union, we have limited ways of preventing third-party distributors from re-packaging, and then reselling, our products in any other country of the European Union. However, our prices vary across the European Union, principally as a function of different government policies regarding product pricing and reimbursement. Third-party distributors may purchase our products in markets within the European Union where our prices are lower, and then re-sell our products in countries where prices are higher. As a result, we face competition from third-party distributors that resell our products into these latter countries. We do not have the right to be the exclusive seller of our products within the European Union, nor do our patent rights protect us from third-party distributors re-selling our products in this manner. As a result, we cannot prevent a shift in sales to markets in which we realize lower unit sales prices for our products. If we sell a larger percentage of our products into these markets, our sales and gross profit margin will decline. We bear a similar risk to the extent that our products may be imported into the United States from Canada.

Competition from non-approved uses and generic drugs could reduce our sales growth

We face competition from generic products and products sold for non-approved uses. For example, Serostim faces competition from drugs prescribed for non-approved indications. Physicians may prescribe anabolic steroids or competing human growth hormone products to treat AIDS Wasting although, as indicated by their labeling, regulators have not approved these products for this indication. In addition, producers of generic products may receive approval for the sale of their drugs by relying on the registration files of products already granted regulatory approval. Because producers of generic products do not have to incur the costs necessary to go through the full drug development process to prove that their products are safe and effective for these indications, they can afford to sell their products at lower prices than products like ours which have gone through that process. It is possible that our products will lose market share to these alternative therapies and that therefore we may not be able to maintain our current level of sales growth and our stock price could decline.

We may also face competition from the introduction of biosimilar products in Latin America and in Asia. These are not generic versions of Rebif as the exact formulation for Rebif is highly dependent on our well-established manufacturing process. In the United States and in Europe, regulatory agencies have so far recognized the need for clinical testing of biosimilar products to establish both efficacy and safety. However, in Latin America (Mexico and Argentina) licenses for biosimilar products were granted in the fourth quarter of 2004. Although biosimilar products are not proven and supply may be restricted, we expect there will be some impact on Rebif sales in these regions.

Sales of counterfeit products may damage our reputation and cause customers to lose faith in our products

As a manufacturer of biotechnology products, we are subject to the risk that third parties will attempt to create counterfeit versions of our products and sell the counterfeits as our products. For example, in January 2001 and again in May 2002, we discovered that a counterfeit product was being sold as Serostim in the United States. Counterfeit products are not approved by regulatory authorities and may not be safe for use. If any counterfeit products are sold as ours, our reputation could suffer and patients could lose faith in our products. In addition, our products could be subject to recall in the event of counterfeit sales. If patients lose faith in our products or we are forced to recall any of our products as a result of the counterfeiting of those products, our sales could decline.

Risks Related to Our Sources of Revenue

If our sales of any of our major products decline, our profitability would be reduced

In 2004, Rebif, our recombinant beta interferon, accounted for 50.1% ($1,090.6 million) of our total product sales. Rebif faces competition from Avonex and Betaseron, other recombinant beta interferon products, from Copaxone (glatarimer acetate), another drug used in multiple sclerosis, and from Tysabri (natalizumab). Because our business is highly dependent on Rebif, a reduction in revenue from sales of Rebif would have a significant impact on our overall profitability. Further, in 2004, Gonal-f, our recombinant follicle stimulating hormone, accounted for 26.3% ($572.7 million) of our total product sales. Gonal-f faces competition from Puregon (marketed in the United States as Follistim), another recombinant product, and a variety of other FSH products. Because our business is highly dependent on Gonal-f, a reduction in revenue from sales of Gonal-f would have a significant impact on our overall profitability.

Our revenues are dependent on reimbursement from third-party payers who could reduce their reimbursement rates

In most of our markets, sales of our products are or may be dependent, in part, on the availability of reimbursement from third-party payers. These payers include state and national governments, such as the health systems in many European Union countries and Medicaid and Medicare programs in the United States, and private insurance plans.

When a new product is approved, the reimbursement status and rate for the product is uncertain and must be negotiated with third-party payers in each European country, a process that can take up to several years. In addition reimbursement policies for existing products may change at any time. Changes in reimbursement rates or our failure to obtain and maintain reimbursement for our products may reduce the demand for, or the price of, our products and result in lower product sales or revenues. For example, in January 2004 the Federal Republic of Germany, Europe's largest pharmaceutical market, announced an across-the-board reduction of 10% in reimbursement rates for all pharmaceuticals, including our products.

In certain markets, the pricing and reimbursement of our products are subject to government controls. In Europe, some third-party payers link the reimbursement price to maximum quantities of the product sold in a given year. Single payer medical insurance systems, which are predominant in Europe, are under increasing financial strain, which creates an incentive to decrease the amount that such systems will pay to reimburse the cost of drugs. In the United States, there have been, and we expect there will continue to be, a number of state and federal proposals that limit the amount that state or federal governments will pay to reimburse the cost of drugs, and we believe the increasing emphasis on managed care will put pressure on the price and usage of our products, which may impact product sales. For example, in 2001 and 2002 many states in the United States imposed prior authorization requirements for the purchase of certain drugs under Medicaid, including Serostim. Not all jurisdictions recognize the importance of infertility treatment and accordingly do not offer reimbursement coverage for such treatment. In addition, in some countries the extent of reimbursement may be affected by local public policy and ethical concerns about certain therapies, such as in vitro fertilization.

Third-party insurance coverage may not be available to patients for products we discover and develop. If third-party payers do not provide adequate coverage and reimbursement levels for our products, the market acceptance of these products may be significantly reduced.

We may have difficulty successfully integrating acquired businesses with our operations

From time to time, we may acquire businesses. We may not be able to successfully implement integration plans, dispose of certain non-core businesses, or profitably manage those businesses. We may not realize the expected synergies of acquisitions.

A significant percentage of our net income is dependent on royalty and license payments that are beyond our control

We derive a significant percentage of our net income from royalty and license income. Our royalty and license income was $280.1 million in 2004 and $160.6 million in 2003, relating primarily to royalties received from Biogen Idec on its sales of Avonex, Organon on its sales of Puregon, Amgen (formerly Immunex) on its sales of Enbrel, and Abbott on its sales of Humira. In addition to ongoing royalty payments, we also receive periodic milestone payments and other revenues pursuant to contracts related to our intellectual property. Our receipt of these payments is largely dependent on the successful development and sale of products by other companies over which we have no control or against which we compete. In addition, some of these revenues are dependent on patents that may be invalidated or expire. If these parties are not successful at developing and selling their products or our underlying patents are no longer in force, our net income could decline.

Our investment income is unpredictable and the value of our investments may decline in the future

Our financial assets include deposits with prime banks, investments in short-term money market funds and rated bonds with a life to maturity of up to three years. The income generated by these assets is sensitive to movements in interest rates and, in the case of the rated bonds, the realizable value of the investment also can be influenced by movements in the market price related to the underlying asset. For example, a decrease in short-term U.S. dollar interest rates would have a direct impact on the revenue generated by our bank deposits and money market funds. An increase in longer-term interest rates would negatively impact the fair value of our longer-term bond investments. Similarly, a rating downgrade or change in the market's perception of risk can lead to a reduction in the fair value of our bond investments. For example, our 2003 net financial income ($36.9 million) was lower than our 2002 net financial income ($54.0 million) due to a low interest rate environment and the maturity during the latter period of longer-term bond investments with higher rates of interest. Although our 2004 net financial income ($44.1 million) was higher than in 2003, we cannot predict how interest rates and other factors that affect net financial income will change in the future. For example, if interest rates continue to stay low or fall further, our net

financial income may be reduced when compared to previous periods.

We have a number of minority participations in listed and unlisted companies that are usually, but not always, related to collaborative agreements with the respective company. The value of the unlisted investments can be difficult to assess, and changes in the market value of the listed investments can have an impact on our income. For example, in the fourth quarter of 2003, we took a non-cash charge of $16.1 million related to the write-down of our equity investment in Swiss International Air Lines.

Foreign exchange fluctuations could significantly impact the U.S. dollar value of our revenues and expenses

Our operations are conducted by subsidiaries in many countries, and the results of operations and the financial position of each of those subsidiaries are reported in the relevant currency and then translated into U.S. dollars at the applicable exchange rate for inclusion in our consolidated financial statements. As a result, our reported sales figures may differ substantially from our sales figures as measured in local currencies. For example, in 2004 our sales growth was 11.5% in local currencies, but 17.2% as reported in U.S. dollars. Due to this translation effect, the prevailing foreign exchange rate could cause our sales growth rates to not meet expectations. If our sales figures do not meet market expectations, our stock price could decline.

Conversely, our reported expenses may also differ substantially from our expenses as measured in local currencies. For example, in 2004 our expenses growth was 22.1% as reported in U.S. dollars, but 16.3% in local currencies. Due to this translation effect, the prevailing foreign exchange rate could cause our net income growth rate to not meet expectations. Again, if our sales figures do not meet market expectations, our stock price could decline.

Risks Related to Government Regulation

Governmental regulations may restrict our ability to sell our products, which could result in a loss of revenues and a decrease in our stock price

Our research, preclinical testing, clinical trials, facilities, manufacturing, labeling, pricing, and sales and marketing are subject to extensive regulation by numerous governmental authorities, including authorities in the European Union (such as the European Medicine Agency or EMEA) and Switzerland, as well as governmental authorities in the United States, such as the Food and Drug Administration, or FDA. Our research and development activities are subject to laws regulating such things as laboratory practices and the use and disposal of potentially hazardous materials including radioactive compounds and infectious disease agents. We are also required to obtain and maintain regulatory approval to market products for approved indications in the European Union, the United States, Japan and other markets. Obtaining regulatory approval is a lengthy and complex process. For example, though we have obtained regulatory approval to sell Gonal-f in 95 countries including the United States and the countries of the European Union, in order to obtain regulatory approval to sell the product in Japan we have been required to conduct additional local clinical studies, which will delay potential registration of Gonal-f in this market. Even if we are able to obtain regulatory approval for our products, both our manufacturing processes and our marketed products are subject to continued review. Later discovery of previously unknown problems with the safety or efficacy of our products or manufacturing processes may result in restrictions on these products or processes, including withdrawal of the products from the market or suspension of our manufacturing operations. For example, in February 2003, the Committee on Safety of Medicines advised that Metrodin HP should no longer be used in the United Kingdom. The Committee based its advice on the precautionary principle that products manufactured from human urine sourced from a country with one or more cases of variant Creutzfeldt-Jakob Disease, or vCJD, should not be used whenever practicable. Metrodin HP was manufactured from urine sourced from Italy, and the withdrawal of Metrodin HP from the United Kingdom market was a precautionary measure following the confirmation of a case of vCJD in Italy. In February 2005, the United States Department of Health and Human Services announced the establishment within the FDA of a new Drug Safety Oversight Board to monitor FDA-approved medicines once they are on the market and update physicians and patients with emerging information on risks and benefits. Any adverse report by this Board with respect to our products could have an effect on our product sales, profits and stock price.

Pharmaceutical usage guidelines may recommend lower use of our products

If government agencies or other respected groups or organizations recommend reducing the use of one of our products, our sales of that product could drop and our revenues could be reduced. In addition, professional societies, practice management groups, private foundations and organizations involved in various diseases may also publish

guidelines or recommendations to the health care and patient communities. These organizations may make recommendations that affect a patient's usage of certain therapies, drugs or procedures, including our products. Such decisions may also influence prescription guidelines for our products issued in other countries. Recommendations or guidelines that are followed by patients and health care providers could result in, among other things, decreased use of our products. For example the National Institute for Clinical Excellence (NICE) in the U.K. systematically issues guidelines in selected therapeutic areas which may limit prescription of our products.

Potential regulation of the use of biological materials could make production of our products more expensive or not possible

We use biological materials, in particular animal-derived materials, in the development and manufacture of our products. Some interest groups in the European Union and the United States are seeking to ban or regulate the use of animal-derived materials generally, including their use in biotechnology products and for research and development.

Although we are developing manufacturing processes for our major molecules that will be free of animal-derived components, we may not be successful in that development and we cannot be certain that regulatory authorities will approve the new processes. If a government were to ban or regulate our use of animal-derived materials, we would incur additional costs that could make the production of our products less profitable or economically impractical, or we could have to cease production of certain of our products, which could cause our net income and stock price to decline.

Risks Related to Legal Uncertainty

If we are not able to defend our intellectual property rights, we may lose the competitive advantage they give us

Our long-term success depends largely on our ability to market technologically competitive products. The patents and patent applications relating to our products and the technologies from which we derive license revenue may be challenged, invalidated or circumvented by third parties and might not protect us against competitors with similar products or technology. Any challenge to or invalidation or circumvention of patents related to products produced using licenses we have granted could affect our licensing revenues. If we are unable to prevent unauthorized third parties from using proprietary rights relating to our products, we will not be able to realize the full value of our research investment, and we will lose a source of competitive advantage. Even if our patents are not invalidated or circumvented, each of them will eventually expire.

The competitive position of a number of our products is dependent on various patents. We believe that these patents discourage other companies from entering our markets. Certain of these patents also allow us to realize licensing revenue from competitors whose products would otherwise infringe these patents. If we cannot defend these patents, other companies could sell products that directly compete with our products.

Moreover, the patent positions of pharmaceutical and biotechnology companies can be highly uncertain and involve complex legal and factual issues. Important legal issues remain to be resolved as to the extent and scope of available patent protection for biotechnology products and processes in the European Union, the United States and other important markets. To date, no consistent policy has emerged regarding the breadth of claims allowed in pharmaceutical and biotechnology patents. As a result, it is difficult for us to assess the amount of protection our patents provide for our competitive position.

We rely on trade secrets and trademarks to protect our technology, especially where we believe patent protection not to be appropriate or obtainable. We protect our proprietary technology and processes, in part, by confidentiality agreements with our key employees, consultants, collaborators and contractors. These agreements may be breached, or we may have inadequate remedies for any breach, or our trade secrets or those of our collaborators or contractors may otherwise become known to or be discovered independently by competitors.

If we do not have access to the intellectual property we need for our business, our ability to develop and market our products may be limited

We are aware that others, including various universities and companies working in the biotechnology field, have filed patent applications and have been granted patents in the European Union, the United States and other jurisdictions claiming subject matter potentially useful or necessary to our business. Some of those patents and applications claim only specific products or methods of making such products, while others claim more general processes or techniques useful or now used in the biotechnology industry, either alone or in combination with other products. For example, Berlex Laboratories and Schering AG own three U.S. patents that they have asserted cover the recombinant manufacture of interferon beta. Following the filing by us of a declaratory judgment action against Berlex and Schering AG asserting that we do not infringe their patent rights, we settled with them and agreed to make a one-time payment to Berlex and pay Berlex royalties on our U.S. sales of Rebif in the United States for a limited period of time.

Litigation and administrative proceedings, which could result in substantial costs to us, may be necessary to enforce any patents issued to us or to determine the scope and validity of third-party proprietary rights. We have in the past been, are currently, and may in the future be involved in patent litigation. If we lose one of these proceedings, we may be required to obtain third-party licenses at a material cost or cease using the technology or product in dispute. If others have or obtain patents or proprietary rights with respect to products we currently are developing, we may not be able to continue to research and develop our products profitably. If we are unable to enforce our patents, we may lose competitive advantage or marketing revenue.

If we are subject to significant legal action or to a government investigation, we may incur substantial costs related to pursuing or settling such litigation or investigation

We participate in an industry that has been subject to significant product liability, intellectual property and other litigation and to government investigations. Many of these actions involve large claims and significant defense costs. For example, our principal U.S. subsidiary has received subpoenas from the U.S. Attorney’s office in Boston, Massachusetts, relating to Serostim. The outcome of this investigation could include the imposition of substantial civil and/or criminal penalties that could be material to us, including exclusion from government reimbursement programs. For a further description of this matter, please see “Item 8—Legal Proceedings.”

Changes in tax laws could adversely affect our earnings

Changes in the tax laws of Switzerland, the United States or other countries in which we do significant business, as well as changes in our effective tax rate for the fiscal year caused by other factors, could affect our net income. During 2004, no major tax legislation was enacted that would materially impact our net income. It is not possible to predict the impact on our results of any tax legislation that may be enacted in the future.

Risks Related to Our Share Price and Corporate Control

Our share price is likely to be volatile and may decline

The market price for our shares has been volatile and may continue to be volatile in the future. During 2004, based on prices on the virt-X, our bearer share price ranged from CHF 711 to CHF 974. During the same period, based on prices on the New York Stock Exchange, the price range for our ADSs ranged from $14.57 to $19.60. The following factors, in addition to other risk factors described in this section, may have a significant impact on the market price of the shares and may cause the price to decline:

Ÿa revenue shortfall, which, due to fixed near-term expenses, causes a period’s results to be below expectations;

- Ÿ a short-term increase in expenses that is not matched by a corresponding increase in revenue;
- Ÿ changes in wholesaler buying patterns;
- Ÿ publicity regarding our collaborations and actual or potential results relating to products and indications under development by us or our competitors;
- Ÿ regulatory developments in the countries in which we operate;

- Ÿ public concern as to the safety of our products;
- Ÿ perceptions as to the prospects of our company;
- Ÿ perceptions as to the prospects of our competitors and the biotechnology industry in general;
- Ÿ general market conditions;
- Ÿ changes in the exchange rate of the U.S. dollar against the euro and the Swiss franc; and
- Ÿ period-to-period fluctuations in our financial results.

The value of dividends on our ADSs will be affected by exchange rates

We declare and pay dividends on our bearer shares in Swiss francs. Exchange rate fluctuations between the Swiss franc and the U.S. dollar will affect the U.S. dollar value of dividends that holders of our ADSs will receive.

Our controlling shareholders may have interests that are adverse to yours

As of December 31, 2004, Bertarelli & Cie held 51.43% of our capital, including treasury shares, and 65.36% of our voting rights. Ernesto Bertarelli, our Vice Chairman, Managing Director and Chief Executive Officer, controls Bertarelli & Cie. In addition, Maria-Iris Bertarelli, Ernesto Bertarelli and Donata Bertarelli Späth own as individuals in the aggregate 7.00% of our capital, including treasury shares, and 10.53% of our voting rights. The members of the Bertarelli family may in the future, through open market purchases or otherwise, acquire additional shares. Ernesto Bertarelli, through his control of Bertarelli & Cie and his ownership of additional shares, currently controls the management of our company and the outcome of all actions requiring the approval of our shareholders. The interests of Ernesto Bertarelli and the Bertarelli family may conflict with the interests of our other investors, and you may not agree with the actions they take. For example, Mr. Bertarelli and the Bertarelli family have the combined voting power necessary to reject any offer to acquire us, even if the offer would be attractive to our other investors. In addition, Mr. Bertarelli and the Bertarelli family control enough votes that they can cause us to increase our share capital, change our corporate purposes and create shares with privileged voting rights. This could have the effect of diluting the voting rights and ownership of our other investors and of maintaining the control of Mr. Bertarelli and the Bertarelli family.

Future sales by current shareholders could cause the price of our shares to decline

If our existing shareholders sell a substantial number of our shares in the public market, the market price of our shares could fall. Subject to applicable Swiss law, United States federal securities laws and other applicable laws, the Bertarelli family may sell or distribute any and all of the shares owned by them. Sales or distributions by the Bertarelli family of substantial amounts of our capital stock, or the perception that such sales or distributions could occur, could adversely affect prevailing market prices for our shares. The Bertarelli family is not subject to any contractual obligation to retain its controlling interest.

It may not be possible to enforce judgments of United States courts against the members of our board of directors

We are a Swiss stock corporation. Most of our directors are not residents of the United States. In addition, a substantial portion of our assets and the assets of our board members are located outside the United States. As a result, it may not be possible to effect service of process within the United States on us or on our directors, or to enforce against them judgments obtained in the United States courts based on the civil liability provisions of the securities

laws of the United States. In addition, awards of punitive damages in actions brought in the United States or elsewhere may be unenforceable in Switzerland.

U.S. persons may not be able to participate in some of our securities offerings

United States securities laws may restrict the ability of U.S. persons who hold our ADSs from participating in certain rights offerings, share dividends or other transactions involving our securities that we may undertake in the future. We are not under any obligation to register any such transactions under the U.S. securities laws.

Our actual results may differ from forward-looking statements that we make in this annual report

Many statements made in this Annual Report under Items 3, 4 and 5 and elsewhere are forward-looking statements relating to future events and/or future performance, including, without limitation, statements regarding our expectations, beliefs, intentions or future strategies that are signified by the words ‘‘expects,’’ ‘‘anticipates,’’ ‘‘intends,’’ ‘‘believes,’’ “plans” or similar language. Our actual results could differ materially from those anticipated in these forward-looking statements as a result of, among other factors, the factors set forth in this “Risk Factors” section.

We caution you that these forward-looking statements, which may deal with subjects such as our research and development plans, our marketing strategies, our planned regulatory approvals, our planned relationships with our research collaborators, the development of our business, the markets for our products, our anticipated capital expenditures, the possible impacts of regulatory requirements and other matters that are not historical facts, are only predictions and estimates regarding future events and circumstances. All forward-looking statements included in this document are based on information available to us on the date of this Annual Report, and we undertake no obligation to update these forward-looking statements to reflect events occurring after the date of this Annual Report. You should carefully consider the information set forth in this section in addition to the other information set forth in this Annual Report before deciding whether to invest in our bearer shares or ADSs.

Item 4. INFORMATION ON THE COMPANY

Overview

We are the third largest biotechnology company in the world based on 2004 total revenues of $2,458.1 million. Biotechnology companies use human genetic information to discover and manufacture therapeutic products for the treatment of human diseases. We currently focus on the highly specialized markets of reproductive health, neurology, growth and metabolism, where we have established strong positions, and on the dermatology market, which we entered, in 2004. We have a global presence with operations in over 40 countries, five principal production facilities located in four countries, sales in over 90 countries and 4,902 employees.

As a biotechnology company, research and development are central to our efforts to grow our business. We currently employ 1,387 research and development personnel, and in 2004 we spent $594.8 million on R&D. Our in-house R&D capabilities, which span a variety of disciplines, and our numerous external collaborations enhance our ability to develop new medications. We currently have approximately 30 high priority projects in preclinical or clinical development.

We have integrated operations that allow us to manufacture and market the products we derive from our R&D efforts. The use of biotechnology techniques has allowed us to improve our manufacturing efficiency and helped us to increase our product gross margin to 86.0% in 2004 from 67.7% in 1995 and to increase our net margin to 20.1% of revenues in 2004 from 4.2% in 1995.

Our 2,084 sales and marketing personnel sell our products primarily by calling on prescribing physicians in our highly specialized markets.

We are a Swiss corporation, with our principal executive offices in Geneva. We were incorporated in 1987, and our bearer shares have been listed in Switzerland since that time. Our American depositary shares or ADSs have been listed on the New York Stock Exchange since July 2000.

Our principal offices are operated by our wholly owned subsidiary, Serono International S.A., and are located at 15 bis, Chemin des Mines, Case Postale 54, CH-1211 Geneva 20, Switzerland. Our telephone number is +41-22-739-3000. We have established a Website at www.serono.com. The information on our Website is not part of this Annual Report.

Recombinant Technology

We currently market eight recombinant products— Rebif, Gonal-f, Saizen, Serostim, Ovidrel, Luveris, Zorbtive and Raptiva. Recombinant DNA technology gives us an efficient, cost-effective and consistent method of producing commercial quantities of proteins.

Proteins are important components of human cells and have various biological functions, and some proteins have been developed as therapeutics. Historically, we obtained proteins relevant to our therapeutic areas by extracting them from natural sources, such as human urine or pituitary tissue, and then purifying them. These processes have presented several challenges in terms of identifying suitable sources and economically collecting a sufficient amount of the raw materials for production.

Using recombinant technology, we now clone, or copy, the human gene containing instructions for the synthesis of a protein product and transfer it to a host cell. We then induce the host cell to produce commercial quantities of that protein. When using recombinant technology to produce pharmaceuticals, the choice of host cell is important. Recombinant DNA technology can be used to transfer genetic information into bacterial, yeast, mammalian or other

cell types. If bacterial, yeast and certain other cells are used for recombinant drug production, certain complex protein molecules may not be able to be produced in their natural forms, rendering the molecules unstable, or biologically less active or even inactive. However, mammalian host cells can produce molecules as they are made in the natural environment. All of our recombinant products are currently produced using mammalian cell technology.

Recombinant technology allows us to solve many of the problems associated with production of complex pharmaceuticals through extraction from natural sources. Because of the nature of recombinant production, we can closely control the quality and purity of the products and more easily achieve batch-to-batch consistency. In addition, we are not as dependent on difficult-to-organize raw material supply chains, so we are able to more quickly respond to changes in market demand for our products.

Neurology

Multiple sclerosis, or MS, is a chronic and often progressive debilitating disease of the central nervous system that primarily affects young adults. It is an autoimmune disease in which the body's immune system reacts against its own cells, thereby destroying the myelin sheath that protects the axons in the central nervous system. Damage to the myelin sheath impedes the normal transmission of nervous impulses. These interruptions of transmission cause motor and sensory difficulties. The progress of the disease is highly variable. However, in its most severe forms, MS leads to rapidly progressive disability and death.

Over one-half of the world's estimated 1.2 million people with MS suffer from the relapsing-remitting form of this disease, or RRMS, and nearly 80% of all MS cases start with RRMS.

RRMS patients suffer from relapses or exacerbations, which are unpredictable occurrences of new symptoms or worsening of old symptoms punctuated by remissions. In the majority of cases patients progress from RRMS into secondary progressive MS, or SPMS, as they start to accumulate disability. In the early stages of SPMS patients continue to have relapses and, together with RRMS patients, are sometimes described as having relapsing MS, or RMS. Additionally patients in the early stages of the disease, prior to a diagnosis of RRMS, may also sometimes be classified as having RMS.

We estimate that the treatment of relapsing MS with disease modifying drugs was an approximately $4.4 billion global market in 2004, based on publicly reported sales data for our product and four competing products.

Products

Rebif

Rebif is a recombinant interferon beta-1a that helps strengthen the body's immune system. It is identical to the interferon beta that the human body produces in certain circumstances, for example, in response to viral infection. Interferons fight viruses, inhibit cell multiplication and regulate the activity of the immune system. Because of their complex effects on the immune system, interferons may have important therapeutic potential in other indications.

We developed Rebif for the treatment of MS, and we currently manufacture and market it for use in the RRMS and RMS indications. In 2004, Rebif was our largest selling product, accounting for $1,090.6 million (50.1%) of total product sales. We began marketing Rebif in the United States in March 2002. In 2004, our estimated market share in the United States in terms of total prescriptions was 16.4% and 18.6% in new prescriptions.

In November 1998, we published the results of the Prevention of Relapses and Disability with Interferon beta-1a Subcutaneously in Multiple Sclerosis, or PRISMS, study in the *Lancet*. The study showed that Rebif is the first therapeutic agent to demonstrate efficacy on all major endpoints in MS (disability, relapses, MRI area and activity). In this study, 560 RRMS patients were given one of two doses of Rebif or a placebo. The results of the trial showed that Rebif reduces the number of relapses experienced by patients and delays the rate at which patients become disabled (as measured by a confirmed 1-point Expanded Disability Status Scale, or EDSS, progression). In addition, brain scans showed that the number of multiple sclerosis lesions is reduced by Rebif (as measured by a reduction in the T2 disease burden).

In June 2001, four-year data from the study were published in *Neurology* and showed that the higher of the two doses tested (44 mcg three times per week) was associated with better efficacy than the lower dose (22 mcg three times per week). In the first quarter of 2001, the European Union granted marketing approval for the highest available dose of Rebif as a first line therapy for patients with RRMS.

This research has since been followed by the publication of the Secondary Progressive Efficacy Clinical Trial of Rebif in MS, or SPECTRIMS study, in the June 2001 issue of *Neurology*. This study suggests that the rate of progression of disability in patients is reduced if Rebif is administered in the early stages of secondary progressive multiple sclerosis (in patients who continue to experience relapses) as opposed to later stages of the disease.

During 2001, we completed a study involving 677 patients in a head-to-head trial comparing the high dose of Rebif with the standard dose of our competitor's product, Avonex. The Evidence for Interferon Dose-effect: European-North American Comparative Efficacy Study, or EVIDENCE, was at the time the largest prospective comparative study of two disease-modifying drugs in MS. The objective of the study was to compare the clinical benefit of Rebif and Avonex based on pre-defined FDA-approved endpoints. We conducted the study with the concurrence of the FDA regarding its design, primary and secondary endpoints and the prospectively defined statistical analysis plan. The study showed that 32% fewer patients treated with Rebif had relapses compared to patients treated with Avonex during a six-month treatment period. In March 2002, the FDA approved Rebif on the basis that it had been shown to be clinically superior in the reduction of exacerbations at 24 weeks. 48-week data from the EVIDENCE study showed that 62% of patients who received Rebif did not have a relapse compared to 52% of Avonex-treated patients. Rebif patients had a 19% relative increase in remaining free of relapses over the 48 weeks compared to Avonex patients. Rebif patients also had a 30% reduction in the rate of occurrence of first relapse during 48 weeks relative to Avonex patients. The 12-month data from the EVIDENCE study, which showed the superiority of Rebif 44 mcg three times per week over Avonex 30 mcg once per week in reducing exacerbations, were published in the November 2002 issue of *Neurology.*

In May 2003, we and Pfizer announced that the final 63-week findings from the EVIDENCE study continue to show that Rebif is significantly more effective in reducing frequency of relapses and magnetic resonance imaging, or MRI, activity as compared to Avonex. Final 63-week data from the EVIDENCE study showed that 56% of patients who received Rebif did not have a relapse during this observation period compared to 48% of Avonex patients. Rebif patients had a 17% relative increase in remaining free of relapses over the 63 weeks compared to Avonex patients. These data further support the benefit of increased dose and frequency of interferon administration in the treatment of relapsing forms of MS. The findings are consistent with data comparing Rebif and Avonex at 24 and 48 weeks.

At the conclusion of the comparative phase of the EVIDENCE study, patients randomized to Avonex were offered our MS therapy, Rebif. Approximately 73% of Avonex patients (n=223) chose to convert to Rebif. In June 2003, we reported that patients who converted from Avonex to higher dose, higher frequency Rebif showed a significant reduction in frequency of relapses and MRI lesion activity. Following their change in therapy, these patients experienced a 50% relative reduction in the frequency of relapses ($p<0.001$) and a 22% relative reduction in MRI lesion activity ($p=0.022$) compared to the previous six months.

In September 2003, we presented new data from a long-term assessment of a group of patients with RRMS on Rebif therapy. The eight-year extension data come from an open-label follow-up of the PRISMS study, a double-blind, placebo-controlled study that began in 1994 and involved 560 patients at 22 centers in nine countries. Patients were originally randomized to receive Rebif 44 mcg subcutaneously three times per week, Rebif 22 mcg subcutaneously three times per week or placebo. 381 patients (67% of the original cohort) were followed up after eight years. The results support the long-term benefit of Rebif 44 mcg subcutaneously three times weekly in the treatment of RRMS on relapses, disability and MRI outcomes measured, with a favorable risk benefit profile through eight years.

In October 2004, we presented data from a prospective pre-planned crossover analysis of the PRISMS study showing that patients with RRMS who were treated for two years with placebo and then treated for two years with Rebif showed substantial clinical benefits with a 54% relative reduction in relapse rate. The data also showed a significant improvement in MRI results for patients treated with Rebif 44 mcg. There was a highly, statistically significant relative reduction in the mean number of brain lesions of 67%. In addition, 76% of patients treated with Rebif 44 mcg remained free of disease progression during the two years of treatment.

In January 2004, we initiated a post-registration head-to-head study of Rebif versus Copaxone (glatiramer acetate) given at approved doses. The objective of the trial is to compare the safety and efficacy of Rebif and glatiramer acetate in RRMS patients to obtain data that will support an evidence-based approach to rational treatment decisions in MS. The study design is a two-year study with a relapse-related primary endpoint as well as other clinical and MRI secondary endpoints. The doses of study drugs are the standard doses of Rebif (44 mcg three times per week) versus glatiramer acetate (20 mg daily) both given by subcutaneous injection. In January 2005, we announced the completion of patient enrolment into this study with over 700 patients enrolled.

In May 2004, we announced the launch of the Rebiject II auto-injector, a device specifically designed to make self-injection of Rebif more convenient for MS patients on Rebif therapy, in Europe and we launched Rebiject II in the United States at the end of 2004. A study conducted in 115 patients with MS on Rebif therapy showed that 71% of those patients found the Rebiject II was better than their previous autoinjection method of injection, with patients indicating that injections using the Rebiject II were less painful and that the Rebiject II was easier to use than their previous autoinjection method of injection.

We have registered Rebif for the treatment of MS in 87 countries, including the United States, Canada, Australia, and all of the countries of the European Union.

Novantrone

In December 2002, we completed a license and commercialization agreement with Amgen, pursuant to which we acquired the rights to sell the MS and oncology drug Novantrone in the United States. Novantrone is a topoisomerase II inhibitor, which acts by inhibiting DNA replication in dividing cells. The drug is approved in the United States for secondary progressive, progressive relapsing and worsening relapsing-remitting MS and for certain forms of cancer. Novantrone has orphan drug status in the United States for use in patients with the approved MS indications until October 2007. In March 2003, we entered into an agreement with OSI Pharmaceuticals pursuant to which OSI markets and promotes Novantrone in the United States for its approved oncology indications. Novantrone is strategic for our neurology franchise in the United States as it is complementary to Rebif and allows us to leverage investments made in our neurology infrastructure. In 2004, Novantrone was our fifth largest selling product, accounting for $83.9 million or 3.9% of total product sales.

Product Pipeline

Our product pipeline in the field of neurology includes projects targeted toward improving the delivery of Rebif and discovery projects seeking new approaches to the treatment of MS.

Mylinax

In October 2002, we entered into a worldwide agreement with IVAX to develop and commercialize cladribine (now known as Mylinax), as potentially the first orally effective disease modifying treatment for MS. Mylinax is a purine-analogue that interferes with the behavior and the proliferation of certain white blood-cells, including monocytes and lymphocytes, which are involved in the pathological process of MS. Data from earlier trials suggest that injected Mylinax may be effective in certain MS patients. We have worked with IVAX to establish an oral formulation of Mylinax and initiated Phase I clinical trials in the fourth quarter of 2003. We obtained positive results from these trials in March 2004. Following discussions with regulatory authorities, we decided to initiate a Phase III clinical trial in early 2005. Cladribine is currently approved for patients with active hairy cell leukemia.

MMP-12 inhibitor

An MMP-12 inhibitor, an orally active matrix metalloprotease inhibitor with potential as a treatment for MS, entered Phase I clinical development in January 2005. Data from preclinical trials shows efficacy in an animal model of relapsing remitting MS.

JNK inhibitor

A JNK inhibitor, an orally active small molecule inhibitor of apoptosis, with potential as a treatment for MS, entered Phase I clinical development in 2004. This molecule demonstrated a promising profile in experimental models of progressive MS.

Osteopontin

Osteopontin, a naturally occurring protein with potential to remyelinate damaged neurons, entered preclinical development in 2003 and could become a treatment for multiple sclerosis as well as various demyelinating neuropathies of the peripheral nervous system.

Reproductive Health

We are the global market leader in the treatment of human infertility and have a broad offering of products in the field. The World Health Organization estimates that eight to 12 percent of all couples experience some form of infertility problem during their reproductive lives. We estimate that sales of our products currently account for more than 46% of the approximately $1.2 billion global gonadotropin market and sales of Gonal-f currently account for about 62% of the approximately $900 million global recombinant FSH segment.

In women, the maturation of ova in the ovary and subsequent maintenance of pregnancy depend on three main gonadotropins: follicle stimulating hormone, or FSH, luteinizing hormone, or LH, and human chorionic gonadotropin, or hCG. In a normal menstrual cycle, the hypothalamus produces gonadotropin releasing hormone or GnRH, which controls the release of FSH and LH. FSH stimulates estrogen production of the ovaries and the maturation and development of follicles. The mid-cycle LH surge induces ovulation, resulting in the formation of the corpus luteum, which, besides other factors, produces progesterone and estrogen. Upon conception, hCG is produced by the trophoblast, stimulating progesterone production of the corpus luteum graviditatis to maintain the pregnancy. In men, FSH stimulates spermatogenesis, and LH stimulates testosterone production of Leydig cells.

Our goal in the reproductive health area is to offer fertility products addressing the major steps in the infertility treatment process. With Gonal-f, Ovidrel and Luveris, we have implemented our strategy of replacing our urine-derived reproductive health products with recombinant versions. At the end of 2002, we decided to proceed with the closure of our production facilities for urine-derived products. We stopped selling urine-derived products in the European Union in 2003, in the United States in the second quarter of 2004, and in the rest of the world (except for Japan, where our recombinant gonadotropins are not yet approved) by the end of 2004.

Major Steps in the Infertility Treatment Process

- Ø Pituitary down-regulation—Cetrotide
- Ø Ovarian stimulation—Gonal-f, Luveris, Serophene, anastrozole (in development)
- Ø Follicular maturation and ovulation triggering—Ovidrel
- Ø Luteal phase support—Crinone
- Ø Treatment of preterm labor. Prevention of preterm delivery is one of the major challenges in perinatology. We currently have two products in pre-clinical development - an oxytocin receptor antagonist and a prostanoid FP receptor antagonist - which have potential in the treatment of preterm labor.

Recombinant Products

Sales of our recombinant products have grown in recent years and currently stand at approximately 94% of our total gonadotropin sales worldwide. We believe that use of recombinant products has increased due to the greater efficacy of recombinant products and the superior tolerance of the products by patients. These products are administered subcutaneously — just under the skin — using a small needle, which is a significant advantage over some of the urine-derived products that must be given through more painful intramuscular injection. We are continuing to encourage the switch to recombinant products, because we believe them to be superior. With Gonal-f, Ovidrel and Luveris, we are the only company that offers a totally recombinant gonadotropin portfolio.

Gonal-f

Gonal-f, the first recombinant drug developed for the treatment of infertility to receive marketing approval anywhere in the world, is a human FSH. Gonal-f is the global market leader, having been approved for use in 95 countries, including the entire European Union and the United States. It is indicated for the treatment of patients suffering from ovulation disorders. Gonal-f also stimulates the development of multiple follicles in women being treated with assisted reproductive technologies, such as in vitro fertilization, in which eggs are extracted from a woman’s body, fertilized and then inserted in the uterus. A multi-dose presentation of Gonal-f is available in the European Union, the United States and other countries and accounted for 64.7% of Gonal-f sales in 2004. Gonal-f is also approved in the European Union, the United States and other countries for treating a sub-form of male infertility called

hypogonadotropic hypogonadism. In 2004, Gonal-f was our second largest selling product, accounting for $572.7 million (26.3%) of total product sales.

Several randomized studies designed to compare Gonal-f to the urine-derived gonadotropins we formerly manufactured have shown that Gonal-f is more effective in increasing the number of follicles and embryos obtained during treatment with assisted reproductive technologies. Based on the latter studies, the European Commission permitted the labeling of Gonal-f to be amended to include a statement that it is more effective than urine-derived FSH preparations.

In order to control product variability, we have developed a highly controlled manufacturing process for Gonal-f. This manufacturing process allows us to produce recombinant human FSH with a highly consistent isoform profile and highly consistent batch-to-batch bioactivity, which is measured by a precise physico-chemical method to determine the potency of the product. As a result, Gonal-f is now filled-by-mass (i.e., protein weight). By doing so, we eliminate the intrinsic variability of the rat bioassay and ensure high batch-to-batch and vial-to-vial consistency of r-hFSH content. In 2004, we received European Union and U.S. FDA approval for our pre-filled liquid pen injector, which is designed to improve the patient-friendliness of Gonal-f injections.

Ovidrel/Ovitrelle

Our recombinant hCG, which we market as Ovidrel in the United States and Ovitrelle in the European Union, is used to induce final maturation of ovarian follicles and to trigger ovulation. hCG is a hormone produced by the human placenta that acts in a similar manner to LH. A monthly surge in the production of LH is responsible for ovulation. The hCG contained in Ovidrel triggers ovulation in a way similar to the way LH does in a natural monthly menstrual cycle. Ovidrel is registered in 70 countries. Recombinant hCG is better tolerated by patients and can be administered through subcutaneous injection, a significant patient advantage over earlier urine-derived products, which had to be given by intramuscular injection. In October 2003, the Ovidrel/Ovitrelle pre-filled syringe was approved by both the FDA and the European Commission, making it the first liquid, ready-to-use recombinant hCG. In 2004, Ovidrel accounted for $17.7 million or 0.8% of total product sales. As of November 2004, in the United States Ovidrel was the number one product in the hCG market segment, which includes many generic competitors.

Luveris

Luveris is the first product ever developed in which LH is available as a stand-alone hormone. Luveris provides a pure source of recombinant LH for the small population of patients that have a deficiency of both LH and FSH (LH <1.2 IU/L) and therefore require treatment with both hormones to achieve pregnancy. We have marketed Luveris in the European Union since mid-2001. In October 2004, the U.S. FDA approved Luveris for concomitant use with Gonal-f for stimulation of follicular development in infertile hypogonadotropic hypogonadal women with profound LH deficiency. We launched Luveris in the United States in the last quarter of 2004. The U.S. FDA has granted Luveris orphan drug status until October 8, 2011. Luveris is registered in 67 countries.

Urine-Derived Products

At the end of 2002, we decided to proceed with the closure of our production facilities for urine-derived products. We stopped selling urine-derived products in the European Union in 2003, in the United States in the second quarter of 2004, and in the rest of the world (except for Japan where our recombinant gonadotropins are not yet approved) by the end of 2004. As a result of our decision to phase out these products, sales of our urine-derived gonadotropins were $38.2 million, down by 57.2%, in 2004.

Pergonal

Pergonal is a preparation of FSH and LH for intramuscular injection extracted from the urine of post-menopausal women. It is indicated for use in inducing ovarian follicular growth in infertile women with ovulation disorders. In addition, it may be used to stimulate the development of multiple follicles in patients having treatment with assisted reproductive technologies. Pergonal, when administered to men at the same time as hCG, is indicated for the stimulation of sperm formation in patients who have a form of male infertility.

Metrodin HP

Metrodin HP, which was marketed in the United States as Fertinex, is a highly purified preparation of FSH extracted from the urine of post-menopausal women. Metrodin HP contains 95% FSH, a much higher percentage than first generation gonadotropin preparations. Metrodin HP was used for many of the same indications as Gonal-f, which has largely replaced Metrodin HP. In 2004, Metrodin HP accounted for $15.9 million or 0.7% of total product sales.

Profasi

Profasi consists of hCG derived from the urine of pregnant women. Profasi is given to women to induce final follicular maturation and trigger ovulation, once follicular development has been achieved by treatment with products such as Gonal-f, Metrodin HP or Pergonal. Profasi is administered to men with certain types of infertility to enhance the production of testosterone, a hormone essential in the development of sperm. It is also indicated for the support of luteal function in women with certain fertility disorders. Profasi is used for many of the same indications as Ovidrel, which has replaced Profasi.

Other Products

Crinone

Crinone is a progesterone product with an advanced delivery technology that permits it to be self-administered as a vaginal gel. Progesterone is a hormone that is required to prepare the lining of the uterus for the implantation of a fertilized egg and for the maintenance of pregnancy. The gel is used in connection with certain assisted reproductive technologies, including in vitro fertilization. Crinone is associated with high clinical pregnancy rates and is convenient for patients, because it is user friendly and does not require painful intramuscular injections. It is the only progesterone product with marketing authorization for infertility treatment in Germany and the United Kingdom. In July 1999, we acquired exclusive worldwide marketing rights to Crinone, which we license from Columbia Laboratories. Pursuant to this license, Columbia Laboratories supplies Crinone to us for resale. The agreement will be in effect for four more years, after which it is renewable for additional five-year terms. In April 2001, we withdrew Crinone from the market due to a manufacturing defect. In March 2002, we relaunched Crinone in the United States and reintroduced Crinone in other worldwide markets later in 2002. As a part of our settlement of litigation with Columbia Laboratories related to the recall, we amended our marketing agreement for Crinone. Under the amended agreement, we will continue to market Crinone outside the United States and to reproductive endocrinologists, obstetricians and gynecologists who prescribe injectable gonadotropins in the United States, and Columbia Laboratories will market a second brand of its product to other obstetricians and gynecologists in the United States in exchange for royalty payments to us. In 2004, Crinone accounted for $19.8 million or 0.9% of total product sales. Crinone is registered in 50 countries.

Cetrotide

In ovarian stimulation for assisted reproductive techniques such as IVF (in vitro fertilization) or ICSI (intracytoplasmic sperm injection), the successful prevention of a premature LH surge is crucial. Cetrotide is the first LHRH antagonist in the world to be approved for the prevention of the LH surge. Treatment with Cetrotide is generally more convenient than treatment with LHRH agonists, which involves prolonged therapy to achieve pituitary down-regulation. We market Cetrotide under an agreement with Zentaris (formerly Asta Medica) which gives us the right to market, distribute and sell Cetrotide worldwide, with the exception of Japan. The agreement expires in 2020. Thereafter, we have a perpetual fully paid up license. We currently market Cetrotide in 79 countries. In 2004, sales of Cetrotide accounted for $24.8 million or 1.1% of total product sales. We provide Cetrotide in two different doses: 0.25 mg for multiple dose application and 3 mg for single dose application. It has been shown and published in peer-reviewed journals that the tolerability of Cetrotide is better when compared to a similar product provided by a competitor. Furthermore, the application of the single-dose Cetrotide protocol results in significantly fewer injections for the patient compared with the competitor’s product.

Product Pipeline

Gonal-f

We are currently consolidating our worldwide labeling for Gonal-f by seeking to register it in additional jurisdictions or for additional indications in jurisdictions where we already have approval. For example, in 2004 we filed for Gonal-f in Japan and the application is currently under review by the Japanese health authorities.

Onercept

Onercept, or TBP-1, is a recombinant, soluble type I TNF receptor which acts as an inhibitor of tumor necrosis factor (TNF) alpha. Based on preclinical data suggesting that blocking TNF inhibits the development of endometriotic lesions, we plan to start a proof of concept trial in endometriosis in 2005.

Anastrozole

In July 2002, we entered into an exclusive worldwide agreement with AstraZeneca pursuant to which we have the right to develop, register and market the aromatase inhibitor anastrozole in ovulation induction and improvement of follicular development. Anastrozole is an oral aromatase inhibitor, which acts by blocking the synthesis of estrogen and thereby improving ovulation. Because of its characteristics, we hope it will have benefits over currently available treatments, both in terms of efficacy and having fewer side effects. We commenced a Phase II trial of the drug investigating single doses in this indication in the first quarter of 2003, which showed that monofollicular development with ovulation and pregnancy can be achieved in the target population. Results indicate that the dose regimen could be further optimized before entering Phase III. Therefore, we plan to start a further Phase II multiple-dose dose-finding, comparative trial versus clomiphene citrate in the first half of 2005. Anastrozole is currently sold by AstraZeneca under the trade name Arimidex for the treatment of breast cancer in approximately 100 countries worldwide.

Oxytocin Receptor Antagonist

We are developing a low molecular weight oxytocin receptor antagonist which can be administered orally and has potential as a treatment for premature labor. Results from a Phase I clinical trial with a lead molecule indicated that this was not optimal. A new optimized lead has been identified and preclinical studies are ongoing.

Prostanoid FP Receptor Antagonist

We are developing a low molecular weight prostanoid FP receptor antagonist which can be administered orally and has potential as a treatment for premature labor. This compound is currently in preclinical development.

Growth and Metabolism

Human growth hormone is used in the treatment of growth retardation in children and the treatment of AIDS Wasting, growth hormone deficiency and short bowel syndrome in adults. We estimate that the worldwide human growth hormone market generated approximately $2.1 billion in sales in 2004, based on publicly reported sales data for Saizen, Serostim and Zorbtive and five competing products.

Growth

Children may experience growth retardation as a result of a variety of conditions. These include growth hormone deficiency, Turner’s syndrome, a genetic disease that affects girls, and chronic renal failure. Growth hormone deficiency is associated with abnormally low levels of pituitary growth hormone.

Saizen

Saizen is recombinant human growth hormone. We introduced Saizen in 1989, and it is now

- Approved in 81 countries, including the U.S., for the treatment of growth hormone deficiency in children;

- Approved in 18 E.U. countries, the U.S. and 25 other countries for treatment of growth hormone deficiency in adults;

- Approved in 72 countries, excluding the U.S., for the treatment of growth failure due to Turner's syndrome; and

- Approved in 38 countries, excluding the U.S., for treatment of children with growth failure associated with chronic renal failure.

In May 2004, we filed an application in Europe for use of Saizen in children who were born too small for gestational age. This indication sometimes is known as intra-uterine growth retardation. In 2004, Saizen was our third largest selling product, accounting for $182.1 million or 8.4% of total product sales.

Saizen is available worldwide in freeze-dried formulations containing 8.8 mg and 5 mg that is stable at room temperature before reconstitution, and is therefore more easily stored and more convenient for patients than some competing drugs. Because growth retardation primarily affects children and requires long-term treatment with daily injections, delivery systems are a key differentiator among competing products. Saizen is delivered by two innovative delivery devices: one.click (autoinjector) and cool.click (needle-free). One.click enables the needle to be introduced automatically under the skin, significantly reducing the pain of injection. We launched one.click in Europe in 2001 and in the United States in September 2004. Cool.click is a needle-free delivery system and was the first needle-free device to be launched in the United States for use with human growth hormone. We launched cool.click in the United States in September 2000 and in Europe in the third quarter of 2002, and we are currently rolling it out worldwide.

In October 2000, we expanded our agreement with Bioject to give us the right to use Bioject's Vitajet 3 needle-free injection system, which is the basis for cool.click, in all current and future human growth hormone products and indications worldwide. In addition, we obtained exclusive options to use all new technologies developed by Bioject for the delivery of human growth hormone.

Metabolism

AIDS Wasting. AIDS Wasting is associated with decreased survival in AIDS patients. It is caused by a disturbance in the patient's metabolism that interferes with the body's effective use of nutrients. This metabolic disturbance causes the body to break down vital organ and muscle tissue, known as lean body mass, to generate energy while at the same time conserving fat. AIDS Wasting is a metabolic condition that is independent of the level of the HIV virus. Clinical data have shown that without critical lean body mass, HIV patients get sick more often and may not live as long as those who are not losing lean body mass.

Conventional treatments for AIDS Wasting, such as appetite stimulants, generally do not help patients regain lean body mass, because they do not treat the underlying metabolic cause of AIDS Wasting. Though protease inhibitors, which are used in the treatment of AIDS, can cause patients to gain weight, studies show that a significant percentage of patients on optimal protease inhibitor therapy still suffer from wasting.

Serostim

Serostim is our recombinant human growth hormone formulation which is approved for the treatment of AIDS Wasting in the U.S., Japan and 11 other countries. In 2004, Serostim was our fourth largest selling product, accounting for $86.8 million or 4.0% of total product sales.

Serostim reverses the underlying metabolic disturbance that occurs in AIDS Wasting through its protein building and protein sparing activity, which promotes a significant increase in patient lean body mass and weight. It remains the only growth hormone whose safety and efficacy for treating AIDS Wasting has been proven in a double-blind, placebo-controlled setting.

Serostim is also the first and only human growth hormone approved for AIDS Wasting by the FDA. In August 2003, following completion of a 750-patient, multi-center, placebo-controlled study which confirmed that Serostim improved physical performance, and increased lean body mass and decreased truncal fat, the U.S. FDA granted Serostim full approval for treatment of AIDS Wasting, confirming the accelerated approval that had been granted in 1996. During 2001, we received FDA clearance for a needle-free device, SeroJet, to deliver Serostim. SeroJet was developed in partnership with Bioject under the exclusive licensing agreement we entered into in October 2000. We launched SeroJet in the United States in February 2002.

Short Bowel Syndrome. Short bowel syndrome, or SBS, is a rare, serious and potentially life-threatening condition that follows extensive surgical removal of portions of the small intestine as a result of disease or trauma. Removal of a

large portion of the bowel results in impaired absorption of nutrients. Currently the standard treatment for SBS involves careful management of dietary intake and hydration or, where appropriate, a process referred to as parenteral nutrition in which patients are fed through an intravenous tube. On rare occasions, surgical transplant of the intestine may also be performed for this condition. There are an estimated 10,000-20,000 patients in the United States who are receiving intravenous parenteral nutrition for SBS.

Zorbtive

Zorbtive is our trade name for our recombinant human growth hormone indicated for short bowel syndrome. In a randomized, double-blind, controlled, parallel group Phase III clinical study, Zorbtive administered with specialized nutritional support was shown to significantly reduce patient dependence on total parenteral nutrition as measured by total volume and frequency of infusion. In December 2003, the U.S. FDA approved Zorbtive for use in the treatment of SBS. We launched Zorbtive in the United States in May 2004. The FDA has granted Zorbtive orphan drug exclusivity for use in the treatment of patients with SBS until December 2010.

Product Pipeline

Serostim in HARS

HIV-Associated Adipose Redistribution Syndrome, or HARS, is an abnormal accumulation of truncal adipose tissue (including visceral fat) in people infected with HIV. It is a rare condition and is a subset of abnormal disorders of fat distribution and altered metabolism often called HIV-related lipodystrophy. In March 2004, the FDA granted orphan drug designation for the use of human growth hormone in this indication in the United States. In the second quarter of 2004, we initiated a Phase III clinical trial of Serostim for the treatment of HARS. The trial was fully enrolled by the end of 2004.

PTB1b inhibitor

A protein tyrosine phosphatase 1b inhibitor with potential as a treatment for diabetes and obesity entered Phase I in the fourth quarter of 2004.

Dermatology

In addition to strengthening our existing core therapeutic areas, our strategy is to expand our product offerings into new highly specialized markets where there are major unmet medical needs. As part of that strategy, in August 2002, we entered into an agreement with Genentech to market the psoriasis drug Raptiva (efalizumab). Under our agreement, we have the exclusive license to market Raptiva worldwide, except in the United States and Japan. We will also collaborate with Genentech and its U.S. partner Xoma on co-developing other indications for Raptiva. As of January 2005, Xoma is no longer involved in the development of Raptiva but receives royalties from Genentech.

Psoriasis is a chronic autoimmune disease with an average prevalence of about 2% in Europe and the United States. Approximately one quarter of these patients have moderate or severe forms of the disease. The disease is characterized by the abnormal growth of new skin cells, resulting in thick, red, scaly, inflamed patches. Psoriasis can be limited to a few spots or involve extensive areas of the body. There is no known cure for the disease. While some current treatments for psoriasis may help control the symptoms of the disease, their benefits are not long-lasting and they may be associated with serious side-effects. It is estimated that the currently available therapies are ineffective or inappropriate in about 20% of moderate-to-severe psoriasis patients.

Product

Raptiva

Raptiva (efalizumab) is a humanized monoclonal antibody designed to inhibit three key inflammatory processes in the series of events that are associated with psoriasis. It is administered subcutaneously once per week. In July 2004, we announced preliminary 30-month results from an open-label study evaluating the safety and efficacy of long-term continuous treatment with Raptiva in adults with moderate-to-severe chronic plaque psoriasis. The results of the study

suggest that continuous, weekly dosing of Raptiva provided sustained clinical benefit over 2.5 years. Of the 159 subjects participating in the study who completed 30 months of treatment, a 75% or greater improvement on the Psoriasis Area Sensitivity Index, or PASI, was observed in 75% of patients with weekly Raptiva therapy (as-treated analysis). Ninety-one percent of patients achieved an improvement of 50% on the PASI and 45% of patients achieved a 90% or greater improvement on the PASI (as-treated analysis).

In September 2004, we received authorization to market Raptiva in the 25 countries of the European Union for people with moderate-to-severe chronic plaque psoriasis for whom other systemic treatments or phototherapy have been inadequate or inappropriate. Raptiva is the first biologic treatment for psoriasis to be authorized for marketing in the European Union. Raptiva is registered in the E.U., U.S. and 12 other countries (Argentina, Australia, Brazil, Bulgaria, Hong Kong, Iceland, Korea, Mexico, Norway, Romania, Singapore and Switzerland). We have made Raptiva available in Germany, Austria, Greece, Ireland, Hong Kong, Portugal, Norway, UK, Denmark, Sweden, Switzerland, Australia, Argentina, Mexico and Singapore**.** We expect that the roll-out of Raptiva will continue throughout 2005 with the launch in major European markets such as France, Spain and Italy and in Canada.

Product Pipeline

Onercept

Onercept, or TBP-1, is a recombinant, soluble type I TNF receptor which acts as an inhibitor of tumor necrosis factor (TNF) alpha, a cytokine that can cause irreversible damage to organs when secreted in excessive amounts by people with inflammatory and other diseases. Following the announcement of positive Phase II results for onercept in psoriasis in 2003, we initiated a multicenter, multinational Phase III program in the third quarter of 2004. Onercept has already been shown to have a highly competitive efficacy profile in Phase II, with more than 50% of patients achieving a 75% improvement in PASI score after 12 weeks.

Research and Development

Research and development is vital to our ability to continue to grow our business. We employ 1,387 research and development personnel, and our R&D expenses were 24.2% of our total revenues in 2004. R&D efforts are spearheaded by our scientists at the Serono Pharmaceutical Research Institute in Geneva, Serono Reproductive Biology Institute in Boston, Serono Genetics Institute (formerly Genset S.A.) in Evry, France and Istituto di Ricerca Cesare Serono and Istituto di Ricerche Biomediche ‘‘Antoine Marxer’’ RBM in Italy, with important contributions provided under collaborative arrangements with other biotechnology companies and institutions, particularly the Weizmann Institute of Science in Israel. Our discovery group at the Serono Pharmaceutical Research Institute focuses on drug discovery in neurological diseases like MS, autoimmune diseases and wasting. The Serono Reproductive Biology Institute concentrates on reproductive health and related clinical indications. Serono Genetics Institute focuses on genomics research. During 2002, 2003 and 2004, we spent $358.1 million, $467.8 million and $594.8 million, respectively, on research and development.

As a leader in the field, we are committed to taking full advantage of the opportunities presented by biotechnology. We have concentrated on establishing state-of-the-art skills in those technologies that will significantly enhance our ability to deliver innovative products to specialist markets. Our R&D efforts are focused on:

- Ÿ pursuing drug discovery efforts that may lead to new products;
- Ÿ enhancing our discovery capabilities through research partnerships;
- Ÿ improving drug delivery of our protein therapeutics;
- Ÿ strengthening our key therapeutic areas through new products and line extensions; and
- Ÿ developing products in new therapeutic areas, such as oncology.

Pursuing Drug Discovery

We are actively seeking new therapies for new indications. Our molecular biologists are using DNA sequencing and identification technologies to identify new drug targets in the human genome. We can monitor the genes expressed in a cell at a particular time by integrating data from gene chips and gene filters. Working with clinical groups around the world, we are able to use our data to identify how genes are expressed in connection with different diseases. By understanding how genes are expressed in connection with different diseases, we identify points of intervention at which molecules may alter the progression and development of the diseases. We then determine whether the point of intervention would be best addressed through the use of protein therapeutics or therapies using smaller molecules.

Advances in chemistry, screening technology and robotics allow us to rapidly test a multitude of compounds to see if any one of the compounds may be used to treat a given disease process. We use high throughput screening and combinatorial chemistry techniques to try to identify small molecules that may have beneficial therapeutic effects on targeted disease processes.

High throughput screening is a technique for quickly screening many possible treatments for a specified condition. The process starts by selecting a type of cell that will react in accordance with a specified disease process. To do this we often genetically modify cells to give them the characteristics we desire. We then select a large number of small, simple molecules that we believe may have a positive therapeutic effect on the disease process. The cells are then exposed to the different molecules, and we select those that, based on their effect on the cells, appear to hold the greatest promise as future therapies. Once we have narrowed the field of potential molecules, using combinatorial chemistry techniques we modify them in different ways to determine whether a slightly different structure of the same basic molecule may have a more powerful effect on the disease process. We then assess whether the molecules we have identified are appropriate for preclinical trials.

In September 2002, we significantly increased our drug discovery capability through our acquisition of Genset S.A. Genset, now the Serono Genetics Institute, provides us with leading expertise in the linkages between genes and diseases, a strong scientific team, an extensive cDNA library of secreted proteins and an integrated technology platform in bioinformatics, genetics, biostatistics and therapeutic genomics.

Our research has helped us to identify several potential new therapeutic compounds that are currently in preclinical development.

Neurology

- Osteopontin, a molecule with potential to remyelinate damaged neurons, entered preclinical development in 2003 and could become a treatment for various neuropathies, including MS.

Reproductive Health

- An orally available low molecular weight prostanoid FP receptor antagonist with potential as a treatment for premature labor entered preclinical development in 2003.

- A new lead molecule of an orally available low molecular weight oxytocin receptor antagonist with potential as a treatment for premature labor entered preclinical development in 2004.

Autoimmune/inflammatory diseases

- The antisense compound Kappaproct is undergoing additional preclinical trials to establish a more solid proof of principle in its use in inflammatory diseases as well as a more adequate dosing regime for ulcerative colitis patients.

- The cytokine tadekinig alpha is undergoing additional preclinical trials to establish whether it has potential in the treatment of autoimmune conditions.

Entering into Strategic Research Collaborations

We are also enhancing our discovery capabilities by entering into strategic research collaborations with several leading companies in the field of small molecule drug discovery.

In February 2004, we extended the collaborative research agreement signed in 2001 with Inpharmatica Ltd. Under the expanded agreement, Inpharmatica received an up-front fee for granting us additional rights to novel protein sequences delivered under the collaboration. The up-front fee has been expensed as research and development expense.

In October 2004, we entered into an agreement with Paratek Pharmaceuticals Inc. to discover, develop and commercialize an orally available disease modifying treatment for multiple sclerosis (MS). Under the terms of the agreement, Paratek received an up-front fee and a loan convertible into Paratek stock and will receive research funding and milestone payments related to development progress and regulatory milestones. In addition to the up-front consideration, Paratek would receive $38.0 million in milestone payments for the first product to be successfully developed and registered in MS. The initial fees have been expensed as research and development expense.

In October 2004, we entered into a broad alliance with ZymoGenetics Inc. to research, develop and commercialize novel protein and antibody therapeutics based on discoveries made by ZymoGenetics. As part of this alliance, we will gain access to a portfolio of ZymoGenetics' genes and proteins, will have rights over the next five years to license up to 12 products, and will have exclusive worldwide rights to develop and commercialize products based on Fibroblast Growth Factor 18 (FGF-18) and the Interleukin 22 Receptor (IL-22R). In addition, the companies will co-develop Interleukin 31 (IL-31). Under the terms of the agreement, we paid ZymoGenetics an up-front fee of $20.0 million in exchange for the rights to license proteins over the next five years, paid $11.3 million for entering into three license agreements and purchased $50.0 million of ZymoGenetics' common stock. We will pay a series of milestone payments, will share all profits from the co-commercialization of products in the United States for which ZymoGenetics has co-funded development, and will pay royalties on eventual sales of the products outside the United States and, to the extent ZymoGenetics elects not to co-develop products, on product sales in the United States. The up-front fee and license fees have been expensed as research and development expense. The purchase of common stock was recorded as an available-for-sale equity investment.

In November 2004, we signed a worldwide agreement with Nautilus Biotech to develop the next-generation of human growth hormone, with improved biological, pharmacological and clinical profiles. Under the terms of the agreement, Nautilus received an up-front fee and will receive potential milestone payments and undisclosed royalties on sales of the improved protein. The up-front fee has been expensed as research and development expense.

In December 2004, we entered into an agreement with Micromet AG to develop and commercialize Micromet's MT201 (adecatumumab), a pan-carcinoma monoclonal antibody directed against the epithelial cell adhesion molecule Ep-CAM for the treatment of cancers of epithelia cell origin. Under the terms of the agreement, Micromet received an initial license fee of $10.0 million and will receive additional milestone payments of up to $138.0 million if the product is successfully developed and registered worldwide in three or more indications. In addition, Micromet will receive undisclosed royalties based on net sales of the product. The up-front fee has been expensed as research and development expense.

In December 2004, we entered into a worldwide collaboration with CancerVax Corporation for the development and commercialization of Canvaxin, an investigational specific active immunotherapy product being developed for the treatment of advanced-stage melanoma. Under the terms of the agreement, we paid CancerVax an up-front fee of $25.0 million and purchased one million shares of CancerVax common stock for $12.0 million. In addition, CancerVax could receive up to $253.0 million in milestone payments for the achievement of development, regulatory and commercial milestones. The fee has been expensed as research and development expense. The purchase of common stock was recorded as an available-for-sale equity investment.

Improving Drug Delivery

An integral part of our research and development programs is the development of more patient-friendly drug delivery systems. Because most of our products must be injected under the skin, we believe easier and less painful drug delivery systems will promote patient compliance and product loyalty.

The value of protein therapeutics can be greatly enhanced by improved delivery systems. These systems may be able to provide alternatives to injection or reduce the frequency of injections. Because many of our products, such as Rebif, Gonal-f, Saizen and Serostim, must be administered frequently and Saizen is used mostly for children, we believe that many of our potential customers would consider the ease of administration to be an important factor when selecting between our products and those of our competitors. As a result, we have set up our own drug delivery laboratory and have established major collaborations with specialist drug delivery companies on projects designed to improve the delivery of all of our major protein and peptide products.

Strengthening Key Therapeutic Areas

Novel protein therapeutics were the first benefits provided by biotechnology, beginning with the replacement of naturally derived hormones and cytokines with biotechnology-derived proteins. With our production of recombinant fertility hormones, growth hormones and interferon beta, we are at the forefront of these developments.

For information on our R&D projects in the four key therapeutic areas on which we currently focus, consult the respective Product Pipeline sections for each therapeutic area (Neurology, Reproductive Health, Growth and Metabolism, and Dermatology) above.

Developing Products in New Therapeutic Areas

In addition to our continuing commitment to our existing therapeutic areas, we are also performing research and developing potential products in new areas like autoimmune diseases, gastroenterology, and oncology. Several molecules are currently in development in new therapeutic areas:

TACI-Ig. A TACI (transmembrane activator and CAML-interactor) fusion protein, which interacts with B lymphocytes and represents a novel therapeutic approach to treating autoimmune diseases, such as systemic lupus erythematosus or SLE and rheumatoid arthritis, as well as B-cell malignancies, is being co-developed with ZymoGenetics. Following the successful completion of a Phase I trial in human volunteers with this molecule, during 2004 we initiated Phase Ib clinical trials in SLE, rheumatoid arthritis and multiple myeloma, as well as a Phase I trial in relapsed or refractory B-cell malignancies.

Canvaxin. We recently acquired the worldwide rights to develop and commercialize CancerVax's specific active immunotherapy product Canvaxin for the treatment of advanced-stage melanoma, a deadly form of skin cancer. Canvaxin is currently being evaluated in two international, multi-center Phase III clinical trials for the treatment of Stage III and Stage IV melanoma.

Adecatumumab. We recently acquired the worldwide rights to develop and commercialize Micromet's antibody product adecatumumab which has potential in the treatment of a broad range of cancers of epithelial origin, including prostate, breast, colon, lung, stomach, pancreatic, head and neck, and ovarian cancer. Adecatumumab, a fully human antibody directed against the epithelial cell adhesion molecule, is currently being evaluated in two Phase II trials for the treatment of metastatic breast cancer and prostate cancer.

Kappaproct. We have acquired the worldwide rights to develop and commercialize InDex Pharmaceuticals' antisense compound Kappaproct for the treatment of ulcerative colitis. A Phase II clinical trial did not reach its primary endpoint in terms of clinical remission versus placebo; however there was a dose-response trend. Patients on the two highest dose levels went into clinical remission faster than those treated with the two lowest dose levels or the patients treated with placebo. Overall, the safety profile was good. Serono and InDex are focusing on finding a more solid preclinical proof of principle in the use of Kappaproct in inflammatory diseases and a more adequate dosing regime for ulcerative colitis patients.

Interferon beta. We are currently conducting a Phase III trial of interferon beta-1a for the treatment of Asian patients suffering from chronic hepatitis C. Results from a study completed in 2001 suggested that patients of Asian origin with this disease may benefit from r-IFN-beta.

Tadekinig alpha. In 2004, we completed Phase IIa trials of tadekinig alpha, our recombinant interleukin-18 binding protein, in psoriasis and rheumatoid arthritis. Results did not show the expected promise based on preclinical data in animal models. Preclinical investigations are ongoing to identify if tadekinig alpha has potential in the treatment of autoimmune conditions.

Major Products and High Priority R & D Projects

Product Type	Trade Name	Indications	Status as of January 31, 2005
Recombinant human interferon1a (r-IFN-ß1a)	Rebif	Multiple sclerosis	Approved in E.U. (25 countries), U.S. and 61 other countries
	*	Chronic hepatitis C in Asian patients	Phase III clinical trial
Mitoxantrone	Novantrone	Multiple sclerosis, certain cancers	Rights to commercialize approved product in U.S.; Orphan Drug Status in U.S. for MS
Cladribine	Mylinax	Multiple sclerosis	Phase III clinical trial
JNK inhibitor	*	Multiple sclerosis	Phase I clinical trial
MMP-12 inhibitor	*	Multiple sclerosis	Phase I clinical trial
Osteopontin	*	Remyelination	Preclinical
Recombinant human follicle stimulating hormone (r-hFSH)	Gonal-f	Female infertility	Approved in E.U. (25 countries), U.S. and 69 other countries
	Gonal-f	Male infertility - hypogonadotropic hypogonadisma	Approved in E.U. (25 countries), U.S. and 38 other countries
	Gonal-f	Multi-dose formulation	Approved in E.U. (25 countries), U.S. and 40 other countries
	Gonal-f	Fill by mass formulation	Approved in E.U. (25 countries), U.S. and 41 other countries
	Gonal-f	Pre-filled pen injector	Approved in E.U. (25 countries), U.S. and 10 other countries
Recombinant human luteinizing hormone (r-hLH)	Luveris	Severe FSH and LH deficiency	Approved in E.U. (25 countries), U.S. and 41 other countries; received Orphan Drug Status in U.S.
Recombinant human chorionic gonadotropin (r-hCG)	Ovidrel/Ovitrelle	Female infertility/ovulation induction and use in assisted reproductive	Approved in E.U. (25 countries), U.S. and 44 other countries

		technology	
Cetrorelix (GnRH antagonist)	Cetrotide	Premature ovulation prevention	Approved in E.U. (25 countries), U.S. and 53 other countries.
Progesterone gel (8%)	Crinone	Luteal phase support	Approved in U.S., 15 E.U. countries and 34 other countries
Anastrozole (aromatase inhibitor)	*	Ovulation induction and improvement of follicular development	Phase II clinical trial
Onercept	*	Endometriosis	Phase I clinical trial
Oxytocin receptor antagonist	*	Pre-term labor	Preclinical
Prostanoid FP receptor antagonist	*	Pre-term labor	Preclinical
Recombinant human growth hormone (r-hGH)	Saizen	Growth hormone deficiency	Approved in 81 countries
	Saizen	Growth hormone deficiency in adults	Approved in 18 E.U. countries, U.S. and 25 other countries
	Saizen	Growth failure due to Turner's syndrome	Approved in 72 countries
	Saizen	Growth failure associated with chronic renal failure	Approved in 38 countries
	Saizen	Small for gestational age babies (IUGR)	Filed in E.U.
Recombinant human growth hormone (r-hGH) high dose	Serostim	AIDS Wasting (cachexia)	Approved in U.S., Japan and 11 other countries
	Serostim	HARS/Lipodystrophy	Phase III clinical trial; received Orphan Drug Designation in U.S.
	Zorbtive	Short bowel syndrome	Approved in U.S.; received Orphan Drug Designation in U.S.
PTP1b inhibitor	*	Diabetes and obesity	Phase I
Efalizumab	Raptiva	Psoriasis	Registered in E.U., U.S. and 12 other countries

Onercept (r-TBP-1)	*	Psoriasis	Phase III clinical trial
Tadekinig alpha (r-IL-18bp)	*	Autoimmune diseases	Preclinical
TACI-Ig	*	Systemic lupus erythematosus	Phase Ib clinical trial
	*	Rheumatoid arthritis	Phase Ib clinical trial
	*	Multiple myeloma	Phase Ib clinical trial
	*	Relapsed or refractory B-cell malignancies	Phase I clinical trial
p65 inhibitor	Kappaproct	Inflammatory diseases	Preclinical
Adecatumumab	*	Prostate cancer	Phase II clinical trial
	*	Metastatic breast cancer	Phase II clinical trial
	CanVaxin	Stage IV melanoma	Phase III clinical trial

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* Trade name not yet determined

Sales and Marketing

We have marketing, sales and distribution organizations based in Europe and the United States, and we employ a sales and marketing force of 2,084 people worldwide. Because we focus on highly specialized markets with a limited number of prescribing physicians, we believe that our sales force can efficiently penetrate each of our target markets. In general, our products are sold to wholesale distributors or directly to pharmacies or medical centers. We utilize common pharmaceutical company marketing techniques, including physician detailing, advertising, targeting opinion leaders and other methods. We also employ marketing strategies specific to our individual product lines.

Neurology

In certain markets we focus on neurologists that specialize in MS. In other markets we focus on general neurologists.

In the United States, we promote Rebif directly through our own sales force and, in addition, since October 2002, through a second sales force operated by Pfizer Inc. under a copromotion agreement under which we have agreed to share U.S. marketing and development costs. Pfizer has an established neurology franchise.

Our agreement with Pfizer allows us to contact a much larger proportion of the expanding prescriber base more frequently than we would have been able to contact acting alone. We believe that Pfizer's presence in the neurology therapeutic area helps us more quickly and effectively distribute the message of Rebif's attributes.

Outside the United States, we are committed to continuing medical education programs, which examine the latest developments in MS, including research and treatments. Our programs in the United States focus on the scope of treatment protocols to address all aspects of the disease and helping medical professionals learn more about ways to offer the highest level of patient care. A major initiative in 2004 was the establishment of the MSBase Foundation to run the state-of-the-art MS registry independently of Serono for the benefit of physicians and their patients.

In 2003, we introduced new resources for the MS community in the United States, including the Learning for life empowerment series as well as the newly enhanced MSLifeLines.com website. The Learning for life series offers an array of information to people living with MS and provides a jumping off point for doctors and patients to communicate better about the specific treatment needs of each patient. Specifically, the empowerment series provides in depth information on use of MRI, parameters to consider in evaluating therapy as well as information on the disease and the different treatment options available for people with MS.

Outside the U.S. we have well-established call centers and nurse programs in many countries to provide support and guidance for MS patients generally and specifically to help with the introduction of Rebiject II and the new 29G needle. In addition to this we have provided help with access to MRI facilities to aid diagnosis in some regions. We are active in lobbying for patients to have greater access to therapy and for MS to receive a higher priority on national healthcare agendas. In particular, we provide support to the European MS Platform and to the Multiple Sclerois International Federation patients associations.

Reproductive Health

We focus our reproductive health marketing efforts on educating and informing reproductive endocrinologists about treatment options for infertility.

In February 2004, we announced the launch of www.fertility.com, a new website for patients outside the United States, which offers a definitive source of information for people who have concerns about their fertility or are seeking or undergoing treatment. This new website provides comprehensive facts and describes therapy throughout each stage of the patient journey, from any initial concerns about infertility to a potential pregnancy. The website provides people

who are concerned about their chances of having a child with information on the physiology of reproduction and causes of possible fertility disorders. For those considering therapy, it outlines the various options available to them. It also provides advice to patients already undergoing treatment. Finally, recommendations are given to couples on the lifestyle choices and medications that may help to support early pregnancy. The website contains a variety of useful links to patient associations as well as references for further reading. For the United States market, we relaunched www.seronofertility.com, which includes comprehensive infertility information for consumers and patients, as well as interactive tools such as a “find a specialist” service, which allows visitors to find local reproductive endocrinologists. The site also features animated, narrated patient instructions for mixing and injecting Serono products. To drive traffic to seronofertility.com, we implemented web advertising programs on popular consumer sites such as google.com, WebMD.com and babycenter.com.

We also have a number of ongoing initiatives that are designed to support access to infertility treatment. In the United States, we launched the first ever manufacturer-sponsored direct-to-consumer (DTC) advertising campaign in the infertility market in June 2003, including television, radio, magazine and web advertising. Consumers and patients who call our free educational service, Fertility LifeLines, toll-free at 1-866 LETS TRY receive customized educational materials via mail, including a list of local fertility centers. In several major markets, including Germany, Spain and the UK, we have performed pharmaco-economic study programs to demonstrate the cost benefit of recombinant products versus urine-derived preparations. This activity supports our strategy to help establish and maintain reimbursement for our products. For those patients in the United States who are not eligible for reimbursement, do not have appropriate insurance coverage and are unable to pay for the treatment themselves we have a Compassionate Care program. This program helps provide patients that meet certain criteria with access to our infertility products at no cost.

Growth and Metabolism

Growth

We focus our marketing of growth products on capturing new patients, since patient loyalty is particularly strong in this market. To do this we target pediatric endocrinologists and leading pediatricians in clinics and treatment centers. We implement medical clinical programs and set up innovative registries. We are also developing new drug delivery devices for use in this market, where patient convenience is particularly important. In September 2000, we launched cool.click, a needle-free delivery system for Saizen, which is the first needle-free delivery system for human growth hormone in the United States and Canada. We launched cool.click in Europe in the third quarter of 2002 and are currently rolling it out worldwide. In September 2004, we launched our autoinjector pen device for growth hormone, one.click, in the United States. The U.S. FDA also granted approval for Saizen to be promoted in the Adult Growth Hormone Deficiency market. This indication will be launched in early 2005.

Metabolism

Our sales and marketing efforts for our AIDS Wasting product focus on the education of HIV/AIDS-treating physicians and their staffs and nurses that work with the patients. In addition to focusing on the therapeutic benefits of Serostim, our sales and marketing efforts are directed toward education about AIDS Wasting.

We also engage in patient-advocacy efforts. A large number of Serostim patients have received reimbursement support via our medical reimbursement specialists who work one-on-one with each patient to secure access to and insurance coverage for Serostim once the patient has agreed to receive assistance from our reimbursement specialists. However, during 2004 state-based reimbursers in the United States continued to impose restrictions on the use of Serostim. In some states these restrictions include requiring prescribers to obtain prior authorization before starting a patient on Serostim treatment.

Due to the apparently enlarging gap between demand data and ex-factory sales, we and the relevant authorities initiated investigations to try and discover the cause of this discrepancy. As a result of these investigations, we determined that there were several causes of this discrepancy, including circulation of counterfeit Serostim in the market, potential diversion of the product and an active secondary source for the product in the marketplace. In order to address this issue, we implemented the Serostim Secured Distribution Program, or SSDP, in the United States in October 2002. This program is designed to track and trace Serostim through the distribution process to ensure that patients who require Serostim receive the genuine product on a timely basis. The program restricts distribution of Serostim to a group of contracted network pharmacies that meet predefined criteria and are the exclusive distributors of the product. Through this program we are able to track each individual box of Serostim from Serono to the contracted network pharmacy. We are working closely with individual state and federal agencies to monitor the program’s effectiveness. The FDA recognized SSDP as an effective anti-counterfeiting system that assures patients

receive genuine product.

In 2001, we received FDA approval for a needle-free delivery device for Serostim. This device is called Serojet and was launched in the U.S. market in February 2002.

Gastroenterology

Zorbtive was launched into the U.S. market in May 2004. We promote Zorbtive to gastroenterologists and specialized surgeons. Our efforts are targeted on educating physicians and other patient care providers on the therapeutic benefits of Zorbtive, which is the first drug therapy approved by the FDA for the treatment of Short Bowel Syndrome. We also focus our efforts on educating patients about the therapeutic benefits of Zorbtive and providing support services to assist patients with their therapy.

Zorbtive is also being distributed through the SSDP. We have partnered with our specialty pharmacies to assist in the education process for providers and their patients.

We also engage in patient-advocacy efforts. Zorbtive patients can receive reimbursement support via our medical reimbursement specialists who work one-on-one with each patient to secure access to and insurance coverage for Zorbtive once the patient has agreed to receive assistance from our reimbursement specialists. Zorbtive is currently not available under Medicare.

Dermatology

We have developed a dedicated dermatology sales and marketing structure in our affiliates, consistent with the scheduled launch of Raptiva. Since the beginning of our involvement in dermatology, we have developed strong relationships with key opinion leaders and psoriasis patients associations worldwide.

Manufacturing

Our principal commercial manufacturing facilities are located in Aubonne and Corsier-sur-Vevey, Switzerland; Bari, Italy; Tres Cantos, Spain; and Martillac, France. In 2004, we closed our manufacturing facility in Israel, which was one of our oldest manufacturing sites and had become obsolete. For clinical supplies and process development, manufacturing facilities are located in Martillac, France and Rome, Italy. We have created additional manufacturing centers that specialize in different phases of the production process. For certain key products, we have two production facilities and/or large inventories available to ensure a continuity of supply in the event of contamination, catastrophe or other unforeseen events at one of our facilities.

Intellectual Property

Our patents are very important for protecting our proprietary rights in the products we have developed. We have applied for or received patents covering inventions ranging from basic recombinant DNA to processes relating to production of specific products and to the products themselves. We either have been granted patents or have patent applications pending which relate to a number of current and potential products, including products licensed to others. We believe that in the aggregate our patent applications, patents and licenses under patents owned by third parties are of material importance to our operations.

We expect that litigation will be necessary to determine the validity and scope of certain of our proprietary rights. We have in the past been and may in the future be involved in a number of patent lawsuits, as either a plaintiff or defendant, and in administrative proceedings relating to our patents and those of others. These lawsuits and proceedings may result in a significant commitment of our resources in the future.

We cannot be sure that our patents will give us legal protection against competitors or provide significant proprietary protection or competitive advantage. In addition, we cannot be sure that our patents will not be held invalid or unenforceable by a court, infringed or circumvented by others or that others will not obtain patents that we would need to license or avoid. We are aware that others, including various universities and companies working in the biotechnology field, have also filed patent applications and have been granted patents in the European Union, the United States and other jurisdictions claiming subject matter potentially useful or necessary to our business. Some of those patents and applications claim only specific products or methods of making such products, while others claim more general biotechnology processes or techniques. Competitors or potential competitors may have filed patent applications or received patents, and may obtain additional patents and proprietary rights relating to proteins, compounds or processes competitive with our products.

In general, we have obtained licenses from various parties that we deem to be necessary or desirable for the manufacture, use or sale of our products. These licenses, both exclusive and non-exclusive, generally require us to pay royalties to the parties on product sales.

Trade secret protection for our unpatented confidential and proprietary information is also important to us. To protect our trade secrets, we generally require our employees, material consultants, scientific advisors and parties to collaboration and licensing agreements to execute confidentiality agreements upon the commencement of employment, the consulting relationship or the collaboration or licensing arrangement. However, we cannot be sure that others will not either develop independently the same or similar information or otherwise obtain access to our proprietary information.

We consider the registered (®) and the filed (^{TM}) trademarks and the filed service marks(^{SM}) Canvaxin^{TM}, Cetrotide®, click.easy®, cool.click®, Crinone®, EasyJect®, Fertility LifeLines^{TM}, Ferti.net®, Fertinex®, Geref®, Gonal-f®, GHMonitor ^{SM}, Howkidsgrow ^{SM}, Learning for life^{TM}, Luveris®, Metrodin HP®, MSLifelines ^{SM}, Mylinax®, Novantrone®, one.click®, Ovidrel®, Ovitrelle®, Pergogreen®, Pergonal®, Profasi®, Raptiva®, Rebif®, Rebiject®, Rebiject II®, Rebiject mini®, Reliser®, Saizen®, SeroJet^{TM}, Serono®, Serophene®, Serostim®, Stilamin® and Zorbtive^{TM}, as well as the filed trademarks (^{TM}) for the “S” symbol, used alone or with the words “Serono” or “Serono biotech and beyond,” in the aggregate to be materially important. We have generally registered or are seeking to register these trademarks throughout Europe, in the United States and in other countries throughout the world.

Out-Licensing

Our strength of innovation is evidenced by our strong patent position and our ability to license certain of our technology and rights to third parties. We receive royalties and license fees from a number of companies with respect to their products. Among these are:

- Ÿ Biogen Idec on its sales of Avonex;
- Ÿ Organon on its sales of Puregon and Antagon;
- Ÿ Amgen on its sales of Enbrel; and
- Ÿ Abbott Laboratories on its sales of Humira.

Competition

We face competition, and believe significant long-term competition can be expected, from pharmaceutical companies and pharmaceutical divisions of chemical companies as well as biotechnology companies. We expect this competition to become more intense as commercial applications for biotechnology products increase.

The introduction of new products or the development of new processes by competitors or new information about existing products may result in price reductions or product replacements, even for products protected by patents. In certain markets, such as Latin America, there is limited patent protection available for our products as a result of the historical weakness of the patent law systems. However, we believe our competitive position is enhanced by our commitment to research leading to the discovery and development of new products and manufacturing methods. Other factors which should help us address competition include ancillary services provided to support our products, customer service and dissemination of technical information to prescribers of our products and to the health care community, including payers.

Over the longer term, our and our collaborators' ability to successfully market current products, expand their usage and bring new products to the marketplace will depend on many factors, including but not limited to the effectiveness and safety of the products, regulatory agencies' approvals for new products and indications, the degree of patent protection afforded to particular products, and the effect of the managed care industry as an important purchaser of pharmaceutical products.

Generic Drugs

Generic products are typically sold at a lower price than our products, because producers of generic drugs do not have to incur research and development costs. Therefore, there is increasing pressure on the applicable regulatory entities in both the European Union and the United States to make it easier for pharmaceutical producers to gain approval for generic drugs, including generic recombinant drugs. Our urine-derived reproductive health products, which we are in the final stages of phasing out, already face increased competition from generic products.

Drug Delivery Systems

A growing area of competition in the biotechnology industry results from developments in drug delivery systems - the manner in which drugs are delivered into the human body and the processes by which drugs are time-released into the blood stream once they have been delivered into the human body. Easier and less painful drug delivery systems promote patient compliance and usage and are, therefore, more marketable. Several of our competitors sell autoinjection devices that facilitate self-administration of their treatments. We will face increased competition from drugs that have drug delivery systems that may be more patient-friendly than our own.

Neurology

Rebif and Novantrone are increasingly used in a highly competitive MS marketplace worldwide. In 2004, Rebif was the fastest growing MS treatment in the U.S. and retained market leadership outside the U.S. In the U.S., Rebif and its three competitors faced an additional new competitor, natalizumab (Tysabri), in the last month of 2004. Currently the prescribing label for Rebif is more comprehensive than that of natalizumab as it includes an effect on disability and long-term efficacy data.

Rebif also competes with interferon beta-1b, which is sold by Schering AG or its affiliate Berlex in Europe under the brand name Betaferon and is sold by these companies in the United States and Canada under the name Betaseron. In addition, Rebif competes with Avonex, an interferon beta-1a product sold by Biogen Idec, and with Copaxone, sold by Teva Pharmaceuticals, in the U.S., Europe and other countries. In early 2004, we initiated a head-to-head Phase IV trial comparing Rebif with Copaxone. We announced in January 2005 that recruitment was completed with over 700 patients enrolled. A number of other companies are working to develop products to treat multiple sclerosis that may in the future compete with Rebif.

Another source of competition is the introduction of biosimilar products in Latin America and in Asia. These are not generic versions of Rebif as the exact formulation for Rebif is highly dependent on our well-established manufacturing process. In the U.S. and in Europe the regulatory agencies have so far recognized the need for clinical testing of biosimilar products to establish both efficacy and safety. However, in Latin America (Mexico and Argentina), licenses for biosimilar products were granted in the fourth quarter of 2004. Although the products are not proven and supply may be restricted, we expect there will be some impact on Rebif sales in these regions. Similar developments are not expected in the European Union or U.S. in the near future.

We have exclusive rights to market Novantrone in the United States for advanced forms of MS and have received orphan drug status for Novantrone in these indications. We believe this provides us with a marketing advantage in the United States.

Reproductive Health

Our reproductive health products compete with Organon’s recombinant FSH, Puregon, which is marketed as Follistim in the United States. Our products also compete with urine-derived products, including Ferring Pharmaceutical’s Menopur, Menogon, which is marketed as Repronex in the United States, and Bravelle as well as with Institut Biochimique’s Fostimon and Merional. Ovidrel is currently the only recombinant source of hCG available. However, Ovidrel competes with urine-derived sources of hCG. Luveris is currently the only recombinant source of LH available. In certain markets, Luveris competes with urine-derived human menopausal gonadotropins, which are less pure preparations of FSH and LH. In the United States, Luveris competes with urine-derived human menopausal gonadotropins within its approved indication of hypogonadotropic hypogonadal women with profound LH deficiency. We have received orphan drug protection for Luveris in the United States through October 8, 2011. Crinone competes with other progesterone products; however it is the only preparation available as a non-injectable formulation that is labeled for assisted reproductive technologies, except in the United States where Columbia Laboratories markets

Prochieve to certain obstetricians and gynecologists.

Growth and Metabolism

Growth

Saizen competes with human growth hormone products produced by companies such as Eli Lilly, BioTechnology General, Novo Nordisk, Pfizer and Genentech. The competition in this market is intense because different human growth hormone products are chemically and biologically similar. As a result, it is difficult for one product to differentiate itself. One way that we differentiate our product is through drug delivery systems. However, many of our competitors now also offer patient-friendly delivery systems for their products. Other companies are working to bring to market comparable growth hormone products that may compete with Saizen in the future.

In addition to the presence of competing products in the growth retardation market, we believe that competition in this market is enhanced by the fact that parents show considerable brand loyalty once they have selected a product for treatment of their child. As a result, much of the competition between pharmaceutical companies in this market must focus on the relatively small number of new patients beginning treatment each year.

Metabolism

Orphan drug exclusivity for Serostim in the United States expired in August 2003. Our competitors may now seek approval of applications for their growth hormone products in the United States for AIDS Wasting indications. The appetite stimulants Megace, which is marketed by Par and Roxane, and Marinol, which is marketed by Unimed, and the anabolic steroid Oxandrin, marketed by Savient, are other drugs approved for the treatment of weight loss associated with AIDS or chronic infection in the United States.

Gastroenterology

We have been granted orphan drug exclusivity for Zorbtive in the treatment of patients with short bowel syndrome until December 2010. That means that our competitors cannot receive FDA approval to promote human growth hormone in the United States for that indication until that date.

Dermatology

In psoriasis we currently compete with Enbrel, commercialized by Wyeth, which received regulatory approval in the European Union about one month after Raptiva. In the other markets outside the European Union we currently compete with Amevive from Biogen Idec. Consistent with the product label, traditional systemic therapies or phototherapy are not considered competitors in the European Union markets.

Government Regulation

Our research, preclinical testing, clinical trials, facilities, manufacturing, labeling, pricing and sales and marketing are subject to extensive regulation by numerous governmental authorities in the European Union, the United States, Switzerland and other jurisdictions. The levels of expenditure and the laboratory and clinical information required for regulatory approval are substantial, and obtaining such approval can require a number of years. The results generated through laboratory and clinical studies conducted worldwide may be used in most countries for the registration of products. However, country-specific regulations, such as in Japan, and possible genetic differences among populations may force us to tailor some studies to specific countries, causing additional delays and expense in the registration process. We cannot sell our products in a given jurisdiction without first obtaining regulatory approval to do so. The success of our current and future products will depend in part upon obtaining and maintaining regulatory approval to market them for approved indications in the European Union, the United States and other markets. The regulatory approval process is lengthy and complex in the European Union, the United States and other jurisdictions. We cannot

be sure that we will obtain the required regulatory approvals on a timely basis, if at all, for any of the products we are developing. Even if we obtain regulatory approval, both our manufacturing processes and our marketed products are subject to continued review. Later discovery of previously unknown issues with our products or manufacturing processes may result in restrictions on these processes, and may ultimately lead to withdrawal of the products from the market. Also, new government requirements may be established that could delay or prevent regulatory approval of the products we have in development.

The European Union requires anyone seeking to market a medicinal product for human use to obtain approval of a Marketing Authorization Application, or MAA. Currently, two main regulatory authorization processes coexist in the European Union. Medicinal products of significant therapeutic interest or constituting a significant innovation undergo a centralized assessment procedure for marketing authorizations valid in all European Union member states, which is administered by the European Medicines Agency, or EMEA. This procedure is applicable to drugs that fall within the definition of ‘‘high technology medicines,’’ and includes all new biotechnology products. Under this procedure, the Committee for Human Products, or CHMP, has 210 days, or a longer period if further information is required, to give its opinion as to whether a marketing authorization should be granted. The European marketing authorization is granted after the CHMP opinion has been reviewed and accepted, and the Decision (i.e., the licence) is granted by the European Commission. The single license is valid for the entire European Union. Products that do not qualify for registration under the centralized procedure, or which were registered under a prior system, are still registered nationally, although by a mutual recognition procedure. The regulatory process is complex and involves extensive consultation with the regulatory authorities of the various European Union member states. Issues still exist regarding the right of member states not to mutually recognize licenses granted in other European Union countries due to poorly defined public health concerns, and there can be no assurance that this European process will not introduce delays. Similarly, prior to commercial sale in the United States, all new drugs and new indications for existing drugs must be approved by the FDA. As in the case of the European Union, securing FDA marketing approvals requires the submission of extensive preclinical and clinical data, chemistry, manufacturing and controls information and other relevant supporting information to the FDA. The submitted data should provide sufficient risk and benefit information for the authorities to determine the approvability of the product and indication in terms of its quality, safety and efficacy.

Regulatory approval of pricing and reimbursement is required in most countries outside the United States. For example, regulators in certain European countries condition their reimbursement of a pharmaceutical product on the agreement of the seller not to sell the product for more than a certain price or in more than certain quantities per year in their respective countries. In some cases, the price established in any of these countries may serve as a benchmark in the other countries. As such, the price approved in connection with the first approval obtained in any of these European countries may serve as the maximum price that may be approved in the other European countries. Also, a price approved in one of these European countries that is lower than the price previously approved in the other European countries may require a reduction in the prices in those other European countries. In that event, the resulting prices may be insufficient to generate an acceptable return on our investment in the products.

Manufacturers of drugs also are required to comply with current Good Manufacturing Practice regulations and similar regulations in the countries in which they operate. These include requirements relating to quality control and quality assurance as well as the corresponding maintenance of records and documentation. Manufacturing facilities are subject to inspection by government regulators, including unannounced inspection in their own and other jurisdictions. Most material manufacturing changes to approved drugs also are subject to regulatory review and approval.

We or our suppliers may fail to comply with applicable regulatory requirements such as adverse event reporting, which could lead to product withdrawal or other regulatory action. Serious, unexpected and unlabeled events observed post-marketing worldwide are subject to expedited reporting requirements to the European, U.S. and other health authorities and could result in changes in the “Warnings” and “Precautions” section of the product labeling.

Various laws, regulations and recommendations relating to safe working conditions, Good Laboratory Practices, Good Clinical Practices, the experimental use of animals and the purchase, storage, movement, import and export and use and disposal of hazardous or potentially hazardous materials, including radioactive compounds and infectious disease agents, used in connection with our research work are or may be applicable to our activities. Although we believe that our safety procedures for handling and disposing of hazardous materials comply with the standards prescribed by applicable laws, regulations and recommendations, the risk of accidental contamination or injury from these materials cannot be completely eliminated.

Environmental Regulation

We seek to comply with all applicable statutory and administrative requirements concerning environmental quality. We have made, and will continue to make, expenditures for environmental compliance and protection. Expenditures for compliance with environmental laws have not had, and we do not expect them to have, a material effect on our capital expenditures, results of operation, financial condition or competitive position.

Capital Expenditures, Divestitures and Investments

Our capital expenditure on tangible fixed assets for 2004 totaled approximately $151.5 million, compared to $185.0 million in 2003 and $125.3 million in 2002. This level of capital expenditure reflects our continuing investment in research and development and manufacturing facilities, our investment in our new corporate headquarters and our continuing implementation of advanced information technology systems.

In the fourth quarter of 2003, we took a non-cash charge of CHF 20.8 million or $16.1 million related to the write-down of our 2001 CHF 25.0 million investment in Swiss International Air Lines Ltd. At the end of 2004, the market value of our investment was CHF 4.2 million or $3.4 million and the significant decline in the market value of the investment was considered to be other than temporary.

In the second half of 2002, our subsidiary, Serono France Holding S.A. conducted a tender offer for the outstanding shares of Genset S.A., a French public company. As a result of this tender offer and subsequent open market purchases, as of March 26, 2003, Serono France Holding S.A. had acquired 7,670,863 shares (representing 92.9% of the outstanding shares), 520,431 bonds convertible into new shares (representing 99.7% of such bonds outstanding) and all of the company's outstanding warrants for an aggregate purchase price of $140.1 million. In addition, following the launch by Genset S.A. of a capital increase in March 2003, Serono France Holding S.A. acquired in the market 354,336 subscription rights. The purchase of these rights increased Serono France Holding S.A.'s stake in Genset S.A. to more than 95% of the share capital of Genset S.A., which permitted Serono France Holding S.A. to launch a squeeze-out merger that enabled it to gain control of all of the outstanding equity securities of Genset S.A. in June 2003. As of June 15, 2003, Serono France Holdings S.A. owned 100% of the Genset share capital.

In the first quarter of 2003, we exercised an option to purchase land adjacent to our current headquarters in Geneva in order to construct a facility to support our future growth. This facility will bring together our corporate management and administration and our Switzerland-based research and development in a single location. We estimate that the cost of this project to scheduled completion in 2006 will be approximately CHF371.1 million or $327.7 million which we will substantially finance by means of a credit facility we have entered into. We started construction in the middle of 2003 and this construction is ongoing.

Organizational Structure

We are a holding company for the companies of the Serono group. A listing of our principal operating companies, their country of incorporation and the proportion of our ownership of each can be found in Note 34 of the Notes to Consolidated Financial Statements elsewhere in this Annual Report.

Facilities

We occupy owned or leased facilities in over 40 countries. Our headquarters are located in Geneva, Switzerland. We maintain research and development facilities in Geneva, the Boston area, Evry, France, and Ardea, Italy. Our principal manufacturing facilities are located in Switzerland, Italy, Spain and France. In 2004, we closed our manufacturing facility in Israel, which was one of our oldest manufacturing sites and had become obsolete. We also have leases for additional office facilities in several locations in Europe, North America, Latin America and Asia. We have made and continue to make improvements to our properties to accommodate our growth. We believe our facilities are in good operating condition and that the real property we own or lease is adequate for all present and near-term future uses. We believe that any additional facilities could be obtained or constructed with our existing capital resources.

In 2003, we exercised an option to purchase a 40,000 square meter section of land near our current headquarters in Geneva for the purpose of bringing together on a single site our headquarters and Switzerland-based research and development activities and supporting our anticipated growth. We estimate that the cost of this project to scheduled

completion in 2006 will be approximately CHF371.1 million or $327.7 million. The total costs capitalized as of December 31, 2004 were CHF 161.3 million or $130.4 million. We substantially financed this project by way of a CHF 300 million committed unsecured revolving bank facility. As of December 31, 2004, the amount outstanding under this facility was CHF131.5 million or $116.1 million. The facility is due for repayment on December 31, 2006. In addition, we purchased approximately 31,000 square meters of land in Martillac, France, at a purchase price of $0.1 million, and thereby added to our existing land holdings in Martillac, France. The additional land may be used at a future date to expand our manufacturing production in Martillac.

The following table lists our principal office, research and development and manufacturing facilities**:**

Location	**Use**	**Owned or Leased**	**Size**
Geneva, Switzerland	Headquarters	Leased-Expires 2006	14,578 sq. meters
Geneva, Switzerland	Research and Development	Leased-Expires 2011	12,698 sq. meters
Rockland, Massachusetts, U.S.A.	U.S. Headquarters	Leased-Expires 2016	200,000 sq. feet
Rome, Italy	Italian Headquarters	Owned	10,212 sq. meters
Ardea, Italy	Research and Development	Owned	46.838 sq. meters
Evry, France	Research and Development	Leased-Expires 2005	13,696 sq. meters
Corsier-sur-Vevey, Switzerland	Manufacturing	Owned	36,395 sq. meters
Aubonne, Switzerland	Manufacturing	Owned	43,800 sq. meters
Coinsins, Switzerland	Manufacturing	Owned	19,800 sq. meters
Rome, Italy	Manufacturing, Research and Development	Owned	51,015 sq. meters
Bari, Italy	Manufacturing	Owned	122,150 sq. meters
Tres Cantos, Spain	Manufacturing	Owned	6,028 sq. meters
Martillac, France	Manufacturing	Leased-Expires 2008	1,107 sq. meters
Martillac, France	Manufacturing	Owned	47,683 sq. meters

Item 5. OPERATING AND FINANCIAL REVIEW AND PROSPECTS

You should read the following operating and financial review and prospects in conjunction with the consolidated financial statements and the notes to the consolidated financial statements appearing elsewhere in this Annual Report. We have prepared our consolidated financial statements in accordance with International Financial Reporting Standards (IFRS), which differ in significant respects from United States Generally Accepted Accounting Principles (U.S. GAAP). You can find a reconciliation of the significant differences between IFRS and U.S. GAAP in note 35 to our consolidated financial statements.

Overview

We are a global biotechnology leader with 4,902 employees, worldwide revenues of $2,458.1 million and a net income of $494.2 million in the year 2004. We have eight biotechnology products on the market and a strong pipeline with approximately 30 ongoing development projects, based both on proteins and small molecules.

We use human genetic information to discover, develop and manufacture therapeutic products for the treatment of human diseases. We currently focus on the specialized markets of neurology, reproductive health, growth and metabolism, and dermatology, our newest therapeutic human genetic area.

We are committed to bringing hope to people suffering from multiple sclerosis or MS. Rebif is a treatment for relapsing MS. Several studies support the concept of maximal benefit with higher and more frequent doses of beta-interferon. Rebif 44 mcg, three times per week, has been shown to achieve maximum treatment effect in terms of disease progression and reducing the frequency and severity of relapses.

We are the world leader in the treatment of infertility. Our vision is to develop and market innovative products to help infertile couples at every stage of the reproductive cycle, from follicular development to early pregnancy, in making their dream of having a child come true. We are the only company that uses recombinant technology to produce all three gonadotropin hormones for treatment of infertility and, with a complete portfolio of highly effective fertility drugs that cover every aspect of the reproductive cycle, we offer clinicians the ability to tailor treatment to individual patient needs.

Our goal is to improve and maintain the quality of life of people with metabolic disorders. To meet this goal, we were one of the first to make recombinant growth hormone available for the treatment of Growth Hormone Deficiency in children and adults (Saizen) and for the treatment of patients suffering from AIDS Wasting (Serostim). We continue our commitment to patients with these disorders through these treatments delivered by easy-to-use devices.

We have a global presence with operations in more than 40 countries, production facilities in four countries and sales in over 90 countries. We have spent 24.2% of total revenues on research and development in 2004. We have integrated operations that allow us to manufacture and market the products we derive from our research and development efforts. Our global sales and marketing infrastructure has made us a global partner of choice in the biotechnology industry.

Critical accounting policies and estimates

Our operating and financial review and prospects are based upon our consolidated financial statements, which we prepared in accordance with IFRS. We have provided in note 35 of the consolidated financial statements a reconciliation of net income and shareholders' equity from IFRS to U.S. GAAP. The preparation of financial statements in conformity with IFRS and the reconciliation under U.S. GAAP require us to make estimates and assumptions that affect the amounts we report in the financial statements and accompanying notes. On an ongoing basis, we evaluate our estimates, including those related to reserves for fiscal and legal claims, sales returns, inventory

obsolescence, bad debt reserves and the assessment of impairment of intangible assets and available-for-sale investments, income taxes, pensions and retirement benefit plans. We base our estimates on historical experience and on various other assumptions that we believe 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 under different assumptions or conditions. We believe the following critical accounting policies affect the more significant judgments and estimates that we use in the preparation of our consolidated financial statements.

Revenue recognition

We recognize revenue from product sales when there is evidence that an arrangement exists, delivery has occurred, the price is fixed and determinable, and collectibility is reasonably assured. Allowances are established for estimated uncollectible amounts, product returns and discounts. We adjust the estimates for returns periodically based upon historical rates of returns, inventory shipment history, estimated levels of product in the distribution channel, and other related factors. While we believe that we can make reliable estimates for these matters, nevertheless unsold products in the distribution channels can be exposed to rapid changes in market conditions or obsolescence due to new competitive environments, product updates or competing products. Accordingly, it is possible that these estimates will change in the near future or that the actual amounts could vary significantly from our estimates.

Assessment of returns

Provisions for sales returns are based on actual historical returns as we feel that this is the best means to estimate future returns of products sold in the current period. The amount of returns we receive varies by region and is dependent upon the return policy within a given country. We perform periodic quantitative analysis by product for each reserve category to assess whether the current assumptions used to calculate the sales return provisions are valid. We calculate a twelve-month rolling return rate based on actual product returns. We then apply this rate against all future outstanding products that could be subject to expiration. The result is the reserve needed for future returns. The reserves that are generated based on the historical rate of actual returns are compared to a qualitative analysis of sales reserves to ensure that the amount of the reserves recorded in our financial statements reflect all of the facts and circumstances that could potentially impact the amount of future returns that we will receive. The qualitative factors that are incorporated into our sales return analysis would include the potential impact on future product returns, for example, of the introduction of a competing product or changes in reimbursement practices.

Assessment of inventory levels in the distribution channel

Our distribution channel includes wholesaler distributors, pharmacies, hospitals and other medical facilities that distribute and/or administer our products. In the U.S. market for example, which accounts for 35.1% of our total product sales, we receive monthly inventory reports from the wholesalers we sell to summarizing by product the amount of inventory held at the end the month. Inventory levels maintained at the wholesalers in the U.S. are approximately 30 days of sales. In Europe, our single largest region, representing 41.1% of our total product sales, we generally maintain inventory levels of less than 30 days. We assess inventory levels maintained in the Europe region based on a comparison of sale volumes to wholesalers against their reported sales to pharmacies, hospitals and other medical facilities.

Throughout all of our regions, wholesalers typically sell to pharmacies, hospitals and other medical facilities. Therefore, there is an additional level of inventory in our distribution channel. However, given the relatively high inventory value of our products and the fact that wholesalers can deliver our products to a healthcare facility on the same day, pharmacies, hospitals and other medical facilities are reluctant to carry significant amounts of our products. Thus we believe that the inventory held at the wholesaler represents the substantial part of the inventory held within the entire distribution channel at any given time.

Assessment of the average age of inventory in the distribution channel

At present time we do not have the ability to track the expiration date of inventory held in the distribution channel on a global basis. Movements in sales reserves during the past three years are summarized in the following table:

	Product returns U.S.$m	Discounts, chargebacks and rebates U.S.$m	**Total sales reserves U.S.$m**
Balance as of January 1, 2002	21.4	23.0	**44.4**
Add: New reserves recorded in 2002	20.0	103.5	**123.5**
Less: Reserves applied during 2002	(20.5)	(94.1)	**(114.6)**
Balance as of December 31, 2002	20.9	32.4	**53.3**
Add: New reserves recorded in 2003	31.1	153.7	**184.8**
Less: Reserves applied during 2003	(15.6)	(132.0)	**(147.6)**
Balance as of December 31, 2003	36.4	54.1	**90.5**
Add: New reserves recorded in 2004	8.8	187.6	**196.4**
Less: Reserves applied during 2004	(15.3)	(187.7)	**(203.0)**
Balance as of December 31, 2004	**29.9**	**54.0**	**83.9**

Gross product sales recorded in 2004, 2003 and 2002 before sales reserves were $2,374.4 million, $2,042.8 million and $1,546.7 million, respectively. New reserves recorded in 2004, 2003, and 2002 as a percentage of gross product sales were 8.3%, 9.0%, and 8.0%, respectively. Reserves for product returns recorded in 2004 were lower when compared to 2003; this was the result of the application of lower product return rates in the U.S. for sales of Rebif and Novantrone. The initial forecasted rates of return that were established upon the launch of these products in the first and fourth quarters of 2002 were estimated without the benefit of historical return data. Return rates for these products were reduced during 2004 based on the volume of actual returns received. In addition, product returns of existing Gonal-f product related to the 2004 U.S. launch of Gonal-f fill-by-mass formulation and the Gonal-f pre-filled pen were less than expected.

Inventory provisions

We write down our inventory by an amount equal to the difference between the cost of inventory and the net realizable value of the inventory, based upon assumptions about future demand and market conditions. If actual market conditions are less favorable than those we project, we may need to take additional inventory write-downs.

Bad debts

We maintain allowances for estimated losses resulting from the inability of our customers to make required payments. If the financial condition of our customers were to deteriorate, resulting in an impairment of their ability to make payments, we might need to make additional allowances.

Impairment testing

We evaluate the carrying value of our tangible and intangible assets for impairment on an annual basis, and also whenever indicators of impairment exist. If we determine that such indicators are present, we prepare a discounted future net cash flow projection for the asset (“value in use”). In preparing this projection, we must make a number of assumptions and estimates concerning such things as future sales performance of our various products and the rates of increase in operating expenses over the remaining useful life of the asset. If the calculation of value in use is in excess of the carrying value of the recorded asset, no impairment is recorded. In the event the carrying value of the asset exceeded the value in use, we would estimate the net selling price of the asset and, where appropriate, we would use the assistance of an external valuation expert. If the carrying value also exceeded the net selling price, we would take

an impairment charge to bring the carrying value down to the higher of net selling price and value in use. The discount rate we use in the calculation represents our best estimate of the risk-adjusted pre-tax rate. Should the sales performance of one or more products be significantly below our estimates, we might have to take an impairment charge on certain tangible assets or intangible assets.

Accounting for available-for-sale investments

We hold available-for-sale investments at fair value and have elected to treat any unrealized gains and losses as increases or decreases in fair value reserves, which affect shareholders' equity. We have a policy in place to review each individual holding of available-for-sale investments at each balance sheet date to evaluate whether or not each investment is permanently impaired. Our policy includes reviewing all publicly available information provided by the company in which we have invested and analysts' reports for evidence of significant financial difficulty, recognition of impairment losses, possibility of bankruptcy, severe operational setbacks and other impairment indicators. If we believe that a permanent impairment has been incurred and the eventual recoverable amount will not exceed the original cost, it is our policy to recognize an impairment loss in the income statement.

Deferred income taxes

We account for deferred income taxes based upon differences between the financial reporting and income tax bases of our assets and liabilities. We record deferred tax assets only to the extent that it is probable that taxable profit will be available in the affiliate that has recognized the deferred tax assets, which is an assessment that is based on management judgment.

Pensions

Substantially all of our employees are covered by defined benefit, defined contribution, insured or state pension plans. The expense incurred under the defined benefit retirement plans is based upon statistical and actuarial calculations, and is impacted by assumptions on discount rates used to arrive at the present value of future pension liabilities, expected returns that will be made on existing pension assets, future salary increases as well as future pension increases. Furthermore, our independent actuaries use statistical based assumptions covering future withdrawals of participants from the plan and estimates on life expectancy. The actuarial assumptions used may differ materially from actual results due to changes in market and economic conditions, higher or lower withdrawal rates or longer or shorter life spans of participants. These differences could impact significantly the amount of pension income or expense recognized in future periods.

Contingencies

Several of our subsidiaries are parties to various legal proceedings including possible breach of contract, patent infringement cases and other matters. As a result, claims could be made against them which might not be covered by existing provisions or by insurance. There can be no assurance that there will not be an increase in the scope of these matters or that any future lawsuits, claims, proceedings or investigations will not be material. Management believes that during the next few years, the aggregate impact, beyond current reserves, of these and other legal matters affecting the company is reasonably likely to be material to the company's results of operations and cash flows, and may be material to its financial condition and liquidity.

Results of operations – Overview

We are active in the research, development, production and marketing of products that address our four current therapeutic areas of neurology, reproductive health, growth and metabolism and dermatology.

Total revenues

Product sales

In 2004, five products accounted for 92.6% of our total product sales. Rebif, our largest selling product accounted for 50.1% of our sales, is a recombinant interferon beta-1a that we sell for the treatment of multiple sclerosis. Gonal-f, our second largest selling product accounted for 26.3% of our product sales, is a recombinant human follicle stimulating hormone that we sell for the treatment of infertility. Saizen and Serostim are different formulations of recombinant human growth hormone, and are our third and fourth largest selling products, respectively and on a combined basis, accounted for 12.3% of our product sales. Saizen is used in the treatment of growth retardation due to a variety of causes. Serostim is used to treat AIDS Wasting. Novantrone, for which we purchased the marketing rights to sell in the U.S. market, is indicated for certain types of worsening MS and also for certain forms of cancer. Product sales of Novantrone for the two separate indications are reported under our neurology therapeutic area and as other product sales, respectively and accounted for 3.9% of our total product sales. In addition to the main products highlighted above, we also sell a variety of other products.

Royalty and license income

We currently receive ongoing royalties under licensing agreements with Biogen Idec for its sales of Avonex, Organon for its sales of Puregon, Amgen for its sales of Enbrel and Abbott Laboratories for its sales of Humira. Our revenues from these agreements increase or decrease in proportion to our licensees' sales of their products. We derive license income from licensing our intellectual property to third parties. In addition, we also receive non-recurring amounts through patent settlements with third parties.

Operating expenses

Our operating expenses are composed of cost of product sales, selling, general and administrative expenses, research and development expenses, and other operating expenses.

Cost of product sales

Cost of product sales includes all costs we incur to manufacture the products we sell in a given year. Our largest components of cost of product sales are employee-related expenses, depreciation of manufacturing plant, property and equipment, materials and supplies, utilities and other manufacturing-related facility expenses. We also purchase directly from outside manufacturers finished products including Raptiva, Crinone and Cetrotide, that we sell as part of in-licensing agreements that grant us exclusive rights to sell these products in specific territories. The payments that we make to our in-licensing partners are capitalized as intangible assets and amortized over the shorter of the term of the license and the period in which we expect to sell the in-licensed product. Amortization expense is reported under other operating expense.

Selling, general and administrative

Our selling, general and administrative expenses are composed of distribution, selling and marketing and general and administrative expenses:

Distribution. In general, we sell our products to wholesale distributors or directly to hospitals, medical centers and pharmacies. Distribution expenses are primarily freight expenses, employee-related expenses and expenses incurred by third-party distributors in distributing our products.

Selling and marketing. We maintained a marketing and sales force of 2,084 employees in 2004 to sell or manage the distribution of our products in almost 100 countries. Our selling and marketing expenditures consist primarily of employee-related expenses and costs associated with congresses, exhibitions and advertising as well as commissions paid to our two co-promotion partners: Pfizer, which co-promotes Rebif in the U.S. market, and OSI Pharmaceuticals, which co-promotes Novantrone in the U.S. as a treatment for certain forms of cancer.

Selling and marketing expense generally maintains a positive correlation with the volume of products that we sell. However, we may incur additional selling and marketing expense upon the introduction of a new product or when we introduce existing products into new markets, as we hire additional sales personnel to undertake product launches. For example, we received European Commission Marketing Authorization for Raptiva (efalizumab) for the treatment of adult patients with moderate to severe chronic plaque psoriasis who failed to respond to, or who have a contraindication to, or are intolerant of other systemic therapies including cyclosporine, methotrexate and PUVA. Raptiva is the first new biological treatment for psoriasis to be authorized for marketing in the European Union. Raptiva was available in 15 countries including Germany and UK by the end of 2004 and will launch throughout the rest of the Serono territories during 2005. The cost of the launch of Raptiva contributed to the increase in reported selling and marketing expense expressed as a percentage of product sales.

General and administrative. We incur general and administrative expenses in maintaining our headquarters in Geneva and our operations in more than 40 countries. We centralize certain functions, such as finance, information technology, treasury, tax and legal, to the extent possible, to achieve economies of scale in operations.

Research and development

Research and development or R&D is one of our key functions, and we employed 1,387 R&D employees in 2004. We incur our primary R&D expenses in connection with the operation of the Serono Pharmaceutical Research Institute in Geneva, the Serono Reproductive Biology Institute in Boston, the Istituto di Ricerca Cesare Serono, which merged into the Industria Farmaceutica Serono, the Istituto di Ricerche Biomediche ‘‘Antoine Marxer’’ RBM in Italy, the Serono Genetics Institute in France, Bourn Hall in UK and our corporate R&D organization.

We also invest significantly in collaborations with other biotechnology companies that can require material up-front payments, future ongoing milestone payments, and eventually future royalty payments that are normally based on a percentage of sales we generate from a product that we have in-licensed. In most cases, up-front and milestone payments, payable under research and development agreements, are charged directly to research and development expense, unless there is significant evidence that all of the criteria for capitalization, as prescribed by IAS 38, “Intangible Assets”, are met. Acquired projects which have achieved technical feasibility, usually signified by regulatory body approval, are capitalized, as it is probable that the costs will give rise to future economic benefits. During 2004, we incurred $83.7 million in collaborative payments that have been recognized as research and development expense, as they did not meet the criteria for capitalization.

On January 1, 2005, we will adopt IAS 38 (revised 2004), “Intangible Assets”, which will have a material impact on the accounting for our collaborative arrangements. This standard recognizes that the price that we pay to acquire an intangible asset as part of an in-licensing agreement reflects expectations about the probability that the expected future economic benefits from the asset will flow to us. The effect of probability is reflected in the cost of the asset. The probability recognition criterion is always considered to be satisfied for separately acquired intangible assets. We expect that the adoption of this standard in 2005 will result in an increase in the amount of capitalized intangible assets. This revised standard is to be applied prospectively. Therefore, the accounting for the transactions made prior to January 1, 2005, will not be amended by this revised standard.

The adoption of IAS 38 (revised 2004), “Intangible Assets”, in fiscal year 2005 will result in a significant difference between IFRS and U.S. GAAP as intangible assets acquired as part of a separate transaction will continue to be expensed under U.S. GAAP until the asset has achieved technical feasibility which is usually signified by regulatory approval. The difference that will be included in our reconciliation from IFRS to U.S. GAAP will be equal to the amount of payments that we make to acquire intangible assets that are part of separate transactions, that have been capitalized as intangible assets and that have not achieved technical feasibility at the time of the transaction. This difference will be deducted from our reported net income in accordance with IFRS to arrive at net income reported under U.S. GAAP. Had IAS 38 (revised 2004), “Intangible Assets”, been effective on January 1, 2004, reported research and development expense for the year ended December 31, 2004, would have been lower by $83.7 million.

Other operating expense

Other operating expense includes royalty and license expense, amortization of intangibles and other long-term assets, litigations and legal costs, patent and trademark expenses, and equity compensation expenses related to our Employee Share Purchase Plan.

We incur the majority of our royalty and licensing expenses under agreements that we have with Amgen and Wyeth on sales of Novantrone; Genentech on sales of Raptiva; Yeda, the commercial arm of the Weizmann Institute in Israel, on royalties received from Biogen, Amgen and Abbott Laboratories and also on sales of Rebif; Columbia University on sales of Gonal-f; Roche on sales of Rebif; and Berlex Laboratories Inc., the U.S. subsidiary of the Schering Group, on sales of Rebif. Our expenses under these licenses vary with the royalties received and the sales of the applicable products.

On January 1, 2005, we will adopt IFRS 2, “Share-Based Payments”, which will require us to expense the fair value of stock options granted to employees and directors. The application of this new standard requires that all stock options that were granted after November 7, 2002 and had not vested before January 1, 2005 must be expensed over their vesting period. Therefore, in 2005, being the first period that we will expense the fair value of stock options, we will adjust our 2004 reported results to reflect additional operating expense in the amount of $12.2 million before tax.

Year ended December 31, 2004 compared to year ended December 31, 2003

The following compares our results in the year ended December 31, 2004 to those of the year ended December 31, 2003. Our analysis is presented as follows:

1. Overview
2. Product sales by therapeutic area
3. Product sales by region
4. Operating expenses to net income

1. Overview

Our total revenues increased by 21.8% to $2,458.1 million during 2004. Our total revenue growth in local currencies was approximately 16.1%, reflecting our strong underlying growth. Worldwide product sales were $2,177.9 million in 2004, representing an increase for the year of 17.2%. Product sales growth in local currencies was 11.5% in 2004. The total currency impact on reported product sales and total revenues was $100.1 million or 4.6% and $107.4 or 4.4%, respectively.

Royalty and licensing income increased by 74.4% to $280.1 million for the year and was impacted by a new license agreement under a non-core technology that was granted during the year and for which we recognized $67.0 million in license income. The license fee is payable in equal annual installments over the next three years. However, the full amount of the license fee was recognized as royalty and license income in 2004 as no further performance obligation exists on our behalf.

Our royalty income increased by 19.8% to $188.7 million during the year and reflects our strong intellectual property rights. The increase was due to higher royalty income received from Abbott Laboratories on its sales of Humira; from Amgen on its sales of Enbrel and from Biogen Idec on its sales of Avonex.

Operating expenses increased by 22.1% to $1,933.9 million or 78.7% of total revenues. Our operating expenses were unfavorably impacted by the weakening of the U.S. dollar against most major currencies and in particular the Swiss franc and Euro. The total estimated currency impact on reported operating expenses was $85.7 million or 4.4%. Our operating margin was 21.3% compared to 21.5% in 2003. Our operating margin, after removing the currency impact, was 21.4%.

Net income increased by $104.2 million or 26.7% and represents 20.1% of total revenues. Our reported net income benefited from a net favorable currency impact of $17.2 million or 3.5%. Basic earnings per bearer shares increased by 31.3% from $24.63 in 2003 to $32.35 in 2004.

Our outlook for 2005 includes sales growth of between 10% and 15%, total 2005 revenues of at least $2.6 billion and net income of between $520 million and $540 million all based on prevailing currency exchange rates.

2. Product sales by therapeutic area

The following tables summarize, for the periods indicated, our product sales by therapeutic area:

	Year ended December 31,				
	2004 U.S. $m	Change in %	2003 U.S. $m	Change in %	2002 U.S.$m
Neurology					
Rebif	**1,090.6**	33.1	819.3	49.3	548.8
Novantrone	**32.4**	5.0	30.9	10,166.7	0.3
Total neurology	**1,123.0**	32.1	850.2	54.9	549.1
Reproductive health					
Gonal-f	**572.7**	8.7	526.9	17.0	450.4
Cetrotide	**24.8**	(0.2)	24.8	35.3	18.4
Crinone	**19.8**	(4.6)	20.8	90.2	10.9
Ovidrel	**17.7**	43.3	12.4	117.2	5.7
Luveris	**10.6**	6.0	10.0	52.4	6.6
Core infertility portfolio	**645.6**	8.5	594.9	20.9	492.0
Metrodin HP	**15.9**	(36.0)	24.8	(50.6)	50.1
Pergonal	**11.5**	(74.9)	45.8	(0.4)	46.0
Profasi	**6.7**	(56.2)	15.4	(22.4)	19.8
Other products	**12.6**	4.9	12.0	(13.4)	14.0
Total reproductive health	**692.3**	(0.1)	692.9	11.4	621.9
Growth and metabolism					
Saizen	**182.1**	20.2	151.5	22.1	124.0
Serostim	**86.8**	(2.2)	88.7	(6.6)	95.1
Zorbtive	**0.9**	-	-	-	-
Total growth and metabolism	**269.8**	12.3	240.2	9.6	219.1
Dermatology					
Raptiva	**4.9**	-	-	-	-
Total dermatology	**4.9**	-	-	-	-
Other products	**87.9**	17.8	74.7	125.5	33.0
Total product sales	**2,177.9**	17.2	1,858.0	30.6	1,423.1
Recombinant products	**1,961.7**	21.9	1,609.4	30.7	1,231.3
Non-recombinant products	**216.2**	(13.0)	248.6	29.7	191.8

Neurology

In 2004, neurology sales were up 32.1% to $1,123.0 million, reflecting the continued strong demand for Rebif, with a significant market share increase. Rebif achieved blockbuster status reaching over one billion U.S. dollars in annual worldwide sales in 2004. Worldwide sales of Rebif increased by 33.1% to $1,090.6 million in 2004, compared to $819.3 million last year. In local currencies, Rebif sales increased by 25.4%. Sales growth was driven by a

combination of a volume increase of 29.0% and a 3.2% increase in average selling price on account of sales denominated in currencies other than U.S. dollar. When holding exchange rates constant, our average selling price decreased by 2.8%, mostly due to pressure on prices, particularly in the European Union.

Rebif sales in the U.S. increased by 56.8% in 2004 to reach $295.6 million, compared to $188.5 million in 2003 reflecting the continued strong demand.

Rebif sales in Europe grew by 25.6% to $531.7 million compared to $423.2 million in 2003. In local currencies, sales increased by 13.7%. This was primarily driven by increased patient market share in Italy, Spain, and France and a growing patient base in the UK following an increase in the funding from health authorities.

Rebif sales in Latin America increased by 23.8% to $75.9 million in 2004 compared to $61.3 million in 2003, primarily due to higher sales in Brazil, Venezuela and Argentina.

Rebif sales in the rest of the world grew by 28.0% (or 21.2% in local currencies) to $187.4 million compared to $146.3 million in 2003 driven by strong sales in the Middle East, Central Europe and Switzerland as well as the emerging markets of Bulgaria and Romania.

For the twelve months ended September 2004, our worldwide dollar market share reached 24.1%, up 1.7% compared to the same period last year. Excluding sales in the U.S., our dollar market share was 35.5%, down 0.3% compared to the same period in 2003. In the U.S., our dollar market share reached 12.6% as of September 30, 2004 compared to 9.7% one year earlier.

Reproductive health

Reproductive health or RH product sales were $692.3 million during 2004 compared to $692.9 million in 2003. In local currencies, RH product sales decreased by 4.7%. Our RH core infertility portfolio made up of three recombinant hormones (Gonal-f, Ovidrel, Luveris) and two supporting products (Cetrotide, Crinone) grew by 8.5% (or 3.4% in local currencies) from $594.9 million in 2003 to $645.6 million in 2004.

In 2004, difficult market conditions, primarily in Europe, impacted our RH franchise performance. The implementation of healthcare reforms in Germany at the beginning of the year reduced pricing and reimbursement levels. However, we have seen a good performance in other regions beginning with the U.S., where recombinant market share increased, though this was partially offset by the phase-out of Pergonal as of March 2004. We had market share gains in Spain and a successful launch of the Gonal-f pen in Oceania and strong sales growth in Middle East, Africa and Eastern Europe.

Our sales of Gonal-f increased by 8.7% to $572.7 million in 2004 from $526.9 million in 2003 or by 3.6% in local currencies. Sales growth of Gonal-f was driven by a volume increase of 5.2% and an increase in the average selling price of 3.4% due to both currency and regional sales mix. After removing the favorable impact of foreign currency, the average selling price decreased by 1.5% during 2004. The growth in volumes was largely due to the increasing penetration of our multidose presentation and the launch of our fill-by-mass formulation and Gonal-f pre-filled pen.

The sales growth of Gonal-f was achieved despite the adverse impact of the German healthcare reform that took effect on January 1, 2004. Gonal-f sales in Germany have decreased during the year by $36.2 million.

Ovidrel sales increased by 43.3% to $17.7 million compared to $12.4 million in 2003. In the same period, Luveris sales increased by 6.0% to $10.6 million. Recombinant gonadotropin sales as a percentage of total gonadotropin sales increased from 86.0% in 2003 to 94.0% this year. Urine-derived gonadotropins sales decreased by 57.2% from $89.3 million in 2003 to $38.2 million in 2004. Metrodin HP sales declined by 36.0% from $24.8 million in 2003 to $15.9 million this year. In line with our strategy to phase out Pergonal in 2004, its sales continued to decrease from $45.8 million in 2003 to $11.5 million this year.

Sales of Crinone decreased by 4.6% (or 7.8% in local currencies) to $19.8 million compared to $20.8 million in 2003. Sales of Cetrotide were slightly below last year, down 0.2% (or 5.4% in local currencies), at $24.8 million in 2004.

Growth and metabolism

Our growth and metabolism product sales increased by 12.3% to $269.8 million in 2004 from $240.2 million in 2003. In local currencies, product sales increased by 8.2%. Sales of Saizen increased by 20.2% to $182.1 million in 2004 from $151.5 million in 2003 or by 13.6% in local currencies. Sales growth resulted from strong demand in the U.S.

market and also in Asia Pacific, mostly in Korea and Taiwan, as well as in Middle East, Africa and Eastern Europe. Volumes and average selling price increased by 16.7% and 3.0%, respectively during the year. After removing the favorable impact of foreign currency, the average selling price decreased by 2.6%.

Serostim sales in AIDS Wasting were $86.8 million in 2004, down 2.2% compared to 2003, reflecting the slight decrease in Serostim demand in the U.S.

Dermatology

We received European Commission Marketing Authorization for Raptiva (efalizumab) for the treatment of adult patients with moderate to severe chronic plaque psoriasis who failed to respond to, or who have a contraindication to, or are intolerant of other systemic therapies including cyclosporine, methotrexate and PUVA. Raptiva is the first new biological treatment for psoriasis to be authorized for marketing in the European Union. We launched Raptiva in 15 countries including Germany and UK during the 2004 and will launch throughout the rest of the Serono territories during 2005. Product sales of Raptiva in 2004 were $4.9 million.

3. Product sales by region

The following tables summarize, for the periods indicated, our product sales by region:

	Year ended December 31,				
	2004 U.S.$m	Change in %	2003 U.S.$m	Change in %	2002 U.S.$m
Europe	**895.2**	12.3	796.8	28.4	620.4
North America	**837.9**	20.7	694.3	44.8	479.6
Middle East, Africa and Eastern Europe	**196.3**	29.8	151.2	40.5	107.6
Asia-Pacific, Oceania and Japan	**137.5**	17.6	116.9	10.1	106.3
Latin America	**111.0**	12.4	98.8	(9.5)	109.2
Total product sales	**2,177.9**	17.2	1,858.0	30.6	1,423.1

Europe

Sales in Europe for the year 2004 increased by 12.3% to $895.2 million compared to $796.8 million in 2003. In local currencies, sales increased by 1.7%. This result was primarily due to increased sales of Rebif in almost all European countries, up 13.7% in local currencies. Our RH core infertility portfolio was down 14.5% primarily from the decrease in sales of Gonal-f in Germany as a result of healthcare reform that was enacted on January 1, 2004. Gonal-f sales in Germany decreased by $36.2 million during the year.

North America

Sales in North America increased by 20.7% in 2004 to $837.9 million. Sales growth in this region was primarily within the U.S. due to the strong performance of Rebif (up 56.8%), Gonal-f (up 13.2%), Saizen (up 24.0%), and Novantrone (up 8.8%). This was partially offset by lower sales of Pergonal as it was phased-out of the U.S. market as of March 2004, down 79.9%.

Middle East, Africa and Eastern Europe

In the Middle East, Africa and Eastern Europe, sales increased by 29.8% to $196.3 million due to the strong performance of Rebif, the RH core infertility portfolio and Saizen, partially offset by decreased sales of Pergonal, Profasi and Metrodin HP.

Asia-Pacific, Oceania and Japan

Sales in Asia-Pacific were $65.1 million, up 6.8% (or 5.5% in local currencies) primarily driven by increased sales of Gonal-f and Saizen up 15.2% and 59.2%, respectively, partially offset by decreased sales of Metrodin HP, Pergonal and Profasi. Sales in Oceania increased by 39.2% (or 22.5% in local currencies) to $40.2 million, primarily attributable to higher sales of the RH core infertility portfolio products. In Japan, sales increased by 18.7% (or 10.4% in local currencies) to reach $32.1 million mainly attributable to higher sales of Saizen, Pergogreen and Serostim.

Latin America

Sales in Latin America increased by 12.4% to $111.0 million primarily driven by strong Rebif sales performance, up 23.8% and the RH core infertility portfolio, up 16.2%. This was partially offset by lower Pergonal sales down 98.3%.

Royalty and license income

	Year ended December 31,				
	2004	Change	2003	Change	2002
	U.S.$m	in %	U.S.$m	in %	U.S.$m
Royalty and license income	**280.1**	74.4	160.6	40.0	114.7

Our royalty and license income increased by 74.4% (or 69.5% in local currencies) to $280.1 million in 2004 compared to $160.6 million in 2003. They were impacted by a new license agreement for a non-core technology that was granted during the year for which we recognized $67.0 million in license income. The license fee is payable in equal annual installments over the next three years. However, the full amount of the license fee was recognized as royalty and license income in 2004 as no further performance obligation exists on our behalf.

Our royalty income increased by 19.8% to $188.7 million during the year compared to $157.5 million in 2003 and reflects our strong intellectual property rights. This increase was due to higher royalty income received from Abbott on its sales of Humira, Amgen on its sales of Enbrel, and Biogen Idec on its sales of Avonex. This was partially offset by a decrease in royalty income earned from Organon on its sales of Puregon, and a number of other products.

4. Operating expenses to net income

Cost of product sales

Cost of product sales in 2004 increased by 8.8% to $304.1 million from $279.6 million in 2003. Cost of product sales as a percentage of product sales decreased to 14.0% from 15.0% in the prior year. The corresponding gross margin percentage was 86.0% in 2004, compared to 85.0% last year. Our gross margin in 2004 includes the impact of closing our manufacturing operation in Israel that resulted in a one-time charge of $20.5 million related to people costs and the write-down of tangible fixed assets. Our gross margin percentage without the impact of these closure costs would have been 87.0%.

The increase in gross margin was primarily the result of favorable changes in product mix and continuing manufacturing productivity gains leading to higher production yields. However, this was partially offset by the strength of the Swiss franc and Euro against the U.S. dollar during 2004, as our costs of manufacturing are incurred in Swiss franc and Euro. Our reported product sales benefited from sales denominated in non-U.S. dollar currencies resulting in a favorable currency impact in 2004 of $100.1 million while cost of product sales was adversely impacted by an unfavorable currency impact of $14.3 million.

The proportion of recombinant products sales reached an all time high in 2004 of 90.1%. This proportion is expected to level off upon the completion of our final phase out of our urinary products combined with our launch of Raptiva outside the U.S. and Japan. Gross margin is expected to continue to benefit in the near term from continued economies of scale and the expected utilization of some of our spare manufacturing capacity. We expect that gross margin will reach 88% within the next two years.

Selling, general and administrative

	Year ended December 31,				
	2004 U.S.$m	Change in %	2003 U.S.$m	Change in %	2002 U.S.$m
Selling and marketing	**612.5**	29.5	472.9	25.4	377.1
General and administrative	**195.4**	19.3	163.9	28.9	127.1
Total selling, general and administrative	**807.9**	26.9	636.8	26.3	504.2

Selling and marketing expenses were $612.5 million, or 24.9% of total revenues in 2004 compared to $472.9 million for last year, corresponding to an increase of 29.5%. This increase in reported selling and marketing expenses was mainly driven by higher sales commissions incurred on sales of Rebif and Novantrone in the U.S., sales and marketing costs associated with the launch of Raptiva, and marketing activities to support our product sales growth including Gonal-f filled-by-mass and Gonal-f pre-filled pen.

General and administrative expenses were $195.4 million or 8.0% of revenues in 2004 compared to $163.9 million in 2003, which represents an increase of 19.3%. This increase was primarily due to increased personnel related costs and facility expenses.

Our reported selling, general and administrative expenses include an unfavorable currency impact of $36.6 million or 4.5% primarily due to the strength of the Euro and Swiss franc compared to the U.S. dollar.

Research and development

	Year ended December 31,				
	2004 U.S.$m	Change in %	2003 U.S.$m	Change in %	2002 U.S.$m
Research and development	**594.8**	27.1	467.8	30.6	358.1
Research and development as a % of revenues	**24.2**		23.2		23.3

Research and development expenses in 2004 reached $594.8 million, or 24.2% of total revenues, compared to $467.8 million, or 23.2% of total revenues, in 2003. Research and development expenses include the costs of several key new collaborative and license agreements that were signed with ZymoGenetics Inc., CancerVax Corporation and Micromet AG. We also continued to invest substantially in the pharmaceutical development of new molecules, most notably onercept and TACI-lg. There were also significant investments in clinical development projects aimed at the development of onercept in psoriasis, Serostim for HARS in the U.S., the Raptiva study supporting the New Drug Application in Europe, which was granted in the third quarter of 2004, and the Rebif vs. Copaxone head-to-head study. Finally there were significant additional investments made in the discovery area, mainly in functional genomics aimed at identifying novel therapeutics proteins from the human genome, and the genetics work in the field of autoimmune diseases at the Serono Genetics Institute.

Other operating expense, net

Other operating expenses, net were $227.1 million in 2004 compared to $199.5 million in 2003, corresponding to an increase of 13.8% or 13.2% in local currencies. This increase was due to higher ongoing royalty expenses that were driven by higher sales of Rebif and additional royalty expenses related to royalty income received for Humira, Enbrel and Avonex.

Operating income

Our operating income increased by 20.5% to $524.1 million in 2004 from $434.9 million in 2003. As a percentage of total revenues, our operating income was 21.3% in 2004 compared to 21.5% in 2003.

Financial income, net

	Year ended December 31,				
	2004 U.S.$m	Change in %	2003 U.S.$m	Change in %	2002 U.S.$m
Financial income	**68.2**	36.8	49.8	(22.9)	64.6
Financial expense	**(24.0)**	85.4	(13.0)	21.7	(10.6)
Foreign currency gains/(losses)	**19.1**	167.1	7.2	140.8	(17.5)
Total financial income, net	**63.3**	43.7	44.0	20.6	36.5

Financial income increased by $18.4 million to $68.2 million in 2004. The increase is due to a one-time gain on the forward purchase of shares in ZymoGenetics Inc. as part of a research and development collaboration that was entered into during the year. Financial income earned on the investment in corporate bonds also increased during 2004 by $9.1 million which reflects the fact that the group held more financial assets during 2004 compared to 2003 despite the impact of the Share Buy Back Plans.

Financial expense increased during 2004 by $11.0 million and reflects the impact of the convertible bond. We are paying annual coupon interest at the rate of 0.5%. In addition, financial expense also includes the non-cash amortization of the conversion feature as well as the redemption premium on the convertible bond if the bond is not converted which amounted to $11.4 million.

Foreign currency gains increased by $11.9 million and were a result of the gains on derivative instruments taken out to hedge the foreign currency exposure that we incur because of the disproportionate amount of our expenses that are incurred in currencies other than the U.S. dollar.

Other expenses, net

Other expenses decreased significantly in 2004. In 2003, we took a non-operating, non-recurring, non-cash charge of $16.1 million related to the write-down of an equity investment as well as a $4.0 million realized loss upon our sale of another equity investment.

Taxes

Our total taxes incurred as a percentage of income before taxes and minority interests increased slightly to a final rate of 15.5% compared to 15.0% in 2003.

Net income

Our net income increased by 26.7% to $494.2 million in 2004 from $390.0 million in 2003. Our net income represented 20.1% of total revenues, compared to 19.3% in 2003.

Exchange rate movements favorably impacted net income by $17.2 million or 3.5%.

Our basic earnings per share grew by 31.3% from $24.63 to $32.35 per share. Our percentage increase in basic earnings per share outpaced our increase in net income due to the impact of treasury shares that were acquired during 2004 as a result of two Share Buy Back Plans. The weighted average number of shares outstanding used to calculate basic earnings per share decreased during 2004 by 556,007 shares resulting in an increase in our basic earnings per share of $1.14 per share.

The first Share Buy Back Plan, authorized to repurchase CHF500.0 million worth of Serono bearer shares, was fully utilized by the end of May 2004. The second Share Buy Back Plan was authorized to repurchase CHF750.0 million worth of Serono bearer shares, of which CHF13.5 million remains unspent. Unlike the first Share Buy Back Plan, whereby shares acquired will be held until granted at some time in the future, shares acquired under the second Share Buy Back Plan will be cancelled subject to approval by shareholders at the Annual General Meeting of Shareholders.

Year ended December 31, 2003 compared to year ended December 31, 2002

The following compares our results in the year ended December 31, 2003 to those of the year ended December 31, 2002. Our analysis is presented as follows:

1. Overview

2. Product sales by therapeutic area

3. Product sales by region

4. Operating expenses to net income

1. Overview

Our total revenues increased by 31.3% to $2,018.6 million for the full year of 2003. Our total revenue growth in local currencies was approximately 20.9%, reflecting our strong underlying growth. Worldwide product sales were $1,858.0 million in 2003, representing an increase for the year of 30.6%. Notwithstanding weakness in the U.S. dollar, product sales growth in local currencies was 19.9% in 2003. Sales growth was driven by an increase of 24.7% in the volume of the products sold that was partially offset by a decrease in the average selling price of our products due to changes in regional sales mix and decreases in sales prices.

Royalty and licensing income increased by 40.0% to $160.6 million for the full year, reflecting the company's strong intellectual property rights.

In 2003, operating expenses increased by 33.3% to $1,583.7 million or 78.5% of total revenues. Operating margin declined to 21.5% in 2003 from 22.7% in 2002 due to an increase in other operating expenses that reflects the in-licensing in of Novantrone and royalties paid to third parties as well as higher expenses from the amortization of intangible assets.

Net income increased by $69.2 million or 21.6% and represented 19.3% of total revenues. Excluding the non-recurring, non-operating charges related to a $16.1 million write-down of our investment in Swiss International Air Lines and a $4.0 million loss on the sale of our investment in PowderJect Pharmaceuticals, net income increased by 26.9% or 19.4% in local currencies. We believe that it is useful to provide a calculation of our net income that excludes these non-recurring, non-operating charges, because it permits our investors to compare 2003 net income calculation with our net income from 2002 in order to better assess our operating performance. Net income per share increased by 22.7% from $20.07 in 2002 to $24.63 in 2003.

2. Product sales by therapeutic area

Neurology

In 2003, neurology sales were up 54.9% (39.5% in local currency) to $850.2 million. Rebif is the fastest growing MS product in the world, with full year sales growing by 49.3% or 34.1% in local currencies. Sales growth was driven by a volume increase of 43.3% in equivalent units; however, average selling price per equivalent unit in local currencies decreased by 6.4% during the year. The majority of the decrease in the proportion of Rebif sales derived from our 44 mcg dosage, which has a lower average selling price per equivalent unit compared to our 22 mcg dosage. Rebif is the market leader outside the U.S., where 2003 sales increased by 32.1% to $630.8 million. Total Rebif sales in the U.S., our fastest growing region, were $188.5 million in 2003, representing an increase in full year sales of 164.8%. Market share more than doubled during the year and, at the end of the year, the rolling 4-week share of total prescriptions was 13.4%. Rebif was the fastest growing disease modifying drug in multiple sclerosis in the U.S. in 2003. At the end of 2003, we estimated that our worldwide market share was approximately 24.4% compared to 19% at the end of 2002. Our target is to become U.S. and worldwide market leader in 2006.

We started promoting Novantrone for MS in 2003 in conjunction with OSI Pharmaceuticals, which is only responsible for marketing Novantrone for oncology. Sales of Novantrone were $88.8 million in 2003.

Reproductive health

2003 was a very good year for our reproductive health franchise due to the success of our portfolio strategy and our focus on recombinant products. Our sales of our RH core infertility portfolio increased by 20.9% (or 10.7% in local currencies) to $594.9 million in 2003 from $492.0 million in 2002. Our sales of Gonal-f increased by 17.0% to $526.9 million in 2003 from $450.4 million in 2002. Sales growth of Gonal-f was driven by a volume increase of 9.7%; however, average selling price in local currencies decreased by 2.2% during the year. The growth in volumes was largely due to the increasing penetration of our multidose presentation and the launch of our fill-by-mass formulation.

As a result of the continued switch to biotechnology products, our sales of Metrodin HP declined by 50.6% to $24.8 million in 2003 from $50.1 million in 2002. We expect that we will continue to gradually replace Metrodin HP with Gonal-f. Our sales of Pergonal decreased by 0.4% to $45.8 million in 2003 from $46.0 million in 2002.

Growth and metabolism

Our growth and metabolism product sales increased by 9.6% (or 3.4% in local currencies) to $240.2 million in 2003 from $219.1 million in 2002. Our sales of Saizen increased by 22.1% to $151.5 million in 2003 from $124.0 million in 2002. Sales growth was driven by a volume increase of 8.5% and an increase in average selling price in local currencies of 2.3% during the year. Saizen's growth is largely due to our portfolio of innovative drug delivery devices, which greatly simplify administration of the drug for our patients. Our sales of Serostim decreased by 6.6% to $88.7 million in 2003 from $95.1 million in 2002, which corresponds to a decrease in sales volume of 10.1%. Serostim sales declined as a result of tighter control and usage guidelines in key U.S. states.

In December 2003, the Food and Drug Administration approved Zorbtive for use in the treatment of short bowel syndrome, a serious and potentially life-threatening condition. Additionally the FDA granted orphan drug status for the use of Zorbtive in this indication through December 2010.

3. Product sales by region

Europe

Our total European product sales increased by 28.4% to $796.8 million in 2003 from $620.4 million in 2002. In local currencies, product sales increased by 10.1% from 2002. The increase was primarily due to the increased sales of Rebif and Gonal-f, which increased by $122.7 million and $57.7 million, respectively, and in local currencies by 16.9% and 9.8%, respectively. Sales of Metrodin HP decreased by $15.7 million or 80.6% in 2003 and by 83.7% in local currencies.

North America

Our total North American product sales increased by 44.8% to $694.3 million in 2003 from $479.6 million in 2002. In North America, the increase was primarily due to the strong performance of Rebif which experienced a $126.5 million increase in sales; strong first year U.S. sales of Novatrone of $77.1 million; and an increase of sales of Saizen by $14.5 million.

Middle East, Africa and Eastern Europe

In the Middle East, Africa and Eastern Europe regions, our product sales increased by 40.5% to $151.2 million in 2003 from $107.6 million in 2002, due primarily to the continued sales growth of Rebif and Gonal-f in these markets.

Asia-Pacific, Oceania and Japan

In the Asia-Pacific region, our product sales increased by 10.5% to $61.0 million in 2003 from $55.2 million in 2002, due largely to increased demand for Gonal-f and Rebif. In Oceania, our product sales increased by 31.6% to $28.9 million in 2003 from $21.9 million in 2002, due largely to higher Rebif and Gonal-f sales. In Japan, our product sales decreased by 6.3% to $27.1 million in 2003 from $29.2 million in 2002, due primarily to weakening demand for Saizen that was partially offset by higher sales of Metrodin HP.

Latin America

Our total Latin American product sales decreased by 9.5% to $98.8 million in 2003 from $109.2 million in 2002, which was principally the result of our sale of two companies in Latin America in connection with our withdrawal from the generics sector, which was not core to our business.

Royalty and license income

Our revenues from royalty and license income increased by 40.0% to $160.6 million in 2003, compared to $114.7 million in 2002. The increase was due primarily to higher royalty income from Amgen on its sales of Enbrel and new royalties from Abbott Laboratories on its sales of Humira that began at the end of the second quarter of 2003. The remaining increase in royalty income stems from higher maintenance fees received from Roche on its sales of Recormon and NeoRecormon, and from royalties received from Organon on its sales of Puregon.

4. Operating expenses to net income

Cost of product sales

For the year ended December 31, 2003, cost of product sales as a percentage of product sales decreased to 15.0% from 15.7% in the prior year. The decrease was primarily the result of favorable changes in product mix and continuing manufacturing productivity gains and improvements leading to higher production yields. However, the effect of these factors was partially offset by stronger European currencies against the U.S. dollar during 2003. Product sales benefited from a favorable currency impact in 2003 of $143.6 million while cost of product sales was adversely impacted by an unfavorable currency impact of $22.1 million. As the proportion of recombinant products sales levels off upon the completion of our final phase-out of our urine-derived products, the rate at which our cost of product sales decreases, as a percentage of product sales, will decline.

Selling, general and administrative

Selling, general and administrative expenses increased to $636.8 million in 2003 from $504.2 million in 2002, which represents an increase of 26.3%, or 15.7% in local currencies. This increase was primarily in marketing and medical activities to support the growth of our sales and to support the promotion of Rebif in the U.S., as well as the launch of Gonal-f FbM in Europe. The increase was also the result of sales commissions related to co-promotion agreements signed in 2002 and 2003. Selling, general and administrative expenses represented 31.5% of revenues in 2003, compared to 32.8% in 2002.

Research and development

Our research and development expenses increased to $467.8 million in 2003, which represents an increase of 30.6% or 17.8% in local currencies. This increase in our research and development expenses was due to the clinical development of Raptiva for launch in Europe including milestone payments to Genentech upon filing the application, and for the license extension to Asia; the pharmaceutical development of onercept and IL-18bp; and the functional genomic program as well as a full year of operating costs related to the Serono Genetics Institute (formerly Genset S.A.), which we acquired in late third quarter 2002.

Other operating expense, net

Our other operating expense, net was $199.5 million in 2003, compared to $85.8 million in 2002. The increase was due to higher ongoing royalty and licensing expenses driven by Novantrone and Rebif sales, and royalty expenses related to Humira, plus higher amortization of intangibles in the form of license payments that are amortized over the life of the license agreement, and higher amortization of goodwill from the acquisition of Genset S.A. Royalty and license expenses increased by $85.4 million to $120.1 million, amortization of intangible assets increased by $7.6 million to $30.4 million, and litigation and legal costs increased by $12.4 million to $25.7 million.

Operating income

Our operating income increased by 24.4% to $434.9 million in 2003 from $349.6 million in 2002. As a percentage of revenues, our operating income was 21.5% in 2003 compared to 22.7% in 2002.

Financial income, net

Financial income was lower in 2003 compared to the previous year due to generally lower interest rates. However, 2002 was adversely impacted by translation losses arising from various currency devaluations in Latin America such that our financial income net increased by $7.5 million to $44.0 million in 2003 compared to $36.5 million in 2002.

Other expense, net

Other expense, net was $19.7 million in 2003 compared to $1.7 in 2002. We took a non-operating, non-recurring, non-cash charge of $16.1 million related to the write-down of an equity investment in Swiss International Air Lines. Other expense, net also includes a $4.0 million realized loss upon our sale of our investment in PowderJect Pharmaceuticals following Chiron's cash acquisition of 100% of the outstanding shares of PowderJect.

Taxes

Our total taxes increased by 9.2% to $68.9 million in 2003 from $63.1 million in 2002. Our tax rate (as a percentage of profit before taxes) decreased from 16.4% in 2002 to 15.0% in 2003 primarily due to the favorable close of prior fiscal years in various countries, which permitted a non-recurring reduction in certain tax provisions during 2003.

Net income

Our net income increased by 21.6% to $390.0 million in 2003 from $320.8 million in 2002. Our net income represented 19.3% of total revenues, compared to 20.9% in 2002. Excluding the non-recurring, non-operating charges related to the $16.1 million write-down of our investment in Swiss International Air Lines and the $4.0 million loss on the sale of our investment in PowderJect Pharmaceuticals, net income represented 20.2% of our 2003 revenues. Exchange rate movements favorably impacted 2003 net income by $23.5 million or 1.2% of total revenues, which represents $1.48 per share.

Our basic earnings per share grew by 22.7% from $20.07 to $24.63 per share. Our percentage increase in basic earnings per share outpaced our increase in net income due to the impact of treasury shares that were acquired during 2002 and 2003 as a result of our Share Buy Back Plan that was initiated in July 2002. The weighted average number of shares outstanding used to calculate basic earning per share decreased during 2003 by 153,416 shares resulting in an increase in our basic earnings per share of $0.24 per share. The Share Buy Back Plan was authorized to repurchase CHF500.0 million worth of Serono bearer shares, of which CHF218.7 million has been spent. Using the share price of CHF882 as of December 31, 2003, we could repurchase 318,900 additional bearer shares, which would increase materially our earnings per share.

Liquidity and capital resources

Our sources of liquidity have been a combination of cash generated from operations and investing activities, short-term and long-term financial debts, as well as two significant public financings. In 2000, we completed a global public offering of 1,070,670 bearer shares in the form of bearer shares and American depositary shares for net proceeds of $951.8 million. In 2003, we issued CHF600.0 million (approximately $444.8 million) of senior unsubordinated convertible bonds due November 2008, convertible into our bearer shares. As of December 31, 2004, we had unused lines of credit for short-term financing of $365.3 million (2003: $366.9 million). Our total financial assets, which are made up of cash and cash equivalents plus short-term and long-term financial assets, amounted to $1,839.4 million.

The analysis of our cash flow is divided as follows:

1. Free cash flow and net cash flow from operating activities
2. Net cash flow used for investing activities
3. Net cash flow used for financing activities
4. Net financial assets

1. Free cash flow and net cash flow from operating activities

	Year ended December 31,		
	2004	2003	2002

	U.S.$m	U.S.$m	U.S.$m
Net cash flow from operating activities	**471.7**	542.9	532.0
Purchase of tangible fixed assets	**(178.9)**	(162.5)	(99.1)
Purchases of intangible and other long-term assets	**(55.0)**	(30.8)	(25.2)
Interest paid	**(4.2)**	(4.3)	(8.1)
Free cash flow	**233.6**	345.3	399.6

We present free cash flow as additional information as it is a useful indicator of our ability to operate without reliance on additional borrowing or use of existing cash. In addition, we feel that free cash flow is relevant to investors as it is a measure of the cash that is generated over and above what is required to sustain our current competitive position. It is our ability to generate free cash flow that funds our research and development activities, business development activities including the in-licensing of new products, the repayment of financial debts and the payment of dividends. We also use free cash flow to evaluate the performance of our businesses.

Our commercial operations generated cash flow from operating activities in the amount of $471.7 million, which is a decrease of $71.2 million compared to 2003. Cash flow from operating activities before working capital changes increased in 2004 by $51.2 million to $589.9 million in 2004. Income before taxes and minority interests increased in 2004 by $127.6 million due to higher product sales and royalty and license income. Depreciation and amortization was higher in 2004 because of the additional depreciation recognized during the year from the closure of our manufacturing operations in Israel.

Financial income and unrealized foreign currency gains, that are deducted from net income to arrive at operating cash flow, were higher in 2004 by $42.8 million, due to an unrealized gain on the forward purchase of shares in ZymoGenetics Inc. of $8.6 million; an increase in interest income earned on bond investments of $9.1 million; and an increase in unrealized foreign exchange gains of $24.5 million.

Other non-cash items, that are deducted from net income to arrive at operating cash flow amounted to $52.2 million, relating mostly to the release of deferred income from up-front payments received from our co-promotion partners, Pfizer Inc. and OSI Pharmaceuticals Inc.

The amount of operating cash flow that was lost due to increases in working capital in 2004 was $118.2 million compared to a decrease of $4.2 million in working capital during 2003.

The increase in trade and other payables, other current liabilities and deferred income provided $127.9 million in operating cash flow, which represents an increase of $23.4 million compared to 2003. Increases in these current liabilities were related to an increase in accrued research and development expenses incurred as part of new collaborative agreements that were signed in the fourth quarter of 2004.

The increase in trade accounts receivable and other receivables erased $141.2 million of operating cash flow compared to only $34.2 million in 2003. This increase in 2004 reflects the sales-driven increase in trade accounts receivable during 2004 versus 2003, as well as a new receivable related to the licensing agreement of a non-core technology signed in the third quarter of 2004 ($60.0 million).

Taxes paid during 2004, that are recognized as a reduction of operating cash flow, increased during 2004, reaching $100.9 million compared to $89.6 million in 2003. The increase in 2004 was due mostly to higher income taxes paid in Switzerland.

Inventory levels were reduced during 2004 and thus provided $24.2 million of operating cash flow despite the fact that inventory as reported within the balance sheet, increased during 2004, by $7.1 million. The increase in reported inventories included a currency impact, which is eliminated when calculating operating cash flow. After removing the currency impact, inventory decreased during 2004 by $24.2 million.

2. Net cash flow used for investing activities

Net cash used for investing activities was $322.1 million in 2004. Our cash paid for investment in tangible fixed assets totaled $178.9 million. This includes $52.7 million spent on our new headquarters and Swiss-based research and development activities. In 2003, we exercised an option to purchase a 40,000 square meter section of land that is near

our current headquarters in Geneva for the purpose of bringing together on a single site our headquarters and Swiss-based research and development activities and to support our anticipated growth. We expect to complete the work on the first phase of this facility by the end of 2006. The estimated cost of the facility, including land and construction costs, is $278.9 million (CHF315.8 million) and a further $48.8 million (CHF 55.3 million) for completion of the laboratories and offices. The total capital commitments related to this project as of December 31, 2004 are CHF200.8 million or $177.3 million. The entire project is being financed with bank debt.

We acquired 3.2 million newly issued shares in ZymoGenetics Inc. as part of a research and development collaboration. We paid a fixed price of $15.74 per share for a total amount of $50.0 million. We also acquired $787.9 million in financial assets consisting of fixed-rate investments in rated Eurobonds denominated in U.S. dollars with maturities up to three years and short-term money market funds. We received a combined amount of $654.6 million from the maturity of a portion of the bond portfolio as well as from the sale of bonds, some of which included bonds that were previously classified as held-to-maturity. The sale of held-to-maturity bonds required us to reclassify the remaining held-to-maturity portfolio as available-for-sale, whereby changes in fair values are recognized as fair value reserves within shareholders' equity, and prevents us from classifying any current or future bond investment as held-to-maturity for the next two years regardless of our intention or ability to hold such bonds to their maturities.

In 2005, we expect to increase our level of investment in tangible fixed assets by approximately 10% to 20% compared to 2004. All capital expenditure excluding the construction of our new headquarters and research and development center will be funded with resources generated from our operations.

3. Net cash flow used for financing activities

Net cash flow used for financing activities was $878.3 million, of which $811.7 million was spent as part of two Share Buy Back Plans. The first plan, which was initiated in July 2002, was authorized to acquire CHF500.0 million worth of bearer shares. The shares acquired during the year under this Share Buy Back Plan, 351,209 bearer shares for a total cost of CHF280.9 million or $221.8 million, will eventually be re-issued. This first Share Buy Back Plan was fully utilized at the end of May 2004.

Subsequent to the completion of the first Share Buy Back Plan, we obtained authorization from the Board of Directors of Serono S.A. to launch a second Share Buy Back Plan for the total amount of CHF750.0 million. The shares acquired under this plan will be eventually cancelled, subject to the approval of the Annual General Meeting of Shareholders. During 2004, 962,435 bearer shares were acquired under this plan for a total value of CHF736.5 million or $611.3 million. The actual cash paid to acquire shares under the second Share Buy Back Plan was $21.4 million less, which represents that amount of withholding taxes that will eventually be remitted to the Swiss tax authority.

We paid $99.4 million in dividends to investors in 2004, an increase of $13.6 million compared to 2003. The dividend per share declared and paid in 2004 was CHF8.00, compared to the prior year dividend of CHF7.00.

We increased the amount of financial debts during the year by CHF58.9 million or $48.7 million. In 2003, we obtained a CHF300.0 million medium term bank facility for the development of our new headquarters and research center in Geneva, Switzerland. This unsecured facility is guaranteed by Serono S.A. and has a maturity date of December 31, 2006. As of December 31, 2004, the amount drawn under the facility was CHF131.5 million or $116.1 million.

4. Net financial assets

We had total financial assets (cash and cash equivalents, short-term financial assets and long-term financial assets not including long-term equity investments in non-group companies) of $1,839.4 million. Net financial assets (total financial assets less short and long-term financial debts) as of December 31, 2004 were $1,164.0 million, and decreased by $743.2 million during the year. The following table sets out the components and the total amount of net financial assets for the last three years.

	For the year ended		
	2004	2003	2002
	U.S.$m	U.S.$m	U.S.$m
Net cash flow from operating activities	**471.7**	542.9	532.0
Net cash flow used for investing activities	**(322.1)**	(556.2)	(690.4)
Net cash flow used for financing activities	**(878.3)**	322.4	(299.1)
Effect of exchange rate changes on cash and cash equivalents	**0.7**	8.8	12.4
Change in cash and cash equivalents	**(728.0)**	317.9	(445.1)
Change in short-term and long-term financial assets	**77.0**	437.2	516.1
Change in short-term and long-term financial debts	**(92.2)**	(463.8)	91.1
Change in net financial assets	**(743.2)**	291.3	162.1
Net financial assets as of January 1	**1,907.2**	1,615.9	1,453.8
Net financial assets as of December 31	**1,164.0**	1,907.2	1,615.9
Consists of			
Cash and cash equivalents	**275.9**	1,004.0	686.0
Short-term financial assets	**785.0**	434.8	378.9
Long-term financial assets	**929.0**	1,104.3	711.2
Less: Investments in non-group companies	**(150.5)**	(52.7)	(40.7)
Total financial assets	**1,839.4**	2,490.4	1,735.4
Short-term financial debts	**(34.5)**	(51.2)	(93.6)
Long-term financial debts	**(640.9)**	(532.0)	(25.9)
Total financial debts	**(675.4)**	(583.2)	(119.5)
Net financial assets	**1,164.0**	1,907.2	1,615.9

We believe that our existing net financial assets, cash generated from operations, and unused sources of debt financing will be adequate to satisfy our working capital and capital expenditure requirements during the next several years. However, we may raise additional capital from time to time for other strategic purposes.

Contractual cash obligations

Our future minimum non-cancelable contractual obligations as of December 31, 2004 are described below:

		Payments due by year (in U.S.$m)			
Contractual obligation	**Total**	Less Than 1 year	1-3 years	4-5 years	After 5 years
Financial debts	**647.9**	7.0	630.8	3.7	6.4
Operating lease	**141.9**	33.5	55.6	20.5	32.3
Capital lease	**0.1**	0.1	-	-	-
Capital commitments	**180.9**	92.3	88.6	-	-
Total	**970.8**	132.9	775.0	24.2	38.7

The capital commitments relate mostly to the construction costs and contractors' compensations for the construction of the new headquarters and research center in Geneva, which is expected to be completed by the end of 2006. Given our ability to generate consistent and significant operating cash flow, we do not anticipate difficulty in renegotiating our borrowings should this be necessary.

In addition to the amounts disclosed above, we have a number of commitments under collaborative agreements as described in note 32 to the consolidated financial statements. As part of these agreements we have made commitments to make research and development payments to the collaborators, usually once milestones have been achieved, but in

some cases on a regular basis. We do not consider any single collaborative agreement to be a sufficiently large commitment that it could impair significantly our financial condition. In the unlikely event that all the collaborators were to achieve all the contractual milestones, we would be required to pay approximately $726.3 million. The exact timing of eventual payments is uncertain, but it would be over a period of 10 years.

Assets with an original cost of $30.7 million as of December 31, 2004 (2003: $65.1 million) have been pledged as security against long-term financial debts and certain unused long-term line of credits.

Inflation

Our results in recent years have not been significantly affected by inflation or changes in prices related to inflation.

Recent accounting pronouncements

You can find a discussion of recent accounting pronouncements related to IFRS and U.S. GAAP applicable to our company in note 36 to our consolidated financial statements. In addition, you can find a discussion of the potential impact of some IFRS exposure drafts published by the International Accounting Standards Board that could have a material impact on our results.

Item 6. DIRECTORS, SENIOR MANAGEMENT AND EMPLOYEES

Board of Directors

Directors are elected each year at our Annual General Meeting and serve until the following Annual General Meeting, which must be held within six months after the end of each financial year.

Name	Age (1)	Position
Georges Muller	65	Chairman
Ernesto Bertarelli	39	Vice-Chairman and Managing Director
Jacques Theurillat	45	Director
Pierre E. Douaze	64	Director
L. Patrick Gage	63	Director
Bernard Mach	71	Director
Sergio Marchionne	52	Director
Hans Thierstein	73	Director

(1) As of February 15, 2005

Georges Muller has been the Chairman of our board since 1999 and a board member since 1992. He has practiced law with the firm of Bourgeois, Muller, Pidoux & Partners in Lausanne, Switzerland for over 25 years and has been of counsel with that firm since 1987. He retired as professor of commercial law at the University of Lausanne School of Law in June 2000 and currently holds the title of Honorary Professor. He is Chairman of the board of directors of SGS SA and The 2000 Management Corporation, and Vice-Chairman of Bertarelli & Cie. He is a director of S.I. Château de Bonmont S.A., Schweizerische Lebensversicherung und Rentenanstalt, Swiss Life Holding, Schindler Aufzüge AG, Actafinance S.A., Animan Publications S.A., Lavotel S.A., Kedge Capital Partners Ltd. and Kedge Capital Services Ltd. He participates on the boards of various foundations and associations, namely Fondation pour la création d'un musée des Beaux Arts, Lausanne (Chairman); Institut Suisse de Recherche Expérimentale sur le Cancer (Chairman); and World Arts Forum. He has worked at the Federal Tax Administration, Division of International Tax Law, in Berne, Switzerland and at Union Bank of Switzerland in Lausanne, Switzerland. Mr. Muller received a PhD in law and degree in business administration (HEC) at the University of Lausanne. He also has received an LLM from Harvard University. Mr. Muller is a Swiss national and resident.

Ernesto Bertarelli is our Chief Executive Officer. He is also Vice-Chairman and the Managing Director of our board. Prior to his appointment as Chief Executive Officer in January 1996, Mr. Bertarelli served for five years as Deputy

Chief Executive Officer and Vice-Chairman of the board, where he was responsible for finance and operations. Mr. Bertarelli began his career with us in 1985, since which time he has held several positions of increasing responsibility in sales and marketing. Mr. Bertarelli is the Chairman of Bertarelli & Cie, Kedge Capital Partners Ltd, Alinghi Holdings Ltd and Team Alinghi SA. He is a director of UBS AG, PHRMA, BIO, European Federation of Pharmaceutical Industries and Associations and the Bertarelli Foundation. He is also a member of the Harvard Medical School Biological Chemistry and Molecular Pharmacology Advisory Council. He received a BS degree from Babson College in Boston, Massachusetts, and an MBA from Harvard Business School. Mr. Bertarelli is a Swiss national and resident.

Jacques Theurillat has been our Deputy Chief Executive Officer since May 2002 and has been a director since May 2000. Mr. Theurillat also serves as our President of European and International Sales & Marketing and served as our Acting Chief Financial Officer during 2004, until the appointment of Stuart Grant. He previously served as our Chief Financial Officer from 1996 until October 2002. Prior to that, Mr. Theurillat was Managing Director of our operations in Italy. He began his career with us in 1987. Mr. Theurillat has law degrees from Madrid University and Geneva University and holds a Swiss Federal Diploma (Tax Expert). He also received an MBA from the Madrid School of Finance. Mr. Theurillat is a Swiss national and a resident of Switzerland.

Pierre E. Douaze has been a director since 1998. Until 1998, he was a member of the executive committee and former chief executive officer of the healthcare division of Novartis, the company that resulted from the merger of Sandoz and Ciba Geigy. Before that merger in 1997, Mr. Douaze worked at Ciba Geigy, where he served in various capacities beginning in 1970. In 1991, he became a member of Ciba Geigy's executive committee, with responsibility for healthcare. He currently serves as a board member of the Galenica Group, Switzerland and Chiron Corporation. Mr. Douaze received a MS degree from the Federal Polytechnical School and an MBA from INSEAD Fontainebleau. Mr. Douaze is a French national and a resident of Switzerland.

L. Patrick Gage has been a director since May 2004. Dr. Gage is a partner in Flagship Ventures, an entrepreneurship and venture capital firm formed to create and finance companies in the life sciences, information technology and communications sectors. From 1997 until 2002, Dr. Gage held various positions at Wyeth. From March 1998 through June 2002, he served as President of Wyeth Research, a division of Wyeth, and from 2000 through June 2002, Dr. Gage also served as Senior Vice President, Science and Technology of Wyeth. From 1989 through March 1998, Dr. Gage served as the head of Research and Development, then Chief Operating Officer and finally, after that company had been acquired by Wyeth, as President of Genetics Institute. Prior to 1989, Dr. Gage held various positions in research management at Hoffmann-La Roche Inc. over an 18-year period. Dr. Gage is also a director of Neose Technologies, Inc. and Protein Design Labs, Inc., serves as Chair of the Life Sciences Advisory Board (SAB) for Perkin Elmer Inc., is a member of the SAB of Functional Genetics, a private biotech company, and serves on the Scientific Advisory Board for Warburg Pincus, a private equity investment company. In addition, Dr. Gage is a director of two non-profit organizations, the Biotechnology Institute and the Philadelphia Orchestra Association. Dr. Gage has a BS in physics from the Massachusetts Institute of Technology and a PhD from The University of Chicago. Dr. Gage performed postdoctoral research at the Carnegie Institution of Washington. Dr. Gage is a United States national and resident.

Bernard Mach has been a director since 1997. He retired from the University of Geneva Medical School in 1998. Until then, Dr. Mach was the chairman of the department of genetics and microbiology and of the graduate program in molecular and cellular biology, and he was the Louis Jeantet Professor of Molecular Genetics. Dr. Mach is a former member of the Swiss Science Council, the scientific advisory board to the Swiss government, and a former president of the Union of Swiss Societies for Experimental Biology. He is also a founder and former board and SAB member of Biogen, founder and chairman of the scientific board of Lombard Odier Immunology Fund, and founder and chairman of NovImmune S.A. Dr. Mach is the Vice-Chairman of Lonza Group AG. Dr. Mach received an MD degree from the University of Geneva and a PhD degree from Rockefeller University in New York and did his internship and residency at the Massachusetts General Hospital/Harvard Medical School. Dr. Mach is a member of the French Academy of Science. He is a Swiss national and resident.

Sergio Marchionne has been a director since May 2000. Since June 2004, Mr. Marchionne has been Chief Executive Officer of Fiat SpA, whose board of directors he joined in May 2003. From February 2002 to June 2004, Mr. Marchionne served as Chief Executive Officer and Managing Director of SGS SA. Mr. Marchionne continues to serve as Vice Chairman of SGS SA. From October 1999 until February 2002, Mr. Marchionne served as Chief Executive Officer of Lonza Group AG, which was spun-off from Alusuisse-Lonza Group in October 1999. Mr. Marchionne still serves as Chairman of Lonza Group AG. Prior to that he worked at Alusuisse-Lonza Group in various capacities, including Chief Financial Officer, and from 1997 as Chief Executive Officer. Mr. Marchionne received an LLB from

Osgoode Hall Law School in Toronto, Canada and an MBA from the University of Windsor, Canada. He is a barrister and solicitor and a Chartered Accountant. Mr. Marchionne holds dual Canadian and Italian nationalities and is a resident of Switzerland.

Hans Thierstein was the Chairman of our board from 1992 until 1999 and has been a board member since 1987. He served as our Chief Financial Officer from 1980 until 1996. Before joining us, Mr. Thierstein was associated with ICN Pharmaceuticals from 1971 to 1980 where he served as treasurer and controller Europe, as vice president and corporate controller in the United States, as general manager of the Swiss and Italian operation, and as vice president of corporate development Europe. Prior to that, he was treasurer and area financial manager and a director of Chesebrough-Pond's, Europe for nine years. In addition, his professional experience includes five years in public accounting, of which four years was with Price Waterhouse, Zurich. From 1996 to 2000, Mr. Thierstein served as a member of the board of the Swiss Society of Chemical Industries. He received a diploma in Commerce and Administration from the Commercial School Meiringen, Switzerland (with an Apprenticeship in district court of justice/debtors and bankruptcy court) and obtained a certificate of the preliminary examination of the Swiss Certified Public Accountants Chamber. Mr. Thierstein is a director of Temtrade S.A. Mr. Thierstein is a Swiss national and resident.

Executive Officers

The current members of our Executive Management Board, who constitute our executive officers, are:

Name	Age (1)	Position
Ernesto Bertarelli	39	Chief Executive Officer
Jacques Theurillat	45	Deputy Chief Executive Officer; President of European and International Sales and Marketing
Roland Baumann	59	Senior Executive Vice-President, Group Compliance Officer and Head of Corporate Administration
Leon Bushara	38	Senior Executive Vice-President, Business Development
Giampiero De Luca	50	Chief Intellectual Property Counsel
Fereydoun Firouz	41	President, Serono, Inc.
Stuart Grant	49	Chief Financial Officer
Franck Latrille	47	Senior Executive Vice-President, Global Product Development
François Naef	42	Senior Executive Vice-President, Human Resources, Legal and Corporate Communication
Timothy Wells	42	Senior Executive Vice-President, Research

(1) As of February 15, 2005

Roland Baumann is our Senior Executive Vice-President, Group Compliance Officer and Head of Corporate Administration. Prior to his appointment to this position in February 2004, he was our Senior Executive Vice-President, Head of the CEO Office, Corporate Strategic Planning & Corporate Administration and Head of Group Internal Audit. From March 2000 to March 2003, he was our Senior Vice President, Strategic Business Planning and Corporate Administration, Head of Internal Audit. Before his appointment to that position, Mr. Baumann worked for us in positions of increasing responsibility related to finance, information systems, internal audit and strategic business planning from 1991. Before joining us, Mr. Baumann was a senior vice president with La Suisse Assurances, where he was the head of business process engineering and finance and accounting services. Mr. Baumann holds a degree in economics and business administration from the Ecole Supérieure des Cadres pour l'Economie et l'Administration in Basel. He is a Swiss national and resident.

Leon Bushara is our Senior Executive Vice-President, Business Development. Before his appointment to that position in 1996, Mr. Bushara worked in positions of increasing responsibility in our Business Development department since 1993. Prior to joining us, Mr. Bushara founded and managed a chain of cafés and restaurants in New York City from 1988 until 1993. Mr. Bushara holds a BA degree from Brown University. He is a United States national and a resident of Switzerland.

Giampiero De Luca is our Chief Intellectual Property Counsel. Prior to his appointment to this position in November 1999, Mr. De Luca worked for us in positions of increasing responsibility related to intellectual property and product development from 1988. Prior to joining us, Mr. De Luca worked as a patent examiner at the European Patent Office, where he focused on patents related to genetic engineering. Mr. De Luca holds a doctoral degree in industrial chemistry from the University of Milan and a diploma from the Institut Pasteur in general microbiology. He is a chartered European patent attorney, chartered Italian patent attorney, and chartered attorney before the Office for Harmonization in the Internal Market. Mr. De Luca is an Italian national and a resident of Switzerland.

Fereydoun Firouz is President of Serono, Inc., our U.S. operating subsidiary. From 2001 until March 2003, he was Executive Vice President, Reproductive Health, of Serono, Inc. Prior to his appointment to that position in 2001, Mr. Firouz worked in positions of increasing responsibility in our sales and marketing operation from 1991 and in our government affairs office in Washington, D.C. from 1989 to 1991. Mr. Firouz holds a BS degree in political science from George Washington University in Washington, D.C. He has participated in the Executive Program on General Management at the F.W. Olin Graduate School of Business at Babson College in Massachusetts. He is a Swiss national and a resident of the United States.

Stuart Grant is our Chief Financial Officer. Prior to this appointment in November 2004, Mr. Grant served for almost three years as Chief Financial Officer of Serono, Inc., our U.S. operating subsidiary. Mr. Grant joined us from Digital Equipment Corporation in 1995, and has held various senior financial and general management positions of increasing responsibility since that time. Mr. Grant has over 25 years of financial and business management experience in the high technology sector, in both the corporate and field environments. Mr. Grant received a Bachelor of Accountancy from the University of Glasgow, and is a Chartered Accountant. He is a British national.

Franck Latrille is our Senior Executive Vice-President, Global Product Development. Prior to his appointment to this position in March 2003, Mr. Latrille was our Senior Executive Vice-President, Manufacturing Operations and Process Development. Before that, he served for three years as our General Manager, Italian manufacturing operations. From 1994 to 1997, he served as general manager of Sorebio, which he co-founded in 1987. Mr. Latrille joined us in 1994, following our acquisition of Sorebio. Mr. Latrille holds a PhD degree in animal physiology and biochemistry and an MS degree from the University of Bordeaux. He is a French national and resident.

François Naef is our Senior Executive Vice-President, Human Resources, Legal and Corporate Communication. Prior to his appointment to this position in February 2004, he was our Senior Executive Vice-President, Human Resources. From November 1999 to February 2001, Mr. Naef served as our General Counsel. He had previously worked in positions of increasing responsibility in our legal department from 1988. Mr. Naef also serves as Company Secretary. Prior to joining us, Mr. Naef was an attorney at the Geneva law firms of Combe & de Senarclens and Me Rossetti. Mr. Naef also serves as General Manager of Serono International SA, one of our principal subsidiaries. He is also a member of the Board and Executive Committee of the Geneva Chamber of Commerce as well as a member of the Economic Council of the State of Vaud. Mr. Naef holds a law degree and a master's degree in European law from the University of Geneva. Mr. Naef was admitted to the Geneva Bar in 1986. He is a Swiss national and resident.

Timothy Wells is our Senior Executive Vice-President, Research. Prior to his appointment to this position in March 2003, he served as our Vice-President Research, Head of Discovery, where he was responsible for integrating the discovery research in our global organization. Mr. Wells joined us from Glaxo Wellcome in 1998, where he had held a number of positions of increasing responsibility. Mr. Wells holds a PhD degree in protein engineering from Imperial College, London, and a MA degree in natural sciences from the University of Cambridge and is a fellow of the Royal Society of Chemistry. He is a British national and a resident of France.

Compensation

During the year ended December 31, 2004, we paid our directors and executive officers as a group, for services in all capacities, $24,991,571. Of this amount, we paid $6,637,849 pursuant to a bonus plan, which provides for payments to executive officers based on their performance and the performance of our company. During the year ended December 31, 2004, we set aside or accrued $797,840 to provide pension, retirement or similar benefits for our executive officers. During the year ended December 31, 2004, we granted to our directors and executive officers options to purchase 38,010 bearer shares at an exercise price of CHF 782, expiring on March 31, 2014, and options to purchase 5,200 bearer shares at an exercise price of CHF 772, expiring on June 1, 2014. The amount we show above as paid to our directors and executive officers as a group includes the tax value of these stock options calculated based on the Black-Scholes option pricing model. In 2004, we allotted a total of 2,661 bearer shares to our directors and executive

officers. During the year ended December 31, 2004, we paid our most highly compensated director a total of $5,864,353, inclusive of fees, salaries, credits, bonuses and benefits of every kind valued according to market value at the time they were conferred. This amount also includes the tax value of stock options granted during the year calculated based on the Black-Scholes option pricing model.

None of our directors has a service contract with us or any of our subsidiaries that provides for benefits upon termination of their mandate.

Board Committees

Audit Committee

In 2001, the Board of Directors established an Audit Committee consisting of Sergio Marchionne (Chairman), Pierre E. Douaze and Hans Thierstein, all non-executive directors. While these directors all have sufficient financial and compliance experience and ability to enable them to discharge their responsibilities as members of the Audit Committee, Sergio Marchionne is our designated Financial Expert on the Audit Committee. In discharging its oversight role, the Audit Committee is empowered to investigate any matter relating to our accounting, auditing, internal control, or financial reporting practices brought to its attention, with full access to all of our books, records, facilities and personnel.

The Audit Committee has the following responsibilities:

- Review with the selected independent auditors for the company the scope of the prospective audit, the estimated fees thereof and such other matters pertaining to such audit as the Committee may deem appropriate and receive copies of the annual comments from the independent auditors on accounting procedures and systems of control (Management Letter);
- Ensure that the independence of the independent auditors is maintained;
- Review with the independent auditors any questions, comments or suggestions they may have regarding the internal control, accounting practices and procedures of the company and its subsidiaries;
- Review and oversee the internal audit activities, including discussing with management and the internal auditors the internal audit function’s organization, objectivity, responsibilities, plans, results, budgets and staffing;
- Discuss with management, the internal auditors and the independent auditors the quality and adequacy of the compliance with the company’s internal controls;
- Receive summaries of the audit reports issued by the internal audit department;
- Review with management and the independent auditors the annual audited financial statements of the company and the quarterly financial statements and any material changes in the accounting principles or practices used in preparing the statements prior to publication and the filing of reports with the SWX Swiss Exchange and the filing of the report on Form 20-F with the U.S. Securities and Exchange Commission;
- Discuss with management and the company’s General Counsel any legal matters (including the status of pending litigation) that may have a material impact on the company’s financial statements and any material reports or inquiries from regulatory or governmental agencies which could materially impact the company’s contingent liabilities and risks;
- Make or cause to be made, from time to time, such other examinations or reviews as the Committee may deem advisable with respect to the adequacy of the systems of internal control and accounting practices of the company and its subsidiaries and with respect to accounting trends and developments and take such action with respect thereto as may be deemed appropriate;

· Subject to approval by the shareholders, recommend annually the public accounting firm to be the independent auditors for the company;

- Set the compensation of the independent auditors and pre-approve all audit and non-audit related engagements performed by the independent auditors;

- Resolve issues related to conflicts of interests involving members of the Board of Directors or the Executive Management Board; and

- Engage independent counsels and other advisors as it deems necessary to carry out its duties.

The Audit Committee maintains free and open communication throughout the year with the independent auditors, the internal auditors and our management, in particular the Chief Executive Officer and Managing Director, the Chief Financial Officer and the Senior Executive Vice-President, Human Resources, Legal and Corporate Communication. Its Chairman is responsible for the leadership of the Audit Committee, including scheduling and presiding over meetings, preparing agendas and making regular reports to the Board of Directors. The Audit Committee meets at least four times a year or more, if required. In 2004, the Audit Committee held six sessions. The external auditors attended all of these sessions.

Compensation Committee

In 2001, the Board of Directors also established a Compensation Committee, which consisted as of December 31, 2004, of Pierre E. Douaze (Chairman), Sergio Marchionne and Hans Thierstein, all non-executive directors. The Compensation Committee ensures that our senior executives are compensated in a manner consistent with our stated compensation strategy, internal equity considerations, competitive practice, and applicable legal requirements.

The Compensation Committee submits to the Board of Directors for approval the principles to be applied for the remuneration of the members of the Board of Directors and of our executives.

The Compensation Committee reviews as often as necessary, but no less than one time per year, the compensation plans for our executives to ensure that such plans are designed to effectively attract, retain and reward our executives, to motivate their performance in the achievement of our business objectives and to align their interest with the long-term interest of the shareholders. In particular, the Compensation Committee ensures that:

- The company’s annual incentive plans for executives are properly administered as to participation in these plans, alignment of awards with the company’s financial goals, actual awards paid to executive officers and total funds reserved for payments under these plans; and

- The company’s long-term plans for executives are properly administered as to participation in these plans, alignment of awards to the achievement of the company’s long-term goals, key personnel retention objectives and shareholders’ decisions concerning the use of capital for management incentive plans.

The Compensation Committee reviews annually and determines the individual elements of the compensation of the Chief Executive Officer.

The Compensation Committee reviews annually the individual elements of the compensation of our senior officers who report to the Chief Executive Officer, ensuring that the objectives defined in the Compensation Committee Charter are met.

The Compensation Committee reviews and recommends to the Board of Directors for approval the remuneration of the members of the Board.

The Compensation Committee is also responsible for:

- Approving our stock option plans and any modification thereof;
- Approving the number of options which are granted to the Chief Executive Officer; and
- Approving the global number of options that the Chief Executive Officer is authorized to distribute to senior management during the year.

In addition, the Compensation Committee makes a recommendation to the Board on all reports that the company is required to make to shareholders pursuant to legal or regulatory requirements in the area of executive compensation.

The Compensation Committee also makes a recommendation to the Board on all proposals for incentive plans that require shareholders' approval, including proposals to create share capital for compensation plans.

The Compensation Committee reports to the Board on its activities at least once in each calendar year. Its Chairman is responsible for summoning meetings, preparing the agenda and ensuring that members of the Compensation Committee receive proper documentation prior to meetings. The Managing Director and Chief Executive Officer is invited to attend meetings of the Compensation Committee, except when discussions are held on his remuneration. In 2004, the Compensation Committee met once and adopted two circulating board resolutions. Its Chairman regularly and openly communicated throughout the year with our management, in particular the Chief Executive Officer and Managing Director, the Chief Financial Officer and the Senior Executive Vice-President, Human Resources, Legal and Corporate Communication.

Employees

As of December 31, 2004, 2003 and, 2002, respectively, we had 4,902, 4,577 and 4,617 employees, of whom 1,387, 1,346 and 1,348, respectively, were engaged in research and development, 2,084, 1,746 and 1,673, respectively, were engaged in sales and marketing, 1,005, 1,082 and 1,215, respectively, were engaged in manufacturing and 426, 403 and 380, respectively, were engaged in other areas such as finance, information technology and human resources. As of December 31, 2004, 2003 and 2002, respectively, we had 3,235, 3,115 and 2,900 employees in Europe, approximately 727, 725 and 655 employees in North America, approximately 205, 180 and 300 employees in Latin America and approximately 735, 555 and 840 employees in the rest of the world. In addition, we maintain consulting arrangements with a number of scientists at various universities and other research institutions in Europe, Israel and the United States. In Europe, our employees are covered by customary collective bargaining agreements. In the United States, none of our employees is covered by a collective bargaining agreement. We have experienced no work stoppages, and we consider our employee relations to be good.

Share Ownership

As of December 31, 2004, Bertarelli & Cie, a partnership limited by shares with its principal offices at Chéserex (Vaud), Switzerland, held 51.43% of our capital, including treasury shares, and 65.36% of our voting rights. Ernesto Bertarelli, our Chief Executive Officer, Vice-Chairman and Managing Director, controls Bertarelli & Cie.

As of December 31, 2004, there were 11,738,175 bearer shares, including 1,611,434 treasury shares, and 11,013,040 registered shares outstanding. The following table sets forth the ownership of our voting securities by all of our directors and current executive officers as individuals and as a group. For the purposes of calculating percentages shown in the table, the 1,611,434 treasury shares are deemed not to be outstanding.

Name of Owner	Registered Shares Owned	Percent of Registered Shares	Bearer Shares Owned	Percent Of Bearer Shares	Aggregate Voting Percent
Ernesto Bertarelli (1)	9,973,200	90.6	4,753,289	46.9	69.6
Roland Baumann	0	0	*	*	*
Leon Bushara	0	0	*	*	*
Giampiero De Luca	0	0	*	*	*
Pierre E. Douaze	0	0	*	*	*
Fereydoun Firouz	0	0	*	*	*
L. Patrick Gage	0	0	*	*	*
Stuart Grant	0	0	*	*	*
Franck Latrille	0	0	*	*	*
Bernard Mach	0	0	*	*	*
Sergio Marchionne	0	0	*	*	*
Georges Muller	0	0	*	*	*
François Naef	0	0	*	*	*
Jacques Theurillat	0	0	*	*	*
Hans Thierstein	0	0	*	*	*
Timothy Wells	0	0	*	*	*
All directors and executive officers as a group (16 persons) (1)(2)	9,973,200	90.6	4,780,223	47.1	69.7

* Less than one percent.

(1) Includes all registered shares and bearer shares reported by Bertarelli & Cie. Ernesto Bertarelli controls Bertarelli & Cie. Includes 9,800 bearer shares that we may issue to Mr. Bertarelli upon the exercise of stock options.

(2) Includes 31,709 bearer shares that we may issue if our directors and current executive officers exercise stock options. As of December 31, 2004, our directors and current executive officers held a total of 102,155 stock options, which have the following exercise prices and expiration dates:

Number of Outstanding Options Held By Our Directors and Current Executive Officers	Exercise Price in CHF	Expiration Date
1,320	522.50	June 17, 2005
2,290	546.25	April 1, 2008
2,755	546.00	April 1, 2009
6,400	512.50	June 10, 2009
3,530	1,520.50	April 1, 2010
3,200	1,397.50	May 16, 2010
7,650	1,346.00	April 1, 2011
8,100	1,434.00	April 1, 2012
1,500	810.00	November 11, 2012
17,600	649.00	March 31, 2013
4,600	692.00	May 12, 2013

38,010	782.00	March 31, 2014
5,200	772.00	June 1, 2014

Stock Options

In 1997, our shareholders first approved the creation of conditional capital for use in stock option plans for our employees. Since that time, our employees have exercised options for 26,806 bearer shares under our Stock Option Plan, and our issued and fully paid share capital reflects the issuance of those bearer shares. We have adjusted the number of options outstanding and their exercise price to reflect the two-for-one stock split that our shareholders approved at the annual meeting of shareholders held on May 16, 2000 and the grant to our option holders of one additional option for each option held as of April 15, 2000 to compensate them for the effect of the 100% stock dividend and the corresponding increase in share capital that our shareholders approved at the annual meeting.

At our annual meetings held on May 16, 2000 and May 25, 2004, our shareholders approved increases in our conditional capital for our stock option plans so that as of December 31, 2004, the total nominal capital authorized for the grant of options to employees and directors under our option plans, as adjusted for the exercise of 4,530 options under our Stock Option Plan and purchase of 21,819 shares under our Employee and Director Share Purchase Plan from January 1, 2004 to and including December 31, 2004, consisted of CHF 18,166,275, corresponding to 726,651 bearer shares with a par value of CHF 25 each.

We generally grant stock options to our employees under our Stock Option Plan every plan year. Each option gives the holder the right to purchase one bearer share or one ADS. Employee options vest ratably over four years. Each employee option has a 10-year duration. The exercise price for employee options is the fair market value of our bearer shares on the virt-X at the date of grant. Until 2002, the option price for our ADSs was set based on the price of the underlying bearer share at the date of grant. Since 2003, the option price for our ADSs has been set based on the fair market value of our ADSs on the New York Stock Exchange at the date of grant. In 1998, we granted 26,200 options to a total of 190 employees, at an exercise price of CHF 546.25 per bearer share. In 1999, we granted 29,160 options to a total of 218 employees, at an exercise price of CHF 546 per bearer share. In 2000, we granted 32,676 options to a total of 302 employees at an exercise price of CHF 1,520.50 per bearer share. In 2001, we granted 77,934 options to a total of 532 employees at an exercise price of CHF 1,346 per bearer share. In 2002, we granted 90,540 options to a total of 625 employees at a weighted average exercise price of CHF 1,350 per bearer share. In 2003, we granted 93,230 options for bearer shares to a total of 558 employees at a weighted average exercise price of CHF 650 per bearer share and 20,000 options for ADSs to one employee at an exercise price of $16.51 per ADS. In 2004, we granted 95,700 options for bearer shares to a total of 1,761 employees at a weighted average exercise price of CHF 791 per bearer share and 1,102,000 options for ADSs to 778 employees at an exercise price of $15.53 per ADS. Of the options for bearer shares, options for 26,806 bearer shares have been exercised and options for 75,293 bearer shares have been cancelled and are available for re-grant under the plan. Of the options for ADSs, no options for ADSs have been exercised and options for 55,200 ADSs have been cancelled and the corresponding bearer shares are available for re-grant under the plan. Total options for 336,808 bearer shares (some of which are in the form of options for ADSs) remain outstanding as of December 31, 2004.

In addition to the options we have granted to employees under our stock option plan, we made a single grant of options to each of our directors when they first took office between 1998 and 2001. Director options vest on December 31 of each year over a period of five years (four years for one director), but directors may not exercise their options for a period of five years (four years in the case of one director) from the date of grant. After the options become exercisable, directors may exercise their options for a period of five years (four years for one director). The exercise price for director options is the price of our bearer shares on the virt-X on the date of the annual meeting of shareholders following which the options were granted.

In 2003, we set up a new stock option plan for directors. Grants of options for bearer shares are made each year following the annual meeting. Options vest beginning one year after the date of grant and vest ratably over four years, expiring 10 years from the date of grant. The exercise price is the fair market value of the bearer share on the date of grant. The Compensation Committee is responsible for selecting the beneficiaries for each of the plan's cycles and determining the number of shares granted. In 2003, we granted 4,600 options for our bearer shares to a total of seven directors at an exercise price of CHF 692 per bearer share. In 2004, we granted 5,200 options for our bearer shares to a total of eight directors at an exercise price of CHF 772 per bearer share.

Our conditional capital covers the grants of options we made to our directors that vested or will vest in 2001 and thereafter, and will cover future grants to directors, but did not cover the grants of options to our directors that vested prior to 2001. After deducting the number of employee options that remain outstanding under our stock option plan and the options we granted to our directors that will vest in 2001 and thereafter, our conditional capital allows us to grant options for approximately an additional 336,808 bearer shares.

A compensation charge in the amount of $1.2 million (compared to $1.4 million in 2003) has been recognized for stock options granted in the plan years 2002, 2001 and 2000. The compensation charge related to the stock options granted is being expensed over the four-year vesting period of the options. In addition, we have taken the stock options granted to employees and directors into consideration in the calculation of diluted earnings per share.

Employee Share Purchase Plan

Our Employee Share Purchase Plan became effective on January 1, 2001 in Switzerland and the United States and was implemented for our affiliates in the rest of the world throughout the 2001 year. The plan is designed to allow our eligible employees to purchase our bearer shares or ADSs through periodic payroll deductions.

A participant may contribute up to 15% of his or her salary through payroll deductions, and the accumulated payroll deductions are applied to the purchase of bearer shares or ADSs on the participant's behalf at the end of the year. The purchase price per share is 85% of the lower of (i) the average closing price of our bearer shares on the virt-X in the 10 business days prior to January 1 of the plan's year and (ii) the average closing price of our bearer shares on the virt-X in the 10 business days prior to December 31 of the plan's year.

On January 3, 2002, January 18, 2002 and November 19, 2002, we issued 14,500, 10 and 1 bearer shares, respectively, under this plan. On January 3, 2003, January 27, 2003 and May 5, 2003, we issued 23,181, 18 and 30 bearer shares, respectively, under this plan. On January 5, 2004, we issued 20,301 bearer shares under this plan. On January 4, 2005 we issued 20,940 bearer shares under this plan.

The shares available for issuance under the plan were authorized by our shareholders through the creation of the conditional capital for stock options discussed above under “Stock Options.” We reserve the right to change, amend or discontinue the plan at any time.

Director Share Purchase Plan

In 2003, we set up a share purchase plan for the Board of Directors. The plan allows directors to purchase our bearer shares through allocation of 50% or 100% of their gross yearly directors’ fees to the plan. The sum of fee deductions accumulated is applied to the purchase of shares on the participant’s behalf at the end of each plan cycle. Each cycle commences on the first business day following our annual meeting of shareholders and terminates on the date of the next annual meeting. Each director may become a participant by notifying us during the 10 business days after the annual meeting. The purchase price per bearer share is 85% of the fair market value of the share on the fifth business day following the annual meeting. The shares available for issuance under the plan were authorized by our shareholders through the creation of the conditional capital for stock options discussed above under “Stock Options.” We reserve the right to change, amend or discontinue the plan at any time. On June 1, 2004, we issued 1,518 bearer shares under this plan.

Share Match Plan

If an employee completes one year of service with us after purchasing shares through the Employee Share Purchase Plan and retains any of the purchased shares at the end of that year of service, then the employee is eligible for our Share Match Plan. Under the Share Match Plan, we will grant additional shares to each eligible employee in an amount to be determined by our Board. For the first plan year, which ended on December 31, 2001, we granted 4,208 additional shares from our treasury shares pursuant to the plan. For the second plan year, which ended on December 31, 2002, we granted 6,648 additional shares from our treasury shares pursuant to the plan. For the third plan year, which ended on December 31, 2003, we granted 5,766 additional shares from our treasury shares pursuant to the plan. For the fourth plan year, which ended on December 31, 2004, for every three shares purchased in the Employee Share Purchase Plan on January 4, 2005 that are still held by an employee on December 31, 2005, we will grant to the employee one additional share. All share grants under the Share Match Plan are at the discretion of our Board. In jurisdictions other than the United States, the matching feature is a part of the Employee Share Purchase Plan.

Item 7. MAJOR SHAREHOLDERS AND RELATED PARTY TRANSACTIONS

Major Shareholders

As of December 31, 2004, Bertarelli & Cie, a partnership limited by shares with its principal offices at Chéserex (Vaud), Switzerland, held 51.43% of our capital, including treasury shares, and 65.36% of our voting rights. Ernesto Bertarelli, our Chief Executive Officer, Vice-Chairman and Managing Director, controls Bertarelli & Cie. On the same date, Maria-Iris Bertarelli, Ernesto Bertarelli and Donata Bertarelli Späth owned in the aggregate 7.00% of our capital, including treasury shares, and 10.53% of our voting rights. Our registered shares and our bearer shares are each entitled to one vote per share.

As of December 31, 2004, there were 11,738,175 bearer shares, including 1,611,434 treasury shares, and 11,013,040 registered shares outstanding. The following table sets forth the ownership of our voting securities by all persons known to us to own more than 5% of our registered shares and bearer shares. For the purposes of calculating

percentages shown in the table, the 1,611,434 treasury shares are deemed not to be outstanding.

Name of Owner	Registered Shares Owned	Percent of Registered Shares	Bearer Shares Owned	Percent of Bearer Shares	Aggregate Voting Percent
Bertarelli & Cie (1)	9,189,300	83.4	4,626,930	45.7	65.4
Ernesto Bertarelli (2)	9,973,200	90.6	4,753,289	46.9	69.6
Maria-Iris Bertarelli (3)	255,940	2.3	154,000	1.5	1.9
Donata Bertarelli Späth (3)	783,900	7.1	130,520	1.3	4.3

(1) Bertarelli & Cie is a partnership limited by shares with its principal offices in Chéserex (Vaud), Switzerland.
(2) Includes all registered shares and bearer shares reported by Bertarelli & Cie. Ernesto Bertarelli controls Bertarelli & Cie. Includes 9,800 bearer shares that we may issue upon the exercise by Mr. Bertarelli of stock options.
(3) Does not include the registered shares and bearer shares reported by Bertarelli & Cie. Ernesto Bertarelli controls Bertarelli & Cie.

All of our registered shares are held by Bertarelli & Cie and members of the Bertarelli family, all of whom are residents of Switzerland. Because our publicly traded shares are in bearer form, there are no holders of record of our bearer shares. Our American depositary shares, or ADSs, each of which represents one fortieth of a bearer share, are issued in registered form. Based on information provided by The Bank of New York, the depositary for the ADS program, there were 50 holders of record of our ADSs in the United States as of February 7, 2005. We believe that approximately 4.5% of our bearer shares (including bearer shares held in the form of ADSs) are beneficially owned by residents of the United States.

Related Party Transactions

In 2000, we leased from an unaffiliated company, under a lease that expires in 2006, a building then under construction adjacent to our headquarters building that we have used to expand our headquarters. The lease provides for a rent of approximately $1.1 million (2003: $1.0 million) per year. Subsequent to the negotiation of the lease, Ernesto Bertarelli acquired a controlling interest in the company that owns the building. We have subleased a portion of the building to another company controlled by Mr. Bertarelli. The lease payments to us in 2004 were approximately $0.3 million (2003: $0.2 million).

We have sub-leased a portion of the Serono Biotech Center located in Switzerland to an unaffiliated company that is indirectly controlled by Mr. Bertarelli. The lease expires in 2005. The lease payments to us in 2004 amounted to approximately $0.1 million (2003: $0.1 million). In 2004, from time to time we made use of a private jet for business-related travel. The jet is owned by a company that is indirectly controlled by Mr. Bertarelli. During 2004, we paid market-rate rental fees for the jet totaling approximately $2.3 million (2003: $1.6 million). In 2004, a company that is indirectly controlled by Mr. Bertarelli provided certain media production services to us for events such as our Annual General Meeting of Shareholders and employee sessions. Services totaling $0.2 million were provided to us by this company for the year ended December 31, 2004. In 2004, we paid a one-time consulting fee of $0.1 million to Bertarelli & Cie, a company controlled by Mr. Bertarelli that is our principal shareholder, for consulting services related to certain business development activities.

There are three loans outstanding to members of the Executive Management Board. The most recent loan was granted on June 12, 2002 for the amount of CHF 300,000 (approximately $224,000). All loans to executives accrue fixed interest at 3% per year. The total amount outstanding as of December 31, 2004 is CHF 0.7 million or approximately $0.6 million (2003: CHF1.1 million or approximately $0.9 million). Two of the loans are repayable in three equal installments and will be fully repaid April 30, 2005, while for the remaining loan, accrued interest is paid on the anniversary of the loan grant date, with the principal payable on December 31, 2005.

We continue to hold an equity investment in Cansera International, Inc., or Cansera, a Canadian company specializing in sterile animal sera and cell culture products from which we purchase products. We purchase products from Cansera on commercial terms and conditions and at market prices. Our total purchases from Cansera for the year ended December 31, 2004 were $1.5 million (2003: $2.4 million). As of December 31, 2004, there was an amount of $0.1 million (2003: $0.1 million) payable to Cansera.

We have obtained in the past, and may in the future obtain, commercial and investment banking services from, and have had other commercial dealings with, UBS AG and its affiliates. Ernesto Bertarelli, our Chief Executive Officer, is a director of UBS AG.

In 2004, we acquired an equity investment in Integrated Solutions S.A., an information systems consulting company located in Switzerland. We entered into a master service agreement with Integrated Solutions S.A. for the provision of information technology services. In 2004, Integrated Solutions S.A. provided us services in the amount of $4.3 million, of which $0.6 million remained payable as of December 31, 2004.

Item 8. FINANCIAL INFORMATION

Consolidated Financial Statements

Our consolidated financial statements specified by this standard are included in Item 18 and set forth on pages F-1 through F-54.

Legal Proceedings

We are a party to various legal proceedings, including breach of contract and patent infringement cases and other matters.

Interpharm Laboratories and others of our subsidiaries are defendants in a lawsuit, filed by the Israel Bio-Engineering Project Limited Partnership, or IBEP, in 1993 in the District Court of Tel Aviv-Jaffa, Israel, concerning certain proprietary rights and royalty rights and other claims of IBEP arising out of funding provided for the development of recombinant human interferon beta as well as certain other products in the early to mid-1980s. The trial of the ownership and contractual preliminary issues started in 2002 and is expected to continue through 2005. In 2003, IBEP sued Amgen Inc., Immunex Corporation, and Wyeth in United States District Court in Los Angeles, California, alleging that the product Enbrel infringes IBEP's asserted rights under a patent known as the "701 patent" issued to Yeda Research and Development Co. Ltd., or Yeda, and exclusively licensed to us. Yeda joined as a defendant and on February 18, 2004, the United States District Court granted Yeda's motion for summary judgment declaring that Yeda was the rightful owner of the 701 patent. IBEP has appealed the summary judgment decision to the United States Court of Appeals for the Federal Circuit, which heard argument on January 11, 2005.

In 1996, one of our Italian subsidiaries entered into an agreement with an Italian company, Italfarmaco, for the co-marketing of recombinant interferon beta-1a in Italy. Italfarmaco terminated the contract at the end of 1999, alleging breach by our subsidiary of its obligations, and initiated proceedings before the International Chamber of Commerce International Court of Arbitration in Milan, Italy, asking for the payment of damages, including loss of profit and business opportunities. We filed a counterclaim alleging Italfarmaco's default in the execution of the agreement and claiming monetary damages. The Arbitration Panel has appointed an expert for the evaluation of the potential damages. We expect the proceedings to last at least through 2005.

In 1999, Institut Biochimique S.A., or IBSA, initiated proceedings before the Tribunale Civile in Rome, Italy, the Tribunal de Grande Instance in Paris, France, and the Cour de Justice of the Canton of Geneva, Switzerland asserting that either our patents relating to highly purified (urinary) FSH are invalid or that the processes used by IBSA do not infringe them. The proceedings filed in Switzerland and France have been stayed, pending the outcome of the proceedings in Italy. The Italian court decided in October 2003 that the patent is valid in its entirety and that the fact that an FSH product is made by a third party using a process different from the one described in the patent is not sufficient to rule out infringement of the product claims. The decision is open to appeal by IBSA. IBSA has not appealed the decision of the court of first instance and the parties entered into a settlement agreement on May 10, 2004.

Our principal U.S. subsidiary, Serono, Inc., received a subpoena in 2001 from the U.S. Attorney's office in Boston, Massachusetts requesting that it produce documents for the period from 1992 to the present relating to Serostim. During 2002, Serono, Inc. also received subpoenas from the states of California, Florida, Maryland and New York, which mirror the requests in the U.S. Attorney's subpoena. Other pharmaceutical companies have received similar subpoenas as part of an ongoing, industry-wide investigation by the states and the federal government into the setting of average wholesale prices and marketing and other practices. These investigations seek to determine whether such practices violated any laws, including the Federal False Claims Act or the U.S. Food, Drug and Cosmetic Act or constituted fraud in connection with Medicare and/or Medicaid reimbursement to third parties. We are cooperating

with the investigation. The outcome of this investigation could include the commencement of civil and/or criminal proceedings involving the imposition of substantial fines, penalties and injunctive or administrative penalties, including exclusion from government reimbursement programs, or a resolution of civil and/or criminal allegations resulting in a substantial monetary settlement. The final settlement or adjudication of this matter could have a material adverse effect on our operations or financial condition. We cannot predict the timing of the resolution of this matter or its ultimate outcome.

Dividends and Dividend Policy

The following table sets forth the amount of dividends that we have declared with respect to the past five years. We calculated the U.S. dollar amounts based on the average exchange rate for the year.

	2004[1]	2003	2002	2001	2000
Declared dividend per bearer share (CHF)	9.00	8.00	7.00	6.25	6.00
Declared dividend per bearer share (U.S.$)	7.27	5.99	4.52	3.69	3.55
Declared dividend per ADS (U.S.$)(2)	0.20	0.15	0.11	0.09	0.09
Declared dividend per registered share (CHF)	3.60	3.20	2.80	2.50	2.40
Declared dividend per registered share (U.S.$)	3.18	2.40	1.81	1.48	1.42

(1) Our dividend for the 2004 fiscal year will not be declared and paid until our annual general meeting on April 26, 2005.

(2) Amount is equal to one fortieth of the amount declared per bearer share in U.S. dollars. Actual amounts paid to holders of ADSs may vary depending on the actual exchange rate obtained by the Depositary in converting dividends from Swiss francs to U.S. dollars and on the expenses of the Depositary.

Our current dividend policy is to pay between 20% and 30% of net income as dividends to our shareholders. The pay-out ratio is adjusted to take into account special events such as the investment for the launch of Rebif in the U.S. We cannot assure you that in the future we will pay dividends in this target range, in another amount or at all. We will review our dividend policy periodically depending on our financial position, capital requirements and general business conditions. We pay cash dividends in Swiss francs net of applicable Swiss withholding tax.

Our bearer shares and our registered shares participate in dividends in proportion to their nominal value, which is CHF 25 for the bearer shares and CHF 10 for the registered shares. Accordingly, the dividends per share on the bearer shares are 2.5 times the dividends per share on the registered shares.

Our shareholders are required to approve in a general shareholders' meeting any distribution of dividends proposed by our Board of Directors. In addition, our statutory auditors are required to declare that the dividend proposal of the Board of Directors is in accordance with Swiss law. We expect to hold the shareholders' meeting to approve any dividends in the second quarter of each year. We will pay any dividends approved at the shareholders' meeting shortly after the meeting.

Under Swiss corporate law, in most circumstances, general reserves exceeding 20% of the nominal share capital of a company are at the disposal of the shareholders' meeting for distribution as dividends if the company is a holding company, as we are.

Owners of ADSs will be entitled to receive any dividends paid on the underlying bearer shares. We will pay cash dividends to The Bank of New York, our depositary, in Swiss francs. The agreement with the depositary provides that the depositary will then convert the cash dividends to U.S. dollars and make payment to the holders of the American depositary receipts, or ADRs, which represent our ADSs, in U.S. dollars. Fluctuations in the exchange rate between

the Swiss franc and the U.S. dollar will affect the U.S. dollar amounts of cash dividends received by holders of ADRs. The depositary may withhold a portion of any dividend if, because of conversion from Swiss francs into U.S. dollars, that portion cannot be divided among the holders of ADRs to the nearest cent.

Significant Changes

Except as otherwise disclosed in this Annual Report, there has been no significant change in our financial position since December 31, 2004, the date of our last audited financial statements.

Item 9. THE OFFER AND LISTING

Market Prices of Bearer Shares and ADSs

Our bearer shares have been traded on the virt-X pan-European Exchange since June 2001, under the symbol “SEO”. All Swiss company shares included in the Swiss Market Index (SMI) are now traded on virt-X, which was created to increase pan-European trading liquidity. Our bearer shares had previously traded on the SWX Swiss Exchange and predecessor Swiss exchanges since 1987. Our bearer shares have been traded in the form of ADSs, each of which represents one fortieth of a bearer share, on the New York Stock Exchange under the symbol “SRA” since July 27, 2000. The following table sets forth, for the periods indicated, the high and low sales prices of our bearer shares in Swiss francs on the virt-X or SWX Swiss Exchange, and our ADSs in U.S. dollars on the New York Stock Exchange.

	SWX Swiss Exchange or virt-X Per Bearer Share		NYSE Per ADS	
Period	**High**	**Low**	**High**	**Low**
	(CHF)		(U.S.$)	
2000[1]	2,160	801	31.94	20.81
2001	1,820	1,100	25.50	16.85
2002	1,537	605	23.19	10.25
2003	958	562	17.79	10.58
First Quarter	800	562	14.35	10.58
Second Quarter	855	633	16.24	11.88
Third Quarter	958	759	17.48	14.30
Fourth Quarter	950	840	17.79	16.13
2004	974	711	19.60	14.57
First Quarter	974	776	19.60	15.21
Second Quarter	833	751	16.32	14.57
Third Quarter	824	728	16.33	14.68
September	824	761	16.33	15.10
Fourth Quarter	784	711	16.52	14.62
October	784	723	15.73	14.62
November	766	724	16.28	15.26
December	755	711	16.52	15.31
2005				
January	768	725	16.40	15.30
February	915	708	18.92	14.75

(1) Trading prices per ADS for 2000 are for the period from July 27, 2000 (the first day of trading of our ADSs on the New York Stock Exchange) through December 31, 2000.

Item 10. ADDITIONAL INFORMATION

Articles of Association

We were formed in 1987 as a *société anonyme* or limited stock corporation under Swiss law. Our registered office is located at 1267 Coinsins (Vaud), Switzerland, and our Articles of Association are entered in the commercial register in the canton of Vaud (Ref. No. L996/00173). Our current Articles of Association are dated March 9, 2005. Article 3 states our corporate purpose as follows: “The principal object of the company is to act as a holding company (for the

acquisition and management of shareholdings in Switzerland and abroad) in the pharmaceutical and related fields. The company may establish enterprises or companies, carry out any financial, commercial, industrial and real estate transactions, and conclude any contracts which further or are directly or indirectly connected with its object."

Transfer of Shares

Bearer Shares

The transfer of our bearer shares is effected by a corresponding entry in the books of a bank or depositary institution that holds the definitive certificates representing the bearer shares in custody or by transfer of possession of the certificate representing the bearer share.

Registered Shares

The transfer of registered shares is subject to approval by the executive committee of our board of directors which acts upon a delegation from our board of directors. The executive committee of the board will not approve the transfer if the prospective acquiror of the registered shares does not certify that the registered shares will be acquired in its own name and for its own account. The executive committee of the board may retroactively cancel any transfer of registered shares that it approved in reliance on a false certification by the potential acquiror of the registered shares that the shares would be acquired in its own name and for its own account. The executive committee of the board may refuse to approve a transfer if it identifies adequate grounds for such refusal, in particular if it concludes that our economic independence may be threatened by the prospective transfer, or that the prospective acquiror of the registered shares is one of our competitors or a competitor of a company in which we hold a participating interest. The executive committee of the board also may refuse to approve the transfer by offering to purchase the registered shares for our own account, for the accounts of other shareholders or for the accounts of third parties. If we offer to purchase the registered shares for the accounts of other shareholders, we will follow the principle of equal treatment of all holders of registered shares.

If the registered shares are transferred by succession, we will automatically enter the name of the acquiror in the share register unless we conclude that there are adequate grounds for refusal, as we describe above. If we refuse to allow such a transfer of registered shares by succession, we will offer to purchase the shares for our own account, for the accounts of other shareholders or for the accounts of third parties. If we offer to purchase the registered shares for the accounts of other shareholders, we will follow the principle of equal treatment of all holders of registered shares.

A holder of registered shares must have the approval of the executive committee of our board in order to use such shares as a pledge, guarantee or security.

A resolution of a qualified majority of at least two-thirds of the number of shares represented and an absolute majority of the nominal value of shares represented at a general meeting of shareholders is required to amend these restrictions on the transfer of registered shares.

Shareholders' Meetings

Under Swiss law, a general annual shareholders' meeting must be held within six months after the end of each financial year. Shareholders' meetings may be convened by the board of directors or, if necessary, by the statutory auditors. The board of directors is required to convene an extraordinary shareholders' meeting if so resolved by a shareholders' meeting or if so requested by shareholders holding in aggregate at least 10% of the company's nominal share capital. Shareholders holding shares with a nominal value of at least CHF 1 million have the right to request that a specific proposal be discussed and voted upon at the next shareholders' meeting. The request must be submitted in writing to the Board of Directors at least 45 days before the date of the Annual General Meeting. A shareholders' meeting is convened by publishing a notice in the Swiss Official Gazette of Commerce and sending a notice to each holder of registered shares at the address indicated in the share register at least 20 days prior to the meeting.

There are no provisions in our Articles of Association that require a quorum for shareholders' meetings.

Resolutions generally require the approval of an absolute majority of the shares represented at the shareholders' meeting. Shareholders' resolutions requiring a vote by absolute majority include, among others, amendments to the Articles of Association other than those indicated below, elections of directors and statutory auditors, approval of the annual report and the annual group accounts, the setting of the annual dividend and decisions to discharge the directors and management from liability for matters disclosed to the shareholders' meeting.

A resolution passed at a shareholders' meeting with a qualified majority of at least two-thirds of the number of shares represented and an absolute majority of the nominal value of shares represented at the meeting is required for:

- Ÿ changes in our purpose;
- Ÿ the creation of shares with privileged voting rights;
- Ÿ the restriction of the transferability of registered shares;

- an authorized or conditional increase in share capital;
- an increase in share capital by way of transformation of reserves, against contribution in kind, for the acquisition of assets or involving the grant of special benefits;
- the restriction or elimination of preemptive rights of shareholders;
- a transfer of our registered office; or
- dissolution other than by liquidation, such as a merger in which we are not the surviving entity.

In addition, under Swiss law, the introduction and abolition of any provision in the Articles of Association providing for a qualified majority must be adopted with such qualified majority.

At shareholders' meetings, shareholders can be represented by proxy. Voting takes place openly unless the shareholders' meeting resolves to vote by ballot or a ballot vote is ordered by the chairman of the meeting.

Net Profits and Dividends

Swiss law requires that at least 5% of the annual net profits of a corporation must be retained by the corporation as general reserves for so long as general reserves amount to less than 20% of the company's nominal share capital.

Under Swiss law, a corporation may pay dividends only if it has sufficient distributable profits from previous business years or if the reserves of the corporation for dividend distribution are sufficient to allow the distribution of a dividend. In either event, dividends may be paid out only after they have been approved by the shareholders' meeting. The board of directors may propose that a dividend be paid out, but cannot itself set the dividend. The statutory auditors must confirm that the dividend proposal of the board conforms to Swiss law. In practice, the shareholders' meeting usually approves the dividend proposal of the board of directors.

Under Swiss law, unless a corporation's articles of association provide for a dividend preference, when a corporation has shares with different nominal values it must pay dividends in proportion to the relative nominal values of the shares. Our articles of association do not provide for a dividend preference. Because our bearer shares have a nominal value of CHF 25 and our registered shares have a nominal value of CHF 10, dividends per share on our bearer shares are 2.5 times the dividends per share on our registered shares.

Dividends are usually due and payable a few business days after the shareholders' resolution relating to the allocation of profits has been passed. The statute of limitations in respect of dividend payments is five years. Dividends for which no payment has been requested within five years after the due date accrue to us and are allocated to our general reserves.

Preemptive Rights

Under Swiss law, any share issue, whether for cash or non-cash consideration, is subject to the prior approval of the shareholders' meeting. Shareholders of a corporation have certain preemptive rights to subscribe, in proportion to the nominal amount of shares held, for new issues of shares, bonds with warrants or convertible bonds. Shareholders may only subscribe for their class of shares if the different classes are increased simultaneously and in the same proportion. A resolution adopted at a shareholders' meeting with a qualified majority, however, may limit or suspend preemptive rights in certain limited circumstances.

U.S. securities laws may restrict the ability of U.S. persons, as that term is defined in Regulation S promulgated under the U.S. Securities Act of 1933, as amended, who hold shares to participate in certain rights offerings or share or warrant dividend alternatives which we may undertake in the future in the event we are unable or choose not to register the securities under the U.S. securities laws and are unable to rely on an exemption from registration under those laws.

Repurchase of Shares

Swiss law limits the amount of shares that we may hold or repurchase. We may repurchase shares only if:

- we have sufficient free reserves to pay the purchase price; and
- the aggregate nominal value of the shares does not exceed 10% of our nominal share capital.

Furthermore, we must create a reserve on our balance sheet in the amount of the purchase price of the repurchased shares. Repurchased shares that we or our subsidiaries hold do not carry any rights to vote at a shareholders' meeting but are entitled to the economic benefits applicable to shares generally.

Notices

We publish notices to shareholders in the Swiss Official Gazette of Commerce. In addition, we usually publish our official notices, such as invitations to shareholders' meetings and payment of dividends, in the following Swiss newspapers: AGEFI, Le Temps and Finanz und Wirtschaft. Our board of directors, however, reserves the right to change any of these media, other than the Swiss Official Gazette of Commerce, or to add additional ones at its sole discretion.

Duration and Liquidation

Our Articles of Association do not limit our duration.

We may be dissolved at any time by a shareholders' resolution which must be passed by:

- an absolute majority of the shares represented at the meeting in the case of dissolution by way of liquidation; or
- a qualified majority of at least two-thirds of the votes represented and an absolute majority of the nominal value of the shares represented at the meeting in other events, such as a merger in which we are not the surviving entity.

Under Swiss law, any surplus arising out of a liquidation, after the settlement of all claims of all creditors, is distributed to shareholders in proportion to the paid-up nominal value of shares held.

Notification of Share Interests

Under the Swiss Stock Exchange Act, shareholders, or shareholder groups acting in concert, who acquire or dispose of shares and thereby reach, exceed or fall below the respective threshold of 5%, 10%, 20%, 33 1/3%, 50% or 66 1/2% of the voting rights of a Swiss listed corporation must notify the corporation and the stock exchange on which such shares are listed of the acquisition or disposition in writing within four business days, whether or not the voting rights can be exercised. Following receipt of such notification, a corporation must inform the public.

In addition, under Swiss company law we must disclose the identity of all shareholders who we are aware hold more than 5% of our voting rights. Such disclosure must be made once a year in the notes to the financial statements as published in our annual report.

Mandatory Bid Rules

According to the Swiss Stock Exchange Act, shareholders and groups of shareholders acting in concert who acquire more than 33 1/3% of the voting rights of a listed Swiss corporation will have to submit a takeover bid to all the

remaining shareholders. This mandatory bid obligation may be waived under certain circumstances, in particular if another shareholder owns a higher percentage of voting rights than the acquiror. The Swiss Takeover Board or the Swiss Federal Banking Commission may grant such a waiver from the mandatory bid rules. If no waiver is granted, the mandatory takeover bid must be made pursuant to the procedural rules set forth in the Swiss Stock Exchange Act and the implementing ordinances enacted thereunder.

Anti-takeover Effects

Each of our bearer shares and registered shares entitles the holder to one vote. Since the nominal value of the bearer shares is two and one-half times greater than the nominal value of the registered shares, the registered shares effectively have super voting rights. Generally, super voting shares are viewed as having anti-takeover implications. As of December 31, 2004, the Bertarelli family controlled approximately 75.89% of the outstanding voting power. As a result, no third party can take over our company without the approval of the Bertarelli family.

Conversion of Registered Shares into Bearer Shares

According to our Articles of Association, at a general meeting of shareholders, our shareholders may vote to convert some or all of our registered shares into bearer shares, and some or all of the bearer shares into registered shares, at any time. If part or all of our registered shares are converted into bearer shares of a nominal value of CHF 10, the privileged voting rights of such converted shares will lapse as a matter of law and one converted share will have 0.4 votes as compared to one vote of a bearer share of CHF 25 nominal value. If at the same time we split our bearer shares into bearer shares of CHF 10, then the present rule of one vote per share may be maintained. The bearer shares into which the registered shares are converted would not be subject to any transfer restrictions.

Conversion of Bearer Shares into Registered Shares

Under current Swiss law and pursuant to our Articles of Association, all or part of our bearer shares may be converted into registered shares. Such conversion has to respect the proportional ownership of each shareholder. The conversion of bearer shares into registered shares as such would not change the rule that one share carries one vote. The transfer restrictions currently in effect for registered shares would not be valid for such converted shares. Under current Swiss law, the only permissible transfer restriction for listed registered shares is that voting rights may not be granted to a shareholder or a group of shareholders acting in concert in excess of a percentage limit that may be expressed in the Articles of Association. Our Articles of Association do not contain any such restriction.

Share Capital Increases and Decreases

Our shareholders may increase our share capital by passing a resolution at a general meeting of shareholders by an absolute majority of the shares represented at the meeting in person or by proxy. A majority of two-thirds of the shares represented in person or by proxy and the absolute majority of the nominal value of the shares represented is required:

- to increase our share capital if the capital increase is made in consideration of contributions in kind, for the purpose of acquiring assets or for the grant of special benefits;
- if the preemptive rights of our shareholders are limited or excluded; or
- in the event of a transformation of reserves into share capital.

In addition, under the Swiss Federal Code of Obligations, the general meeting of shareholders may, with a majority of two-thirds of the shares represented in person or by proxy and an absolute majority of the nominal value of the shares represented, decide on an increase of share capital in a specified aggregate nominal amount up to 50% of share capital in the form of:

- conditional capital for the purposes of issuing shares (i) to grant conversion rights or warrants to holders of convertible bonds or (ii) to grant rights to employees of the corporation to subscribe to new shares; and
- authorized capital to be utilized by the board of directors within a period not to exceed two years.

Pursuant to Swiss law, any decrease in share capital following a special procedure requires the approval of a general meeting of shareholders by an absolute majority of the shares represented in person or by proxy at the meeting.

Convertible Bonds

In November 2003, our subsidiary, Ares International Finance 92 Ltd (now known as Serono 92 Limited), issued CHF 600,000,000 aggregate principal amount of unsubordinated convertible bonds due in 2008. The bonds, which we have

guaranteed, bear interest at a rate of 0.50% per annum. Unless the bonds have previously been redeemed or converted, they will be redeemed on November 26, 2008 at 105.8108% of their principal amount, which would provide a yield to maturity of 1.625% per annum. The bonds were issued in bearer form in denominations of CHF 5,000 nominal amount or integral multiples thereof, and are convertible into our bearer shares at a rate of 3.5333 bearer shares per CHF 5,000 bond, subject to adjustment. The initial conversion price is CHF 1,415.11 per bearer share, and the bonds are convertible in the aggregate into 423,996 bearer shares, which may be treasury shares or shares issued from our conditional capital. Under certain circumstances, which are specified in the Terms of the Bonds which are filed as part of Exhibit 2.7 to this annual report and incorporated by reference into this decription, the conversion price may be adjusted or we may elect to redeem, or be required to redeem, the bonds. The bonds are listed on the SWX Swiss Exchange.

Exchange Controls and Other Limitations Affecting Shareholders

There are currently no limitations, either under the laws of Switzerland or in our Articles of Association, on the rights of non-residents of Switzerland to hold or vote our shares or ADSs. In addition, there are currently no Swiss foreign exchange control restrictions on the conduct of our operations or affecting the remittance of dividends on unrestricted shareholders' equity.

Taxation

The following is a discussion of the material Swiss tax and United States federal income tax consequences of the acquisition, ownership and disposition of bearer shares or ADSs by U.S. Holders, as defined below.

This summary does not purport to address all tax consequences of the ownership of bearer shares or ADSs and does not take into account the specific circumstances of any particular investors. In particular, the description of U.S. tax consequences deals only with U.S. Holders that will hold bearer shares or ADSs as capital assets and who do not at any time own individually, nor are treated as owning, 10% or more of the shares of the company. In addition, this description of U.S. tax consequences does not address the tax treatment of special classes of U.S. Holders, such as banks, tax-exempt entities, insurance companies, persons holding bearer shares or ADSs as part of a hedging or conversion transaction or as part of a "straddle," U.S. expatriates, persons subject to the alternative minimum tax, dealers or traders in securities or currencies and holders whose functional currency is not the U.S. dollar.

This summary is based on the tax laws of Switzerland and the United States (including the Internal Revenue Code of 1986, as amended, or the "Code", its legislative history, existing and proposed regulations thereunder, published rulings and court decisions) and on the Convention Between the United States of America and the Swiss Confederation for the Avoidance of Double Taxation with Respect to Taxes on Income, or the Treaty, all as in effect on the date hereof and all of which are subject to change (or changes in interpretation), possibly with retroactive effect. In addition, the summary is based in part upon the representations of The Bank of New York, or the Depositary, as depositary under our ADS program, and the assumption that each obligation in the deposit agreement between us and the Depositary and any related agreement will be performed in accordance with its terms.

For purposes of this discussion, a U.S. Holder is any beneficial owner of bearer shares or ADSs that is for U.S. federal income tax purposes:

- an individual citizen or resident of the United States;
- a corporation, or other entity that is taxable as a corporation, organized under the laws of the United States or any State thereof, including the District of Columbia;
- an estate the income of which is subject to U.S. federal income tax without regard to its source; or
- a trust the administration of which is subject to the primary supervision of a court in the United States and for which one or more U.S. persons have the authority to control all substantial decisions, or which elects under U.S. Treasury regulations to be treated as a U.S. person.

If a partnership holds bearer shares or ADSs, the U.S. federal income tax treatment of a partner will generally depend upon the status of the partner and the activities of the partnership. Persons holding bearer shares or ADSs through a partnership should consult their tax advisers as to their status.

A Non-U.S. Holder is any beneficial owner of bearer shares or ADSs that is not a U.S. Holder. An Eligible U.S. Holder is a U.S. Holder that:

Ÿ is a resident of the United States for purposes of the Treaty;

- does not maintain a permanent establishment or fixed base in Switzerland to which bearer shares or ADSs are attributable and through which the beneficial owner carries on or has carried on business (or, in the case of an individual, performs or has performed independent personal services); and

- who is not otherwise ineligible for benefits under the Treaty with respect to income and gain derived in connection with the bearer shares or ADSs.

This discussion does not address any aspects of U.S. taxation other than federal income taxation or any aspects of Swiss taxation other than income and capital taxation, withholding tax and stamp duties. You are urged to consult your tax advisors regarding the U.S. federal, state and local and the Swiss and other tax consequences of owning and disposing of bearer shares or ADSs. In particular, you are urged to confirm your status as Eligible U.S. Holders with your advisors and to discuss with your advisors any possible consequences of your failure to qualify as Eligible U.S. Holders. Also, Non-U.S. Holders should consult their own tax advisors, particularly as to the applicability of any tax treaty.

In general, and taking into account the earlier assumptions, for Swiss tax and U.S. federal income tax purposes, holders of ADRs evidencing ADSs will be treated as the owners of the shares represented by those ADSs, and exchanges of shares for ADRs, and ADRs for shares, will not be subject to Swiss tax or to U.S. federal income tax.

Swiss Taxation

Withholding Tax on Dividends and Distributions. Dividends paid and similar cash or in-kind distributions made by us to a holder of bearer shares or ADSs, including liquidation proceeds in excess of the nominal value of the shares and stock dividends, are subject to a Swiss federal withholding tax, or the Withholding Tax, at a rate of 35%. We must withhold the Withholding Tax from the gross distribution and pay it to the Swiss Federal Tax Administration.

A recipient of one of our distributions who is not a resident of Switzerland for tax purposes and does not hold the bearer shares or ADSs in connection with the conduct of a trade or business in Switzerland through a permanent establishment or a fixed place of business, which is called a non-resident holder, is subject to the Withholding Tax described above. The non-resident holder may be entitled to a full or partial refund of the Withholding Tax if the country in which he resides has entered into a bilateral treaty for the avoidance of double taxation with Switzerland. The United States has entered into such a bilateral treaty with Switzerland, which we call the Treaty.

Capital Gains upon Disposal of Bearer Shares or ADSs. Under current Swiss law, a U.S. holder of bearer shares or ADSs, who is not a resident of Switzerland, will be exempted from any Swiss federal, cantonal or municipal income tax during the year on the sale of bearer shares or ADSs.

A non-resident holder of Swiss shares will not be liable for any Swiss taxes other than the Withholding Tax described above and the Stamp Duties upon Transfer of Securities (described below) if the transfer occurs through or with a Swiss bank or other Swiss securities dealer. If, however, the bearer shares or ADSs can be attributed to a permanent establishment or fixed place of business maintained by such person within Switzerland during the relevant tax year, then this person may be subject to Swiss taxes generally in relation to its holding of the shares.

Obtaining a Refund of Swiss Withholding Tax

The Treaty provides for a mechanism whereby an Eligible U.S. Holder can seek a refund of the Withholding Tax paid on dividends in respect of our shares, to the extent such withholding exceeds 15%. The Depositary intends to make use of informal procedures under which it will submit a certificate to the Swiss tax authorities in respect of all U.S. Holders who have provided certifications of their entitlement to Treaty benefits. So long as these procedures remain available it generally should be possible for Eligible U.S. Holders to recover on a timely basis Withholding Tax in

excess of the 15% rate as provided in the Treaty. There can be no assurance that these informal procedures will remain available.

Alternatively, an Eligible U.S. Holder may apply for a refund of the Withholding Tax withheld in excess of the 15% Treaty rate. The claim for refund must be filed with the Swiss Federal Tax Administration, Eigerstrasse 65, 3003 Berne, Switzerland. The form used for obtaining a refund is Swiss Tax Form 82 (82C for companies; 82E for other entities; 82I for individuals), which may be obtained from any Swiss Consulate General in the United States or from the Swiss Federal Tax Administration at the address above. The form must be filled out in triplicate with each copy duly completed and signed before a notary public in the United States. The form must be accompanied by evidence of the deduction of Withholding Tax withheld at the source. We will provide this information on request.

Stamp Duties upon Transfers of Securities (Umsatzabgabe)

The sale of bearer shares or ADSs, whether by Swiss resident or non-resident holders, may be subject to a Swiss securities transfer stamp duty of up to 0.15% calculated on the sale proceeds if it occurs through or with a Swiss bank or other Swiss securities dealer as defined in the Swiss Federal Stamp Tax Act. In addition to the stamp duty, the sale of bearer shares by or through a member of the Swiss Exchange may be subject to a stock exchange levy.

United States Federal Income Taxation

Taxation of Dividends. Under the U.S. federal income tax laws, and subject to the passive foreign investment company rules discussed below, U.S. Holders will include in gross income the gross amount of any dividend paid by us (before reduction for Swiss withholding taxes) out of our current or accumulated earnings and profits (as determined for U.S. federal income tax purposes) as ordinary income when the dividend is actually or constructively received by the U.S. Holder, in the case of bearer shares, or by the Depositary, in the case of ADSs. Dividends received by a U.S. Holder will not be eligible for the dividends-received deduction generally allowed to U.S. corporations in respect of dividends received from other U.S. corporations. The amount of the dividend distribution includable in income of a U.S. Holder will be the U.S. dollar value of the Swiss franc payments made, determined at the spot Swiss franc/U.S. dollar rate on the date such dividend distribution is includable in the income of the U.S. Holder, regardless of whether the payment is in fact converted into U.S. dollars. Generally, any gain or loss resulting from currency exchange fluctuations during the period from the date the dividend payment is includable in income to the date such payment is converted into U.S. dollars will be treated as ordinary income or loss. Such gain will generally be income from sources within the United States and such losses will generally be used to offset U.S. source income for foreign tax credit limitation purposes. Distributions in excess of current and accumulated earnings and profits, as determined for U.S. federal income tax purposes, will be treated as a return of capital to the extent of the U.S. Holder's basis in the bearer shares or ADSs and thereafter as capital gain. We do not maintain calculations of our earnings and profits for U.S. federal income tax purposes.

Subject to certain limitations, the Swiss tax withheld in accordance with the Treaty and paid over to Switzerland will be creditable against the U.S. Holder's U.S. federal income tax liability. To the extent a refund of the tax withheld is available to a U.S. Holder under the laws of Switzerland or under the Treaty, the amount of tax withheld that is refundable will not be eligible for credit against the U.S. Holder's U.S. federal income tax liability. See "—Swiss Taxation—Obtaining a Refund of Swiss Withholding Tax," above, for the procedures for obtaining a refund of tax.

For foreign tax credit limitation purposes, the dividend will be income from sources without the United States, but generally will be treated separately, together with other items of "passive income" (or, in the case of certain holders, "financial services income").

Distributions of additional shares to U.S. Holders with respect to their bearer shares or ADSs that are made as part of a pro rata distribution to all of our shareholders generally will not be subject to U.S. federal income tax.

Taxation of Capital Gains. Subject to the passive foreign investment company rules discussed below, upon a sale or other disposition of bearer shares or ADSs, a U.S. Holder will recognize gain or loss for U.S. federal income tax purposes in an amount equal to the difference between the U.S. dollar value of the amount realized and the U.S. Holder's tax basis (determined in U.S. dollars) in such bearer shares or ADSs. Generally, such gain or loss will be a capital gain or loss. Capital gains realized by a U.S. Holder that is an individual, estate or trust are generally subject to federal income tax at a reduced rate, if the U.S. Holder's holding period for the bearer shares or ADSs exceeds one year. Limitations apply to the deductibility of capital losses by corporate and non-corporate U.S. Holders. Any gain recognized by a U.S. Holder on the sale or other disposition of the bearer shares or ADSs generally will be treated as U.S. source gain and any loss generally will be used to offset U.S. source income for purposes of the U.S. foreign tax credit limitations.

Additional Tax Considerations

Passive Foreign Investment Company Rules

We believe that our bearer shares or ADSs should not be treated as stock of a passive foreign investment company, or PFIC, for U.S. federal income tax purposes, but this conclusion is based on our interpretation of the law and it is a factual determination made annually and thus may be subject to change. In general, we would be a PFIC with respect to a U.S. Holder if, for any taxable year in which the U.S. Holder held its bearer shares or ADRs, either (1) at least 75% of our gross income for the taxable year were ''passive income'' or (2) at least 50% of the value (determined on the basis of a quarterly average) of our assets were attributable to assets that produce or are held for the production of passive income. If we were to be treated as a PFIC, unless a U.S. Holder made a ''QEF election'' or a mark-to-market election, gain realized on the sale or other disposition of bearer shares or ADSs would in general not be treated as capital gain, and a U.S. Holder would be treated as if such holder had realized such gains and certain ''excess distributions'' ratably over the holder's holding period for the bearer shares or ADSs and would be taxed at the highest tax rate on ordinary income in effect for each such year to which the gain was allocated, together with an interest charge in respect of the tax attributable to each such year.

Backup Withholding and Information Reporting

In general, reporting requirements will apply to dividends in respect of bearer shares and ADSs and the proceeds received on the disposition of bearer shares or ADSs paid within the United States or through certain U.S. related financial intermediaries to U.S. Holders other than certain exempt recipients (such as corporations), and backup withholding may apply, from time to time at rates established under the Code, to such amounts if the U.S. Holder fails to provide an accurate taxpayer identification number and other information or fails to comply with certain other requirements. The current backup withholding rate is 28%. The amounts of any backup withholding from a payment to a U.S. Holder will be allowed as a credit against the U.S. Holder's U.S. federal income tax liability.

Available Information

We are subject to the reporting requirements of the U.S. Securities Exchange Act of 1934, as amended, applicable to a foreign private issuer, and in accordance with the Exchange Act we file annual reports on Form 20-F with and provide other information to the Commission. You can inspect our annual reports, including exhibits thereto, and other information filed with or provided to the Commission without charge and copy those documents, upon payment of prescribed rates, at the public reference facility maintained by the Commission at Room 1024, 450 Fifth Street, N.W., Washington, D.C. 20549. You may obtain information on the operation of the Public Reference Room by calling the Commission at 1-800-732-0330. You can obtain copies of our filings by mail from the Public Reference Section of the Commission at 450 Fifth Street, N.W., Washington, D.C. 20549, at prescribed rates. In addition, you can inspect and copy these materials at the offices of the New York Stock Exchange, Inc., 20 Broad Street, New York, New York 10005. Our filings and other Commission submissions made on or after October 23, 2002 are also available to the public on the Commission's website at http://www.sec.gov.

Item 11. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

We are exposed to market risk, primarily related to foreign currency exchange rates, interest rates and the market value of our investments in financial assets and equity securities. These exposures are actively managed by the Serono treasury group in accordance with a written policy approved by the Board of Directors and subject to internal controls. Our objective is to minimize, where we deem appropriate, fluctuations in earnings and cash flows associated with changes in foreign currency exchange rates, interest rates and the market value of our investments in financial assets and equity securities. It is our policy to use a variety of derivative financial instruments to manage the volatility relating to these exposures, and to enhance the yield on our investment in financial assets. We do not use financial

derivatives for trading or speculative reasons, or for purposes unrelated to the normal business activities of the group. Any loss in value on a financial derivative would normally be offset by an increase in the value of the underlying transaction.

1. Foreign exchange exposure

We present our consolidated financial statements in U.S. dollars. As a consequence of the global nature of our business, we are exposed to foreign currency exchange rate movements, primarily in European, Asian and Latin American countries. We enter into various contracts that change in value as foreign currency exchange rates change, to preserve the value of assets, commitments and anticipated transactions. Typically we use foreign currency options and forward foreign exchange contracts to hedge certain anticipated net revenues in currencies other than the U.S. dollar. Net investments in our affiliates with a functional currency other than the U.S. dollar are of a long-term nature and we do not hedge such foreign currency translation exposures, other than in circumstances where the currencies are particularly volatile and could lead to unforeseen impacts on earnings and cash flows of the Serono group.

Our product sales and operating expenses (comprising selling, general and administrative and research and development) by currencies are as follows:

	Year ended December 31,		
	2004	2003	2002
	%	%	%
Product sales			
In U.S. dollar	**49**	47	46
In Euro	**34**	36	37
In other currencies	**17**	17	17
Total	**100**	100	100
Operating expenses (SG&A and R&D)			
In U.S. dollar	**39**	37	34
In Swiss franc	**28**	29	30
In Euro	**23**	23	27
In other currencies	**10**	11	9
Total	**100**	100	100

During 2004, the U.S. dollar weakened against most major currencies, including the Swiss franc and the Euro, which are our most important non-U.S. dollar currencies. This weakening resulted in a total positive currency effect on product sales of 4.6%, which was largely offset by a negative currency effect on operating expenses of 4.4%. The net impact on net income was a positive 3.5% in 2004 (positive 6.0% in 2003). This was primarily due to the strength of the Euro, the currency in which we have the largest proportion of non-U.S. dollar revenues, against the Swiss franc, the currency in which we have the largest proportion of non-U.S. dollar costs.

The primary purpose of our currency exchange risk management is to achieve stable and predictable cash flows. Consequently, our current policy is to enter into foreign currency options and forward foreign currency exchange contracts to cover the currency risk associated with existing assets, liabilities and other contractually agreed transactions (typically up to two months forward), as well as a portion of the currency risk associated with transactions that we anticipate conducting within the following six months. We use foreign currency options and forward foreign currency exchange contracts that are contracted with banks, which in most cases have credit ratings of A or higher, and that have a maximum maturity of 12 months.

2. Interest rate exposure

We manage our exposure to interest rate risk through the relative proportions of fixed rate debt and floating rate debt, as well as the maturity profile of our fixed rate financial assets. Net financial income earned on the group's net financial assets is generally affected by changes in the level of interest rates, principally the U.S. dollar interest rate. We manage our exposure to fluctuations in net financial income by making investments in high quality financial assets that pay a fixed interest rate until maturity. Interest rate swaps are also used to limit the impact of fluctuating interest rates on both financial income and financial expense.

3. Counterparty risk

Counterparty risk includes issuer risk on debt securities, settlement risk on derivative and money market transactions, and credit risk on cash and fixed term deposits. We limit our issuer risk by buying debt securities which are at least A rated. We reduce our settlement and credit risk by entering into transactions with counterparties that are usually at least A rated banks or financial institutions. Exposure to these risks and compliance with the risk parameters approved by the Board of Directors is closely monitored. We do not expect any losses due to non-performance by these counterparties, and our diverse portfolio of investments limits our exposure to any single counterparty or sector.

4. Equity price risk

We are exposed to equity price risks on the marketable portion of the available-for-sale equity securities. Our equity investments are typically related to collaboration agreements with other biotechnology and research companies. Equity securities are not purchased as part of our normal day-to-day management of financial assets managed by the group treasury department, with the exception of shares that are acquired under our Share Buy Back Plans.

5. Commodities

We have very limited exposures to price risk related to anticipated purchases of certain commodities used as raw materials in our business. A change in commodities prices may alter our gross margin but, due to our limited exposure to any single raw material, a price change is unlikely to have a material unforeseen impact on our earnings.

6. Sensitivity analysis

The table below presents the changes in fair values of our financial instruments in response to hypothetical changes in exchange or interest rates. The analysis shows forward-looking projections of changes in fair value assuming certain adverse market conditions. This is a method used to assess and mitigate risk and should not be considered as a projection of likely future events and losses. Actual results and market conditions in the future may be materially different from those projected and could cause losses to exceed the amounts projected.

For those financial instruments which are sensitive to changes in interest rates, we have calculated the potential change in the fair value resulting from an immediate hypothetical one percent increase or decrease in the yield curves from their levels as of December 31, 2004, with all other variables remaining constant. For those financial instruments which are sensitive to changes in foreign currency exchanges rates, we have calculated the potential change in the fair value resulting from an immediate hypothetical ten percent weakening or rising in the U.S. dollar against all other currencies from their levels as of December 31, 2004, with all other variables remaining constant. For those financial instruments that are sensitive to changes in equity prices as they are listed on stock exchanges, we have estimated the potential change in the fair value resulting from an immediate hypothetical ten percent decrease in the quoted market prices from their levels as of December 31, 2004, with all other variables remaining constant. The fair values of financial instruments are quoted market prices or, if not available, net present values estimated by discounting future cash flows.

For illustrative purposes, only unfavorable variances are shown in the sensitivity analysis below, although movements in interest rates, foreign currency exchange rates or equity prices can also result in favorable variances.

		Fair value changes arising from				
(U.S. dollar equivalents in thousands)	**Fair value as of December 31, 2004**	1% increase in interest rates (unfavorable)	1% decrease in interest rates (unfavorable)	10% rising in U.S. dollar against other currencies (unfavorable)	10% weakening in U.S. dollar against other currencies (unfavorable)	10% decrease in equity price (unfavorable)
Short-term bank deposits included in cash and cash equivalents	**212,746**	(32)	-	(1,537)	-	-
Available-for-sale debt securities	**1,563,196**	(15,249)	-	-	-	-
Available-for-sale equity securities	**150,833**	-	-	(719)	-	(14,692)
Financial debts, excluding convertible bond	**(166,815)**	-	(276)	-	(15,123)	-
Convertible bond	**(523,179)**	-	(20,491)	-	(58,131)	-
Forward foreign exchange contracts	**7,230**	-	-	-	(18,285)	-
Foreign currency options	**1,065**	-	-	(3,151)	-	-
Interest rate swaps - fair value hedges	**(1,728)**	-	(93)	-	-	-
Interest rate swaps - cash flow hedges	**(13,717)**	-	(22,629)	-	-	-

Our exposure to interest rate risk is primarily related to our investments in debt securities, the convertible bond, and the financing related to the construction of the new headquarters and research center in Geneva. The majority of our debt securities consist of fixed-rate investments in rated Eurobonds denominated in U.S. dollars with maturities up to three years and short-term money market funds. A sensitivity analysis indicates that a one percent increase in interest rates as of December 31, 2004 would unfavorably impact the net aggregated fair value of those securities by $15.2 million, while a one percent decrease in interest rates would unfavorably impact the fair value of our convertible bond by $20.5 million. We have entered into interest rate swaps to fix the cost of the anticipated post completion financing linked to the new headquarters and research project. The current fair value of this swap is negative $13.7 million and the adverse impact of a one percent decrease in interest rates would unfavorably impact the value of the swap by $22.7 million.

Our financial assets are primarily denominated in U.S. dollars, the market values of which are not significantly impacted by changes in foreign exchange rates. However, changes in foreign exchange rates would have a more significant impact on the fair value of our Swiss franc denominated convertible bond, the Swiss franc borrowings related to the Geneva headquarters and research center project and other borrowings denominated in currencies other than U.S. dollars. The value of our financial debts, including our convertible bond, would increase by $73.3 million if

the U.S. dollar devalued by ten percent.

We have investments in available-for-sale equity securities. We classify all such investments as long-term financial assets. The fair value of these investments is $150.8 million. The majority of these investments are listed on stock exchanges. If the market price of the traded equity securities were to decrease by ten percent, the fair value would decrease by $14.7 million.

Item 12. DESCRIPTION OF SECURITIES OTHER THAN EQUITY SECURITIES

Not applicable.

PART II

Item 13. DEFAULTS, DIVIDEND ARREARAGES AND DELINQUENCIES

Not applicable.

Item 14. MATERIAL MODIFICATIONS TO THE RIGHTS OF SECURITY HOLDERS AND USE OF PROCEEDS

A-D. Not applicable.

E. Use of Proceeds

1. Registration Statement on Form F-1
Commission File No. 333-12192
Effective Date: July 26, 2000

4.g. As of December 31, 2004, we have invested the net offering proceeds primarily in a combination of short-term (original maturities less than one year) and long-term (with maturities ranging between 12 months and four years) corporate debt securities. These financial assets were mainly denominated in U.S. dollars.

Item 15. CONTROLS AND PROCEDURES

Disclosure Controls and Procedures

Our principal executive officer and principal financial officer have conducted an evaluation of the effectiveness of our disclosure controls and procedures as of the end of the period covered by this annual report. Based on that evaluation, the principal executive officer and principal financial officer concluded that such controls and procedures were satisfactory to ensure that material information regarding our company, including our consolidated subsidiaries, was made known to such officers by others within those entities, particularly during the period in which this annual report was being prepared.

Changes in Internal Controls Over Financial Reporting

There were no significant changes in our internal controls over financial reporting during the period covered by this annual report that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

Item 16A. AUDIT COMMITTEE FINANCIAL EXPERT

Our board of directors has determined that Sergio Marchionne, a member of our Audit Committee, is an audit committee financial expert.

Item 16B. CODE OF ETHICS

We have adopted a code of ethics applicable to our principal executive officer, principal financial officer, principal accounting officer or controller and persons performing similar functions. Our board of directors has revised the code of ethics to extend its applicability to our directors, members of our Executive Management Board, Regional Vice-Presidents and General Managers. The code of ethics is filed as an exhibit to this Annual Report.

Item 16C. PRINCIPAL ACCOUNTANT FEES AND SERVICES

Our principal independent auditor is PricewaterhouseCoopers S.A., Geneva, Switzerland.

Fees and Services

During the years ended December 31, 2004 and 2003, we paid the following fees for professional services to PricewaterhouseCoopers:

	2004	2003
	(U.S.$ in thousands)	
Audit Fees	2,450	2,369
Audit-Related Fees	243	206
Tax Fees	608	591
All Other Fees	155	270
Total	3,456	3,436

Audit Services are defined as the standard audit work that needs to be performed each year in order to issue an opinion on our consolidated financial statements and to issue reports on our statutory financial statements. It also includes services that can only be provided by the auditor signing the audit report such as auditing of non-recurring transactions and application of new accounting policies, audits of significant and newly implemented system controls, pre-issuance reviews of quarterly financial results, consents and comfort letters and any other audit services required for U.S. Securities and Exchange Commission or other regulatory filings.

Audit-Related Services include those other assurance services provided by auditors but not restricted to those that can only be provided by the auditor signing the audit report. They include amounts for services such as acquisition due diligence, audits of pension and benefit plans, contractual audits of third party arrangements, assurance services on corporate citizenship reporting, and consultation regarding new accounting pronouncements.

Tax Services represent tax compliance and other services and expatriate and executive tax return services.

Other Services consist of actuarial services for pension and employee benefit plans. As required by the Sarbanes-Oxley Act of 2002, PricewaterhouseCoopers could no longer provide certain of these services to us after May 2004.

Policy on Pre-Approval of Audit and Non-Audit Services of Independent Auditors

Our Audit Committee is responsible for the oversight of our independent auditor's work. Our Audit Committee's policy is to pre-approve all audit and non-audit services provided by PricewaterhouseCoopers. These services may include audit services, audit-related services, tax services and other services, as described above. In such an event, the Audit Committee sets forth its pre-approval in detail, listing the particular services or categories of services which are pre-approved, and setting forth a specific budget for such services. In urgent circumstances, the Audit Committee's Chair, Sergio Marchionne, or Hans Thierstein, a member of the Audit Committee, may issue such a pre-approval. Additional services may be pre-approved on an individual basis. PricewaterhouseCoopers and our management then report to the Audit Committee on a quarterly basis regarding the extent of services actually provided in accordance with the applicable pre-approval, and regarding the fees for the services performed.

All of the services provided by PricewaterhouseCoopers since Rule 2-01(c)(7) of Regulation S-X became effective were approved by our Audit Committee pursuant to the approval policies described above. None of such services were approved pursuant to the procedures described in Rule 2-01(c)(7)(i)(C) of Regulation S-X, which waives the general requirement for pre-approval of non-audit services in certain circumstances.

ITEM 16D. EXEMPTIONS FROM THE LISTING STANDARDS FOR AUDIT COMMITTEES

Not applicable.

Item 16E. PURCHASES OF EQUITY SECURITIES BY THE ISSUER AND AFFILIATED PURCHASERS

	Total Number of Bearer Shares Purchased	Average Price Paid per Bearer Share (U.S. $)	Total Number of Bearer Shares Purchased as Part of Publicly Announced Plans or Programs	Approximate Value of Bearer Shares that May Yet Be Purchased Under the Plans or Programs (U.S. $)
January 1-31, 2004	--	--	--	223,610,232
February 1-29, 2004	37,500	673.54	37,500	195,592,279
March 1-31, 2004	123,100	632.56	123,100	117,035,066
April 1-30, 2004	47,259	616.72	47,259	86,297,602
May 1-31, 2004	143,350	624.61	143,350	--
June 1-30, 2004	59,050	629.38	59,050	561,064,199
July 1-31, 2004	138,000	604.67	138,000	469,504,540
August 1-31, 2004	262,500	617.13	262,500	306,623,156
September 1-30, 2004	57,435	637.24	57,435	275,932,990
October 1-31, 2004	--	--	--	287,954,107
November 1-30, 2004	348,100	656.74	348,100	75,296,796
December 1-31, 2004	97,350	652.51	97,350	11,961,579