GLAXOSMITHKLINE

THIRD QUARTER 2014
ANALYST BRIEFING

Wednesday, 22 October 2014 @ 14.00 hrs

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Sir Andrew Witty (CEO): Thank you for joining us on this afternoon's call. I am here with Simon Dingemans, who will pick up on the detail of the quarter in just a few minutes. Let me make a few introductory comments.

You will have seen from the quarter release that in the third quarter, turnover was down 3%, earnings per share up 5%, bringing year to date earnings per share to -2% at constant exchange rates. Clearly, the quarter was helped by targeted expense reductions and we are on track for full year EPS to be broadly similar to last year at CER excluding divestments.

During the quarter, strong Emerging Markets, Japan and ViiV HIV growth offset, to some degree, the continued trend in the US. Turning to the US, the trend we are seeing is driven by the impact on pricing of *Advair* and access limitations becoming more common and delaying product uptake in primary care. The pricing effect has been a little greater than we expected earlier in the year, driven by market changes and competitor dynamics. It does feel like a new reality in US primary care and, as we look across other product launches in other categories, *Breo* and *Anoro* launches benchmark well, but all launches appear in primary care much slower.

Obviously, this has had an impact for us in 2014 but we have adjusted quickly to the situation both as far as how we are contracting, and in the management of our SG&A line. We now have very good visibility as we have signed the majority of contracts and won substantial access for *Advair*, *Breo* and *Anoro*, with a substantial majority of top plans already secured; in some cases, with exclusive position for some of our products, i.e. we are the beneficiary of class lock-out contracts whereas during 2014, we have been the victim of class lock-out contracts.

During 2015, we would expect to see the price effect flow through from 2014. We expect the continued decline of *Advair* as a result but we also expect an acceleration of *Breo* and *Anoro* as access increases and heavy free trial offers begin to come to an end. We also expect to see *Advair* volumes increase as the product regains coverage on key formularies. Globally, we expect total Respiratory to return to growth in 2016 and we remain confident in our long-term market leadership ambition.

The Novartis transaction is the other major event of 2014 and is on track for completion in the first half of next year. I would remind you that the deal will realise $16 billion proceeds as we sell the Oncology business, and I would also remind you that seven years ago we had almost zero sales in Oncology, the whole business has been built from the pipeline we have delivered during that period. The $16 billion will fund the £4 billion B share scheme during 2015 for our shareholders. The deal also fundamentally reshapes the company, as immediately the larger sales base will be around 40% exposed to high annuity businesses of Vaccine and Consumer, and will benefit from the higher terminal growth rates that you would expect from those two businesses. This provides new opportunities for sustainable sales and earnings flows. The deal will ensure market leadership and true global scale for both Vaccines and Consumer, and will allow us for the first time appropriately to report on these businesses alongside the Pharma business.

We are taking this moment to change the executive management structure of the Group to ensure focused and senior leadership of the three commercial businesses going forward. With Moncef Slaoui moving to take overall leadership of our Vaccine business, he is obviously a highly accomplished vaccine expert, and he will work with our current management team there to integrate the Novartis business, a highly complex piece of work, and he is the right person to lead it.

Abbas Hussain, who has been running our International Pharmaceutical business, will now take up a new role as Head of Global Pharmaceuticals and will take the US into his portfolio, working with Deirdre. Emma Walmsley, who joined us a few years ago from L'Oréal, will lead the Consumer Healthcare joint venture. As a result of Moncef's focus, Patrick Vallance will become Head of Pharma R&D. These changes put some of the industry's most experienced leaders in our enterprise leadership positions and will be responsible for implementing the transaction in Vaccine and Consumer, and delivering the portfolio transformation in Pharma.

Turning to Pharma specifically, after the unprecedented number of new drugs and vaccines approved over the last few years, we have three points of focus and opportunity going forward. Firstly, the continued roll-out and launch of the Respiratory, HIV, Diabetes and, until the close of the transaction, Oncology new medicines. In fact, in 2015 alone we expect around 250 discrete pipeline product launches around the world, each count being one new pipeline product in one new market.

Secondly, we intend to bring forward the next wave of products with around 40 new molecular entities in late development and a very exciting portfolio now emerging from our

DPUs with mostly first-in-class potential therapies in areas such as cancer, heart failure, respiratory disease, as well as inflammatory and autoimmune disease.

Thirdly, we intend to focus and scale our Pharma operations for the changing pricing dynamics we see, for the movement of Oncology to Novartis and to ensure that R&D has the right level of flexible resource to further deliver the next waves of innovation.

We are announcing today, therefore, a new restructuring programme, in addition to the announced Novartis-related programme, which will reshape our Pharma business and release £1 billion of annual cost savings, and ensure that we have moved resources to our current and next waves of new products.

In line with my long-term belief in passing value into the hands of shareholders, we have, over the last six years, repeatedly identified and created opportunities to build and crystallise value. Through dividends, special dividends, share buybacks or the planned B scheme, we have sought to return this value to our shareholders, and have focused on organic growth drivers, rather than engage in high premium acquisitions.

Since I became CEO, we have returned £33 billion to shareholders through dividends and share buybacks. Our ongoing Established Product Portfolio process, which we aim to bring to conclusion around the turn of the year, and the Oncology value creation are clear and current examples of this approach.

Five years ago, I created a joint venture in our HIV therapy area at a time when GSK was suffering substantial competitive and generic pressure and risk. ViiV has been an extraordinary success story and is now establishing itself as an innovative and fast-growing specialty business. Our new dolutegravir-based medicine has already sold over £170 million this year, with significant further pipeline opportunities already advancing. We have a very high belief in these prospects.

In line with our commitment to identify ways to realise shareholder value, we have announced today that we are beginning the process to explore a possible IPO of a minority stake in this business.

On dividend, for the quarter we have maintained a dividend of 19 pence and we expect the full year 2014 dividend to grow 3% to 80 pence. We have also provided guidance today for shareholders that for 2015 we expect to maintain the dividend at the same level as 2014. This will provide us with flexibility as we restructure and integrate the Novartis businesses next year.

Despite the challenges that the US respiratory market has brought during 2014, the Novartis transaction and the re-shape of the Pharma business and the substantial R&D

progress mark major steps forward in our long-term strategy. The potential to IPO a minority stake in ViiV further signals, alongside our Oncology transaction, a patient but enduring commitment to explore avenues to create shareholder value while delivering our global mission to improve lives around the world.

To the point of our mission, I would be remiss not to acknowledge the many GSK employees who are working tirelessly on our candidate Ebola vaccine. Given the apparent health emergency we are leaving no stone unturned in this project and, if all goes well, I fully expect GSK to be the first company in a position to make a vaccine available to health agencies and governments, hopefully towards the end of 2014. This, in the same year that GSK filed for approval for the world's vaccine against malaria.

With that, I will close my comments and ask Simon to give you a more detailed review of the quarter.

Simon Dingemans (Chief Financial Officer): Thanks, Andrew. The Group's performance in the quarter reflected many of the same factors we saw at the half year and, in particular, the transition of our Respiratory portfolio continued to impact Respiratory revenues, down 8% overall in the quarter, driven primarily by the continuing shift in contracting terms for *Advair* in the US. Significant further price reductions have been required to renew or regain a number of key contracts for *Advair* and, while most of these contracts do not deliver improved access until the beginning of 2015, they have generally started to impact pricing immediately, driving the increased pricing pressure we have seen in the quarter.

The quarter also saw continued competition for *Lovaza* and the ongoing impact of supply on our Consumer business, despite the significant progress we have made in remediating these issues.

On the positive side, we also saw in the quarter more of the strong progress in many other parts of the business that we saw earlier in the year, reinforcing the broad base of growth drivers we are building across the Group. In particular, Emerging Markets, Japan and ViiV all reported significant growth in Q3.

New products are also contributing and we continue to invest behind our multiple new launches, as we extend their approval and access globally. Even though it is still early days for many of these, sales for new products year-to-date were over £900 million. In ViiV, *Tivicay's* launch has been exceptional and now *Triumeq*, approved in August, is already off to a good start. In Oncology, *Mekinist* and *Tafinlar* are performing very strongly.

In Respiratory, *Breo* and *Anoro* are both clearly on a slower trajectory but coverage and access is steadily improving, with *Breo* Part D coverage now over 70% and *Anoro* also building, with Part D coverage expected to be over 50% through October.

Transitioning the Respiratory business and growing our other new products to critical mass will take time, but the additional flexibility that we have built into our cost base in recent years means that we can respond much more effectively and quickly to extract cost savings that can help in mitigating the pressure from lower sales in the US in the short-term, while also protecting our investments behind the new launches. Demonstrating this, SG&A in the quarter was down 6% which, along with ongoing financial efficiencies, contributed to EPS up 5% on a 3% decline in revenue.

Given the new pricing dynamic we are experiencing, particularly in the US, we have announced today a new initiative that will further strengthen the flexibility and profitability of our pharmaceutical business, predominantly through a restructuring of commercial operations, R&D and support functions. The restructuring will also scale the Pharma business to an appropriate size, post- the transaction with Novartis.

We expect to deliver savings from this new programme of approximately £1 billion pre-tax annually by 2017, with around half delivered in 2016. Initial savings from this new restructuring in 2015 will be relatively smaller but will help us to offset some of the earnings impact of declining sales of *Advair*, as our Respiratory business continues its portfolio shift.

To be clear, these savings will be incremental to the £1 billion of annual cost savings we are delivering from the Major Change programme that we announced in February 2013. We are well on track here and, consistent with our earlier OE programme, we are ahead of our plans on delivery of benefits. The new savings are also on top of and separate from the £1 billion of annual cost synergies we expect to realise from the proposed Novartis transaction. We are making excellent progress towards completing that transaction but we still expect to close it in the first half of 2015.

Turning to the quarter in a little more detail, as usual, my comments are on a CER and ex-divestment basis. In the US, Pharma and Vaccines were down 10% in the quarter and this particularly reflects the 25% reduction in *Advair* sales. Total *Advair* volume was down 10%, with price down 15%, reflecting the new contracting conditions I mentioned earlier. Price pressure was a little higher than we had expected and it has helped us secure a number of important contract wins for 2015 – not only for *Advair* but also for our new products. You should expect a similar dynamic in Q4, but remember also that Q4 last year saw quite strong inventory build in Respiratory.

Despite the improvements to formulary for *Advair* for next year, you should still expect *Advair* revenues in the US to continue to decline, in line with recent trends, as the full year effect of contracts and pricing agreed during 2014 rolls through into 2015, but also as we continue the shift to our new portfolio which we expect will allow us to grow total global Respiratory sales again in 2016.

Elsewhere in the US, Oncology sales continued to contribute very strongly, up 44% in the quarter. There was good growth across that portfolio, with particular contributions from *Votrient* and the recently launched *Tafinlar* and *Mekinist* products. *Benlysta* also continued to contribute, with reported growth of 10%, but 19% on an underlying basis.

Vaccines were down 3% in the quarter, reflecting the impact of a broader return to the market of vaccines that compete with our paediatric vaccines and *Boostrix.* Hepatitis sales also saw some supply constraints.

As we mentioned last quarter, flu supplies have been delayed somewhat and we are expecting a greater proportion of deliveries in Q4 than usual.

In Europe Pharma and Vaccines sales down 2%, growth from Oncology and *Avodart* in particular helped mitigate lower Respiratory sales.

Seretide was down 5% mainly on price with volumes relatively steady reflecting the continuing benefit of our recent refocusing of the European business. We are also making encouraging progress in obtaining access in a number of key markets in Europe for our new products, although pricing remains challenging. Nonetheless we are now much better placed to manage the transition to our portfolio over the next few years in Europe as competition to *Seretide* increases.

In Emerging Markets, total sales of pharma and vaccines grew 12% with strong growth in virtually every therapy area boosted by the improved growth in the China business as the impact of the Government investigation annualised. Vaccines grew 13% with a number of products benefitting from the phasing of tenders, particularly *Synflorix* and *Boostrix.* For the fourth quarter vaccine sales have a tough comparator and phasing of tenders has also been somewhat earlier in the year during 2014 than previous years. Both factors will impact vaccines in Emerging Market sales in the fourth quarter.

In Japan, despite some softening of the market, sales are up 6% helped by restocking of *Avodart* and the strong performance in Vaccines. Respiratory sales growth mainly reflected seasonal products, while together *Advair* and *Relvar* sales were broadly flat; with *Relvar* sales still limited by the two-week Ryotan limitation for new products until the end of November.

ViiV grew 18% to £373 million in Q3 on the back of the very successful launch of *Tivicay* but also continuing strong sales of *Epzicom* which benefitted from combination sales ahead of *Triumeq* which was launched during the quarter in Europe and the US. *Tivicay* sales were £78 million in the quarter.

Turning to Consumer, the business was down 3% in Q3 as sales continued to be impacted by supply disruptions. We are making progress with the remediation of those issues and even though we do not expect the business to be back in full supply before the end of this year. We continue to expect Consumer to be broadly flat at the top line for 2014 as a whole.

On operating costs, excluding currency, the operating margin improved 0.6 percentage points. In particular, SG&A costs were down 6% on a very targeted response to the top line performance.

In the quarter we also had an expected credit of just over £200 million from simplifying our entity structure and trading arrangements. Remember this broadly matches the structural benefit to SG&A we reported in Q3 last year so was not a factor in the year-on-year decline.

R&D was down 1% despite the headwind of around £50 million of structural benefits included in R&D in Q3 last year and the reduction really reflecting the completion of a number of trials and ongoing cost management.

Cost of goods remains under some upward pressure given the pricing environment and the new launch investments but we continue to target savings here to mitigate that trend and the major change programme underway is already contributing significantly to reduce manufacturing costs.

On the financial side we delivered further efficiencies in the bottom half of the P&L with interest down from £178 million last year to £161 million in Q3 2014 reflecting the improved funding position. Our effective tax rate was also down 3.5 percentage points from Q3 last year to this quarter, delivering 21.2% overall year to date.

We now expect the full year core tax rate will be somewhat less than the 22% we originally indicated but the ultimate rate will depend on the final mix of trading for the fourth quarter.

Net cash flow from operations in the third quarter was £1.6 billion excluding legal payments, down £300 million from last year. Cash flows continue to be significantly impacted by FX with approximately £100 million of the decline due to negative currency and divestment impact, the balance mainly due to the operating performance.

Working capital has also taken cash investments, particularly inventory. Inventory days are likely to remain higher this year than last as we put inventory behind new launches and ensure the full recovery of consumer supply.

Net debt at the end of the quarter was £14.8 billion, £300 million lower than a year ago but £2.2 billion higher than year-end 2013 with the increase due to a number of factors, including the £0.6 billion spent on increasing our shareholding in our Indian pharmaceutical company, the fine paid to China and the small amount of share buy-backs we completed earlier in the year. The balance is mainly due to reduced cash from operations and the impact of divestments and a significant negative headwind from currency over the nine months of around £560 million.

Given the significant currency swings we are dealing with, it's important that we protect the dividend which we continue to prioritise as central to our strategy of delivering returns to shareholders and as Andrew said, as a result we have decided to maintain the dividend for the next two quarters to target a total dividend for this year of 80p, an increase of 3% over last year.

We have also announced today that we intend to hold the 2015 dividend at the same 80 pence level to improve our financial flexibility and the support for the dividend while we go through the Novartis integration, which will also deliver a return of £4 billion to shareholders after closing which, as I have said before, is expected sometime in the first half of 2015.

And looking ahead finally to the full year, consistent with the guidance we gave at the half year, we continue to expect full year core EPS to be broadly similar to 2013 on a CER basis, ex-divestments and with that I'll turn it back to Andrew.

Sir Andrew Witty: Thanks, Simon and perhaps the operator could now open the call for questions.

Questions & Answer Session

Graham Parry (Bank of America Merrill Lynch): Great, thank you for taking my questions. I start off with one on margins. Obviously an impressive looking margin in the quarter with a much lower SG&A than the street was looking for. Could you just talk us through the sustainability of that level of margin and particularly how much of that is coming from FX versus savings?

A related question, looking into 2015 if you could just talk through what you see the moving margin parts into next year and the outline for margins into 2015. Secondly, do you have any line of sight on structural benefits into next year versus the £200 million that you put through this year?

Then on the ViiV IPO could you give any kind of sense of timing and how much a minority stake would be and do you need any consent from Pfizer and Shionogi?

Finally, on *Anoro*, again numbers are looking quite low here, could you just give us a sense again of how much of your prescriptions are getting rejected at the pharmacy level and also the level of free sampling that is happening in the market here? Aside from the £1 million that you reported, how much do you think it would be underlying if we stripped out wholesaler effects and promotional effects?

Sir Andrew Witty: Okay, Graham, I'll touch on the ViiV and the *Anoro* question and then Simon will pick up the three or four margin questions that you covered. As far as ViiV is concerned we are not publicly declaring what we think the quantum of the flow could be. Obviously we made it clear it is a minority. As you know, we own almost 80% of the business, so we have a reasonably large amount of room for manoeuvre, which would leave a substantial quantum still under GSK. We will work on that. I would think this process is a year. For your modelling perspective I would assume to keep ViiV as is within GSK for 2015. This is more likely, subject to market conditions, a '16 event than a '15 event because of all the work that needs to happen. We will obviously work with our partners on this. They may or may not choose to participate in that; we will see.

As far as *Anoro* is concerned, about a third to 40% of scripts are still being rejected. *Anoro* access in Part D has just moved up significantly, so at the end of this week we will be at 50%, but up until this week we have still been at the 30% territory. Again, we are building the access reasonably quickly by any benchmark, but it is only just coming up to those sorts of levels; a reasonably punchy number still being rejected or reversed, the first thing to say. About between a third and 40% of scrips are being filled with free trial offers and that is one of the characteristics we are seeing of the US. I saw one of our competitor companies in a completely different category are offering 12 months free trial TV adverts for one of their new products in a different category. There is no question that free trial offers are more and more common and between a third and 40% of *Anoro* scrips are being filled with free trials – part of the reason why you see zero sales, because we have made adjustments to our, essentially, discounting assumption as we see what that trend looks like.

Then just to also give you a little sense, during the quarter we delivered 220,000 samples of *Anoro*, which is obviously a very substantial quantum. We see shares looking

very encouraging. If we look at new to brand prescription share, which in our view is the best leading indicator, we are in double-digit territory of pulmonologists, which again you would expect to be the first adopters. We are starting to see good pick-up in terms of shares. You would expect to see that translate through to NRxs and ultimately TRxs as you go into 2015 and obviously as we get more access and more coverage, which particularly looks very positive from January onwards, then you would expect to see the free trial offer start to drop off.

The underlying pick-up looks okay. It is not as fast as we would have liked, but when we benchmarked *Anoro* and *Breo* – *Breo* we have more data, so let me talk about *Breo* – when we benchmark *Breo* to other primary care dominant launches from the last two years, it looks very good compared to other primary care launches. We are seeing the whole primary care marketplace slower: slower access, slower take-off initially, but certainly the leading shares for both *Breo* and *Anoro* look quite encouraging.

I will pass over to Simon on the margin question.

Simon Dingemans: Thanks, Graham. On the margin, currency was clearly a factor in the quarterly performance. Of the 1.6 percentage point increase in margin, around 1% of that is due to currency. Clearly we will have to see how that plays out in the fourth quarter, but it benefitted all three of the major cost lines. In terms of the underlying performance, as I commented earlier, SG&A we have very deliberately targeted in the quarter and you will expect some of those programmes to continue to roll into Q4 and are really the precursor to some of the beginnings of the benefits of the restructuring programme we have announced today that will flow into 2015 and beyond.

As to the margin position in 2015, until we get to close the Novartis transaction and we have a full view of the combined group, it is a bit early to give guidance specifically in that territory, other than to comment again that you should expect a significant reset of the margin as we change the mix of the groups so, substantially on the closing of that transaction.

On structural benefits we continue to look for similar opportunities. We haven't identified any particularly that I would call out for 2015 or beyond, but we do keep searching for value opportunities like that.

Sir Andrew Witty: Thank you. Next question.

Alexandra Hauber (UBS): Good afternoon, thank you. Firstly when you get into 2016 return to growth of the respiratory franchise, that of course depends on your 2015

decline, so I was wondering whether you can comment on where you see 2016 respiratory relative to 2014? Is it up or down or roughly flat, or is it still too early to say because you don't know yourself how the through is next year?

Secondly, just coming back to the SG&A this quarter and your cost-cutting programme, can you, Simon, perhaps tell us a little bit more on how on the one side you have such a flexible cost structure you can switch on and switch off costs quite flexibly and on the other side needing to spend £1.5 billion for further cash in cash to get the extra savings? Essentially I am trying to look at where the flexibility this quarter was particularly coming from.

A third question – the changes on the management. Can we therefore assume that the 'NewCo' is going to report according to a divisional structure, and if so, whether what you are showing currently as unallocated costs will be the corporate cost? Also whether the materials that you will distribute ahead of the EGM will give us the first indication of the divisional structure?

Sir Andrew Witty: Thanks, Alexandra. Simon will pick up on the divisional point. As far as Respiratory in 2016 is concerned, we expect to be back to growth but exactly how 2015 plays out will be the put and take of how quickly we can recover volume. To give you an idea, so far we have won seven of the top 10 contracts in the US, for some of those we have class lock-outs in place which should help us to drive volume. However, as to exactly what the pace of that is vis-à-vis the price is not completely clear. As a general point, we feel very confident as we move through 2015 into 2016 and 2017 that the balance of what is driving the growth in the business becomes much more important, which is why we have made the point that we have made.

As far as SG&A is concerned, in the short run we have a lot of discretionary spend decisions around non-people-driven costs in the business, and we can flex those in different parts of the organisation. As soon as we started to see, in the middle of the year, late Q2, the price impact being greater than we anticipated, that gave us the chance to start to manage that.

When you look forward and say now we need to adjust our cost base on, let us call it, a more permanent basis to a new reality as far as price from the US, then you want to look at more structural matters. That requires financing to release those opportunities, in some markets more than others, and we want to take the opportunity not just to shrink the cost base but to make sure we are taking the costs from parts of the organisation where we believe we can, at the same time, create greater focus on, and where there is opportunity for growth and greater opportunity to simplify and take complexity out of the business. Again,

unravelling all of that is often somewhat more expensive. Therefore, in the short run, yes, we have a reasonable degree of cost flexibility of which we are taking advantage but, because we want to make sure we have a cost base which is, in the long run – next year, the year after and the year after that – appropriate for where we think the price points have come to, we need to do things a little more significant.

Simon Dingemans: On the cost of the restructuring, the costs we have indicated today are very much in line with the costs of previous restructurings on a cost/benefit ratio. There will be some element of the costs we have indicated that are non-cash and, as to exactly how much, we still have to work through as far as the detailed implementation but I believe that the ratio is pretty consistent.

Going forward, when we close the transaction, which is the right point to make a shift, we shall begin to report much more distinctly on Vaccines, Pharma and Consumer, so that you can clearly see the different profile of those businesses, their different characteristics and look at them on a much more end-to-end basis. However, we shall not do that before we get there and that seems like the right point.

Sir Andrew Witty: Alexandra, we see an opportunity as we now have, post the Novartis transaction, three businesses with real scale, a chance to rethink and put pressure on our corporate and overhead costs, and to use those three businesses to expose and leave only the absolute minimum of non-allocated costs. Clearly, if a business can't be allocated the cost, what is left should be at a minimum. It is much harder to do that when you have an unbalanced group of businesses. What we shall have here are three very clear global businesses. The first order of business, beyond making them competitive in the marketplace, will be to use that structure to shine an acute spotlight on the costs which currently sit in the middle, if I can call it that, and I would expect that to be quite a story for us over the next two or three years as we use this shift to ensure that we have that level of cost driven down. Those costs are often some of the most tricky to get at and this transaction is a very good opportunity to do it.

Andrew Bond (Citigroup): I have three questions. Andrew, you have said that, historically, the pipeline is the best since you have been at the company. Obviously, there have been some approvals and some failures since then but are you happy to make that same comment today? Secondly, following on from the first question, should we expect an intensification of efforts to bolster your mid-stage pipeline in your remaining therapeutic areas? Finally, could you remind us when the Corporate Integrity Agreement in the US

expires and whether you would use that opportunity to review your US field force compensation structure relative to your peers?

Sir Andrew Witty: Thanks, Andrew. On the last, the CIA was a five-year CIA and, as of today, the short answer to your question is no. As far as pipeline, I stick to the view that this is the most impressive pipeline we have had. We have had 11 approvals over the last four years, the next best company in the world achieved nine and, since I took over, we have had 17 approvals, so we have had a substantial amount of product flow. The majority of our current Oncology business has been approved in that timeframe and has taken a business in which we had almost zero sales or value to one that we have just sold for $16 billion, so that speaks for itself. As far as the ViiV assets, particularly the dolutegravir assets, are underpinning the current growth of that business and lead us to conclude that it is appropriate to think about an IPO for that business, which again is a very direct consequence.

As a general comment, it is entirely consistent with what I laid out back in 2008, which is that we would deliver a wide variety of products none of which necessarily would individually carry the company but, together as a portfolio, they would over time allow us to move forward the Pharma business and I believe we are still absolutely in that position.

In addition to the six major products which we had approved over the last 12 months, all of which were approved on first cycle review by the FDA and have now been approved in a variety of other countries, we have another 40 new molecular entities in Phase II and Phase III, which is a substantial quantum of product. As I indicated in the release today, we have then the beginnings now of products beginning to emerge from the DPUs. The end of 2014 and 2015 will be a very interesting period as a whole wave of new products starts to surface. If you look within that, you see products in autoimmune disease, in inflammatory disease, heart failure, respiratory, cancer and others.

As I look forward into the next four to five years, it is highly likely that 100% of GSK's discovery and development pipeline will be first-in-class products. That is testament to the creativity that we have designed and built into the DPUs. Just as we are not really tempted to go off and spend high premiums to buy growth in the market, we are increasingly of the view that we don't want to get drawn into that in late stage development either. From all of the analysis we look at, and we think that the best place to partner is early and not late. We feel that we have a very full pipeline and that we have many assets in that pipeline.

Of course, with the acquisition of the Novartis Consumer and Vaccine businesses, that in itself takes some pressure off the Pharma business in terms of creating a greater balance within the company. The combination of all of that gives us a high degree of

confidence that we are able to see the move to sustainable sales and earnings for the long run. We will have a business which is not dependent on one drug but on many different medicines and vaccines, and we will have a business which has a very high exposure to Consumer and Vaccine opportunities which have high terminal growth rates. These will therefore allow us to tolerate some of the Pharma ups and downs that you typically see.

Next question.

Tim Anderson (Sanford Bernstein): I have a very high level question, Andrew. Can you talk about how you view Glaxo's future over the next five years? The consensus view has been pretty bearish on multiple fronts, given what has happened in 2014. I guess what I am trying to get at here is, what else might change radically, going forward, if anything? You have announced new cost cuts and you have talked about the partial IPO of ViiV, and that comes on top of the recent deal with Novartis. I wonder whether you perhaps now view Glaxo as being at a new steady state that looks good and sustainable from here, without the need for many additional changes.

My second question is on ViiV, and it is just a quick question. You report operating margins of 66% but I think that excludes certain costs like R&D. Could you give us what the fully-loaded operating margin would be for ViiV.

Sir Andrew Witty: Thanks, Tim. I will just make a couple of comments on your first general question. If we went back a year unchanged, then GSK was trading at its highest share price since the formation of the company back in 2001. What has changed over that interim period is that we have seen a reset of pricing in the US on Respiratory, and we have seen a slightly slower launch of the two respiratory products. Actually, the launch of the other products – the HIV products and the Oncology products and the Vaccines products – have all gone very well, but a slightly slower launch of the two respiratory products. That has clearly affected the way in which people think about the company, but that price reset is now in the system. The products are launching or launched, not just in the US but around the world.

As I said earlier on the call, what really counts is that the leading edge market shares are starting to look pretty good. I remain of the view, and so does my organisation, that we will deliver what we said we would, which is a broad portfolio of new respiratory medicines, which are capable – in addition to whatever the legacy business of *Advair, Flovent* and *Ventolin* is - of being bigger than it ever was just as *Advair.* The impending filing of mepolizumab will simply be another addition to that.

For me, 2014 has been disappointing in terms of the impact of the US pricing but in my view it has not changed the strategic future of the company at all. That is the first thing to say. The second thing to say is that, as a consequence, the decisions and the moves we have made during this year are absolutely in line with the strategy that I outlined back in 2008 and I think we have stuck to that very diligently. It is a strategy which is not dependent on M&A, not dependent on premium-driven M&A, but it is a strategy which is focused on long-term R&D, organic performance. All the evidence says that that is delivering, both in terms of quantum, innovation and ability to file, register and launch the products. That piece of it continues to be a major focus for us.

Secondly, we have always made it clear that we wanted to be strong in the Consumer, Vaccine and Pharma business, and the Novartis transaction creates that opportunity.

Thirdly, I have been very clear – and perhaps different from some other companies – that we will always be very pragmatic about how we create and return value to shareholders. I recognise that, in the sector, the TSR is often measured through share price appreciation, and share price appreciation does not always reflect dividend payouts and the like. However, if you look at the dividend quantum and the share buyback quantum that has been given to shareholders, at £33 billion in the last six year – driven, in part, by very thoughtful and objective decisions around which businesses we wanted to own or not own, I think you can see a very clear track record here. You can look at whether it is tail businesses, or whether it is the drinks Consumer business, or whether it is the Oncology business right now, or whether it is ViiV in the future. I believe we take a very objective view about at what moment, if ever, does the business have the potential to create more value in a different structure or with a different ownership than the current structure. I don't see us changing that mindset.

As I look forward, I think the synergies and the logic of the three businesses that we are building towards, post-Novartis, are very compelling. However, we will always be asking ourselves that question: are there ways, are there parts of those businesses, or even whole parts of those businesses, which would create more value with a different approach? What is key, obviously, is that we need to get that transaction closed and we are on track to do that in the first half. There is then tremendous synergy opportunity to be extracted, and then we will move forward. We will see what the situation is at that point.

Strategically, for me, 2014 has been a difficult, and a challenging year for the reasons that I have outlined, but it has not been a strategically destabilising year at all and I am confident in the strategy of the group. I recognise it's different to others and I recognise

that different people can have different views of it, but from where I sit I think this is the right way to deliver super long-term shareholder value by having a very productive R&D operation supplemented by businesses with high terminal growth rates. I think that's the right approach and it's one we've stuck to and we'll continue to stick to.

Simon, do you want to comment on the ViiV margin?

Simon Dingemans: On ViiV in terms of the margin, there is some R&D to be allocated and clearly if you were to think about this as a totally separate company, even though it is pretty separate within GSK today, there are probably some additional overheads and costs that you have to allocate. So probably from a working assumption point of view I would assume a margin of 60-odd percent at the operating level.

The other factor to remember is that there are clearly also a number of preferred elements in the returns that the different shareholders get from the different products in the portfolio. That structure will probably have to be simplified as part of this process. Exactly how that falls out it is too early to say, but if you model it out on a 60% margin you would probably be in broadly the right place.

Sir Andrew Witty: Thanks Simon and Tim, and next question.

Vincent Meunier (Morgan Stanley): Hello gentlemen, thank you for taking my questions. The first one is on ViiV Healthcare, a follow-up. Have you considered the pros and cons of selling the participation or maybe partnering ViiV with other companies instead of just making a partial IPO? And also, can you already say what you will do with the cash from the IPO?

Regarding the savings programme, can you elaborate on the measures put in place in order to avoid the commercial disruption, particularly in the context of the SG&A cut in Q3?

And regarding the Chinese situation, can you give an update on the DoJ investigation, what should we expect now in terms of the remaining steps? Thank you.

Sir Andrew Witty: Thanks, Vincent. As far as the last question, nothing to say on that so I have no update for you there at all.

As far as SG&A and avoiding disruption, I think across GSK we have a pretty good experience of how to manage this. We are going to be very keen to protect those parts of the organisation which are very much on the front line, if I can put it that way, of

commercialising our products and of course those in R&D who are really touching the key assets as they come through the system.

As we have laid out, this is going to take place over the next two to three years. It's not going to be a kind of super dramatic, big bang phenomena because we want to absolutely target these changes at the right moment to affect the business in the right way with minimum disruption. I think we have a reasonable amount of experience of that. We have been through lots of changes over the years and I have a high degree of confidence.

I think our senior management, so the level underneath the executive management of the group see this as a great opportunity to reshape the business in their bits of the group in a way which they want it to be for the future because we know the marketplace is changing all the time, customers are changing all the time and our portfolios have changed and we need to therefore change accordingly.

What I am very encouraged by is the reaction of our senior management as very embracing of this as an opportunity and that's always the first key thing. If the management see this as an opportunity rather than a task, then it will get done in a much more constructive, positive way and I am very optimistic about that.

As far as ViiV is concerned, listen, I am sure we will be inundated with investment bank ideas of what we should or could do. We think that partial IPO or an IPO of a minority stake is a sensible vehicle for us to assess. It gives the opportunity to create and crystallise value for shareholders, it gives an opportunity for a valuation to be done properly and it also gives the opportunity for GSK resident shareholders to remain a significant shareholder in that going forward for as long as GSK holds a residual stake. We think that serves a number of purposes. Obviously if there were significantly more value-creating scenarios then we are obviously going to look at them but we think that's the right place to start.

As far as how we might spend any proceeds, we'll cross that bridge when we get to it.

Next question.

Dani Saurymper (Barclays): Good afternoon. I have three questions if I may. Just firstly on the new restructuring programme that you have announced of £1 billion by 2017 timeframe, is that a net number or do you expect to reinvest some of those savings back into the business?

Secondly, I just wanted to confirm there are some comments on the tape regarding the established product portfolio and your expectation that more likely than not the products

will be divested. Just in relation to that, I want to understand if the cost savings programme you have announced, whether there would be any incremental savings you could anticipate from the sale of some of those EPP products. You have alluded to in the past that there are significant scope for savings should you choose to go down that road.

And then just lastly on Respiratory, I was curious to understand with regard to your 2016 return to growth comment if you had any expectation within that of a generic *Advair* launch, and then just very lastly as regards to *Anoro* and your commentary around slow uptake. Can you perhaps comment (a) on whether you are seeing in the LAMA class in the US discounting by Boehringer Ingelheim on Spiriva in response to your launch, we have heard that, and secondly, your experience thus far in Germany as you go up against Ultibro and how the launch is faring so far in Germany.

Sir Andrew Witty: Yes okay, thanks very much. As far as the £1 billion cost savings, that will drop to the bottom line over the next three years, so that's the net number.

As far as the established product portfolio, what I said on the previous call was that I think it is more likely than not that we will sell some element of the established product portfolio but I guided that it is unlikely we would sell the whole thing and so I think that the chances that some element of that portfolio attracts sufficiently high valuation to compensate the shareholder properly, based on what I am seeing I think that has a reasonable prospect.

Now I can't guarantee it, so I'm not telling you we are absolutely going to do that, but some element, it is reasonable to expect, may end up going. There will be some savings associated, but they tend to be quite long tail savings, because they are associated with manufacture and often times these transactions bring with them a contract manufacture period. The savings may well come in after three years as you go through a typical transition period, so I wouldn't guide you to get excited about that in the short run; it is more of a medium term opportunity.

As far as return to growth in 2016 we do not anticipate a generic *Advair* before the end of 2016, so that probably answers your question. Again, we remain of the view we have always had, which is this is not a trivial proposition for anybody; we don't know when or if it might ever come or what status it might ever have, but we certainly don't anticipate it in that time frame. As far as *Anoro* is concerned, yes, aggressive contracting from all of our competitors. We have also been aggressive in contracting this year and so we have been very focussed on making sure that we are not disadvantaged both on *Advair*, but also on the entry of new products. That has taken a bit of time. It has cost us some price points clearly, but we have been successful in securing very substantial access. At least a part of that has

been other companies trying to close out the marketplace on the way through. That is really what has driven the dynamic of 2014, if I am honest.

As far as *Anoro* in Germany, we have just literally started, so nothing to report yet; literally just beginning. Next question?

Keyur Parekh (Goldman Sachs): Good afternoon. Two questions, if I may, please? First, Andrew, just on the dividend, if you can confirm that 2015 dividend at 80p would still be the case even if you were to go ahead and divest a part, however small or big, of the established products portfolio? Secondly, in the context of your long term progressive dividend policy, 2015 is an exception, i.e. post 2016 the progressive dividend policy still holds?

Secondly on the cost savings of £1 billion sterling, if you just help us think about some details around that, where does it come from in terms of SG&A? What is R&D? What is manufacturing over the next three years? Do your earlier comments on trying to take a final look at the central costs post the transaction, if you would care to give us some more colour around the opportunity there? Thank you.

Sir Andrew Witty: Thanks. In the first point, yes, I wouldn't anticipate any decision on the EPP affecting the commitment we have made on the dividend for 2015. We do have a long term commitment to increase dividends for our shareholders. Obviously we will update you on 2016 and beyond when we get there, but we have very clearly re-stated our long term commitment to increase the dividend. We are not going into detail today on the cost savings, but suffice to say it will be blended across different parts of the organisation. As always you should expect SG&A's savings, and to some degree R&D savings, to come at the front end and manufacturing savings to come at the back end. In terms of phasing you might see them in a slightly different way, but they will be blended across the piece. Central costs will certainly be a focus for us, particularly as we go through the transaction, as I have said already. The transaction gives us a very new lens to go after that over the next couple of years. Next question?

James Gordon (JP Morgan): Thanks for taking my questions; two questions, please. The first question was about the Novartis transaction and the 2015 outlook. My question was should we still anticipate accretion to 2015 EPS in the transaction despite the margin dilution? Is there any prospect for EPS growth in 2015 which consensus

currently models, or should we take a flat dividend in 2015 as a reflection of where earnings might be to 2015?

The second question was in terms of IPOs, if this makes sense as a way to monetise ViiV, could it also make sense to IPO part of consumer that you are going to have, as presumably you also think that is undervalued at the current level?

Sir Andrew Witty: Thanks so much, James. As you remember, when we announced Novartis we said in the first full year it would be marginally accretive. Of course the real question is when is the first full year? When exactly do we close? That is important because it determines how much of the Oncology business we have for how long in the year, how much of the Vaccine and Consumer business we have for how long in the year and also it determines when the B share scheme gets executed, which of course has an effect on the EPS accretion in the short run. If you remember when we introduced this transaction to you all, the initial accretion was helped a lot by the B share scheme; it is then helped by the synergies and then in the long term, the deal becomes hyper-accretive because you are essentially contrasting a retained vaccine and consumer terminal value against what would in years seven, eight, nine and ten be a decline in Oncology business. You have these three phases of synergy.

That first phase in the first 12 months, even with the margin dilution that Simon talked about, as we described to you at the time we launched it would be marginally accretive. The exact effect on 2015 depends on exactly when it closes. Today I am only able to give you guidance that we are on track for the first half. Obviously if it closed on December 31, then the marginally accretive statement would stand, if it closed later it might be different and we would give you guidance at that point.

In terms of we are not giving you guidance today for next year, I think it is pretty clear from what we have said that we expect the headwind of Respiratory pricing to continue to flow through into 2015. That clearly is a significant headwind for us to deal with. We are putting in place a number of measures, not least the restructuring programme to begin to offset some of that on a more permanent basis and the measures we have been able to take during the end of this year. That indicates to you that we see 2015 being another tough year for us as we adjust to that new reality in the US. The good news is we have a lot of products beginning now to pick up the slack, we get the transaction closed in the first half which starts to give us opportunities to grow and to build up the Vaccine and Consumer business and access those synergies. Therefore, as we progress through 2015 into 2016, we start to see movements through this phase that we have had to deal with. We see in 2016 a return to growth on Respiratory, we see the full-year benefits start to kick in from the transaction, we

see longer-term contribution from new products and so on, so that is the way we see next year playing out.

Matthew Weston (Crédit Suisse): I have three questions if I may. If we just contrast the first two quarters of *Anoro* in the US, they seem to be tracking the experience of *Breo* very closely with some pipeline filling and then some incremental discounts impacting the second quarter. As we work through the next few quarters of *Anoro*, are you confident that the revenue will exceed the performance of *Breo* in terms of following the same launch trajectory and, if not, how comfortable are you with the £250 million consensus expectations for *Anoro* for next year?

Secondly, on China, now that the legal issues, certainly in the domestic market, are behind you, can you give us an update of your experience as far as physician reaction to GSK and what you are doing in that market to regroup and refocus growth? Andrew, you are very clear to point out how much you have implemented the strategy as you set it out when you took over the role as CEO and, as I recall, strong emerging markets was a key element of that?

Finally, on the difference between non-core and core earnings, historically GSK core versus non-core represented about 70%, or there was a 30% difference between those two metrics. For this quarter, there is now a 70% difference between those two metrics and, even if we exclude the China fine, one is still half of the other. Can you walk us through some of the key elements that have been excluded from core in Q3, particularly in that acquisition and accounting column, which is by far and away the single largest adjustment that you are putting through the P&L?

Sir Andrew Witty: Thanks, Matthew, and thanks in particular for the last question as that is a really good thing for people to hear and understand, and Simon will touch on it.

In China we have just gone through the end of the case and, as you would expect, we are making sure that we learn the lessons from that. We are very focused on ensuring that we do, indeed, learn those lessons: we have a new management team in place in China but these are very early days and I shall not go into more detail. Suffice to say, you have seen the annualisation of the effect, so China no longer has the same negative drag we have seen on the business.

As far as my commitment to emerging markets is concerned, that is reflected in the very strong performance in the quarter with double digit growth rates from the emerging

markets. We continue to be very robust about that and, when you look at where EMs are now, they are more or less the same size as Europe, whereas five or six years ago they were around a third of the size of Europe, so you can see the change.

As you know, Matthew, nothing is easy in this world. That brings with it currency volatility, of which you see some this year, and it means you are operating in very difficult markets which can throw you curved balls from time to time. However, I reiterate the fundamental reason why we are focused on emerging markets is that, of the six billion people who live in the world today, only about 600 million people live in western Europe and America. We have to focus on building the business for the long term but we also need to have our eyes open, there will be challenges and it is not a one-way street as far as just good news flowing from those markets. It would be, however, a big mistake to be put off every time the weather changed in those environments, so we are very committed to that and we remain very focused on it.

As far as *Anoro* is concerned, the NBRx share of *Anoro* for pulmonologists is just into double digits and it looks like a very similar kind of pick-up. Again, we are increasingly looking at a scenario in the US where primary care drugs are being adopted at a slower pace but they will be adopted. We now have excellent data out there with our salesforce in terms of the competitiveness of *Anoro* and I believe that we shall continue to see these products build up. I shall not endorse or otherwise anybody else's numbers. I shall restate what I have said hundreds of times to you all before, which is that, over time, the combination of all of our various Respiratory products, plus the legacy of what is left from *Advair*, *Flovent* and *Ventolin*, will generate a Respiratory business which is larger in size than the business we had before this all started. That has always been our goal, I am as confident on that as I ever was, and we shall continue to drive down that road, so that is very much 'game on' as far as we are concerned. Simon will talk about the famous core to non-core.

Simon Dingemans: Thanks for the question on that. First, remember that many of these charges are non-cash and, in particular, amortisation and impairment charges and quite a lot of the charges that you often see in the acquisition column are non-cash, which is indeed the case this quarter. In particular, we have two significant adjustments going through. The first is £350 million which is a revaluation of the contingent consideration we owe to Shionogi on dolutegravir-containing products, which is a revaluation given the out-performance that we have seen of *Tivicay* in the last couple of quarters, so we have reassessed that this quarter. That takes the total provision there up to £1.3 billion. The other is a change in the treatment dictated by the IRS in relation to the US industry pharma fee, which led to a forward-looking treatment rather than a backward-looking treatment.

Therefore, we have adjusted our current year for the IRS's required treatment and in that adjustment column in non-core, you will see the previous adjustment, which, again, is non-cash and does not affect how we pay for the fee going forward. It is just correcting the treatment for the latest guidance that we have been given. That has obviously creating the main distortions that you have seen.

There are also a number of other Novartis costs in anticipation of closing the transaction, including some hedging that we have in place to protect the cash returns that we will get out of that transaction, and that will fund the £4 billion – we obviously need to make sure that we still receive £4 billion at the end of the transaction. Those are the main drivers, and why it has jumped up this quarter. That is the principle reason.

Sir Andrew Witty: Thanks, Simon, and thank you, Matthew, for asking the question. It is important that people understand this, between those two numbers. It is particularly ironic that you end up having bad news in the core to non-core because we have increased our forecasts for Tivicay and, as a result, we have to take a bigger provision. Make of that what you will, but I am sure that that has triggered off all sorts of calculations about what our real forecast is for Tivicay and therefore what the imputed value of the ViiV business really is. That should keep everybody up all night, I would have thought!

We have time for one last question, please.

Kerry Holford (Exane): I have two questions, please. Could you first talk a little more about the targeted expense reductions that you mentioned in SG&A and R&D? I am interested to know whether there has been any change in the size of the Respiratory sales force in particular, and just to understand what those reductions might mean for *Anoro* and *Breo*, given that they are still in a very critical stage of their roll-out.

Secondly, I would be interested in your view as to why US primary care drug launches are becoming so much more difficult. Do you think this is a reflection of the quality or the lack of differentiation of some of the new products being launched, or is it pure price pressure and access? Are you having formulary positioning discussions with payors in the US much earlier than you have been, in order to secure that access that you are now confident that you will have from 2015? Does that mean that you just need to have those conversations much earlier or is it simply that you are now willing to be more flexible in the rebates that you can offer on some of your existing products?

Sir Andrew Witty: Thanks very much, Kerry. As far as the expense reductions are concerned, I can absolutely reassure you that there will be no change to the

size of the Respiratory salesforces – in fact, no change to the size of any salesforces during this period. I don't think you need to worry about that, because we have identified things that we believe will not affect the performance of the products, and those are the cost opportunities we have taken.

As far as the US market is concerned, we have looked at primary care dominated launches in 2012, 2013 and 2014. We see *Breo*, which is the one where we have the most data, performing very much in the upper quartile of those launches. These are products from all categories and so, obviously, you are looking at different markets. However, whether you are in diabetes, or in respiratory, or cardiovascular – wherever you are, it might be instructive just to look at one chart. If you look at NRx performance for *Breo* versus Brilinta versus the JAK inhibitor from Pfizer – and I have picked those because they are three products which are priority products for the three big companies – two of the three companies use the traditional selling model, and one uses the GSK selling model. When you look at the performance of those three, you will see straightaway how *Breo* stands out from those other two product launches, in a very positive way. I don't see anything from that which really says that there is something very special going on, just *vis-à-vis* GSK.

What might be going on in the market? The first thing to focus on is that, if you look at the US market now, the top 10 commercial plans control 86% of the market place. The top 10 Part D accounts control 88% of the market place. You therefore have a very consolidated purchaser market place, who are all reacting to the 'Affordable Care' Act, and they are all reacting to continued integration and acquisition of both a lateral and a vertical level. That is creating a great deal more visibility on contracting strategies, and there is much more information visible to payors.

Secondly, there is a scenario where, in many categories – diabetes, respiratory and many others – you have enough competitors who are prepared to start bidding on price. As I mentioned, and not in one of our categories and not a relevant competitor to GSK, I have just seen this week that one of the major companies is advertising to new patients on a brand new drug with 12-months' free vouchers. That is a pretty significant give, if you will, in terms of pricing. I think what that reflects is probably their intention to try and get people to start the product in advance of the plans covering the product, which is a little bit what we've seen in the respiratory market, that it takes a while for these things to start.

I think you have a general shift in power toward the purchaser. It's not completely obvious to me that in primary care, degrees of differentiation make a huge difference which is a little bit of an interesting conclusion, it's not totally obvious that that's the case and we just have to take a perspective that things take a little bit longer, you have to be patient and

the results in the first 12 months may not be indicative of where you ultimately land. That is clearly different to the specialty field, but that is the reality in the US marketplace.

Now, having said all of that, the US remains a very attractive marketplace. It still has relatively high prices than other parts of the world and in the medium to long run these products will find their place and be adopted well, but it's not the 1990s anymore and we have to have the right model to do that. It's one of the reasons, much as I know not everybody on this call agrees with us, it's one of the reasons why we think our selling model is absolutely the right way to go and we feel very good about it.

With that, I know we have run a little late. I am really sorry, but we wanted to give as many people as possible the chance to ask questions. Thanks so much for your attention today and obviously the IR Team is available if you want to have any follow-up.

Thank you.

- Ends -