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PFIZER INC
Form 10-Q
August 06, 2007

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549
FORM 10-Q

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

For the quarterly period ended July 1, 2007

OR

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

For the transition period from _____ to _____

COMMISSION FILE NUMBER 1-3619

PFIZER INC.

(Exact name of registrant as specified in its charter)

DELAWARE
(State of Incorporation)

13-5315170
(I.R.S. Employer Identification No.)

235 East 42nd Street, New York, New York 10017
(Address of principal executive offices) (zip code)
(212) 573-2323
(Registrant's telephone number)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports) and (2) has been subject to such filing requirements for the past 90 days.

YES X NO

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, or a non-accelerated filer. See definition of "accelerated filer and large accelerated filer" in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer X Accelerated filer Non-accelerated filer

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act).

YES NO X

At August 1, 2007, 6,927,108,833 shares of the issuer's voting common stock were outstanding.

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FORM 10-Q

**For the Quarter Ended
July 1, 2007**

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PART I - FINANCIAL INFORMATION

Item 1. Financial Statements.

PFIZER INC AND SUBSIDIARY COMPANIES
CONDENSED CONSOLIDATED STATEMENTS OF INCOME
(UNAUDITED)

(millions, except per common share data)	Three Months Ended		Six Months Ended	
	July 1, 2007	July 2, 2006	July 1, 2007	July 2, 2006
Revenues	\$ 11,084	\$ 11,741	\$ 23,558	\$ 23,488
Costs and expenses:				
Cost of sales(a)	2,109	1,790	3,996	3,461
Selling, informational and administrative expenses(a)	3,844	3,881	7,205	7,276
Research and development expenses(a)	2,165	1,742	3,830	3,285
Amortization of intangible assets	783	823	1,598	1,648
Acquisition-related in-process research and development charges	--	513	283	513
Restructuring charges and acquisition-related costs	1,051	268	1,863	567
Other (income)/deductions - net	(487)	(359)	(889)	(615)
Income from continuing operations before provision for taxes on income and minority interests	1,619	3,083	5,672	7,353
Provision for taxes on income	272	790	961	1,052
Minority interests	2	3	5	5
Income from continuing operations	1,345	2,290	4,706	6,296
Discontinued operations:				
Income from discontinued operations - net of tax	--	108	--	210
Gains/(losses) on sales of discontinued operations - net of tax	(78)	17	(47)	20
Discontinued operations - net of tax	(78)	125	(47)	230
Net income	\$ 1,267	\$ 2,415	\$ 4,659	\$ 6,526
Earnings per common share - basic:				
Income from continuing operations	\$ 0.19	\$ 0.31	\$ 0.67	\$ 0.86
Discontinued operations - net of tax	(0.01)	0.02	(0.01)	0.03
Net income	\$ 0.18	\$ 0.33	\$ 0.66	\$ 0.89
Earnings per common share - diluted:				
Income from continuing operations	\$ 0.19	\$ 0.31	\$ 0.67	\$ 0.86
Discontinued operations - net of tax	(0.01)	0.02	(0.01)	0.03
Net income	\$ 0.18	\$ 0.33	\$ 0.66	\$ 0.89
Weighted-average shares used to calculate earnings per common share:				
Basic	6,966	7,282	7,009	7,298
Diluted	6,990	7,305	7,033	7,330
Cash dividends paid per common share	\$ 0.29	\$ 0.24	\$ 0.58	\$ 0.48

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(a) Exclusive of amortization of intangible assets, except as disclosed in *Note 10B. Goodwill and Other Intangible Assets: Other Intangible Assets*.

See accompanying Notes to Condensed Consolidated Financial Statements.

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PFIZER INC AND SUBSIDIARY COMPANIES CONDENSED CONSOLIDATED BALANCE SHEETS

(UNAUDITED)

(millions of dollars)	July 1, 2007*	Dec. 31, 2006**
<u>ASSETS</u>		
Cash and cash equivalents	\$ 2,138	\$ 1,827
Short-term investments	20,115	25,886
Accounts receivable, less allowance for doubtful accounts	9,497	9,392
Short-term loans	540	514
Inventories	5,734	6,111
Prepaid expenses and taxes	3,564	3,157
Assets of discontinued operations and other assets held for sale	34	62
Total current assets	41,622	46,949
Long-term investments and loans	5,067	3,892
Property, plant and equipment, less accumulated depreciation	16,298	16,632
Goodwill	20,985	20,876
Identifiable intangible assets, less accumulated amortization	22,902	24,350
Other assets, deferred taxes and deferred charges	3,529	2,138
Total assets	\$ 110,403	\$ 114,837
<u>LIABILITIES AND SHAREHOLDERS' EQUITY</u>		
Short-term borrowings, including current portion of long-term debt	\$ 2,432	\$ 2,434
Accounts payable	1,845	2,019
Dividends payable	2,010	2,055
Income taxes payable	516	6,466
Accrued compensation and related items	1,573	1,903
Other current liabilities	6,760	6,510
Liabilities of discontinued operations and other liabilities held for sale	--	2
Total current liabilities	15,136	21,389
Long-term debt	5,777	5,546
Pension benefit obligations	3,389	3,632
Postretirement benefit obligations	1,955	1,970
Deferred taxes	7,602	8,015
Other taxes payable	5,426	--
Other noncurrent liabilities	3,024	2,927
Total liabilities	42,309	43,479
Shareholders' equity		
Preferred stock	110	141
Common stock	442	441
Additional paid-in capital	69,555	69,104
Employee benefit trust, at fair value	(604)	(788)
Treasury stock	(51,833)	(46,740)
Retained earnings	50,304	49,669
Accumulated other comprehensive income/(expense)	120	(469)
Total shareholders' equity	68,094	71,358
Total liabilities and shareholders' equity	\$ 110,403	\$ 114,837

* Unaudited.

** Condensed from audited financial statements.

See accompanying Notes to Condensed Consolidated Financial Statements.

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PFIZER INC AND SUBSIDIARY COMPANIES CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS (UNAUDITED)

(millions of dollars)	Six Months Ended	
	July 1, 2007	July 2, 2006
<u>Operating Activities:</u>		
Net income	\$ 4,659	\$ 6,526
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	2,712	2,694
Share-based compensation expense	228	326
Acquisition-related in-process research and development charges	283	513
Gains on disposal of investments, products and product lines	(79)	(168)
(Gains)/losses on sales of discontinued operations	39	(31)
Deferred taxes from continuing operations	(951)	(438)
Other deferred taxes	--	45
Other non-cash adjustments	37	270
Changes in assets and liabilities (net of businesses acquired and divested)	(2,020)	(633)
Net cash provided by operating activities	4,908	9,104
<u>Investing Activities:</u>		
Purchases of property, plant and equipment	(757)	(887)
Purchases of short-term investments	(10,738)	(5,663)
Proceeds from redemptions of short-term investments	17,101	13,239
Purchases of long-term investments	(1,243)	(248)
Proceeds from redemptions of long-term investments	22	47
Purchases of other assets	(82)	(78)
Proceeds from sales of other assets	29	3
Proceeds from the sales of businesses, products and product lines	14	14
Acquisitions, net of cash acquired	(463)	(1,989)
Other investing activities	(336)	(116)
Net cash provided by investing activities	3,547	4,322
<u>Financing Activities:</u>		
Increase in short-term borrowings, net	78	938
Principal payments on short-term borrowings	(763)	(10,583)
Proceeds from issuances of long-term debt	1,243	1,054
Principal payments on long-term debt	(60)	(2)
Purchases of common stock	(4,999)	(2,000)
Cash dividends paid	(4,040)	(3,468)
Stock option transactions and other	383	318
Net cash used in financing activities	(8,158)	(13,743)
Effect of exchange-rate changes on cash and cash equivalents	14	(9)
Net increase/(decrease) in cash and cash equivalents	311	(326)
Cash and cash equivalents at beginning of period	1,827	2,247
Cash and cash equivalents at end of period	\$ 2,138	\$ 1,921
<u>Supplemental Cash Flow Information:</u>		
Cash paid during the period for:		
Income taxes	\$ 3,672	\$ 921
Interest	354	414
See accompanying Notes to Condensed Consolidated Financial Statements.		

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PFIZER INC AND SUBSIDIARY COMPANIES NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

Note 1. Basis of Presentation

We prepared the condensed consolidated financial statements following the requirements of the Securities and Exchange Commission (SEC) for interim reporting. As permitted under those rules, certain footnotes or other financial information that are normally required by accounting principles generally accepted in the United States of America (GAAP) can be condensed or omitted. Balance sheet amounts and operating results for subsidiaries operating outside the U.S. are as of and for the three-month and six month periods ended May 27, 2007, and May 28, 2006.

We made certain reclassifications to prior period amounts to conform to the second-quarter 2007 presentation.

Revenues, expenses, assets and liabilities can vary during each quarter of the year. Therefore, the results and trends in these interim financial statements may not be representative of those for the full year.

We are responsible for the unaudited financial statements included in this document. The financial statements include all normal and recurring adjustments that are considered necessary for the fair presentation of our financial position and operating results.

The information included in this Quarterly Report on Form 10-Q should be read in conjunction with the consolidated financial statements and accompanying notes included in Pfizer's Annual Report on Form 10-K for the year ended December 31, 2006.

Note 2. Adoption of New Accounting Policy

As of January 1, 2007, we adopted the provisions of Financial Accounting Standards Board (FASB) Interpretation No. 48 (FIN 48), *Accounting for Uncertainty in Income Taxes, an interpretation of SFAS 109, Accounting for Income Taxes*, and supplemented by FASB Financial Staff Position FIN 48-1, *Definition of Settlement in FASB Interpretation No. 48*, issued May 2, 2007, and changed our policy related to the accounting for income tax contingencies. To understand the cumulative effect of these accounting changes, see *Note 6A. Taxes on Income: Adoption of New Accounting Standard*.

We continue to account for income tax contingencies using a benefit recognition model. Beginning January 1, 2007, if we consider that a tax position is 'more likely than not' of being sustained upon audit, based solely on the technical merits of the position, we recognize the benefit. We measure the benefit by determining the amount that is greater than 50% likely of being realized upon settlement, presuming that the tax position is examined by the appropriate taxing authority that has full knowledge of all relevant information. These assessments can be complex and we often obtain assistance from external advisors.

Under the benefit recognition model, if our initial assessment fails to result in the recognition of a tax benefit, we regularly monitor our position and subsequently recognize the tax benefit: (i) if there are changes in tax law or analogous case law that sufficiently raise the likelihood of prevailing on the technical merits of the position to more likely than not; (ii) if the statute of limitations expires; or (iii) if there is a completion of an audit resulting in a favorable settlement of that tax year with the appropriate agency.

Liabilities associated with uncertain tax positions are now classified as current only when we expect to pay cash within the next 12 months. Interest and penalties, if any, continue to be recorded in *Provision for taxes on income* and are classified on the balance sheet with the related tax liability.

Prior to 2007, our policy had been to account for income tax contingencies based on whether we determined our tax position to be 'probable' under current tax law of being sustained, as well as an analysis of potential outcomes under a given set of facts and circumstances. In addition, we previously considered all tax liabilities as current once the associated tax year was under audit.

Note 3. Acquisitions

In the first quarter of 2007, we acquired BioRexis Pharmaceutical Corp., a privately held biopharmaceutical company with a number of diabetes candidates and a novel technology platform for developing new protein drug candidates, and Embrex, Inc., an animal health company that possesses a unique vaccine delivery system known as Inovoject, which enables baby chicks to be vaccinated while inside their eggs. In connection with these and other small acquisitions, we recorded \$283 million, in *Acquisition-related in-process research and development charges* in the first quarter of 2007.

In the second quarter of 2006, we completed the acquisition of all the outstanding shares of Rinat Neuroscience Corp., a biologics company with several new central-nervous-system product candidates. In connection with this and other smaller acquisitions, we recorded \$513 million, in *Acquisition-related in-process research and development charges* in the second quarter of 2006.

On February 28, 2006, we completed the acquisition of the sanofi-aventis worldwide rights, including patent rights and production technology, to manufacture and sell Exubera, an inhaled form of insulin for use in adults with type 1 and type 2 diabetes, and the insulin-production business and facilities located in Frankfurt, Germany, previously jointly owned by Pfizer and sanofi-aventis, for approximately \$1.4 billion (including transaction costs). In 2006, in connection with the acquisition, as part of our final purchase price allocation, we recorded \$1.0 billion of developed technology rights, \$218 million of inventory and \$166 million of *Goodwill*, all of which have been allocated to our Pharmaceutical segment. The amortization of the developed technology rights is primarily included in *Cost of sales*. Prior to the acquisition, in connection with our collaboration agreement with sanofi-aventis, we recorded a research and development milestone due to us from sanofi-aventis of \$118 million (\$71 million, after tax) in the first quarter of 2006 in *Research and development expenses* upon the approval of Exubera in January 2006 by the Food and Drug Administration (FDA).

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Note 4. Discontinued Operations

The following amounts, primarily related to our Consumer Healthcare business which was sold in December 2006 for \$16.6 billion, have been segregated from continuing operations and included in *Discontinued operations - net of tax* in the condensed consolidated statements of income:

(millions of dollars)	Three Months Ended		Six Months Ended	
	July 1, 2007	July 2, 2006	July 1, 2007	July 2, 2006
Revenues	\$ --	\$ 1,027	\$ --	\$ 1,946
Pre-tax income	\$ --	\$ 160	\$ --	\$ 315
Provision for taxes on income	--	(52)	--	(105)
Income from operations of discontinued businesses - net of tax	--	108	--	210
Pre-tax gains/(losses) on sales of discontinued businesses	(79)	26	(39)	31
Provision for taxes on gains	1	(9)	(8)	(11)
Gains/(losses) on sales of discontinued operations - net of tax	(78)	17	(47)	20
Discontinued operations - net of tax	\$ (78)	\$ 125	\$ (47)	\$ 230

For a period of time, we will continue to generate cash flows and to report income statement activity in continuing operations that are associated with our former Consumer Healthcare business. The activities that give rise to these impacts are transitional in nature and generally result from agreements that ensure and facilitate the orderly transfer of business operations to the new owner. Included in continuing operations for the second quarter of 2007 were the following amounts associated with these transition service agreements that will no longer occur after the full transfer of activities to the new owner: *Revenues* of \$50 million; *Cost of sales* of \$45 million; *Selling, informational and administrative expense* of \$5 million; and *Other (income)/deduction-net* of \$7 million in income, and for the first six months of 2007: *Revenues* of \$94 million; *Cost of sales* of \$80 million; *Selling, informational and administrative expense* of \$7 million; and *Other (income)/deduction-net* of \$9 million in income.

Note 5. Adapting to Scale Productivity Initiative

We incurred the following costs in connection with our Adapting to Scale (AtS) productivity initiative, which was launched in early 2005 and broadened in October 2006:

(millions of dollars)	Three Months Ended		Six Months Ended	
	July 1, 2007	July 2, 2006	July 1, 2007	July 2, 2006
Implementation costs(a)	\$ 317	\$ 180	\$ 491	\$ 365
Restructuring charges(b)	1,035	262	1,830	556
Total AtS costs	\$ 1,352	\$ 442	\$ 2,321	\$ 921

(a) For the second quarter of 2007, included in *Cost of sales* (\$170 million), *Selling, informational and administrative expenses* (\$79 million), *Research and development expenses* (\$131 million) and *Other (income)/deductions - net* (\$63 million income). For the second quarter of 2006, included in *Cost of sales* (\$104 million), *Selling, informational and administrative expenses* (\$58 million), *Research and development expenses* (\$40 million) and *Other (income)/deductions - net* (\$22 million income). For the first six months of 2007, included in *Cost of sales* (\$264 million), *Selling, informational and administrative expenses* (\$128 million), *Research and development expenses* (\$162 million) and *Other (income)/deductions - net* (\$63 million income). For the first six months of 2006, included in *Cost of sales* (\$228 million), *Selling, informational and administrative expenses* (\$97 million), *Research and development expenses* (\$62 million) and *Other (income)/deductions - net* (\$22 million income).

(b) Included in *Restructuring charges and acquisition-related costs*.

AtS costs associated with *Discontinued operations* in 2006 were not significant.

Through July 1, 2007, the restructuring charges primarily relate to our plant network optimization efforts and the restructuring of our worldwide marketing and research and development operations, while the implementation costs primarily relate to system and process standardization, as well as the expansion of shared services.

The components of restructuring charges associated with AtS follow:

(millions of dollars)	Costs		Utilization		Accrual as of July 1, 2007(a)
	Incurring Through July 1, 2007		Through July 1, 2007		
Employee termination costs	\$ 2,664	\$ 1,306	\$ 1,358		
Asset impairments	606	606	--		
Other	294	197	97		
Total	\$ 3,564	\$ 2,109	\$ 1,455		

(a) Included in *Other current liabilities* (\$1.2 billion) and *Other noncurrent liabilities* (\$215 million).

During the second quarter of 2007, we expensed \$821 million for *Employee termination costs*, \$93 million for *Asset impairments* and \$121 million in *Other*. During the first six months of 2007, we expensed \$1.6 billion for *Employee termination costs*, \$116 million for *Asset impairments* and \$162 million in *Other*. Through July 1, 2007, costs incurred for *Employee termination costs* represent the expected reduction of the workforce by approximately 18,400 employees, mainly in research, manufacturing and sales. As of July 1, 2007, approximately 9,900 of these employees have been formally terminated. *Employee termination costs* are recorded when the actions are probable and estimable and include accrued severance benefits, pension and postretirement benefits. *Asset impairments* primarily include charges to write down property, plant and equipment. *Other* primarily includes costs to exit certain activities.

Note 6. Taxes on Income

A. Adoption of New Accounting Standard

As of January 1, 2007, we adopted the provisions of FIN 48, *Accounting for Uncertainty in Income Taxes*, an interpretation of SFAS 109, *Accounting for Income Taxes*, as supplemented by FASB Financial Staff Position FIN 48-1, *Definition of Settlement in FASB Interpretation No. 48*, issued May 2, 2007. See *Note 2. Adoption of New Accounting Policy*, for a full description of our accounting policy related to the accounting for income tax contingencies. As a result of the implementation of FIN 48, at the date of adoption, we reduced our existing liabilities for uncertain tax positions by approximately \$11 million, which has been recorded as a direct adjustment to the opening balance of *Retained earnings* and changed the classification of virtually all amounts associated with uncertain tax positions approximately \$4.0 billion, including the associated accrued interest of approximately \$780 million, from current to noncurrent. For details, see section C. *Tax Contingencies* below.

B. Taxes on Income

On January 23, 2006, the Internal Revenue Service (IRS) issued final regulations on Statutory Mergers and Consolidations, which impacted certain prior-period transactions. In the first quarter of 2006, we recorded a tax benefit of \$217 million, reflecting the total impact of these regulations.

On January 25, 2006, we were notified by the IRS Appeals Division that a resolution had been reached on the matter that we were in the process of appealing related to the tax deductibility of an acquisition-related breakup fee paid by Warner-Lambert Company in 2000. As a result, in the first quarter of 2006, we recorded a tax benefit of approximately \$441 million related to the resolution of this issue.

As of July 1, 2007, we intend to permanently reinvest the earnings of our international subsidiaries and, therefore, we have not recorded a U.S. tax provision on unremitted earnings.

C. Tax Contingencies

We are subject to income tax in many jurisdictions and a certain degree of estimation is required in recording the assets and liabilities related to income taxes. For a description of our accounting policy associated with accounting for income tax contingencies, see *Note 2. Adoption of New Accounting Policy*. All of our tax positions are subject to audit by the local taxing authorities in each tax jurisdiction. Tax audits can involve complex issues and the resolution of issues may span multiple years, particularly if subject to negotiation or litigation.

The United States is one of our major tax jurisdictions and the IRS is currently conducting audits of the Pfizer Inc. tax returns for the years 2002, 2003 and 2004. The 2005, 2006 and 2007 tax years are also currently under audit as part of the IRS Compliance Assurance Process (CAP), a real-time audit process. All other tax years in the U.S. for Pfizer Inc. are closed under the statute of limitations. With respect to Pharmacia Corporation, the IRS is currently conducting an audit for the year 2003 through the date of merger with Pfizer (April 16, 2003). Although the U.S. audits for Pharmacia Corporation for all previous years have been closed, tax years 2000 through 2002 are still open under the statute of limitations. In addition to the open audit years in the U.S., we have open audit years in other major tax jurisdictions, such as Canada (1998-2006), Japan (2004-2006), Europe (1996-2006, primarily reflecting Ireland, the U.K., France, Italy, Spain and Germany), and Puerto Rico (2002-2006).

We regularly reevaluate our tax positions and the associated interest and penalties, if applicable, resulting from audits of federal, state and foreign income tax filings, as well as changes in tax law that would either increase or decrease the technical merits of a position relative to the more likely than not standard. We believe that our accruals for tax liabilities are adequate for all open years. Many factors are considered in making these evaluations, including past history, recent interpretations of tax law, and the specifics of each matter. Because tax regulations are subject to interpretation and tax litigation is inherently uncertain, these evaluations can involve a series of complex judgments about future events and can rely heavily on estimates and assumptions. Our evaluations are based on estimates and assumptions that have been deemed reasonable by management. However, if our estimates and assumptions are not representative of actual outcomes, our results could be materially impacted.

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Because tax law is complex and often subject to varied interpretations, it is uncertain whether some of our tax positions will be sustained upon audit. The amounts associated with uncertain tax positions are as follows:

(millions of dollars)	July 1, 2007	January 1, 2007
Non-current deferred tax assets(a)	\$ 451	\$ 395
Other tax assets(a)	726	647
Income taxes payable(b)	(135)	(47)
Other taxes payable(b)	(5,426)	(4,962)
Total amounts associated with uncertain tax positions	\$ (4,384)	\$ (3,967)

(a) Included in *Other assets, deferred taxes and deferred charges*.

(b) Includes gross accrued interest. Accrued penalties are not significant.

Tax liabilities associated with uncertain tax positions represent unrecognized tax benefits, which arise when the estimated benefit recorded in our financial statements differs from the amounts taken or expected to be taken in a tax return because of the uncertainties described above. These unrecognized tax benefits relate primarily to issues common among multinational corporations. Virtually all of these unrecognized tax benefits, if recognized, would impact our effective income tax rate.

Tax assets associated with uncertain tax positions represent our estimate of the potential tax benefits in one tax jurisdiction that could result from the payment of income taxes in another tax jurisdiction. These potential benefits generally result from cooperative efforts among taxing authorities to minimize double taxation. The recoverability of these assets, which we believe to be more likely than not, is dependent upon the actual payment of taxes in one tax jurisdiction and, in some cases, the successful petition for recovery in another tax jurisdiction.

If our estimates of unrecognized tax benefits and potential tax benefits are not representative of actual outcomes, our financial statements could be materially affected in the period of settlement as we treat settlements as discrete items in the period of resolution. Based on the protocol of finalizing audits by the relevant taxing authorities, which could include formal administrative and legal proceedings, except for amounts reflected in *Income taxes payable*, we are unable to estimate the range of reasonably possible change related to our uncertain tax positions within the next 12 months. However, any settlements would likely result in a significant decrease in our uncertain tax positions.

Note 7. Comprehensive Income

The components of comprehensive income/(expense) follow:

(millions of dollars)	Three Months Ended		Six Months Ended	
	July 1, 2007	July 2, 2006	July 1, 2007	July 2, 2006
Net income	\$ 1,267	\$ 2,415	\$ 4,659	\$ 6,526
Other comprehensive income/(expense):				
Currency translation adjustment and other	500	688	372	998
Net unrealized gains/(losses) on derivative financial instruments	9	22	18	93
Net unrealized gains/(losses) on available-for-sale securities	9	(36)	5	(33)
Benefit plan adjustments	113	(17)	194	(29)
Total other comprehensive income/(expense)	631	657	589	1,029
Total comprehensive income	\$ 1,898	\$ 3,072	\$ 5,248	\$ 7,555

Amounts of comprehensive income associated with discontinued operations in 2006 were not significant.

Note 8. Financial Instruments**A. Long-Term Debt**

On May 11, 2007, we issued the following notes to be used for general corporate purposes:

\$1.2 billion equivalent, senior, unsecured, euro-denominated notes, due May 15, 2017, which pay interest annually, beginning on May 15, 2008, at a fixed rate of 4.55%.

The notes were issued under a new securities registration statement filed with the SEC in March 2007.

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B. Derivative Financial Instruments and Hedging Activities

There was no material ineffectiveness in any hedging relationship reported in earnings in the first six months of 2007.

Foreign Exchange Risk

During the first six months of 2007, we entered into the following new or incremental hedging or offset activities:

Instrument(a)	Primary Balance Sheet Caption(b)	Hedge Type(c)	Hedged or Offset Item	Notional Amount as of July 1, 2007 (millions of dollars)	Maturity Date
Forwards	OCL	--	Short-term foreign currency assets and liabilities(d)	\$ 2,651	2007
Forwards	Prepaid	CF	Yen available-for-sale investments	2,212	2007
Swap	ONCL	--	Euro fixed rate debt	1,216	2017
Forwards	OCL	CF	Euro available-for-sale investments	1,041	2007
Forwards	Prepaid	CF	Euro available-for-sale investments	696	2007
Swap	Other assets	FV	Swiss franc loan	143	2009

(a) Forwards = Forward-exchange contracts.

(b) The primary balance sheet caption indicates the financial statement classification of the fair value amount associated with the financial instrument used to hedge foreign exchange risk. The abbreviations used are defined as follows: Prepaid = *Prepaid expenses and taxes*; Other assets = *Other assets, deferred taxes and deferred charges*; OCL = *Other current liabilities*; and ONCL = *Other noncurrent liabilities*.

(c) CF = Cash flow hedge; FV = Fair value hedge.

(d) Forward-exchange contracts used to offset short-term foreign currency assets and liabilities are primarily for intercompany transactions in euros, U.K. pounds, Japanese yen and Canadian dollars.

These foreign-exchange instruments serve to protect us against the impact of the translation into U.S. dollars of certain foreign currency denominated transactions.

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Interest Rate Risk

During the first six months of 2007, we entered into the following new hedging activities:

Instrument	Primary Balance Sheet Caption(a)	Hedge Type(b)	Hedged Item	Notional Amount as of July 1, 2007 (millions of dollars)	Maturity Date
Swap	ONCL	FV	Euro fixed rate debt	\$ 1,216	2017
Swaps	ONCL	CF	Available-for-sale investments	646	2009

(a) The primary balance sheet caption indicates the financial statement classification of the fair value amount associated with the financial instrument used to hedge interest rate risk. The abbreviation used is defined as follows: ONCL = *Other noncurrent liabilities*.

(b) FV = Fair value hedge; CF = Cash flow hedge.

The interest rate instruments serve to hedge the fixed or variable interest rates on the hedged items, matching the amount and timing of the hedged items.

Note 9. Inventories

The components of inventories follow:

(millions of dollars)		July 1, 2007		Dec. 31, 2006
Finished goods	\$	1,898	\$	1,651
Work-in-process		2,624		3,198
Raw materials and supplies		1,212		1,262
Total inventories	\$	5,734	\$	6,111

Note 10. Goodwill and Other Intangible Assets

A. Goodwill

The changes in the carrying amount of goodwill by segment for the six months ended July 1, 2007, follow:

(millions of dollars)	Pharmaceutical	Animal Health	Other	Total
Balance, December 31, 2006	\$ 20,798	\$ 61	\$ 17	\$ 20,876
Additions(a)	--	39	--	39
Other(b)	69	--	1	70
Balance, July 1, 2007	\$ 20,867	\$ 100	\$ 18	\$ 20,985

(a) Primarily related to Embrex, Inc.

(b) Includes the impact of foreign exchange, partially offset by adjustments to certain purchase accounting liabilities.

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B. Other Intangible Assets

The components of identifiable intangible assets, primarily included in our Pharmaceutical segment, follow:

	July 1, 2007		Dec. 31, 2006	
(millions of dollars)	Gross Carrying Amount	Accumulated Amortization	Gross Carrying Amount	Accumulated Amortization
Finite-lived intangible assets:				
Developed technology rights	\$ 32,993	\$ (14,093)	\$ 32,769	\$ (12,423)
Brands	1,016	(434)	888	(417)
License agreements	209	(50)	189	(41)
Trademarks	117	(75)	113	(73)
Other(a)	529	(285)	508	(266)
Total amortized finite-lived intangible assets	34,864	(14,937)	34,467	(13,220)
Indefinite-lived intangible assets:				
Brands	2,863	--	2,991	--
Trademarks	77	--	77	--
Other(b)	35	--	35	--
Total indefinite-lived intangible assets	2,975	--	3,103	--
Total identifiable intangible assets	\$ 37,839	\$ (14,937)	\$ 37,570	\$ (13,220)
Total identifiable intangible assets, less accumulated amortization	\$ 22,902		\$ 24,350	

(a) Includes patents, non-compete agreements, customer contracts and other intangible assets.

(b) Includes pension-related intangible assets.

Amortization expense related to acquired intangible assets that contribute to our ability to sell, manufacture, research, market and distribute products, compounds and intellectual property are included in *Amortization of intangible assets* as they benefit multiple business functions. Amortization expense related to acquired intangible assets that are associated with a single function are included in *Cost of sales*, *Selling, informational and administrative expenses*, and *Research and development expenses*, as appropriate. Total amortization expense for finite-lived intangible assets was \$826 million for the second quarter of 2007 and \$848 million for the second quarter of 2006, and \$1.7 billion for the first six months of both 2007 and 2006. Amounts of amortization expense associated with discontinued operations in 2006 were not significant.

The expected annual amortization expense is \$3.3 billion in 2007; \$2.8 billion in 2008; \$2.6 billion in 2009; \$2.5 in each of 2010 and 2011; and \$2.3 billion in 2012.

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Note 11. Pension and Postretirement Benefit Plans

The components of net periodic benefit costs of the U.S. and international pension plans and the postretirement plans, which provide medical and life insurance benefits to retirees and their eligible dependents, for the three months ended July 1, 2007, and July 2, 2006, follow:

(millions of dollars)	U.S. Qualified		Pension Plans U.S. Supplemental (Non-Qualified)		International		Postretirement Plans	
	2007	2006	2007	2006	2007	2006	2007	2006
Service cost	\$ 71	\$ 92	\$ 7	\$ 11	\$ 72	\$ 75	\$ 11	\$ 12
Interest cost	111	112	14	15	86	76	35	31
Expected return on plan assets	(170)	(154)	--	--	(94)	(79)	(9)	(6)
Amortization of:								
Actuarial losses	15	28	11	10	23	25	9	8
Prior service costs/(credits)	2	2	--	(1)	--	1	--	1
Curtailments and settlements - net	4	21	(2)	1	(5)	7	(2)	12
Special termination benefits	3	4	--	--	2	7	4	2
Less: amounts included in discontinued operations	--	(4)	--	(1)	--	(4)	--	(1)
Net periodic benefit costs	\$ 36	\$ 101	\$ 30	\$ 35	\$ 84	\$ 108	\$ 48	\$ 59

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The components of net periodic benefit costs of the U.S. and international pension plans and the postretirement plans, which provide medical and life insurance benefits to retirees and their eligible dependents, for the first six months of 2007 and 2006, follow:

(millions of dollars)	U.S. Qualified		Pension Plans U.S. Supplemental (Non-Qualified)		International		Postretirement Plans	
	2007	2006	2007	2006	2007	2006	2007	2006
Service cost	\$ 148	\$ 186	\$ 14	\$ 22	\$ 145	\$ 149	\$ 22	\$ 24
Interest cost	234	224	28					