

- a. R&D is clearly very important to Pfizer's business. Its R&D expenditures are very high relative to sales and the percentage has been growing even though sales growth is rapid. These expenditures, at least in the short run, reduce Pfizer's reported earnings given the long time lag between discovery and profitable sales of prescription drugs.

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b		Amounts in \$millions	1999	1998	1997	1996	1995	
A		Net sales	14,133	12,677	10,739	9,864	8,684	
B		R & D expense	2,776	2,279	1,805	1,567	1,340	
		% sales	B / A	19.60%	18.00%	16.80%	15.90%	15.40%
C		Pretax income	4,448	2,594	2,867	2,528	2,017	
		Tax expense	(1,244)	(642)	(775)	(758)	(609)	
D		Reported net income	3,199	1,950	2,082			
E		Reported Shareholders' equity	8,887	8,810	7,933	6,954	5,506	
F		Reported Shareholders' equity (Average)	8,849	8,372	7,444	6,230		
		Reported ROE	D / F	36.2%	23.3%	28.0%		
		Total assets	20,574	18,302	14,991	14,251	12,339	
G		Average assets	19,438	16,647	14,621	13,295		
		Asset turnover	A / G	0.727	0.762	0.734	0.742	
		R & D expense (if capitalized and amortized) from:						
		Current Year	1 / 6	463	380	301	261	223
		Current - 1	2 / 6	760	602	522	447	345
		Current - 2	2 / 6	602	522	447	345	293
		Current - 3	1 / 6	261	223	173	147	
H		Amortization		2,085	1,727	1,443	1,200	
I		Expense less amortization	B - H	691	552	363		
		Additional Reported Tax (Deferred Tax Liability) 35%		242	193	127		
J		Additional Net Income		449	359	236		
		Adjusted pretax income	C + I	5,139	3,146	3,230		
K		Adjusted net income	D + J	3,648	2,309	2,318		
		<b>Capitalized R &amp; D end of the year</b>						
		Current Year	5 / 6	2,313	1,899	1,504	1,306	1,117
		Current - 1	3 / 6	1,140	903	784	670	518
		Current - 2	1 / 6	301	261	223	173	147
		R & D asset (ending, pretax)		3,754	3,063	2,511	2,149	1,781
		R & D asset (ending, after-tax) = Retained						
L		Earnings	65%	2,440	1,991	1,632	1,397	
		Adjusted Shareholders' equity	E + L	11,327	10,801	9,565	8,351	
M		Adjusted Shareholders' equity (Average)		11,064	10,183	8,958		
		Adjusted ROE	K / M	32.97%	22.7%	25.9%		

- c Capitalization and amortization of R & D increases net income each year, the expected result given rising expenditures. There is little impact on ROE as higher equity offsets higher net income. (This latter result is not surprising given the findings of Sarath et. al, discussed in footnote 3 on page 233.)
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1. Asset turnover will decline under capitalization due to the higher level of assets; sales are unchanged.
  2. Cash from operations will rise under capitalization as R&D expenditures will be classified as investing cash flows and will never be reported as a component of cash flows from operations.