GSK Q4 results 2011
7 February 2012
Simon Dingemans, CFO

Margin progression:

Q: Margins in Q4 were slightly lower than where you were guiding, is that a concern?

A: I don't think it's something to be too concerned about. We always knew that 2011 was going to be particularly impacted by the roll off of around £1.8b of pandemic Avandia and Valtrex sales and that's clearly had a material impact on margin. During the year we've also seen some additional pricing pressures in Europe, and also in our emerging markets businesses, these have not been immune from some of the political uncertainty and economic pressures we've seen elsewhere. And we have seen some additional pricing pressure in those markets, particularly in the later stages of the year, putting that together that's also impacted margin.

But perhaps, as well, it's important to remember that we are investing heavily behind our growth platforms during the course of last year and it would be wrong, at this point, to pull back from those, especially in areas such as R&D when the late stage pipeline is at such a critical phase. And it's support of those growth platforms that's left us a little bit lower than we originally expected on the margin, but much better positioned going forward in terms of the growth of the company.

Q: So what is the outlook for margins?

A: Well if you look through some of the pressures that we've been facing in 2011 you can see a number of our cost saving initiatives of the last several years, and some of the new ones we've identified that are beginning to contribute last year, showing through in terms of the leverage that we are building into the company. But remember we've got to offset against that both mix and the continuing need to invest behind our growth platforms. And in 2012 that's why we've said that we expect only a very gradual increase in operating margin, and by that I mean a few tens of basis points and more in 2013 and further thereafter.

And that's really reflecting that different mix of pressures. And the ultimate delivery of that leverage and how it progresses going forward will be driven, in part, by how we deliver at the top line as well and how we see the products that we are bringing through the pipeline launch and how their taken up by the market. So there's a number of different factors that will determine the ultimate curve, but it will start slowly and accelerate thereafter.

Financial strategy

Q: You introduced a new financial strategy in 2011, can you give me an update on the progress against that strategy during the year and your expectations for 2012?

A: Well it's still early days, but I'm encouraged by the take up within the company of the new architecture that we outlined back in July. And just to remind you what that architecture is designed to do is drive the returns from our strategy by supporting the sales growth that we are clearly building at the top line, driving operating leverage into the company to improve the group margin going forward, increase our financial efficiency and convert more of our earnings into cash. That way we can drive both earnings per share and free cash flow growth which gives us more flexibility to invest or return cash to shareholders depending on where we see the best returns.

We've reorganised the company's planning processes and that's allowed us, in the cycle, at the end of last year to roll those metrics and those measures across the company in terms of how the individual businesses are thinking about their prospects and plans going forward, so very good take up there.

I think in terms of delivery of results; some contribution at the operating level and certainly some additional cost savings that we talked about back in July are beginning to come through, the extra £300m that we identified. And probably the biggest contribution of the architecture in 2011 was more at the financial level or particularly in conversion of cash.

So at the financial level we've delivered ahead of expectations on a number of our tax planning efficiency measures, which have delivered a 26.2% tax rate for the year ahead of our expectations. And on the cash conversion we've seen very good cash generation, particularly on the back of further progress in working capital delivery, and this is a particular measure that we've really driven by rolling it into the planning process, which we've now driven across the company, and a big focus for the company during the year, and one that we'd really raised the profile for, so that's really also beginning to pay off and give us a lot more flexibility in terms of how we think about and how we fund those investments.

I think going forward we are really going to see the operating performance, see some benefits from the architecture as we continue to build on the original operating excellence program. And we've announced today that we've already identified a further £300m savings to come out of that program which will take the total to £2.8b over the next several years. And those are going to deliver to the operating margin which is one of the key tenants of the architecture that we talked about. So I think still early days, but good progress so far.

Restructuring programme

Q: You increased your restructuring target by £300m, where are those savings coming from? Is this about jobs?

A: No, this is not really about jobs, this is about taking the platform and the simpler business that we've created over the last two or three years and really driving greater efficiencies out of that platform. So, whether it's in the simplification of our manufacturing base, which is now allowing us to align that manufacturing base much more closely to our particular product portfolio and particularly to the geographies in which we operate so that we have manufacturing plants now focused much more tightly on delivering product to our emerging market footprint, which is different from our US footprint or our Japanese footprint, to pick an example, or taking out the central functions where we've consolidated quite a lot of our global functions. We've delivered 20% savings in operating costs over the last two or three years. And now we have a common platform that we can really use to drive efficiencies from, and we are looking at how we can do that across our IT functions, across our human resources functions and particularly in the finance capability where we are looking to concentrate quite a lot of our activities in a number of business hubs which will allow us to then engage with our businesses and support them much more actively. So it's really about capability rather than jobs.

Reporting 'Core' earnings

Q: You've also moved to reporting 'Core' earnings. Why this shift? Does it really make a difference?

A: Well when I came on board I took a look at our reporting structure and over the last several years it's becoming increasingly complicated with a middle column highlighting the restructuring that we've been going through and the number of other changes as well. And I wanted to try and simplify this and make our results much more comparable to those of our peers. And so that's the real reasons we are moving to 'Core'.

'Core' strips away some of the disruption that we've seen in our numbers, but it also takes out some of the disposal gains and some of the other one-offs that have swung the numbers either positively or negatively and gives us a much closer alignment in terms of 'Core' operating performance and 'Core' earnings with the underlying ongoing trading of the business and the cash generation capability of the business through the cash earnings numbers that you see underneath the 'Core' earnings performance measures that we'll report. And so it's really about aligning our external reporting much more closely with how we manage the business and the ongoing trading performance of the operations within the Group. [End]