GSK Capital Markets Day: Haleon

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Tobias Hestler – CFO Designate of Haleon

Haleon: Committed to delivering attractive and sustainable growth, maximising shareholder value

Thank you Teri.

I am sure that by now you have been able to get a sense of the group's strengths, and why we are excited about the future.

I'm Tobias Hestler, CFO Designate of Haleon and I have over 20 years' experience as a finance professional and CFO, in both healthcare and consumer industries. I joined GSK from Novartis and have been working closely with Brian for a number of years to shape our business.

I am going to take you through our financials and share how the significant change agenda that we have driven over the last few years supports our confidence, in both medium-term outlook and continued market outperformance.

Haleon: strongly positioned for growth

Over the past few years, we have built a company strongly positioned for growth.

We have reshaped our portfolio through an extensive rationalisation programme and completed the Pfizer integration to plan.

We optimised our operating model, strengthening our go to market capabilities and delivered significant efficiencies in a sustainable way, whilst at the same time continuing to invest in our business and brands for the future.

The results of our strategy and execution to date can be seen in our strong financial results.

In the medium term, we expect to deliver organic annual sales growth of 4 to 6%, and sustainable moderate operating margin expansion at constant currency. I'll go into these in more detail shortly.

All references to forward-looking statements throughout this presentation are provided at CER.

Finally, you have already seen our priorities for disciplined capital allocation, which will support delivering strong shareholder returns in the coming years.

Portfolio reshaped, well positioned for growth

Our portfolio has been significantly reshaped since 2015, through a deliberate strategy to build a consumer healthcare company, solely focused on the attractive and relevant consumer healthcare sector.

Through our two joint ventures and a targeted divestment program, we have significantly increased scale, while also increasing the share of our business in higher growth categories, markets and channels.

For example, we have focused on Power Brands which have higher growth rates than the overall group, which are now just under 60% of our revenues compared with 44% in 2015, and which will be a key driver of growth in years to come.

We have built a leadership position in VMS, now 16% of our revenues, which has a higher growth rate than the other categories.

We have strengthened our position in key geographies. We are now the market leader in the US and significantly strengthened our position in China. These 2 markets now account for over 40% of our revenue, providing a strong route to market platform in key markets for future growth.

Finally, our e-commerce business is now 8% of revenue and has doubled over the last 2 years.

Delivery of this strategy has fundamentally reshaped our portfolio over this time, and has positioned us well to continue to deliver above-market growth.

Optimised operating model, lean cost base and capabilities improved

Beyond the reshaping of our portfolio.

We have made significant improvements to our footprint and operating model.

We have delivered a sustainable increase in our margin to support reinvestment for growth.

And we have continued to invest in brands, capabilities and tools.

Let me take you through some of this to give you a sense on what we have achieved.

Firstly, we have optimized our footprint, reducing the number of manufacturing, distribution and R&D sites, to right size our business and provide room for future growth.

Secondly, we have significantly improved the efficiency and effectiveness of our A&P spend: we doubled digital media spend over the last 2 years and as you have heard today, this is now more targeted on driving growth and return on investment.

And as a result, in the US and China, most of our A&P spend is now digital with more to come in other markets.

We also rebalanced our spend behind our Power Brands to drive future growth from our biggest opportunities, and increased consumer-facing A&P with a strong return on investment from data driven media spend.

Finally, we transformed our operating model and upscaled our capabilities to support stronger execution.

We empowered our local markets to innovate, increasing our agility to adapt to changing consumer healthcare needs.

We invested in data and tools to drive improved data-led decision-making and stronger returns on our investments.

And we have built specialised tools that enable better execution, for example our Shopper Science Labs which you heard about earlier today from Lisa and Filippo.

These changes enabled us to deliver a 325 basis points improvement in margin, despite increasing A&P investment and adverse currency pressure.

Delivering momentum while investing for growth

Our strategy since 2019 has delivered strong financial results with good momentum for the future.

Before I take you through the numbers, a few comments on the basis on which these figures are prepared.

Starting with the asset perimeter. Our 2019 actuals only include 5 months of contribution from the legacy Pfizer results. As a reminder we closed this transaction on 1 August 2019.

The financials also reflect the current Haleon perimeter.

And finally, sales growth is provided on a like-for-like basis, showing the underlying historical performance assuming 12 months of the portfolio in the prior year.

I will focus on the results over the last 2 years, as this reflects the go-forward business. I will take you through the key line items in more detail shortly, but let me draw out the highlights.

We delivered a sales CAGR of 4.4% over the last two years despite a net negative effect from COVID, with a healthy balance of price and volume.

Turning to profitability, we have a leading gross margin, relative to our peers, at 63%, demonstrating the strength of our brands, our optimized manufacturing footprint, and constant focus on price and efficiencies to offset inflation. Importantly, this margin is sustainable.

We delivered an adjusted operating margin of 22.8% in 2021, which was up 325 basis points. This was achieved whilst investing in our brands and offsetting adverse currency impacts.

Let me spend a moment sharing how this margin compares to the 2022 outlook which GSK set out when it announced the Pfizer deal, which was a mid-to-high 20s margin for the business as a segment of GSK by the end of 2022.

As I mentioned, we ended 2021 with a 22.8% margin.

Firstly, the margin ambitions from 2018 were provided at CER using 2017 foreign exchange rates. The impact of adjusting for this using 2021 currency rates would be a margin that was approximately 1% higher.

Second, the financials presented today reflect the Haleon perimeter and this base is how we will report going forward. If these financials were instead presented on the basis of our business being a segment of GSK this would result in a 50 basis point increase to our 2021 margin.

Third, we disposed of more brands than originally planned. This was the right thing to do, resulting in a more focused portfolio, but resulted in an incremental reduction in margin of approximately 70 basis points.

Finally, as you know, we almost fully delivered on the original Pfizer £500 million synergies in 2021 and we will realise around a further £120 million of synergies, taking the total to around £600 million.

Adjusting for these items, we have delivered against the margin targets set out in 2018, whilst reinvesting 25% of the transaction synergies as planned, to drive growth.

Moving on to cashflow, we delivered approximately £1.5 billion of underlying free cash flow in both 2020 and 2021.

We delivered strong momentum during this period, despite the impact of the pandemic, the focus on integration of the Pfizer assets which is now complete, and our focus on separation activities which will be completed later this year.

All of this gives us confidence in our ability to both grow our top line, and deliver further margin expansion over the medium term.

Sustainable model driving investment for growth and attractive returns

As Brian shared with you earlier, we are focused on delivering sustainable outperformance and attractive shareholder returns. Our approach is reflected in this model.

This model's foundation is our scale and strong brand position which supports attractive gross margins. Alongside operational leverage and efficiency programmes this enables us to invest in our brands in a sustainable and disciplined way for growth. This underpins our confidence to consistently deliver 4 to 6% organic annual sales growth, ahead of the market in the medium term.

Balancing this investment to support growth we will deliver sustainable moderate margin expansion.

Coupled with strong cash flows and high cash conversion, this creates the capacity to support our disciplined capital allocation priorities, which will prioritise reinvestment in the business, dividends, and deleveraging in the near-term, all underpinned by a commitment to maintaining a strong investment grade balance sheet from the outset.

I will now take you through each element of this framework underpinning the delivery of attractive growth and returns.

Focused plan to deliver 4-6% organic annual sales growth

We delivered a 4.4% sales CAGR over the past 2 years, which represents a solid base for future growth.

As we look forward, we expect 4 to 6% organic annual sales growth in the medium term, which we are confident in delivering based on a number of reasons: a large and growing part of our business is in higher growth categories and geographies, which increases our growth profile.

We have clear strategic building blocks to drive further growth, as Brian highlighted earlier, by increasing household penetration, and capitalising on new and emerging growth opportunities across channels, geographies and portfolio expansion. As a reminder, we see attractive Rx-to-OTC switch opportunities, but do not need to rely on these to deliver on our sales growth target.

Importantly, all of this is underpinned by A&P and R&D investment which will grow ahead of sales growth.

And finally, this is supported by the strong execution across all of our markets that Keith, Filippo and Lisa took you through earlier.

Top line – outperforming the market growing by 4.4% CAGR

The annualised organic sales growth of 4.4% between 2019 to 2021, shows that we outperformed the market two-fold, despite the negative impact from the pandemic, and our focus on integration and separation activities.

This performance was supported by our reshaped portfolio with greater focus on higher growth brands, categories and regions.

We saw a step change in digital revenues, reflecting our new approach.

We increased our A&P ahead of the rate of sales growth by approximately 6% per annum, in a disciplined and targeted manner, to drive growth.

We also delivered a healthy balance of both price and volume growth through the period, a trend we have delivered over time, and one that we will look to maintain going forward.

Outperformance in high growth categories drives momentum

Over the last 2 years we delivered very strong performance across the majority of our categories.

Our Oral Health and VMS categories, which combined account for 44% of our sales, outperformed the market and we expect these categories combined to deliver mid to high-single digit organic growth, and to make up around 50% of our sales by 2025.

In Pain Relief, which is 23% of our sales, we outperformed the market, whilst our Respiratory category performed in line with the market.

Our Digestive Health and Other category grew by nearly 2%, with good performance in Digestive Health, which represents about half of the category, but there was some drag from the remaining brands, a few of which were adversely impacted by reduced impulse purchases given COVID over the last two years.

I've mentioned that our sales growth in the 2-year period to 2021 was subject to a net negative impact from the pandemic. The material impacts were in 2 key categories:

In VMS, the pandemic produced about 60 basis points tailwind for group-level growth. This was mostly in 2020 but VMS showed continued strong performance in 2021 and we expect to continue to grow off this higher base.

In contrast, our Respiratory category declined, primarily due to a historically weak cold and flu season in Q4-20 and Q1-21. We estimate this created about a 110 basis point headwind for group-level growth over the period. As you saw in our recent Q4 results, we are now seeing a strong recovery in this category as the market returns to growth.

On a combined basis, we therefore believe that our 4.4% sales growth was subject to a net negative COVID impact of around 50 basis points.

That 4.4% sales growth was ahead of the market, which grew around 2%.

Regional performance in high growth geographies drives momentum

Turning now to regional performance.

You've already heard from Filippo, Keith and Lisa on the regions. We have attractive growth opportunities across all three, so I won't repeat that here.

We will report results on these three geographical segments, consistent with how we manage and run our business.

APAC is, and will continue to be, key for the group and now accounts for 22% of our global sales, and we expect that share to grow in the future.

As you think about our historical performance, I did want to highlight the negative COVID impact experienced in North America and EMEA & LATAM, mainly due to the larger share of the Respiratory category in these regions, although as reported in our Q4 results, we have seen a rebound in the Respiratory business.

In EMEA & LATAM we expect good growth in Emerging Markets, combined with lower but stable growth in Europe, leveraging the leading share and already mature markets with already strong margins. In North America, we expect improved momentum and growth as the region recovers from the challenges in 2021 from the drag from cold and flu, as well as supply challenges.

As Filippo and Keith set out earlier, we have good growth opportunities both from penetration and increased portfolio expansion in our Emerging Markets, and not only do we have strong positions in these markets, but also robust plans in place to fully capture future growth.

In aggregate Emerging Markets account now for 32% of Haleon revenue – again, proof of our increased exposure to higher growth markets, which will be supportive of our growth targets going forward. We expect these markets to continue to grow high-single digits.

Growth opportunities across all categories

Looking ahead at a category-level, we have clearly defined priorities and plans to capitalise on the growth opportunities we see throughout our portfolio, which are anchored in the strategy Brian took you through.

I won't talk through all of the points on this page, but let me highlight a few examples for you.

In Oral Health, you have seen across all of our regions how we are driving increased penetration and delivering on an unmet consumer health need, with headroom across all of our regions for future growth, particularly in high growth markets like India.

In VMS, Filippo has highlighted the strategy for further geographic roll out and focus on Centrum and local strategic VMS brands across EMEA & LATAM.

And in OTC, we see opportunities for growth right across our categories. This includes leveraging our strong innovation capabilities, including 2 Rx-to-OTC switches in the pipeline.

Growing exposure to high growth digital channel

And finally, on channel expansion, Brian has already laid out our strong performance and significant opportunities for e-commerce penetration.

Digital sales now account for 8% of our revenue globally and even higher at 12% in the US and 20% in China.

Our e-commerce sales have doubled in just 2 years from £0.4 billion in 2019 to £0.8 billion in 2021.

We are growing ahead of the industry thanks to investment to date and are focused on delivering out-performance relative to the market in this key growth channel.

High level drivers of delivering medium term sales outlook

Stepping back there are 4 key growth drivers which underpin our medium-term sales outlook, all supporting our expectations in the medium term.

First, from a category perspective: Oral Health and VMS combined should reach about 50% of the business by 2025 and we expect these categories combined to deliver organic sales growth in the mid to high-single digits.

Second, from a geographic perspective, given the continued outperformance expected in Emerging Markets, we expect these markets to continue to grow high-single digits, and as a result, to be in the high-30s as a percentage of group sales by 2025.

As Brian highlighted, from a channel perspective we expect e-commerce sales to continue to grow strongly, and as a result be mid-teens as a percentage of group sales by 2025.

And from a portfolio expansion perspective, assuming successful trials and approval, we expect the 2 Rx-to-OTC switches to add an incremental 1% revenue in-year growth each, when launched from 2025.

In summary all of this sets us up well for future sustained growth.

Sustainable model driving investment for growth and attractive returns

With that let's move on to the second part of our model: how we convert sales growth into sustainable moderate margin expansion.

Track record of delivering adjusted operating margin expansion while investing for growth

As I explained earlier, we have a strong track record of delivering operating margin improvement. Between 2019 and 2021 we expanded our adjusted operating margin by 325 basis points after around 1 percentage point adverse currency impact.

Strong operating leverage increased our margin by around 2 percentage points, driven by a healthy balance of price and volume, product mix improvement and cost efficiencies.

At the same time, we re-invested over £200 million into A&P, with A&P growing at approximately 6% and ahead of our sales growth.

We then had a couple of further impacts from our transformation.

Synergies of around £500 million contributed five percentage points to the margin.

And the divestment programme to exit growth dilutive brands, which is now completed, reduced margins by around 2 points.

This took us to a 2021 healthy and strong adjusted operating margin of 22.8%.

Focused investment for top-line growth through margin efficiency

Our investment in growth is enabled by an attractive margin profile.

We have an industry leading gross margin of 63%, compared to a peer average of around 51%.

More broadly, we have a lean cost base which is reflected in our 2021 adjusted operating margin of 22.8%.

We then optimise these over time with 3 further levers:

First, net price and mix optimisation, including strategic initiatives such as increased higher margin Power Brand penetration in key markets like India, or increased focus on trade investment spend to improve our net revenue management.

Second, continued manufacturing, supply chain and procurement efficiencies. Here, further improvements in our supply chain are allowing us to optimize our third-party manufacturing network and achieve procurement savings.

Third, continued cost discipline, across processes, systems and standalone costs throughout the business.

This framework will allow Haleon to create capacity to reinvest in A&P in a very focused way, at a rate faster than sales growth, whilst still delivering moderate margin expansion.

I am confident that we have the right discipline and focus and the right tools and analytics, to support us in our A&P allocation and investment processes, to deliver both strong future sales growth and strong returns on this incremental investment spend.

Operating model driving modest annual margin expansion in the medium term, in 2022 increased synergies largely offsetting standalone costs

We expect moderate margin growth in the medium term. We are very confident that there is no need to change the pace of investment in our brands, which has served us well over the last few years.

The news today relates to the costs of running CH as a standalone public company. These will be around £175 to £200 million per annum. Importantly, we have been working hard to mitigate these and today we are also announcing increased Pfizer synergies, taking the total to around £600 million.

The other dynamics in our 2022 margin are business as usual.

Let me give you the key factors for the 2022 margin, which will form the base from which we will continue to deliver moderate margin expansion over the medium term.

I am not going to give you 2022 margin guidance, given the regulatory challenges in doing so, as part of the upcoming demerger prospectus.

On the drivers of margin growth:

Firstly, we expect to see favourable volume mix benefits in 2022, reflecting continued strong growth and outperformance from our Power Brands;

Secondly, we expect pricing to be more of a benefit in 2022, reflecting the annualisation of pricing taken in 2021 and further net price improvements that are under way;

Thirdly, we will continue to achieve further supply chain efficiencies.

The final piece will then come from the additional Pfizer synergies which will add around £120 million in the year.

The offsets to these are:

First, as you have heard, we will continue to invest in our brands. In fact, we expect to continue to maintain our approach of investing ahead of sales on a targeted basis, as seen in recent years;

Secondly, as with all companies we are seeing inflationary pressure and some supply chain impacts. But, reflecting the nature of our products and packaging, these pressures are very manageable across our P&L. As a reminder commodities and commodity-related costs account for less than 10% of our sales base;

Finally, we have the standalone public company costs which annually are £175 to £200 million, which are in large part offset by the increased Pfizer synergies, and you should assume this full amount in 2022.

So, in summary, there is no change to our margin dynamics.

We are largely absorbing the standalone costs through additional synergies.

And are well positioned to manage market wide inflation.

We are confident in our ability to manage margins very well, even in more complex environments, and this sets us up strongly for our medium-term moderate margin expansion target.

Sustainable moderate margin expansion in medium term

We are confident in our ability to deliver sustainable moderate margin expansion in the medium term, whilst continuing to invest in A&P and innovation.

We expect to continue to improve our gross margin, driven by positive mix, COGS efficiencies and pricing benefits.

On A&P, we will continue to reinvest at a rate ahead of sales growth, whilst optimizing spend and delivering efficiencies.

We will further our innovation capabilities to realise commercial opportunities based on consumer needs, by reinvesting in R&D.

And, we expect a reduction in the Other SG&A ratio, largely driven by economies of scale, and further optimisation of processes, systems and standalone costs over time.

Overall, we have a model that we are confident will deliver: strong and sustainable margins, and moderate margin expansion in the medium term, whilst funding investment in A&P and innovation to drive sales growth.

Sustainable model driving investment for growth and attractive returns

Now let's move to the third part of our model and focus on the high cash conversion of the business.

Strong cash flow supportive of capital allocation priorities

Our cash flow is strong, providing us with flexibility to support our capital allocation priorities as we look forward as an independent company.

We generated approximately £1.5 billion of underlying free cash flow in both 2020 and 2021.

Our reported free cash flow includes net proceeds from divestments, totalling £1.1 billion, largely in 2020. And £1.3 billion of one-time costs related to integration and separation to date. Both of these items are excluded from the underlying free cash flow metric on this page.

Given these programmes have already completed, or in the case of separation will be largely completed by the end of 2022, the underlying cash flow is a better measure of our performance.

We have delivered this strong cash flow through strong working capital management, and capital allocation discipline. One priority is capex at around 3% of sales.

Strong capital base with stable capex

We are investing on an ongoing basis to support our manufacturing and R&D footprint, while building the capacity to sustain our future growth ambitions. In particular, we have been investing in automation, digitalisation and e-commerce capabilities to drive greater efficiency.

We expect to sustain a stable level of capex at around 3% of sales going forward, with no significant upcoming projects anticipated to alter this level of spend.

Finally, given we operate in a highly regulated environment, we will continue to ensure that we adhere to strict quality control requirements and regulations.

Strong cash flow supporting capital allocation priorities

Looking ahead, we expect strong cash generation, underpinned by our attractive sales growth, strong and moderately expanding margins, and high cash conversion.

We expect our cash tax expense to be around £0.3 billion in 2022, while interest expense is expected to be approximately £0.2 billion in the near term.

We will continue to focus on working capital management with more opportunities in inventory management, which we expect will result in a flat working capital profile over time.

And given separation will be largely complete by end of 2022 we expect less than £100 million of restructuring spend going forward. We foresee no major restructuring programmes.

Taken together, these factors will deliver strong free cash flow.

Sustainable model driving investment for growth and attractive returns

We will apply a disciplined approach to capital allocation to drive attractive shareholder returns and a strong balance sheet.

Growth focused disciplined capital allocation

We have a very clear set of priorities for capital allocation.

Our number one priority remains investing in the business to drive sustainable growth and attractive returns.

Secondly, the initial dividend is expected to be at the lower end of the 30-50 per cent pay-out range, subject to Haleon board approval.

Thirdly, while we are excited about the organic opportunities and growth prospects for our business, we will also look to undertake M&A where it's commercially compelling and consistent with strategy. Importantly, we do not need M&A to deliver on our growth ambitions.

Given our strong cash generation, we are very confident that we will be able to de-lever our balance sheet, assuming a starting position of up to 4x net debt/EBITDA, to below 3x by the end of 2024.

Last but not least, we will sustain a strong investment grade balance sheet from the outset.

Medium term outlook and full year 2022

Let me now bring this all together in our medium term outlook:

We expect to drive 4 to 6% organic annual sales growth, ahead of the market; we expect to deliver sustainable moderate margin expansion each year; with high cash flow and stable cash conversion, we expect to de-lever to below 3x by the end of 2024; as mentioned earlier, the initial dividend is expected to be at the lower end of the 30-50 per cent range, subject to Haleon Board approval.

In addition, I would like to set out a few additional considerations for full year 2022:

Haleon expects to achieve organic sales growth in the range of 4 to 6% for 2022; adjusted operating margin is expected to benefit from continued strong operating leverage and pricing in 2021; inflationary cost pressures and supply chain costs are expected to be well-accommodated given our gross margin and ongoing supply chain efficiencies; Haleon will continue to drive brand investment ahead of sales growth; finally, incremental synergies from Pfizer will largely offset new annual costs in 2022 associated with running a standalone public limited company.

Interest expense will be around £0.2 billion.

The estimated tax rate on adjusted profit will be in the range of 22 to 23 percent.

And we will provide further direction on 2022 once a standalone company.

Haleon: strongly positioned for growth

In conclusion, we are strongly positioned for growth, with the business transformed over the last 3 years and fully focused and ready to deliver 4 to 6% organic annual sales growth.

We expect to deliver sustainable moderate margin expansion, at the same time as investing in the business.

Our strong cash generation supports capital allocation priorities, including reinvestment and a dividend, whilst also de-leveraging our balance sheet.

The strong performance that we have delivered since 2019, despite the pandemic and integration and separation activities, gives us confidence in our expected delivery in the medium term.

I am proud of what we have achieved to date and I am excited about the financial prospects for Haleon.

I am looking forward to connecting with you more in the future.

With that, I would like to hand back to Brian to wrap up, and we welcome your questions.