

GSK

Simon Dingemans

Hello and welcome to this discussion of GSK's first quarter results for 2015.

We have issued a press release today setting out in detail our views of the prospects for the Group now that we have completed the three-part transaction with Novartis. This has achieved a major reshaping of GSK that has significantly improved our ability to deliver sustainable growth over the longer term provided we maintain our flexibility to invest and deliver on the many value opportunities we see in the integrated business.

In the short term, however, the transition to our new shape will create some additional pressure on our reported results which are also being impacted by the ongoing transition of our respiratory business. 2015 will effectively be a re-basing of the Group's business as a result, given that we continue to expect our respiratory business to return to growth in 2016.

The results for Q1 that we have also released today reflect some of the transactional impact but it will become more significant over the balance of the year given we only closed the transaction at the beginning of March.

Today in London, we are hosting a meeting, which will also be webcast, for investors and analysts to hear directly from the leaders of our re-shaped Vaccines, Pharma and Consumer businesses as well as from Andrew and me. As you can see from our release today we have re-cast our reporting to allow you to see much more clearly the performance and profitability of the three businesses going forward. A video replay and transcripts will be available for you on our website shortly after.

The focus of the meeting later today will primarily be on the future outlook for the Group in its new shape.

For now my aim is to provide my usual commentary on the quarter.

I'll start with how we will report this year.

On 2 March we completed the transaction with Novartis.

Our Q1 2015 results include oncology sales for two months compared with Q1 2014 results that include three months. This will negatively impact the reported growth for our Pharmaceuticals business. Similarly, the 'reported' growth for our vaccines and consumer healthcare businesses benefited from having one month of sales in 2015 from the businesses we have just acquired.

In addition to 'reported' growth rates, we are providing pro forma growth rates for sales and margins down to the core operating profit level. For Q1, the pro forma comparison subtracts March 2014 oncology sales from the base and adds March 2014 sales for the vaccines and consumer products acquired. This should provide a better indication on an apples to apples basis of our run rate.

Given the various assumptions inevitable in any pro forma comparison, we have decided that any specific guidance should be given on a reported basis only. So, when we discuss our financial guidance for this year it will be on the basis of comparing our expectations for Core EPS with what we actually reported for core EPS in 2014. As usual, any growth comparisons will also be on a constant currency basis.

Moving onto our performance.

Looking at the headline results for Q1, total sales were up 1% on a reported basis while core EPS was down 16%.

This reflects the various pressures and comparator issues for 2015 that we have been highlighting for some time. This also includes ongoing pressure on our high-margin Advair/Seretide business in the US and Europe, generic competition to Lovaza in the US, the tough comparator in Japan for Q1 due to 2014 stocking patterns, and the changing mix of our business.

On the positive side, our Consumer Healthcare business had a very strong quarter, helped by the launch of Flonase OTC in the US. ViiV h Healthcare had an excellent quarter too with the dolutegravir products continuing to build momentum. Vaccines also grew on both a reported and pro forma basis.

Let me now go a bit further into the detail of the sales performances for each of our businesses.

As usual my comments are focused on CER growth and on core results.

Sales growth analysis

Pharmaceuticals excluding vaccines

Total Pharmaceuticals sales were down 7% in the quarter.

Excluding the March 2014 oncology sales, pro forma sales were down 5%.

US

In the US, sales were down 21% pro forma and this mainly reflects lower sales of Advair down 21% (an 8% headwind in the quarter); and, lower reported sales of Ventolin and Flovent (which together represented an additional headwind of approximately 6% in the US

region). The reported growth rates for both Flovent and Ventolin were negatively impacted by true ups for rebates in 2014 and 2015.

Established Products sales were also down significantly (a 9% headwind) driven primarily by Lovaza generic competition. The impact of Lovaza should start to annualise out from now - given generics started in April 2014.

Breo sales doubled to £14 million and Anoro had sales of £9 million.

While we have made progress with our new respiratory products and Advair's reported decline was broadly in line with expectations, we still have more to do and we are making a number of further changes to our sales coverage of our key respiratory products to improve on execution.

Europe

In Europe, pharma sales were down 3%, primarily reflecting lower sales of Seretide, which was down 11% as competition intensified and also our transition to our new portfolio. Established product sales were also down 14% due in part to ongoing generic competition but also some supply constraints.

Relvar had sales of £16 million, offsetting about half of Seretide's decline, so we are starting to build some traction with Relvar in the region. Anoro launches are at a very early stages in about half of the countries in Europe and there will be more as the year progresses.

International

International sales were down 4% on a pro forma basis, mainly due to lower sales in Japan, which were down 8% pro forma.

Sales were down in Japan due to a tough comparator with Q1 last year which saw significant wholesaler stocking last year ahead of a tax increase in April 2014. Also a large government Relenza order in Q1 2014 did not recur this year. Despite this, total respiratory sales were up 1% as Relvar continued to build momentum following the lifting of the Ryotan restrictions, offsetting almost half of Adair's decline of 27%, which benefitted significantly last year from wholesaler stocking. Seasonal products made up the rest.

Sales in Emerging markets were down 1% pro forma. Growth in several areas including respiratory was more than offset by the impact of disruptions in some countries in the Middle East region and lower Established products sales, due to both the phasing of shipments and some supply constraints. Seretide was up 6%, with strong growth in China.

Regarding supply for Established products, both Europe and Emerging markets have delivered very significant volume growth in recent years and our ability to support ongoing volume growth without interruptions is now being impacted by capacity constraints and various bottlenecks in the supply chains. We have increased our investment to improve this, but in the near-term we expect periodic constraints and interruptions that will impact our ability to maximize the potential of the established product portfolio in both regions.

ViiV

For ViiV Healthcare, sales grew 42% with strong growth in every region. Tivicay and Triumeq sales are continuing to build in all markets where the drugs have been launched. Our expectations of the overall potential of these products has continued to grow and is a key reason for our decision announced today that we will retain our control of ViiV and do not intend to move towards an IPO.

In the quarter, the US was up 66%, Europe was up 35% and International up 9%. Tivicay has now been launched in 39 markets and Triumeq's launch has begun in 15 markets. The launch of Triumeq in Japan will be getting underway in Q2.

Vaccines

Turning to vaccines, overall vaccines grew 10% on a reported basis, 3% pro forma.

US vaccines grew a strong 11% pro forma, driven primarily by Hepatitis which benefitted from CDC stockpile movements and other wholesaler restocking. Infanrix was down 13% reflecting the return to the market in 2014 of a competing vaccine.

In Europe, vaccines grew 4% but were down 3% pro forma. Strong growth from Boostrix was more than offset by lower sales of Infanrix which encountered new competition during 2014, as well as the phasing impact related to a Cervarix tender.

International sales grew 3% pro forma primarily due to benefits of phasing of shipments between the two years.

The second quarter will represent a more difficult comparator for vaccines partly because EM had a strong Q2 last year when it grew in excess of 20%. Also, the business is operating with some volume constraints. We have been investing in significant new capacity to meet the strong demand for our vaccines but the timelines to bring on new capacity are long and delivering the improvements will mean some short term supply constraints. This avoids having to take whole facilities down but will impact the vaccines business throughout 2015 and 2016 in different regions at different stages but particularly Europe and the Emerging Markets where we have the broadest product ranges.

Consumer

Consumer Healthcare sales were up 24% in Q1 2015, up 8% pro forma.

Growth was helped by very strong results from the US launch of Flonase and the brand contributed approximately half of the growth in Q1.

Oral care also delivered a very strong performance with strong innovation introductions in the Sensodyne range and improved supply.

Oral care along with Skincare delivered strong growth in International sales but overall pro forma performance was constrained by tougher competition in Wellness and some destocking for Horlicks in India which was up 4% even though consumption growth for this product in the market was still double digit.

Operating profit margin breakdown

Moving to operating profit, the overall core margin for Q1 was down 4.1 percentage points. Exchange had no material impact on the core margin in the quarter.

The impact of the Novartis transaction was a negative 120 basis points, even though the transaction was only completed one month before the end of the quarter. This reflects the disposal of the higher margin oncology products and the acquisition of lower margin vaccines and consumer businesses. This also includes the impact of a higher than expected cost base that we inherited particularly in the Novartis vaccines business.

You will recall that I have flagged that before we deliver cost savings synergies, the change in the mix of the business from the Transaction was expected to put significant pressure on the operating margin of around 200 to 300 basis points in a full year. Seeing the impact, albeit after just one month, I continue to think this is a reasonable expectation for the full year, with the impact likely to be at the top end of this range given the higher costs that we are starting with.

On a pro forma basis, that is excluding the impact of the transaction, the core margin was down 290 basis points. This primarily reflects adverse price and mix movements including the decline in higher margin US Pharmaceuticals sales, the cost of supply chain improvements in vaccines, and also investments in launch capacity.

As we progress through the year, we expect to offset some of these pressures through the delivery of incremental annual cost savings totaling approximately £600m in 2015 and an additional £700m on top of that in 2016. This includes Novartis synergies and is after taking into account the impact of the £219m of structural savings that we delivered in Q3 2014 that will not recur this year.

In our earnings release you will notice that we have added additional details regarding the operating margin performances of the separate businesses. And we are now showing operating margins for each – after R&D costs so that they are clearly comparable.

Looking at the full year 2015, I expect the combined impact of the various margin pressures net of total incremental savings to result in a bit more pressure than we saw in Q1 as we get a full year's impact from the Transaction mix shift. A reasonable expectation is overall around a 500 bps decline.

Financial efficiencies

Moving down the income statement, looking at financial efficiencies, we continued to deliver a low funding rate on our net debt, and net finance expense was £156m down from £161m in Q1 2014.

Profit from associates was £7m vs £1m in Q1 last year. But now that we are no longer accounting for Aspen as an equity affiliate, following the sale of half of our shares for around half a billion pounds in March, we expect this line to be immaterial for the rest of the year.

The core effective tax rate was 20%, down from 22% in Q1 2014, but in line with the full year rate in 2014. I continue to expect the full year rate for 2015 to be around 20% having now reflected the impact of the Novartis businesses into our planning.

Net Debt

Our net debt at the end of the first quarter was £8.1 billion, compared to £14.4 billion at the end of 2014.

This primarily reflects:

- o £10.1 billion equivalent of proceeds from the sale of our oncology products. The taxes due on the gain have not been paid yet but are expected to be paid over the balance of the year.
- o It also reflects £3.3 billion equivalent net paid to acquire Novartis' business.
- o And approximately half a billion pounds of proceeds from the sale of part of our Aspen stake.

Dividend payments to our shareholders in the quarter totaled £924m.

Net cash flow

Turning to cash flow, the adjusted cash flow from operations for the quarter was £532m, down £436m versus last year.

Approximately half of this reduction relates to spending on our various restructuring initiatives, which we have stepped up significantly and where we have started to accelerate our investment in order to deliver the annual targeted savings faster than previous planned.

The balance of the reduction reflects the decline in underlying performance of the business and the operating margin pressures I have already discussed.

Working capital investment in Q1 reflected the normal Q1 build of about one day and a five day net impact from the Novartis Transaction net of currency mainly from additional inventories inherited in the Vaccines business.

Full year outlook comments

Looking out for the full year 2015, we expect core EPS to be down a high teens percentage on a constant currency basis.

This reflects the ongoing transition in our respiratory business and the significant additional impact on our operating margin of the change in mix from the transaction and the greater minority interests that we will now carry as ViiV and the Consumer JV grow.

This guidance includes an estimated dilutive impact for 2015 of approximately 6 to 8 percentage points from the transaction due to several factors that have changed since we originally agreed terms with Novartis.

First, as a result of the timing of completing the transaction, the expected ramp up of synergy delivery has pushed a significant part of the expected benefit over the first 12 months into 2016, given that the plans always expected that the last few months of that first period would be the heaviest contributors.

Second, as I mentioned earlier, now that we have seen the 2014 results for the businesses we acquired, we have inherited a higher cost base particularly for the vaccines business. We have plans to get at those costs but it will take time to do so hence the negative impact on 2015.

Thirdly, to secure regulatory approval and complete the transaction we agreed to divest products with about £100m in sales.

And last, we have decided not to use a b share scheme and consolidation to return proceeds from the transaction to shareholders, so EPS will not reflect the benefit of a lower share count. This change has about a 5% dilutive impact on a full year but about a 2-3% impact on 2015

Given that many of these elements are about timing, we do expect them to swing back in 2016 although the removal of any share buyback benefit and the impact of the regulatory disposals will remain. Despite this, we expect the momentum behind the transition in our existing business and the newly acquired Novartis businesses to deliver strong core above trend EPS growth in 2016 that should be able to reach double digits.

Capital allocation and cash returns to shareholders

Today we have also announced the output from our recently completed review of our capital allocation strategy for the new Group following the completion of the Novartis transaction.

We are committed to maintaining our current credit ratings.

We are also prioritising as part of that review our ordinary dividends to shareholders and accelerated investments to support more rapid delivery of synergy benefits and other growth opportunities in our portfolio.

As a result, we have announced that we plan to pay an ordinary dividend of 80p per share annually over the next 3 years (2015-17).

But we also want to ensure we maintain the flexibility to deploy capital in response to certain events, which may or may not occur over the next several years. Specifically these include the potential exercise of 'put' options by partners in ViiV Healthcare and in the Consumer Healthcare JV; and the possible introduction of a generic version of *Advair* in the USA is also factored in.

Accordingly, we have decided to reduce the planned return to shareholders from the net proceeds generated from the Novartis transaction. We now plan to return £1 billion (approximately 20p per share) to shareholders via a special dividend which will be made alongside our ordinary dividend for the fourth quarter.

Any future returns to shareholders of surplus capital will be subject to the Group's strategic progress, better visibility on the put options and other capital requirements.

We believe these decisions support the long-term interests of shareholders.

Please see our press release and tune into our meeting later today for further discussion of the Group's outlook for the future.

Thank you for listening today and as always our investor team is available to answer any follow up questions that you might have.

Thank you.
