

GSK Q4 Results 2011

7 February 2012

Sir Andrew Witty, CEO

Performance & outlook

Q: How would you characterise the Q4 results you are announcing, and the performance over the year?

A: Well, I think the year for GlaxoSmithKline was a very good productive year for the Group across the board actually. We saw good performances across all of our business, emerging markets, our consumer business, our American business coming back to strength again. At an underlying level, we reported 4% sales growth for the year, very much in line with what we've seen now for the last couple of years. Q4 was a little bit slower, but that was really due to some vaccine phasing issues and we'd highlighted that we had higher vaccine sales earlier in the year, a little less in Q4 compared to the prior year; that's really what happened in Q4.

And also for me-- very exciting during the year --it was a great year for R&D. As you know one of the big, big focus points for us over the last four years has really been to reenergise our R&D organisation and we saw some very, very good progress on that front. And we announced today we already have, this early in the year, four new products ready to file with many more reporting more data later in the year. So, overall, I think 2011 was a good year for GSK. It was certainly a year where I would say we are absolutely on track for our goals.

Q: Your outlook for 2012 is notable because it is positive. Why are you confident?

A: For us the headwinds that we've faced for the last four or five years are diminishing, and we've been building more of our own tailwinds in terms of our R&D portfolio and the investment we've been making in our new growth business like emerging markets, consumer, the vaccine business.

And so we've been working hard to try and reposition the group for exactly this period that we knew would come, a period where many products in this sector were going off patent with other companies, a period where there is going to inevitably be more price pressure. But we've been strengthening ourselves to try and take advantage of that.

And you know adversity isn't all downside for everybody, I think there is real opportunity for companies who have strengthened themselves, changed their exposures to be in the places where the growth is. This is a time where we should feel optimistic. And certainly at GSK we do feel optimistic. We feel like we are moving into a new era for the company and we now need to focus on absolute disciplined execution to make sure that we take advantage of all of the opportunities that we've worked so hard to try and create for ourselves.

Returns to shareholders

Q: You've also announced a supplementary dividend on top of the regular dividend, on top of the £2.2b share buyback. What's the thinking behind the supplementary dividend and is this a mechanism that we can expect to see going forward?

A: Well I've made it very, very clear that our number one priority is to be able to deliver diversified sales growth which we then believe we can drive over the next several years: a gradual, and then an accelerating, rate of leverage through our P&L that we'll be able to produce more cash from those profits, and then we are determined to give that cash back to our shareholders through a variety of mechanisms.

Now during 2011 what we did is we began our long term share buyback program. We spent around £2.2b buying back our shares last year. And we've also increased our ordinary dividend to 70p a share for the year, a really healthy increase in dividend. On top of that, because we'd announced we would be disposing some of our tail products in the consumer business, we've decided to pay out the proceeds of the first element of that (our NA OTC tail) out to shareholders as a supplemental dividend, 5p per share, so total dividends today we're announcing are 75p a share for 2011.

And I think what people should expect is, A, a continued commitment to generate and improve returns, and B, those returns being paid out to shareholders, but in a variety of ways to try and balance the different needs of different shareholders.

Regional dynamics: Japan/Emerging Markets/US

Q: Japan has really delivered this year, and it's clearly an important market for you. But what is the opportunity in Japan?

A: Japan is an absolutely fascinating business, and I remember when I first took over as CEO, in fact the very first slide I presented, I talked about Japan being a priority for the company going forward. And a lot of people, I think, at the time said, 'Well why is he talking about Japan?' And if you look at Japan over the last four years it's just been a great growth story for the business, mostly because of our success to bring into Japan a very large portfolio of new products, some of which had not been launched in the far past, some of which are much newer products and more contemporary with what we've launched in America and Europe.

In fact, over the last five years that rollout has really delivered all of the growth. So today, for 2011, 48% of the sales we reported in Japan are from products which are younger than five years old. That's a phenomenal rate of innovation. And that's what's led in particular in 2011 to the strong growth rate, 30% up on an underlying basis over the prior year. So this is a huge business for us. It's a business now turning over £2b a year, continues to grow, and it's a business where we expect to be able to continue to launch new products this year, next year, the year after, so very sustainable. So for me, Japan has become, alongside the United States, one of the two key pro-innovation markets where we are going to dedicate our R&D efforts to make sure that we maximise those forward opportunities.

Q: If we look at emerging markets, there does seem to be some bleed and knock-on from the economic pressures seen globally on emerging markets. What's your experience been?

A: It's very varied. So we are very fortunate that we have built a very broad emerging market business. It's really a portfolio of companies in over 100 countries. Now in that portfolio, of course, in any given year you're going to have various pluses and minuses whether their economic or sometimes unfortunately natural disasters which can cause disruption to a marketplace. The key is to have sufficient broad exposure so that you can absorb trouble in one place and still grow in others.

What we've seen during 2011 is exactly that. So we've seen a very strong performance in Latin America, very good performance in our pharmaceutical business in China, as an example, offset by some pressures in

the Middle East due to mostly the political instabilities in the Middle East, which everybody has been watching on TV, and in places like Russia where there have been some very specific price cuts pushed through.

But when you take all that to the side what you continue to see is the portfolio has grown very well, quicker than the US, quicker than Europe, but of course not quite as quick as it was the year before. I think we should take the long view on emerging markets, the demographic development of these countries is wholly positive for a business like GSK. If we look at the performances across most of those countries we continue to see very substantial numbers of our products growing in double digits. I remain very much convinced that the future is in emerging markets for a business like GSK.

Q: If we can take a look at the US, because there is a place where we've had economic pressures, we've had healthcare reform, it's been tough for a few years in the US. Are you now seeing an end to some of those negative pressures in the US?

A: Well again the United States is an area where pressures come both generally and specifically. So for GlaxoSmithKline we've had both over the last five years. In fact since 2006 we've lost to generics or to drug withdrawal due to Avandia, something like \$10b of turnover. And that's a very specific GSK negative. And we've had to absorb all of that during the last several years. It's really been the biggest headwind for the group. On top of that there have been very substantial price cuts in the US because of the Healthcare Reform Act and other new taxes on the pharmaceutical industry, which we all suffer from not just GSK.

Now as we look forward our headwinds from our portfolio have really diminished, so the rate of genericization's, the rate of these products which have gone away has really slowed. And as we look forward we have a much more stable business, great Advair Respiratory business, looks very solid for the next several years, now being increasingly complimented by a whole series of new products being introduced. And in fact over the last three years we've had more new products approved by the FDA in America than any other company. So our specific headwinds/tailwinds is looking much better.

Also I think quite encouragingly, at least for the next year or so, we don't really anticipate too much more very significant negative pressure from pricing in the US. Now that may change again as we go through the electoral cycle and we see things develop in the US. But I think for 2012 it looks relatively clear what's going to happen.

Pipeline progress & R&D returns

Q: Now you've touched on idea that this diversification of your revenue streams away from the 'White pill/Western markets' that's underpinned growth, now we can see real potential in the R&D pipeline to underpin future growth. What's your view of that late stage pipeline?

A: Well it's very much still work in progress and I am very hesitant to declare victory until we've actually crossed the finishing line, and I think that's an important caveat in all of this because R&D is a very high risk business and things do go wrong. Having said all of that, if we look at all of the metrics and all of the measures of how we judge R&D we feel like progress is going very much in the right direction.

So what do I mean by that? The overall number of medicines and vaccines that we have in development, we've maintained around 30 programs in advanced development. That's key, because it's showing you that

we've got a level of sustainability of our R&D organisation which allows us to be more confident over the medium term.

If I look at the progress of that 30 we are seeing some very good delivery of data. We've announced today a lot more data has been coming into the company over the last few months, and even here we are today, early February, and we've got four new medicines ready to file for regulatory approval this year, and we've got data coming on another six which could complete before the end of 2012.

So, we are sat here in a situation where we've either completed or we could complete up to 10 new medicines in one year and still have, more or less, 30 projects in late stage development. That really is a kind of sensation of a step change in R&D productivity. And I say productivity because all of that's been achieved for more or less exactly the same amount of money that we were spending four years ago. So we haven't delivered this increase in output by doubling the R&D budget, in fact quite the opposite. R&D budget has been essentially static but the productivity of the organisation has transformed, so that looks very promising.

Now, what we need to do is make sure those medicines and vaccines get all the way to approval, and of course we have to finish that job over the next year or two. And we need to make sure that we are very clear about where the points of differentiation in each of those different medicines are and make sure we price them accordingly.

Q: You've also announced that the R&D rate of return has improved to 12%. Why is that significant?

A: Well the rate of return is really a measure, first of all, on whether or not we are investing shareholders money in a sensible way, which returns for them something which is commensurate with what they might expect elsewhere or from all the other places they could invest. Why bother buying shares in GSK if you can't generate a rate of return higher than 2% or 3%? There of course needs to be a competitive rate of return.

We are the only company, I think still the only company to have published our rate of return calculations. And when we first came out with this just over two years ago it was 11%. We are now up to 12%, which is very encouraging and we are on track to our medium term goal of hitting 14%, which we think is a very, very realistic target but would be, I think, very, very competitive with any other kind of investment choice people might want to make. So if we can get to that level we really feel like that has signalled the, if you will, permanent step change in the performance of R&D.

Q: You introduced the discovery performance unit as a way to reenergise the drug discovery process. There has been a review of them, the first review, do they work?

A: Oh, I am absolutely sure they work. Now I can't tell you that we've got all the answers because drug discovery is a 10 to 12 year cycle time, so I can't show you a score card which shows you that after only two or three years that we've suddenly delivered lots of drugs from these programs. That's not really the right question to ask.

The right question to ask is: are we taking a more focused view on how we invest in discovery? Are the people who run our discovery taking greater accountability of the decisions that they're asked to take? And are we being thoughtful about making sure that as we go forward we, I like to think about it that we, prune that organisation and its focus to make sure it constantly gets healthier rather than allowing it to go a little bit wild and maybe lose some of its focus.

And if you look at what we've done over the last three years I think all the evidence says we've done all of those things. And particularly in the review that we've carried out in the second half of last year, which really lead to a whole number of changes; so the creation of four new DPUs, the closure of three, the realignment of six or seven, eight leaders changed to make sure we had the very best people leading the projects. So very much a pruning and reshaping of that portfolio of 38 or so discovery units.

For me though the much more important question is what does it feel like? So again it takes so long to know whether what you've done will ultimately lead to a new drug in 10 or 12 years, one of the most important measures for me is when I spend time visiting the laboratories where these researches are what does it feel like? And it feels completely transformed. The energy level, the engagement, the team working, the multi-disciplinary, integration of our researchers inside the labs, just the busyness in the labs it has a completely different atmosphere. It has an atmosphere which gives me a very strong sense that we are onto something here, that we are onto, not just a set of metrics or logos, but a completely different culture of research.

And I am a passionate believer that ultimately success in research in the biomedical field and in GSK is going to be a function of really allowing those few incredible people to do their best work in one of our laboratories rather than somewhere else. That's about the culture.