GLAXOSMITHKLINE

Q3 2013 RESULTS
PRESENTATION TO ANALYSTS

Wednesday, 23 October 2013 @ 14.00 hrs

GLAXOSMITHKLINE
Q3 2013 RESULTS
PRESENTATION TO ANALYSTS
Wednesday, 23 October 2013

Sir Andrew Witty (CEO): Good afternoon everybody and thank you for joining us for the Q3 analyst teleconference. As usual, I am joined by Simon Dingemans, our CFO who, after I have made a few introductory comments, will add his commentary to the quarter, and then we shall open for Q&A.

GSK's third quarter performance has seen us continue to deliver a broadly-based sales growth, bring significant new products from our R&D pipeline to market and grow returns for our shareholders.

Turning to the numbers first, total sales were up 1%, core operating profit was up 11% and core earnings per share were up 16% to 28.9 pence. The increase in core operating profit was driven by continued strong cost control, including a reduction in R&D expenditure and the delivery of a further benefit from the programme of initiatives we started in 2012 to reshape and reduce certain long-term operating expenses.

As we saw last year, and signalled to you earlier this year, contributions from this programme are unevenly phased, and we shall continue to look for more of these types of opportunities to help deliver sustained reductions in costs and balance sheet liabilities.

We continue to return cash to shareholders with the dividend again increasing by 6% to 19 pence per share, and £1 billion worth of shares were repurchased by the end of the quarter. I can also today reaffirm our full year guidance of core EPS growth of 3-4% on sales growth of around 1%, both at constant currencies.

Sales grew 1% despite the impact of a significant decline in China sales, and the timing of various vaccine tender shipments. This was a resilient performance and is being driven by contributions across the Group.

In the United States, first of all, sales grew 2% impacted by wholesaler and retailer destocking in the quarter and, if this was excluded, growth would have been around 5%. This performance marks the continued growth of our business in the US, and is encouraging given the obvious intensifying price competition we continue to see in the market. With our significant new product flow and the changes we have made to our commercial model, we remain very optimistic about future growth in the US.

I was also pleased to see pharmaceutical and vaccine sales grow at 5% in Europe and, while the environment here remains tough, I believe we are starting to see the results

from our restructuring efforts to focus the business on our core assets in key growth areas such as Respiratory, Oncology and Vaccines.

The performance in EMAP this quarter down 9% has been impacted by the timings of both vaccine tender shipments and, of course, the significant decline in China sales. If we exclude just China, pharmaceutical sales growth in the region was 5%.

Operations in China were clearly disrupted in the third quarter with sales down 61% but we remain fully committed to supplying our products to patients in the country. At this stage, it is still too early for us to quantify the longer-term impact of the investigation to our performance in China. The investigation is ongoing and is complex and detailed. We continue to cooperate fully with the authorities and to respect the process of the investigation. As such, there is very little further I can say until it has reached its conclusion.

However, I do want to reiterate that the activities described by the authorities are very serious and totally unacceptable. They are contrary to our values and to everything I believe in. We very clearly recognise there is a profound need to earn the trust of the Chinese people again, and we shall take every action necessary to do so.

To round off on business performance for the quarter, Consumer Healthcare sales grew 4%. We continue to focus this business around a portfolio of key core brands and drive growth through geographic expansion and innovation.

Before closing, I would like to highlight the great performance from the R&D team. 2013 was always going to be an important year for our R&D organisation, and I am delighted to the progress to date with four of the six key assets highlighted at the start of the year already approved. Given how difficult drug development remains, this level of achievement in the last nine months is remarkable and unprecedented for GSK, and I want to pay thanks to everyone who has worked hard to make this possible.

The four approvals consist of *Breo* for COPD, *Tafinlar* and *Mekinist* both for metastatic melanoma, and *Tivicay* for HIV. In addition, we have received approval for our quadrivalent influenza vaccines in the US, and significant new indications for three other products. Taken together, these approvals represent substantial new growth opportunities in key areas of Oncology, HIV and Respiratory disease.

I would particularly like to highlight our Respiratory portfolio. Last week, we began shipping *Breo Ellipta* to US wholesalers. This product is also now approved in Japan for asthma and has received a positive opinion in Europe for COPD and asthma. We also received in the quarter a positive recommendation from an FDA advisory committee for

approval for another product – *Anoro* – for COPD. A regulatory decision here is expected before the end of the year.

These achievements mark the latest developments in our 40-year leadership of this therapy area. They are clear indicators of our ability to expand our current portfolio with new medicines and inhaler technologies, which can make a real difference to the lives of patients with respiratory disease.

I also want to highlight the positive findings seen earlier this month for our malaria vaccine RTSS. This is something that I and the whole company are delighted with. As many of you may know, we have been working on this project for around 30 years, and we are now preparing a file for approval with regulators in 2014. The vaccine has been shown to reduce by approximately 50% cases of malaria in children aged five to 17 months and, given the terrible nature of this disease, it has the potential to help transform public health in Africa.

Finally, as we deliver our pipeline, we continue to reshape our business and divest non-core assets. We have agreed to sell *Lucozade* and *Ribena* to Suntory for £1.35 billion, and have accepted an offer of £700 million from Aspen for our anticoagulant products *Arixtra* and *Fraxiparine* and their related manufacturing site. We believe these represent good value for shareholders.

With that and to give you a little more detail on the quarter, I would like to hand over to Simon Dingemans.

Simon Dingemans (CFO): Thank you, Andrew. To recap, in the third quarter we delivered 1% sales growth despite significant lower sales in EMAP which are impacted primarily by a decline in China sales, but also the phasing of tender shipments in our vaccines business.

The broad range of growth contributions we are now seeing across our business more than offset these pressures in the quarter and if you exclude China Pharma and Vaccines the rest of the Group's operations delivered overall turnover growth of 2% in the quarter.

Our results for both the quarter and the first nine months also show how we are improving leverage across the P&L. This is reflected in core operating profit up 11% and EPS growth of 16% and 1% turnover growth in the quarter, but also EPS up 5% on turnover in line with last year for the first nine months. The 1% growth in turnover reported in Q3 is without any material contribution yet from our recent launches.

We are pleased that in the US some of our key pipeline launches, such as *Mekinist*, *Tafinlar* and Tivicay are underway and since the quarter end, as Andrew highlighted, *Breo* has started shipping. As more geographies and products come online contributions from our portfolio of new products should grow, but we continue to expect that in the current environment they may take some time to build.

To ensure that we deliver against this opportunity we are continuing to invest behind the pipeline while tightly managing our cost base. Our on-going restructuring programmes are on track and delivering in line with our plans and in aggregate they contributed additional savings over the last year of over £200 million and total savings are now running at an annualised rate of over £2.7 billion.

We also continue to implement the programme we started last year to identify specific initiatives that could reshape and reduce our long term operating expenses.

Particularly this quarter we delivered a significant reduction in our long term employment costs through a restructuring of our post-retirement medical benefit programmes. This is something we have been planning for over a year and was reflected in the guidance we gave at the start of 2013. The restructuring contributed £267 million in savings in Q3, but will also contribute on-going savings and service costs and reduces our balance sheet liabilities. Very much like the other elements of this programme that last year led us to restructure our pension obligations, releasing savings in Q2 2012 of around £100 million and in Q4 of £290 million. Overall provisions for pensions and medical plans are now £1.4 billion lower than a year ago.

We continue to look for further opportunities along these lines, but it is unlikely that any more will be delivered this year. This will clearly create some comparator issues for Q4, as you think about your models, given the timing of delivery and last year's savings relative to this year.

Overall, despite the impact of China, the momentum we are seeing elsewhere in the business is offsetting this drag and as a result we are, today, reaffirming our guidance for the full year of EPS growth on a constant currency basis of 3-4%, on sales growth of around 1%.

Turning to our topline performances, as usual I will provide some additional commentary on the performance in the quarter and my focus will be on constant currency growth rates and core results.

In the US, in the quarter, US Pharmaceuticals and Vaccines sales were impacted by further destocking by wholesalers and retailers and this cost this part of the business almost 3 percentage points of growth. Despite this pressure in the quarter the US business still

delivered growth of 2%, even though we are also seeing an increased level of price competition in certain areas of our portfolio. This particularly affected the Respiratory business, which was down 3%. Newer products grew more strongly, particularly Oncology up 14%, and remember this is before any material contribution from the recent launches. *Benlysta* sales doubled and the US Vaccines business put on a particularly strong performance, up 24%, with continued benefit from on-going shortages of a competitor. Importantly the first shipments of our new quadrivalent flu vaccine also provided a significant contribution with flu sales up 29%, to over £100 million. While the majority of flu sales were in Q3, we do expect further sales in Q4 and remember last year we sold almost all the capacity we had in Q3.

In Europe our Pharmaceuticals and Vaccines sales were up 5%. The reported growth does reflect the annualisation of a number of austerity measures and a weak comparator quarter, but it also reflects the benefits of the refocusing of our resources behind key brands, such as *Seretide,* down 1% this quarter versus down 6% a year ago, *Votrient,* which more than doubled and *Duodart*, which grew 27%. We are also being more aggressive in pursuing vaccine tenders and the improvement in the growth of vaccines up 4% shows the benefit of these efforts. Despite the clear progress we are making we do remain cautious on the region's overall outlook, due to the potential for future austerity measures as well as increased competition to *Seretide*.

In EMAP, the mainland China Pharmaceutical and Vaccines business was down 61%, reflecting the impact of the current investigation. Given that it is on-going it is too early to make any reliable assessment of the longer term impact.

Beyond China EMAP was also affected by the phasing of vaccine tenders which continued to be lumpy in the region and heavily phased to the fourth quarter. However the rest of the EMAP business continues to deliver with Pharmaceutical sales outside China up 5%, driven by good contributions across the portfolio, but particularly from Respiratory, up 9%, CNS up 19%, and Dermatology, up 9%, as well.

In Japan we saw another strong quarter for the Pharma business, up 7%, with particularly good contributions on the Respiratory portfolio, with *Advair* up 8%. Vaccines were down mainly due to the suspension of the Government vaccination programme for Cervarix.

On Consumer our top line growth of 4% was driven by growth in Europe up 6%,the Rest of the World Region up 5%. Despite a significant decline in China, where price controls and regulatory changes that we flagged in the previous couple of quarters, continued to affect *Fenbid* and *Contac* and reduced overall consumer growth by approximately 2% in Q3.

This is likely to continue to be a challenge for the consumer business through the balance of the year, particularly as price reductions in China are finally implemented in Q4.

The fourth quarter also faces a tougher comparator given the strong start to the flu season we saw in 2012.

On the costs side, at the operating level, our core operating margin in the quarter was 31.6%, which included an exchange loss of £49 million on the settlement of inter-company transactions.

Excluding currency the operating margin was up 3.1 percentage points and benefitted from the delivery of the specific restructuring initiatives we covered earlier, as well as our on-going cost reduction programmes.

The benefits of this particular restructuring fell mostly in SG&A, but also benefitted to a smaller extent COGs and R&D.

Cost of goods margin was up slightly: 0.4 percentage points. This reflects the continued unwinding of prior year costs of manufacturing shortfalls that I have previously flagged, as well as mix, partly offset by some lower write-offs, restructuring benefits and other cost saving initiatives. I continue to expect cost of goods to remain under some pressure due to mix, but also as we initiate commercial volumes of our new products.

Excluding currency the SG&A margin declined 1.9 percentage points with cost savings and restructuring benefits more than offsetting the continued investments we are putting behind the pipeline and other growth markets.

R&D expense at £791m for the quarter was a decrease of £91 million versus last year. This reflects the completion of some of our more significant late stage programmes, but also continued efficiencies in our R&D operations. I now expect that the full year R&D costs will be a bit below the total for 2012, which was 3.5 billion.

On the bottom-half of the P&L we have been able to continue to deliver on the funding side, with the net funding rate for the quarter significantly lower than last year due to the shape of the refinancing that we have completed. This has enabled us to keep our net financing costs broadly in line, despite the significant increase in net debt, given some of the acquisitions that we have made over the last period.

Our core income tax rate was 23.5% in the quarter, bringing the year to date rate to 23.3%. It looks now that we will do a bit better than the 24% we previously expected for the full year, but how much will depend on the final mix of trading during the fourth quarter.

We continue to focus on cash flow and operating cash inflows in the quarter of approximately £2.1 billion, reflecting strong conversation ratios. Working capital also remains a priority and we are eight days ahead of Q3 last year, whilst still driving significant improvements in service levels into our business and also putting significant inventory behind the pipeline launches in other growth markets. The remaining four days reduction is the impact of disposals.

It is early days, but the conversion cycle improvements are clear signs of the effectiveness of the supply chain restructuring that is under way. Receivables and payables also continue to improve.

Our strong cash flow enabled us to increase the dividend 6% for the quarter. The dividend clearly remains the priority, but we also see our shares as an attractive investment and so continuing to return cash to shareholders during the buy-back programme. We purchased nearly £1 billion by the end of the quarter and through the irrevocable mandate we had in place during the closed period we have been able to repurchase an additional £300 million of shares to bring the total to date to £1.3 billion. We continue to target being in the range of £1-2 billion for the full year. Remember there will be periods in the year when we are not able to be in the market, as you look at how that plays out over the balance of the year.

Before concluding I should remind you then in September we finalised agreements to dives *Lucozade* and *Ribena* to Suntory and also our two anticoagulant brands to Aspen. We can expect to complete these transactions in Q4 and together expect after tax proceeds roughly of £1.9 billion, which represents a very attractive return. The proceeds will be used to reduce debt in the short term, but will be incorporated into the group's available resources for future investment or shareholder returns. We also expect to record a substantial non-core gain on these transactions in Q4 and for modelling purposes you should assume the revenue of these products and these businesses drop out at the end of 2013.

Finally in summary, despite the impact of China, we continue to expect to deliver for the full year 3-4% earnings growth in constant currency terms on turnover growth of 1%. With that I'll hand it back to Andrew.

Sir Andrew Witty: Thanks very much, Simon. Very happy to open up the call to questions, please.

Question and Answer Session

Graham Parry (Bank of America Merrill Lynch): Thanks for taking my questions. Firstly on the pension benefit. Given you booked £395 million last year, you are only booking £267m this year. Am I correct in assuming that is about a 2% headwind for operating profit growth in 2013? If add in Vesicare of about 2% your guidance is implying underlying EPS growth more like 7-8% after we strip out those two headwinds. Then looking into 2014 should we think about other base to add pipeline growth onto, or would we expect that £267m benefit for this year to drop out next year and just be pure headwind?

Secondly on China, if you could just explain how the phasing of your business has gone through July, August and September? Which is the worst month? Is September starting to look a little better than August? Are we seeing any stabilisation there at all?

Thirdly, if you could quantify the European contracting benefits to pharma and the wholesaler benefit to wellness sales to consumer in the EU, just so we can track the underlying growth properly there?

Sir Andrew Witty: Thanks very much Graham. Simon may want to add a little bit, but your math on the impact of the headwinds of Vesicare and the year-on-year between the pension adjustment we made last year and the US health benefits programme we confirmed today, your math works out. We are obviously not going to give you guidance for next year, but your assessment of what the equivalent headwind is for 2013 makes sense.

China: I won't go into too much detail, but July August were worse than September. I wouldn't call that a trend yet. We want to see how October and November plays out. It is very clear that July and early August were particularly difficult for us.

I'm not sure I completely understood your question on Europe. Simon, did you understand?

Simon Dingemans: No. I was going to ask Graham to repeat it.

Sir Andrew Witty: Graham, you are going to have to bear with us and just repeat that if you wouldn't mind. [*Pause*] Okay, Graham if you want to ask again come back on and then we'll come back to it. I'm sorry, I just couldn't quite follow the thread of the question.

If we could move on to the next question then, please.

Tim Anderson (Sandford Bernstein): Thank you. If I can just go back to China and really how this might influence other markets outside of China either in emerging markets or developed markets.

In your press release you say you have notified the US Department of Justice and the UK's fraud office of the China situation and I'm wondering why you would feel compelled to do that.

The second question is on generic *Advair* in the US and the IP landscape specifically which has never been 100% clear to me because it entails both the drug and device and I know you guys talked about the last device patents expiring in mid-2016 but is it in the realm of possibilities that you will be able to exercise some sort of additional IP that could end up delaying generics beyond that? I would imagine you would be pulling all available levers here.

Sir Andrew Witty: Tim, thanks very much for the question. As far as communicating with various regulators, they are kind of a routine thing. We signalled that even at Q2 I think and nothing particularly unusual but absolutely the appropriate thing to do in these sorts of situations.

As far as generic *Advair* is concerned I have always believed there is much more to the genericisation of products like *Advair* than simply the IP environment and there are really in my view three discrete things that have to all happen.

One is obviously a clear runway from an IP perspective and as you well know and I think you allude to, we retain, particularly for the *Diskus* device, IP protection in the US through into 2016, so there is an issue around is there a clear runway on IP.

Secondly, are there clear guidelines about how to register such a product and thirdly, even if you have one and two, can you actually manufacture the product to the specs which have been agreed within the regulatory process?

What we have seen with a repeated number of putative generic competitors is that one or other of those hurdles have proved insurmountable for them and it's not always the same hurdle.

Now over time obviously the IP hurdles start to diminish by definition but those other hurdles still remain, and again even with things like draft guidance and I emphasise the word 'draft' so presumably it still has the potential to change from the FDA, there remains the challenge of whether or not people can manufacture. I think even if you talk to companies like AstraZeneca and you talk to companies like us, there have been times in our history

whereas the originator of the product we have had delays in product launches as we have made sure manufacture is absolutely where we needed it to be.

So we know those issues are real and I think the composite of all of that continues to tell me that this is going to take a while for anybody to get through. Certainly everything we are hearing from the latest frontrunners in the generic debate is that even they think this is multiple years away and whether or not they can ultimately get to a substitutable generic is in itself a further hurdle of uncertainty.

Now from where we sit, I will be honest with you Tim, our focus is moving on from the debate around will there or won't there be a generic of *Advair* and is much more focussed on the new portfolio of respiratory so if you think about where we are today versus a year ago, we have *Breo* approved, shipped, in launch phase in the US. We have it approved in Japan for asthma and we have it recommended for approval in Europe for COPD and asthma. The entire world, the major markets are essentially ready to go on *Breo.*

We have *Anoro* now at its very final stage with the help of a positive recommendation from Ad Com for the US. We have filed in the last few months our UMEC LAMA monotherapy. We filed today our monotherapy steroid. We are progressing very well with our Phase III programme for mepolizumab in severe asthma, we are going to be progressing that molecule into different disease indications you will see shortly and it's no secret that we are chasing down the triple combination opportunity as well.

It's really that portfolio which is going to be the future of the Respiratory business. I fully anticipate *Advair* is going to be a very substantial part of our future for a very substantial number of years, just as *Ventolin* is 40 years after we launched it and 20 years after we lost the patents so I really do feel today very materially more optimistic about what our long-term game plan has always been which is to remain the respiratory market leader and to grow market share over the next several years. That is all about confidence and delivery of the advanced Respiratory pipeline.

Tim, thanks for your question and next question please. I think Graham may be back on to clarify his Trivial Pursuit question. Graham, go ahead.

Graham Parry (Bank of America Merrill Lynch): It was a question about in your release you referred to in the EU seeing some contracting benefits in Pharma and then you also saw some wholesaler benefits to your Wellness sales in Consumer in the EU, both questions about the EU business. I was just wondering if you could quantify what those

benefits were both on the contracting side for Pharma and on the Wellness side in Consumer EU.

Simon Dingemans: I think on the Consumer side, we have seen over the last several quarters the European business delivering at low single digit growth and that is probably the underlying trend. We saw some stocking in the quarter reflecting that contracting position and some internal restructuring as well which we will unwind in Q4.

I think on the Pharma side it's less significant and not something that I think we should break out from an overall improved focus in the business which is driving the top line performance. In the growth of 5% that we have, if you want some guidance on that, that's running a couple of points ahead of the underlying trend in the quarter but it is only a quarter so I think the overall improvement you are seeing quarter by quarter really reflects the broader set of initiatives that we are putting into the business. So, hopefully, that is helpful.

Sir Andrew Witty: Thanks, Simon and Graham, for bearing with us to clarify it. Next question.

Andrew Baum (Citigroup): I have a couple of questions. First, US script trends for *Advair* and *Flovent* continue to deteriorate, I think they are about minus 8% now in volume terms. How much of that decline in volume in market share is just due to pricing pressure? I read the recent *Thorax Review*, highlighting the 75% increase in pneumonia with *Advair* versus Symbicort. How challenging is that for you in the marketplace? Following on from that, given *Breo's* greater redundancy in the lung and the pneumonia signal, how much will that be a challenge for you as you try to roll out that product? Perhaps you could also comment separately on the Express Scripts formulary restrictions and how we should be thinking about the impact on the marketplace over the next 12 months? Thank you.

Sir Andrew Witty: What we have seen on *Advair* over the last several years is gradual slow script volume decline, which bounces up and down according to where the market. So the market has slowed down a little over the last couple of quarters, that has just knocked that script decline down into the -4/-5% territory. At the same time, what we typically get are shifts in prescription size, which often brings that volume back up again. Then, of course, there are various price effects, whether that be list price effect or RAR effect. One of the things we have been very good at over the last several years is managing very carefully our discount exposure in the US particularly in *Advair*. That contrasts quite significantly to some other products in the sector.

On *Flovent*, similarly what you see with products like *Flovent* are swings as you see slightly more dynamic contracting. In *Flovent*, what we have seen during the year are some shifts where we have seen more exposure into Medicaid businesses, we have seen some shifts in and out interestingly, so early in the year we saw some shifts out of some commercial books of business. We have also seen some of that decision-making go back the other way in the last few weeks in our favour. Therefore, on these older, more established products in the US, you will see a lot of, not necessarily, quarter-to-quarter volatility, but you are going to see volatility over a 12-month period as the puts and takes of contracting play through.

That is one of the reasons why in the release I made the point that it is a more dynamic pricing environment in the US. There are more companies trying to use discounting in the marketplace, and you have to respond to that, and that is what you are seeing a little bit in some of these shifts as you go through. That makes it very frustrating for you to forecast, because you can win a block of business and it makes a big positive difference; you can lose a block and it can go the other way.

As far as the ESI decision-making, it is really important to understand what has happened here. First of all, for *Breo* we are on or ahead of our expectations for coverage in the US, making great progress in the blocks of business that really matter, particularly in Part D blocks of business. I often say to my team that it is the first time we have launched a product in the US where we have coverage before we start, because we normally launch very quickly after the NDA approval. Because we wanted to take our time to get everything right this time for *Breo*, particularly in making sure we had enough volume and batches manufactured to go, it gave us a bit of a window to get some coverage in place before we start, so we are launching into an environment which is much more positive than we normally do at this stage, and I have been very pleased with that.

Now ESI, and I think this is a feature of the dynamic of that marketplace, has decided to introduce a very high control formulary for a subset of its patient population, not for all of its patients: somewhere between perhaps a quarter and a third of its patients may be affected by this. What they have done is look at all the major products, including products in other categories like diabetes, where they are looking to try to drive some opportunity for discount. The question is whether or not those high control formularies are going to drive huge amounts of change in the marketplace. History tells us from other people who have done that that it takes a long time and does not always move the share that is anticipated but we have to wait and see how that plays out. Within the overall potential for *Advair/Breo,* this remains a small part of the overall number of lives covered. As I said, we are feeling very confident about the *Breo* coverage as we stand.

As far as the data you described, I am guessing that refers to one of the AstraZeneca-sponsored studies done in Scandinavia, and I think it is called Pathos but, if I am incorrect on that, obviously come back but I am guessing you are talking about the Pathos study. We do not believe that is really indicative because, first of all, it was a retrospective study. Secondly, it looks at a part of the world where, for obvious historic reasons, the non-*Seretide* product in the class dominates the space. Therefore, we believe that there is almost a selection bias which happens in that trial where our product ends up being used by people who are potentially more severely ill. As a result of that, we are not convinced that it draws any particularly important or relevant conclusion. Obviously, Andrew, if you are talking about a different study, you should get in touch and we can talk about that more off line.

As far as *Breo* is concerned, from the overall FDA review of all the data that have been generated, we feel confident that we have a very effective medicine with an appropriate risk/benefit described in the label. As is always the case with GSK, we shall make sure that the balance is properly communicated to the prescribers but all of the sensation we get so far is that the balance of all the aspects and features of this medicine is something that is very attractive to potential prescribers. We are thrilled to be in a position to launch it right now, hard on the heels of three other launches in the US which have already started successfully. With that, next question please.

Mark Clark (Deutsche Bank): Good afternoon. I want to ask a question about China. Regarding the 61% reduction, is there any way you can give us some feel as to how much of that is due to inventory rundown by scared wholesalers, if you like, how much is end user demand collapsing? I am also interested in the fact that some products one would expect to lose share to directly competing products, for example *Advair* to Symbicort, I am sure we could all have guessed that they would lose out. Some of your products are essentially the standard of care, yet those are also highlighted in the statement as having fallen sharply. I wonder if you could just talk us through some of the dynamics just so we can at least make our own assumptions as to the scale of any rebound?

Sir Andrew Witty: Thanks, Mark. I won't go into a huge amount of detail, mostly because I think it is premature to call a trend here and there is a lot of potential volatility. As I signalled earlier it was worse at the beginning of the quarter than at the end, but again I am not going to call that as a trend, it is just a fact.

A couple of things just to be aware of. You will all be aware that some time ago, a year/perhaps 18 months ago, China changed the pharmacopoeia for vaccines, which

affected many importing companies, including our own. What that meant was a number of vaccines were no longer able to be imported because of the pharmacopoeia changes; it has absolutely nothing to do with the events of the last three months. That alone accounts for about 15% of the decline we have seen in this quarter. A chunk of this, although we have characterised appropriately the total decline in China, a chunk of this is clearly nothing to do with these events.

If you then look into the rest there is clearly a de-stocking effect. The problem we can't tell you really what that truly is. Data doesn't exist in China in the same way it exists in the US to be able to call out inventories, but it is clear there has been a destocking effect. We can only really get to the bottom of what that looks like over the next six to eight weeks, where what we see through September/October/November, perhaps even December, really will start to give us the proper trend of what is going on. Very hard to call it out beyond those guidelines. It would be misleading for me to get into more specific analysis because it is just as likely to be noise in the system as something real. It is as frustrating for me as it is for you. Next question.

Andrew Kocen (Redburn): Hi there. I have a couple. One on SG&A, which grew pretty strongly on an underlying basis if you exclude the provision reversal. Is that down to launch cost? If it is how long should we expect the bulge to last for? Then secondly on R&D should we expect another update on your IRR from R&D at the full year results now we are a couple of years on from the last one? Also how do you really feel you have delivered in terms of genuine innovation? Apologies for this, it feels churlish with all the launches you have this year and I am not saying you haven't delivered, but clearly the innovative, scientific, risky products that you have pursued over the last couple of years have tended not to work and the ones that you are launching now, whilst important have not really been that novel in terms of mechanism. Philosophically how do you feel about your R&D going forwards?

Simon Dingemans: Let me take the SG&A question. A little bit in the same vein as the benefits that we have delivered on the medical side I wouldn't focus too much on the individual quarter. If you look at the nine months you are broadly flat on last year in terms of overall SG&A expense. That is being driven by recycling of the savings we are making out of our on-going programmes as well as some of these particular initiatives that we have identified to give us the flexibility to support the pipeline launches without a big bolus or ramp-up in expenditure, as we have talked about a number of times. I would step

back from the quarter and just look at the underlying trend, which is broadly steady and that is probably what you should think about going forward.

Sir Andrew Witty: Thanks, Simon. Andy, as far as R&D is concerned yes, we would intend to do an update on the rate of return analysis for the full year. As far as how innovative or not have we been, the reality is it is a portfolio, isn't it? We have developed over the last several years what we think is a balanced portfolio. We all know and in fact Glaxo in the '90s fell into the trap of having a portfolio which was all unprecedented mechanisms. I remember an era when we had medicines in there for stroke, cognitive function, etcetera and they all failed and partly created one of the big gaps in the company's history. We can all think of other companies, competitors of ours, who have been very dominated again by unprecedented mechanisms and had sequential failures of very late stage developments which then went on to cause great strategic challenge for those companies.

It is important to have the blend. What is then critical is that within the blend everything creates value for the patient and for the payer. That is where you have to really look at the GSK portfolio and you have to give it some credit for that. Yes, *Breo* isn't a first-in-class product, but it addresses the two or three fundamental needs that we know patients are really striving for in COPD who are using inhaled therapy. They want basically a full, 24 hour duration of action drug. They don't feel that exists in the marketplace and they want it. They want devices which are easier to use and that is what we have striven to build into this. The data which will potentially really define this product will come with things like the SUMMIT study, but by definition that can't come before we start, but the investment we are making there demonstrates the confidence we have in the potential of this drug.

If you look at *Anoro* it is a first-in-class. Okay, it uses two mechanisms which pre-exist, but nobody else has been able to put it together at the speed we have and be able to get it at the stage of development it is for the US marketplace and again demonstrates an ability to leverage our skills to create value, hopefully for patients in the US an extraordinary contribution to COPD.

If you then say "Okay, let's look at the rest of the portfolio", the MEK inhibitor is a first-in-class; unprecedented mechanism, first-in-class. BRAF is a second into market. These products must have something to say for them, because in the first 12 weeks of marketing we have taken 50% market share of new prescriptions, so presumably somebody sees some therapeutic value there. I believe they have remarkable benefit as individual treatments for melanoma.

If we look at *Tivacay* in HIV, widely now regarded as being a very substantial breakthrough in terms of quality of asset. Yes, it's the second into its category but as we have seen many, many times before the second or third drug is very, very often superior. What we have seen is in head-to-head trial after trial after trial great data coming forward, so again very positive.

If I then flick down the list of what's coming and you start to look at things like mepolizumab, looking at that within severe asthma as well as the new indications which we are just beginning to move in towards Phase III, if we look at the P38 kinase inhibitor for ACS, if you look at darapladib, if you look at the MAGE-3 programme, if you look at our new oral med for malaria vivax, if you look at our programme for threatened pre-term labour, retosiban, oxytocin receptor antagonist, if you look at our work in amyloidosis, if you look in our anti-TNF mAb, all through the pipeline you will see drug after drug after drug which is either a very thoughtful, substantial clinical enhancement of what pre-exists or is going into an unprecedented area.

The bottom line is we have a very, very substantial pipeline which as a portfolio we believe creates the opportunity for great value creation over the long run. If you look at the thing that really matters, which is how much of this asset portfolio makes it to the finish line, then you can see that whether you look on a one-year basis where we have had four major NDA approvals – the next best performing company only has two in 2013. If you look over the last eight years where we have had 17 major NDAs approved in the US of which I think 11 are new molecular entities, that's really the track record that we are looking to deliver and that's why I think we are going to deliver an improvement in our rate of returns as we are bringing these projects through to fruition with profiles which can underpin confidence for future sales.

Next question.

Jeff Holford (Jefferies): Hi. Thanks for taking my questions – just two. Just on relative pricing of *Advair* and *Breo in the US* market, can you give us any more colour on how you expect to proceed here going forwards now with the launches getting underway? Do you intend that you keep these on parity pricing with each other? Are there any initiatives like couponing which you will particularly apply to *Breo* to help force some switch there?

Also just to relate to some of your comments earlier, Andrew. Now you have a bit more visibility on your disposal gains coming through you sound a bit more cautious than usual in terms of increasing the buy-back more aggressively, at least through to the end of

this year anyway. Is that just to do with the timing of when the proceeds will be received or does it reflect any slight shift in sentiment on capital allocation from you as you gain from disposals? Thank you.

Sir Andrew Witty: Thanks very much. I think on the latter, no shift in our mind-set because of the capital allocation and I have said repeatedly that while again we are not giving you guidance for next year, I think you should be surprised if we gave you any guidance different on share buy-backs than we have given you for the last two or three years. We are very, very comfortable with the notion of starting the year saying 'Look, we are going to buy back between one and two billion'. That sometimes proves quite difficult to do when you have very, very busy regulatory years like we have this year. But the intent absolutely is to continue to lean into the buy-back at a nice, steady pace and not create lots of drama and noise in the buy-back space, but a nice steady pace combined with a commitment to constantly increase the dividend. That is exactly where we're going.

You are quite right that the proceeds of these disposals won't come until the end of the year but the reality is no change in terms of our I think balanced, sustainable commitment to how we use capital and most importantly reaffirm the signal that we are not in the business of creating reserves of capital to go do some major acquisition. We remain very much of the view that we are tilted toward the seller rather than the buyer of assets. It doesn't mean we will never buy an asset or invest in a business that maybe we already partially own, but as you have seen over the last 20 months or so, we have been very much a divester rather than an acquirer. Why? Because we want to continue to improve the quality of the company as the pipeline and the Pharma Vaccine business portfolio strengthens, take out complexity, take out low margin businesses, take out businesses where we believe that others may be better owners than we are at a time when we have a tremendous amount of opportunity to prosecute in the Pharma Vaccine space.

That's really the position that we have on that. Next question.

James Gordon (JP Morgan): Hello, thanks for taking my questions. This is James Gordon from JP Morgan. The first question was just following up on the response about the use of divestment cash.

I was wondering, do you worry about fines and that might mean that you need to carry a larger than normal cash buffer? What's the right level of net debt for GSK or how much cash do you actually need to carry?

One other question was on emerging markets, and if we exclude China, EMAP Pharma and Vaccines grew 2% this quarter but what is the realistic run rate for Q4 and for next year if we exclude China?

Just a final question which was it is about a year after the HGSI acquisition. *Benlysta* growth has been good for the US but not doing much for outside the US, so my question there would be I suppose how should we see this acquisition and do you think *Benlysta* is going to accelerate a lot now? Is it going to become a very material product for GSK and I suppose the other part of the HGSI acquisition, or one other part, would be the not having to pay royalties to HGSI.

So for albiglutide what are the plans there in terms of is that something you see you are going to sell yourself or partner with someone?

Sir Andrew Witty: Okay James, we will try and cover all of that. As far as fines, what's important and the number you should be looking at is what legal provisions we take. Our obligation, quite rightly, is to make sure that we have provided in our accounts for what we believe to be the most likely outcome of liabilities for the company, whether they be legal or any other liability and we review that regularly at every quarter and we make adjustments up and down according to that.

So that signals to you what our composite view is of our legal liabilities and I think this quarter we are holding a legal provision of about £750 million, something like that. Within that, that covers a whole raft of things. I would say that that is at the low end of where it's been for the last several years because we have resolved a huge amount of litigation over the last few years.

We can't give you any guidance on EMAP growth rates because that would be guidance. We will wait and do that in February and we will decide what we share with you at that point. It is fair to say that EMAP growth rates remain slightly volatile quarter-to-quarter, mostly because of vaccines. There is no question, just as we have seen in the last several years, that you should anticipate Q4 being a substantial vaccine quarter for EMAP, because that is just the way the customers choose to order the product.

As far as HGS is concerned, *Benlysta* has had a slow start ex-US, but it is beginning to build up to a quite nice momentum, particularly in Europe. Interestingly enough we have seen a very similar phenomena with *Prolia*, the drug we partner with Amgen. Very slow to start; very prolonged period of market access negotiations, but gradually beginning to get in place and beginning to see some quite nice movement.

I think we will now start to see, particularly through ’14 and ’15 *Benlysta* start to move up in Europe. I have been very pleased with the continued progression, as you highlight, in the US. It is also worth remembering we bought HGS for a whole variety of reasons, one of which was *Raxi*, the monoclonal they have for anthrax, which as we announced earlier in the year we have secured a whole series of quite important business opportunities in terms of stockpiling. We have achieved all of our synergy goals and, of course, we have taken full control, not just of *Benlysta*, but of darapladib and, of albiglutide.

We continue to explore opportunities for partnership with albiglutide which may be different region-to-region. We will update you when and if that is appropriate. Albiglutide is obviously the sixth of our six key assets that we profiled. We are expecting a regulatory decision towards the end of Q1 of next year so it gives us a little bit of time to finalise exactly what we are going to do there.

I have to say, given all the data we have seen through the eight studies I think our potential positioning for this drug looks very compelling and I think it is a product that we are increasingly motivated and excited about. Next question.

Keyur Parekh (Goldman Sachs): Good afternoon. Thank you for taking my questions. I have three, if I may? First Andrew, I notice you are talking about pricing pressure in India in addition to what you are facing in China. Can you help us think about the possibility for further pricing pressures across the rest of the Emerging Markets?

Secondly, for Simon, as you look at the on-going benefits from the cost reduction and substantial benefit you are getting this quarter, how should you think about the on-going benefits on this service cost?

Thirdly, Andrew, as you launch the respiratory products, what is going to be the marketing message? Are you looking to switch patients from *Advair* to *Breo*, or should we think of this is more as an opportunity for new patient starts? Thank you.

Sir Andrew Witty: Thanks very much. As far as India is concerned, as you know there has been a new price control regulation brought into India. That has affected a whole raft of companies. Of course, as one of the biggest companies, with some very big products we have been affected by that. That is going to take the next couple or three quarters to really wash through the system and you are going to see some adverse quarter-on-quarter comparisons as those price cuts come through. It is also worth remembering that some of the products which were in the old price control system will now be able to have

price increases; not immediately, but in the future, so again, GSK had a lot of products in that old system. There are going to be some puts and takes there.

The key to India is the key to the whole price question for Emerging Markets, which is understanding what the volume elasticity of demand is. The reality, of course, is that India in particular, almost every product we sell has multiple generic copies out there, very often sold at lower prices than our own. It is highly likely that as we see prices cut, we are very likely to see volume go up, because if you had the choice between the generic and the lead brand in a market like India we are going to see increase volume demand for the product. What you will continue to see is governments intervene periodically on pricing; I don't think that is unexpected or surprising. I continue to believe that the underlying demographic momentum of most of these countries means that over a period of two or three years very often the volume compensates for that price effect. You just have to realise that over the period of a decade you are going to have two or three rounds of price interventions at different points. Simon, if you want to answer, then I will come back to the respiratory question.

Simon Dingemans: In terms of the on-going benefits as well as the particular benefit we reported this quarter if you assume a few tens of millions you are probably in the right sort of territory. Remember, each of these produces similar kinds of savings, so they build up over time.

The other important thing to remember is it also addresses significant balance sheet liabilities, which require cash funding over time, as you agree the valuations of those. It is reducing the volatility of those requirements and leaving us cash free to invest elsewhere or return to shareholders. There are a number of benefits from these programmes.

Sir Andrew Witty: I would just like to add to this and complement Simon. Right from when I first announced Simon's appointment and people asked me why we had hired Simon, I explained I wanted him to focus on a number of things in the business, but also to address a) our tax strategy b) our interest rate exposures and c) our long term financial exposures, and at the time I talked about pensions. Simon has done a fantastic job over the last two or three years on all three of those dimensions.

On this latter piece, of these significant long term costs which, frankly, many companies have not tackled – this company hadn't tackled for a long time, what you are seeing is a programme year after year now of taking on these big areas of day-to-day P&L costs, but also significant balance sheet liabilities which needed to be addressed. We planned last year to do the UK pension environment, which was a very difficult thing to do. We did that. We planned this year to do US healthcare for folks who are still in employment, but who are going to retire in the future. We have other things that we have planned for next

year and it seems to me completely right that we should be putting in place a very sustained programme, not just to tackle the things we can turn on or off in a quarter but to really fundamentally get a grip of the shape of some of those cost areas, which are not talked about very often on these calls and that represent enormous expense for the company and, in some cases, can create almost unlimited liabilities in the long run. I just want to congratulate Simon for extraordinary leadership in delivering this. That is one of the reasons why, just like in two quarters last year, we have another quarter this year where, unfortunately, we had this slightly lumpily phased benefit but it is part of a long-term, multi-year programme, and I would guide you to expect more of these sorts of things over the next few years.

As far as the question you asked about Respiratory, I shall not go into the detail of how we are going to compete with *Breo*. It is obviously a very competitive marketplace but it is fair to say that the benefits we believe that *Breo* brings will be interesting not just to patients who are on *Advair* but to new patients coming into the marketplace, and to people who are on other competitive products. This is the first once-a-day product and it is a 24-hour duration of action medicine. We know that is something in which many patients and physicians are interested, and having combined that with a very easy-to-use device, we believe that we have here something that will be very attractive to physicians and to patients. I guess we shall see over the next six, nine, 12 months what the reaction is in the marketplace but it is a very exciting time at GSK to have hard on the heels of two new cancer drugs, an HIV drug and now a respiratory drug all launching in the US marketplace. We have time for one last question?

Kerry Holford (Crédit Suisse): I have three questions please if I may. You just hinted there, Andrew, about further restructuring plans for 2014. I wonder if you can give us any more detail on what they could be: could they be as sizeable as those we have seen this quarter? Then really a conceptual question as to whether they should be treated as core within the core earnings going forward? You also touched earlier on the destocking, particularly in Respiratory in the US. Do you think that is likely to reverse in the fourth quarter, or is it something that is unlikely to change going forward? Do you think that the US wholesalers are now just happier to run with lower inventory levels for many of these Respiratory drugs going forward? Lastly, can you confirm whether you have recruited more sales reps ahead of the US *Breo* launch, and do you plan to recruit more ahead of the *Anoro* launch early next year?

Sir Andrew Witty: Thanks, Kerry. On a couple of those points, first of all we are not talking about restructuring. It is a restructuring of the way we treat things like benefits, so there are no big costs associated with it and I don't want people to be confused that there are big costs associated with these changes in the way we would normally talk about restructuring. I prefer the word "reshaping" the long-term cost profile of the business. We have a plan for more of these things next year, I am not going to tell you what they are just yet for some obvious reasons I think. [This year's benefit is somewhat lower than next year's and we shall potentially give you some sense of that next year]*. Simon, you might want to add to that and why don't you make a comment on the core earnings, and then we shall come back to the other two.

Simon Dingemans: As Andrew has highlighted, they are not restructuring in terms of charges and savings from fixed costs as the OE programme or our major change programme would be. This is about changing the nature of benefits we are providing in the future, and the savings arise, therefore, from the accrued savings that you make over time and those are to the core P&L. Those charges would otherwise flow through the core P&L, so we believe it is only appropriate that the savings should flow through the core P&L. That is how we thought about it last year, this is very much more of the same. What we plan for the future will be treated in the same way as well.

Sir Andrew Witty: Thanks, Simon. Just on the last couple of points, the destocking we have seen has been pretty sustained over the last 12-14 months. It is not clear to me whether or not it will restock in the fourth quarter. We have often seen restock trends in the fourth quarter but, for example, last year we did not, so we just have to wait and see what plays through on that front. What has been interesting over the last six or nine months is we have seen some destocking both at wholesaler and retail level. We are seeing a lot of these companies talk about cash management, so it wouldn't surprise me if this is a bit more permanent than temporary but, again, we just have to wait and see what comes from that.

As far as our sales forces, if your real question is should you expect a big jump up in SG&A because we are going to hire a lot more people, the answer is no. We feel that we have the right overall scale of operations to deal with the products we are launching at the moment, including *Anoro* if we are able to get approval at the end of the year.

**This year's benefit is somewhat lower than last year's and we shall potentially give you a sense of next year's benefit in due course.*

I would say that we have reconfigured, as you would expect, our deployment of resources in the US as we move from the older portfolio to the new portfolio. I shall not quantify that but I can tell you there are substantially more people involved in our Respiratory business now than there were a year ago. More importantly, we have reconfigured over the last four years our entire US operations to be much more, we believe, aligned with where the modern customer dynamic is really going in the US. We believe that, combined with our innovative incentive system, puts us qualitatively in a different place to many of our competitors in the US.

From the launches that are under way, the success we have had with MEK and BRAF, the initial progress we are seeing, although very early days, in HIV with *Tivicay*, and we shall see with *Breo*, so far so good in terms of really, really testing whether or not our new approach to the US marketplace will work. We are very encouraged by the early signals and incredibly excited that we have the first once-a-day steroid bronchodilator combination so far ahead may be there will never be another once a day product, as far as I can see from other companies in the US and right hard on the heels of that we have the potential to get *Anoro*, so the opportunity to completely step forward in the US is there and I am excited to see the early results we have coming in. We will see how it plays out, it is very early days, we are not taking anything for granted, but I can tell you we are totally focused on making the most of these opportunities.

With that I am going to thank everybody for their attention on this call and if you, of course, have individual questions the IR Team at GSK is at your disposal. Thank you.

[*Ends*]