**3.D Risk Factors**

Our business faces significant risks and uncertainties. You should carefully consider all of the information set forth in this annual report on Form 20-F and in our other filings with the SEC before deciding to invest in any Novartis securities, including the following risk factors faced by us and our industry. Our business, financial condition or results of operations could be materially adversely affected by any of these risks as well as other risks and uncertainties not currently known to us or which we presently deem immaterial.

**Risks Facing Our Business**

***Our business is significantly affected by ongoing pricing pressures.***

Our business and the healthcare industry in general are significantly affected by ongoing pricing pressures. These pricing pressures include government-imposed industry-wide price reductions, mandatory reference prices, an increase in parallel imports, the shifting of the payment burden to patients through higher co-payments, mandatory substitution of generic drugs and growing pressure on physicians to reduce the prescribing of patented prescription medicines. We expect these efforts to continue as governments, healthcare providers, insurance companies and other stakeholders step up initiatives to reduce the overall cost of healthcare to patients, restrict the prescribing of new medicines, increase the use of generics and impose overall price cuts. These initiatives do not only affect the results of our Pharmaceuticals Division, but also have an increasing impact on the prices which we are able to charge for the generic drugs marketed by our Sandoz Division. This is particularly true in Germany, our second largest market for generic products, where various measures were introduced to require generic manufacturers to lower their prices. Similar effects are also being felt on Sandoz's business in other markets, particularly in Europe. We expect that these and other challenges will continue to put pressure on our revenues, and therefore could have an adverse effect on our business, financial condition or results of operations.

For more information on the pricing controls and on our challenging business environment see "Item 4.B Business Overview—Pharmaceuticals—Price Controls" and "Item 5.A Operating Results—Factors affecting results of operations—Challenging Business Environment and Ongoing Pricing Pressures".

***Our Pharmaceuticals Division faces intense competition from lower-cost generic products.***

Our Pharmaceuticals Division faces increasing competition from lower-cost generic products. Our Pharmaceuticals Division's products are generally protected by patent rights which are expected to provide us with exclusive marketing rights in various countries. However, those patent rights are of varying strengths and durations. Loss of market exclusivity and the introduction of a generic version of the same or a similar medicine typically results in a significant and sharp reduction in net sales for the relevant product, given that generic manufacturers typically offer their versions of the same medicine at sharply lower prices.

In 2007, there is a significant risk that generic competition will emerge for our Top 20 product *Trileptal* and that US generic competition will emerge for our Top 20 product *Lamisil,* which already faces generic competition outside the US. *Lamisil*'s US patent will expire in June 2007. In 2006, *Lamisil* accounted for $574 million in annual sales in the US, or 1.6% of our net sales from continuing operations (3.9% of the sales in the US). Similarly, patent protection for *Trileptal*'s active ingredient has expired in the US and other major countries. In 2006, *Trileptal* accounted for $549 million in sales in the US, or 1.5% of our net sales from continuing operations (3.8% of our sales in the US).

In addition to *Lamisil*, three other products that are still among our Top 20 products have already encountered generic competition in some markets: *Neoral, Sandostatin SC* and *Voltaren*. As a result, revenue from these products has declined, and may decline significantly further in the future. A number of our other top-selling products, including the anti-hypertension drugs *Diovan* and *Lotrel* as well as the

oncology drugs *Gleevec/Glivec* and *Zometa,* could also potentially face generic competition in the coming five to ten years in various markets, particularly the US and Europe.

***Competition in the healthcare industry is generally becoming more intense.***

Competition in the healthcare industry generally continues to intensify. The time between the launch of innovative "first-in-class" treatments and "me-too" or generic versions has shortened significantly in recent years, which is putting increasing pressure on our Pharmaceuticals Division to maximize revenue from a new product quickly following its launch, in order to be able to recover its significant research and development costs. As a result of increasing competition from generic companies, certain research-based pharmaceutical companies have started to sell their products directly to the generic market upon expiration of their patents by forming strategic alliances with generic pharmaceutical companies. This allows them to undercut the revenues and profitability of generic manufacturers, including our Sandoz Division. At the same time, competition among generics manufacturers also continues to intensify as the entire healthcare industry adjusts to increased pressures by governments and other stakeholders to contain healthcare costs. Finally, the generic industry is rapidly consolidating and has witnessed the emergence of large, global market players that compete vigorously for market share. We expect all of these trends to continue, which could have a material adverse effect on our business, financial condition and results of operations.

***Our Sandoz Division may face patent infringement lawsuits by research-based pharmaceutical companies.***

From time to time, our Sandoz Division may seek approval to market a generic version of a product before the expiration of patents claimed by others for the relevant product. We do this in cases where we believe that the relevant patents are invalid, unenforceable, or would not be infringed by our generic product. As a result, we frequently face patent litigation and in certain circumstances, we may elect to market a generic product even though patent infringement actions are still pending. Should we elect to proceed in this manner and conduct a "launch-at-risk", we could face substantial damages if the final court decision is adverse to us. This could have a material adverse effect on our business, financial condition or results of operations.

***Our research and development efforts may not succeed.***

Our ability to continue to grow our business and to replace any lost sales due to the loss of exclusivity for our products due to patent expiration depends upon the ability of our research and development activities to identify and develop high-potential breakthrough products and to bring them to market. To accomplish this, we commit substantial effort, funds and other resources to research and development, both through our own dedicated resources, and through various collaborations with third parties. Developing new pharmaceutical products and bringing them to market, however, is a costly, lengthy and uncertain process and there can be no guarantee that our research and development activities will produce a sufficient number of commercially viable new products, in spite of these significant investments.

In the pharmaceuticals business, the research and development process can take up to 12 years, or even longer, from discovery to commercial product launch. New products do not only need to undergo intensive pre-clinical and clinical testing, but also pass a highly complex, lengthy and expensive approval process. During each stage of the process, there is a substantial risk that we will encounter serious obstacles or will not achieve our goals and accordingly we may abandon a product in which we have invested substantial amounts of time and money. There also appears to be a renewed focus on product safety by regulatory authorities following widely publicized product recalls such as Merck & Co.'s recall of its pain medicine Vioxx®. As a result, regulatory authorities may be more cautious in approving new products or even reassess the safety and efficacy of our existing products. If we are unable to maintain a continuous flow of successful new products and successful new indications or brand extensions for existing products sufficient to cover our substantial research and development costs and to replace sales that are lost as older products approach the end of their commercial life cycles or are displaced by competing

products or therapies, this could have a material adverse effect on our business, financial condition or results of operations.

In addition, we invest a significant amount of effort and financial resources into research and development collaborations with third parties which we do not control. Many of these third parties may be small companies which may not have the same organizational resources and development expertise as Novartis. Should these third parties fail to meet our expectations, we may lose our investment in these collaborations or fail to receive the expected benefits, which could have a material adverse effect on our business, financial condition or results of operations.

***Litigation, in particular product liability and patent lawsuits and government investigations, may impact our operating results.***

In recent years, the industries that make up our business have become important targets of litigation around the world, especially in the US. In particular, our business has been, and may continue to be subject to a variety of lawsuits and other legal proceedings that can arise from time to time in the ordinary course of business, including product liability and patent lawsuits, and government investigations. As a result, claims could be made against us which, in whole or in part, might not be covered by insurance. While we do not believe that any of the existing claims against us will have a material adverse effect on our financial position, litigation is inherently unpredictable and excessive verdicts do occur. In the ordinary course of business, we also frequently defend our patents against challenges by our competitors. Should we fail to successfully defend our patents, we will be faced with generic competition for the relevant products, and the resulting loss of revenue. Adverse judgments or settlements could therefore have a material adverse effect on our results of operations in any particular period. For more detail regarding specific legal matters currently pending against us, see "Item 18. Financial Statements—note 19.2" and "Item 4. Information on the Company—4.B Business Overview—Pharmaceuticals—Intellectual Property" and "—Consumer Health—Intellectual Property" setting forth the status of various intellectual property matters.

***Our business is significantly impacted by strict regulatory requirements.***

We must comply with a broad range of regulatory requirements for the development, manufacture, marketing, labeling, distribution and pricing of our products, particularly in the US, the EU and Japan. These requirements do not only affect our development costs, but also the time required to reach the market and the uncertainty of successfully doing so. Stricter regulatory requirements also heighten the risk of withdrawal of existing products by regulators on the basis of post-approval concerns over product safety, which would reduce revenues and can result in product recalls and product liability lawsuits. In addition, we may voluntarily cease marketing a product or face declining sales based on concerns about efficacy or safety, whether or not scientifically justified, even in the absence of regulatory action. The development of the post-approval adverse event profile for a product or the relevant product class may have a material adverse effect on the marketing and sale of the relevant product. For more detail on the governmental regulations that affect our business see the sections headed "Regulation" included in the descriptions of our four operating divisions under "Item 4.B Business Overview".

***The pharmaceuticals industry faces increased public pressure.***

There is considerable public sentiment against the pharmaceuticals industry, and the industry is under the close scrutiny of the public, governments and the media. In addition, there is significant pressure on our industry from certain less developed nations to make our products available to their population at drastically lower costs. Any increase in such negative public sentiment or increase in public scrutiny or pressure from such less developed nations could lead, among other things, to changes in legislation, to changes in the demand for our products, additional pricing pressures with respect to our products, or increased efforts to undercut intellectual property protections. Such changes could adversely affect our business, financial condition or results of operations.

***The manufacture of our products is technically highly complex and we may face supply disruptions.***

The products we market, distribute and sell are either manufactured at our own dedicated manufacturing facilities or through toll manufacturing or other supply arrangements with third parties. In either case, we need to ensure that the manufacturing process complies with applicable regulations and manufacturing practices as well as our own high quality standards. Many of our products, however, are the result of technically complex manufacturing processes or require a supply of highly specialized raw materials. For some of our products and certain key raw materials, we may also rely on a single source of supply. As a result of these factors, the production of one or more of our products may be disrupted from time to time. Both our Vaccines and Diagnostics Division and our Ciba Vision Business Unit, for example, have experienced significant production shutdowns in the recent past. We may also not be able to rapidly alter production volumes to respond to changes in demand for particular products. A disruption in the supply of certain key products or our failure to accurately predict the demand for those products could have a significant adverse effect on our business, financial condition or results of operations. In addition, because our products are intended to promote the health of patients, any supply disruption could lead to allegations that the public health has been endangered and could subject us to lawsuits.

***An increasing amount of intangible assets and goodwill on our books may lead to significant impairment charges in the future.***

We regularly review our long-lived assets, including identifiable intangible assets and goodwill, for impairment. Goodwill, in-process research and development and acquired development projects not yet ready for use are subject to impairment review at least annually. Other long-lived assets are reviewed for impairment when there is an indication that an impairment may have occurred. The amount of goodwill and other intangible assets on our consolidated balance sheet has increased significantly in recent years, primarily as a result of our recent acquisitions. Although we do not currently have an indication of any significant additional impairments, impairment testing under IFRS 3 may lead to further impairment charges in the future. Any significant impairment charges would have a significant adverse effect on our results of operations. For a detailed discussion of how we determine whether an impairment has occurred, what factors could result in an impairment and on the increasing impact of impairment charges on our results of operations see "Item 5.A Operating Results—Critical Accounting Policies and Estimates—Impairment of Long-Lived Assets".

***Our distribution network is consolidating.***

Increasingly, significant portions of our sales, particularly in the US, are made to a relatively small number of US drug wholesalers, retail chains, and other purchasing organizations. For example, our three most important customers, all from the US, accounted for approximately 10%, 9% and 7%, respectively, of Group net sales in 2006 and there has been a trend toward further consolidation among our distributors, especially in the US. As a result, our distributors are gaining additional purchasing leverage over us, which increases the pricing pressures facing our businesses. Moreover, we are exposed to a concentration of credit risk as a result of this concentration among our customers. Should one or more of our major customers experience financial difficulties, the effect on us would be substantially greater than would have been the case in the past. The increased purchasing power of these customers also increases the risk that we may not be able to effectively enforce the high standards which we expect of our distributors and customers. Each of these factors could have a material adverse effect on our business, financial condition and results of operations.

***An inability to attract and retain qualified personnel could adversely affect our business.***

We highly depend upon skilled personnel in key parts of our organization and we invest heavily in recruiting and training qualified individuals. The loss of the service of key members of our organization—particularly senior members of our scientific and management teams—may delay or prevent the achievement of major business objectives. In addition, the success of our research and development

activities is particularly dependent on our ability to attract and retain sufficient numbers of high quality researchers and development specialists. We do, however, face intense competition for qualified individuals from numerous pharmaceutical and biotechnology companies, universities, governmental entities and other research institutions. We may therefore be unable to attract and retain qualified individuals in sufficient numbers, which would have an adverse effect on our business, financial condition or results of operations.

***Environmental liabilities may impact our results of operations.***

The environmental laws of various jurisdictions impose actual and potential obligations on us to remediate contaminated sites. We have also been identified as a potentially responsible party under the US Comprehensive Environmental Response Compensation and Liability Act in respect to certain sites. Failure to properly manage environmental risks could adversely affect our results of operations. For more detail regarding environmental matters, see "Item 4.D Property, Plants and Equipment—Environmental Matters" and "Item 18. Financial Statements—note 19.1."

***Foreign exchange fluctuations may adversely affect our earnings and the value of some of our assets.***

A significant portion of our earnings and expenditures are in currencies other than US dollars, our reporting currency. In 2006, 45% of our net sales were made in US dollar, 26% in euro, 6% in Japanese yen, 2% in Swiss franc and 21% in other currencies. During the same period, 39% of our expenses arose in US dollar, 24% in euro, 16% in Swiss franc, 5% in Japanese yen and 16% in other currencies. Changes in exchange rates between the US dollar and other currencies can result in increases or decreases in our costs and earnings. Fluctuations in exchange rates between the US dollar and other currencies may also affect the reported value of our assets measured in US dollars and the components of shareholders' equity. For more information on the effects of currency fluctuations on our consolidated financial statements and on how we manage currency risk, see "Item 5.A Operating Results—Effects of Currency Fluctuations" and "Item 11 Quantitative and Qualitative Disclosures about Non-Product—Related Market Risk."

***A regional or global influenza pandemic could severely affect our business.***

The occurrence of an influenza pandemic could severely affect our business in a number of ways, including by disrupting the production and delivery of our products or other parts of our supply chain, by causing staffing shortages or by negatively affecting the demand for some of our products or the general level of economic activity in the affected areas. In addition, our Vaccines and Diagnostics Division is seeking to become a global supplier of a vaccine against a potential pandemic influenza virus. In the event of a pandemic, however, governments may be more willing to abrogate property rights for medicines that might otherwise be in short supply and there is a risk that governments in affected regions could seize supplies of such a vaccine or require us to supply the vaccine at a reduced price.

***Earthquakes could adversely affect our business.***

Our corporate headquarters, the headquarters of our Pharmaceuticals Division, and certain of our major Pharmaceuticals Division production facilities are located near earthquake fault lines in Basel, Switzerland. In addition, other major facilities of our Pharmaceuticals, Sandoz and Vaccines and Diagnostics Division are located near major earthquake fault lines in various locations around the world. In the event of a major earthquake, we could experience business interruptions, destruction of facilities and/or loss of life, all of which could materially adversely affect our business, financial condition or results of operations.

***We may be held responsible for the potential misconduct by our third party agents, particularly in developing countries.***

We have operations in approximately 140 countries around the world. In many of these countries, particularly in less developed markets, we rely heavily on third party distributors and other agents for the marketing and distribution of our products. Many of these third parties are small and do not have internal compliance resources that are comparable to those within our own organization. In many emerging growth markets, the local legal systems have also undergone dramatic changes in recent years. In many cases, specific regulations on the marketing and sale of pharmaceutical products either do not exist or the interpretation and safeguards of the new regulatory systems are still being developed, which may result in legal uncertainty and in existing laws and regulations being applied inconsistently. In addition, many of these countries are also plagued by widespread corruption. Should our efforts in screening our third party agents and in detecting cases of potential misconduct fail, we could be held responsible for the non-compliance by these third parties with applicable laws and regulations, which may have a negative effect on our reputation and our business.

**Risks Related To Our ADSs**

***The price of our ADSs and the US dollar value of any dividends may be affected by fluctuations in the US dollar/Swiss franc exchange rate.***

Our American Depositary Shares (ADSs) trade on the New York Stock Exchange (NYSE) in US dollars. Since the shares underlying the ADSs are listed in Switzerland on the SWX Swiss Exchange (SWX) and trade on the European trading platform Virt-X in Swiss francs, the value of the ADSs may be affected by fluctuations in the US dollar/Swiss franc exchange rate. In addition, since any dividends that we may declare will be denominated in Swiss francs, exchange rate fluctuations will affect the US dollar equivalent of dividends received by holders of ADSs. If the value of the Swiss franc decreases against the US dollar, the price at which our ADS trade and the value of the US dollar equivalent of any dividend will decrease accordingly. During 2006, on the other hand, the price of our ADSs increased by 9% mainly because of the weakening US dollar, while the price in Swiss francs of the underlying Novartis shares only increased by approximately 2%.

***Holders of ADSs may not be able to exercise preemptive rights attached to shares underlying ADSs.***

Under Swiss law, shareholders have preemptive rights to subscribe for cash for issuances of new shares on a pro rata basis. Shareholders may waive their preemptive rights in respect of any offering at a general meeting of shareholders. Preemptive rights, if not previously waived, are transferable during the subscription period relating to a particular offering of shares and may be quoted on the SWX. US holders of ADSs may not be able to exercise the preemptive rights attached to the shares underlying their ADSs unless a registration statement under the US Securities Act of 1933, as amended, is effective with respect to such rights and the related shares, or an exemption from the registration requirements thereunder is available. In deciding whether to file such a registration statement, we would evaluate the related costs and potential liabilities as well as the benefits of enabling the exercise by the holders of ADSs of the preemptive rights associated with the shares underlying their ADSs. We cannot guarantee that any registration statement would be filed, or, if filed, that it would be declared effective. If preemptive rights could not be exercised by an ADS holder, JPMorgan Chase Bank, N.A., as depositary, would, if possible, sell such holder's preemptive rights and distribute the net proceeds of the sale to the holder. If the depositary determines, in its discretion, that such rights could not be sold, the depositary might allow such rights to lapse. In either case, the interest of ADS holders in Novartis would be diluted and, if the depositary allows rights to lapse, holders of ADSs would not realize any value from the granting of preemptive rights.