GLAXOSMITHKLINE

Investor event

Wednesday, 26 July 2017 @ 14.00

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Emma Walmsley (CEO): Welcome and good afternoon to everybody here and good morning to those of you who are either watching or listening in from the US. Today, we have announced our Q2 results and I am also setting out the priorities that we shall drive to improve our performance and our returns for the long term with the first phase focus on the next three years.

Cautionary statement

Of course, for the whole presentation we start off with our cautionary statement as usual.

Agenda

As far as the agenda this afternoon, Simon and I are going to share our priorities and financial implications for the next hour and a half, then we shall have a short break followed by an extended one and a half hour Q&A with a broader group. Today, we have a fantastic team from GSK here: Patrick who leads R&D; David Redfern, Chair of our HIV business and Chief Strategy Officer and Leader of the Strategic Pharma work; Brian and Luke are here, the relatively new Heads of our Consumer and Vaccines businesses. I also have with me Jack Bailey, President of our US Pharma and Vaccines businesses; Eric Dube who leads our Global Respiratory business; Deb Waterhouse, the new leader in our HIV business and her head of R&D John Pottage. They have both landed here today directly from attending the IAS meeting in Paris.

To stay with our R&D theme and to answer more specific questions you may have, either in the later session or afterwards in the reception this evening, we also have another eight key R&D leaders here in the room.

Do more, feel better, live longer

I shall spend most of this presentation talking about our pathway to better returns but I want to start, standing in front of you for the first time as the new CEO, by sharing with you my view on the purpose of GSK. This company does important work. Our purpose matters: to help millions of people every day do more, feel better and live longer. We prevent and cure disease in more than 150 countries around the world. We keep hundreds of millions of people well from the new-born babies through to the elderly. This is the reason that most people join GSK - it is certainly true for me - and it is what drives the discretionary effort of our employees and partners all over the world. So this purpose will remain our ultimate priority under my leadership.

We have a long history, traceable back perhaps 300 years, in a variety of company configurations: a history of helping to change the burden and impact of disease through innovation. As we strengthen and modernise this company, this business, to set a platform for its future success, we must make sure that we drive performance, first and foremost, through applying great science to impact human health.

The demand for healthcare and innovation is more intense than ever as life expectancy, of course, continues to improve but we are no doubt in a challenging and fast-changing industry and environment.

Fast changing environment and competing industry trends

The good news, of course, is that this is a market full of opportunity, first and foremost with fundamental advances in science, perhaps most notably in genomics but also exciting new frontiers such as our own bioelectronics. In fact, with this acceleration of science and technology, we should all expect some material shifts in the way our industry operates, in who our competitors and partners are as we use digital, data and analytics fundamentally to transform the way we discover and develop medicines; the way we interact with patients and consumers and healthcare professionals.

As life expectancy expands, of course demographics drive demand but, equally, they put pressure on budgets and pricing pressure is not new in this industry. It has long been a concern in Europe but it is now a major factor in the US as both public and privately funded bodies look at ways to tackle the affordability of medicines. For us, this pressure is most obvious now, and as we look into next year, in the inhaled respiratory market.

Finally, it is hard to believe that the industry is not poised for more change. Potential tax reforms in the US, pressures on performance and R&D output could all be drivers of sector consolidation over the next few years, and this could have in turn significant implications. So, it is important that we are agile and have flexibility if these changes should materialise.

Balanced business to deliver sustainable growth and returns to shareholders

In this kind of healthcare world, GSK offers the opportunity to capture value and withstand the pressures across our three businesses. We participate in a broad spectrum of the healthcare market: if you think about it chronologically, from prevention with Vaccines, self-medication and wellness in Consumer Health, to high end therapeutic treatment with strong life-cycle management in Pharma. We are not reliant or over-dominated by one therapy area or product. Portfolios in each of these businesses have innovative and established products with leading positions in major therapy areas and categories, whether it is meningitis in Vaccines, Respiratory, pain relief and oral health in Consumer or, again, of course, Respiratory and HIV in Pharma.

Our recent transaction in 2015 created new scale in Vaccines and Consumer. All three businesses now benefit from a global footprint, capable of accessing growth in established and emerging markets. This includes significant scientific, technical and regulatory expertise for the manufacture of high quality products.

Earnings and cash flows for the three businesses provide balance and a level of sustainability to the Group's performance and its ability to invest in future growth and in returns to shareholders.

Stronger recent performance across our three businesses

Recent performance has demonstrated the benefits of our 2015 transaction and, in the last 18 months, new product growth in all three businesses has been stronger. Good delivery of our new inhaled *Ellipta* portfolio and *Nucala*, our new biologic asthma treatment, is driving an effective transition in our respiratory business. And the success of *Tivicay* and *Triumeq* has re-established GSK as a world leader in HIV. Both are showing strong and encouraging Q2 performance.

In Vaccines, new meningitis vaccines *Bexsero* and *Menveo* are both growing strongly and, whilst this business will continue to see volatility based on tender agreements, our supply position is stabilising, providing good further opportunities for growth.

In Consumer Healthcare, growth in our seven power brands is ahead of the market, driven particularly by well-loved brands like *Sensodyne* and *Voltaren*. We are seeing a marked slowdown in Consumer market growth and that is clear in our own Q2 numbers, but while growth has slowed we still very much believe that we have a portfolio capable of responding to this challenge and we definitely have the profitability levers in place to continue to deliver our target margin improvement of at least 20% by 2020. That is around double the proforma margin of 2014.

Sales growth and cost saving measures, together with exchange rate movements, have seen cash flow and margin improvements for all three businesses in the last 18 months. The adjusted operating margin has improved by 400 basis points since 2015.

However, while this recent delivery is encouraging, it has to be set against a longer-term context for GSK's performance.

Need to improve long term performance and build off recent momentum

The reality is that longer-term performance has been weaker than we all would have liked. Although recent new product momentum has been better, sales growth on a longer-term basis has been limited due to some slow start or missed launches, the reducing contribution to profit and cash flows from our largest product, *Seretide/Advair*, and insufficient R&D output to compensate. Supply issues have also been a clear factor.

All of this is clearly reflected in our long term TSR performance, which has been uncompetitive when viewed against our peers.

Need to improve focus and output of pharma R&D

Our R&D performance is an important part of what we need to change and improve upon. In fact, in output, we have had a significant number of launches, especially in the last three years. We have been amongst the industry leaders on volume metrics, and have had some undoubted successes.

However, Peak Year Sales per asset – the chart on the right here – have been among the lowest of our sector peer group, so we have not consistently translated the output into commercial success. Arguably, this is a combination of asset choices made, issues with the competitiveness of our labels, and the competitiveness of our commercial execution. In all cases, this requires a much more integrated partnership between Commercial and R&D.

Investment spread across too many projects

What is also clear is that comparatively we have allocated capital in R&D to a much broader range of projects versus our peers and, as average spend per project was also low, we arguably did not back some key assets with sufficient resources for strong enough data packages.

Opportunity to improve development timelines

And development cycle times for GSK also appear to be longer than the average for the industry, notably in Phase II clinical development, and we know that pace is critical in such a competitive environment. All of this points to the need for a significant overhaul and re-evaluation of how we develop our clinical assets and, most importantly, our Commercial and R&D interface.

Key objectives 2017-2020

Alongside this challenge of addressing R&D development, there are several other key things we have to get right over the next three years. All three businesses need to perform, but our priority is clearly Pharma. It will start with some key changes to our operating model and portfolio.

- We must maximise value from recent and new product launches;
- We must address the pricing exposure in our portfolio - this is acute in the inhaled respiratory market. We have to ensure our pricing strategies and our cost base reflect the reality of the therapy areas and geographic markets we are operating in.
- We must make the right choices to invest and develop early clinical stage pharma pipeline for our next wave of innovation, which will come in the early 2020s. This pipeline appears promising but it is early, and much of it is still unproven. Over the next three years, we will start to see clinical data on m any assets. How we get to the best decisions on investing behind them is of course of critical importance.

Beyond Pharma, we must realise the benefits of our newly scaled Consumer and Vaccines and, across all three businesses, put more discipline into our capital allocation processes.

Our distribution of returns to shareholders has also been ahead of cash flows in the past few years and so improving our cash generation for more flexibility to invest in future growth is also key.

As R&D data reads out, we have to make sure we can back our winners. At the same time, we need to be ready for inorganic solutions to strengthen our pipeline or take advantage of other opportunities to strengthen our company, such as the Consumer put option.

Today we are repeating and updating the 2020 outlooks for the Group which were set out to investors in 2015. To deliver this outlook we have a lot of work to do. All of these objectives need to be met and, as a reminder, our outlook is for sales to grow at a compound annual growth rate of low to mid-single digits over the five-year period to 2020 and,

- for adjusted EPS to grow mid-to-high single digits.
- These outlooks are all given using constant exchange rates, with 2015 as the base year, and they do anticipate the launch of at least one *Advair* generic adding to an already strong market pricing pressure in the near term.
- But another very important point I want to make today is that these outlooks are also, given the potential development options in our pipeline, subject to data-driven R&D investment opportunities.
- Of course, we have already made some assessment of the R&D investment that will be required going forwards and built this into our plans, but I want to be clear and

transparent with all our investors that if additional investment is required to maximise full value of a particular asset we will act with the long-term interests of the Group's performance in mind.

So, let me start to outline some of the changes we are and will be making to achieve these important goals.

3 long term priorities for all 3 businesses

First, we are going to have fewer and more focused priorities for GSK.

The environmental trends I already outlined at the beginning of this presentation are going to lead to fundamental changes in our industry. Responses to them require agility and our own change at pace, but they also need to be set alongside the long-term nature of R&D and responsible use of our capital.

So, under my leadership, all three businesses will be tasked to be focused on three long-term priorities:

- Innovation;
- Performance; and
- Trust.

Improve innovation across GSK, top priority is Pharma

Now, innovation is important to all three of our businesses, but, again, the top priority is Pharma. We are very focused on maximising commercial opportunities for our recent and near-term launches.

We have made mention of the three important launches to come.

- Closed Triple - we know around a quarter of COPD patients end up on triple therapy and this will provide a simple, single inhalation, a way of delivering it in a device that allows the move from single to dual to triple as needed.
- The first of our HIV two drug regimens, potentially reducing the burden of drug treatment with a well-tolerated and highly efficacious combination.
- Then, lastly, *Shingrix* - we believe a step-change in efficacy for the prevention of shingles, a debilitating disease that is going to impact one in three of us in this room, one in two of us once we reach the age of 85.

Beyond the near-term launches, the big priority is to strengthen the pipeline and, as I said earlier, our performance here has been hampered by allocation of resources and suboptimal Commercial/R&D interface. A combined Commercial and R&D Team have reviewed the full asset portfolio and investment priorities and, as a result, we have developed a priority list of assets to invest behind and develop, but, of course, this list will continue to evolve as the data reads out.

We will continue to invest behind areas where we already have strong leadership positions, Respiratory and HIV, expanding potentially from HIV into broader infectious diseases with our ongoing work in antibiotics and Hep B, but these two are our core therapy areas.

We will also focus our near-term investment into very specific assets in two potential specialty therapy areas, depending on data of course, Oncology and Immuno-inflammation. And, we have a number of programmes in both these areas that, if clinically successful, could provide us with options to generate value ourselves or with others.

We are targeting 80% of our R&D capital to be allocated behind these four areas over time and we intend to pursue disciplined business development to strengthen the early-stage pipeline in these priority areas.

We will also continue investing in our core capability differentiators, our expertise in developing targets through genetics, modern medicinal chemistry approaches and advanced manufacturing. We believe, for example, our cell and gene therapy technology platform could be a key manufacturing asset for GSK and we intend to be focused on deploying it behind our Oncology portfolio.

We will be part funding this reinvestment in more focused priorities by stopping investment in areas and assets where we see less opportunity for GSK. We have already made the decision to terminate, partner or divest 13 clinical programmes and around 20 additional preclinical programmes.

We have completed a strategic review of our Rare Diseases business and for the assets currently in our pipeline intend to secure opportunities for further development and generation of financial returns outside of GSK, to give them the very best possible chance of successful clinical development.

We have also recognised that we need to improve the governance of our pipeline decision making and this starts with changes in processes and people.

- Luke Miels, who is going to be starting with us in September as President of our Global Pharma business, and his experience at Roche and Sanofi and

AstraZeneca will be invaluable in helping to build commercial rigor into the way in which we prioritise our pipeline programmes and define competitive target medicine profiles. We have also recently appointed Tony Wood who is joining us Pfizer and will be responsible for leading platform technology and science.

- We are undertaking a deep review of the efficiency and effectiveness of our Drug Development function and we have set up a new Development Advisory Board alongside, and as well as the new Board Scientific Committee to which I know our recently appointed Board member, Dr Laurie Glimcher, CEO of the Dana-Farber Cancer Institute will be a fantastic addition.

Developing the pipeline in Pharma

Development capital focus on 2 core and 2 potential therapy areas

So let me just give a few more details on the priority assets selected at this stage. Our clear aim here is to develop the next wave of innovation, a new Pharma portfolio for the early 2020s and beyond.

This slide lays out on the right-hand side the assets we are currently prioritising for development in the two core and two potential areas. Clearly again we are very data-dependent on progressing development on many of these earlier-stage assets here but in all cases, we believe they have the exciting potential to offer new, differentiated innovation to patients and payers and sizeable peak year sales contributions to the Group.

In some cases we already have encouraging early efficacy signals, be it with cabotegravir when given bi-monthly injection, maybe even eight weeks as you will have seen in our data presented at IAS or the exacerbation reductions in specific COPD populations for PI3K delta or danirixin, a good example of where we've just recently accelerated our trial times by more than a year with real-time data analytics.

In our two potential therapy areas we have also had some encouraging recent news, whether that's positive Phase IIb data on a new topical agent for psoriasis and atopic dermatitis, tapinarof or in the strong early efficacy readout in multiple myeloma for BCMA.

About 20% of our Discovery and Development spend will be allocated to areas outside these two core and two potential areas, so you can see here that there are still two late-stage development assets in other therapeutic areas which we believe with sufficient differentiation could still offer good commercial returns and of course we continue to invest in Discovery across a broad range of therapeutic areas. We believe retaining this broad reach at the earlier stages of R&D is important for our longer term success, and Patrick and John and the team can answer all of your specific questions on why these assets are our priorities for us later on.

Their successful commercialisation will of course be critical and with an improved R&D and Commercial interface, I expect us to be making better decisions going forwards and we will not be closed at all to exploring and achieving different routes to market for these assets, particularly with our potential new specialty medicines.

As we develop this next pipeline, there is a final critical point I would like to emphasise. This portfolio will have the advantage of being developed at a time when the Group's patent exposure is relatively low once we have digested *Advair* with nothing material until the mid-2020s, something we believe is attractive when considering GSK's risk profile.

Refocusing to reinvest

Decision made to terminate, partner or divest 13 clinical programs, others under review

So I have said we are reinvesting behind priorities and partly funding that by terminating, partnering or divesting assets that are better progressed by someone else, where our new data perhaps shows they have a lower likelihood of success or we do not see them to be of sufficient scale for us. The 13 decisions that have already been made are listed here and there are more of course to come.

We have also made a decision to terminate, partner or divest around 20 preclinical programmes as I have said and this is going to free up immediately some R&D spend and up to, should it be appropriate, 500 people to put behind the priority programmes we have identified. And just as the priority list will continue to evolve as new data comes through, we should expect this list to evolve too with an ongoing reduction in the cost and time to stop.

Data on key assets in next 3 years to inform investment in Pharma pipeline, organically or inorganically

And lastly on the pipeline, this provides a timeline on data visibility, although clearly not visible in the room, but it is published and these data will inform our development choices and our investment strategies, both organically and in business development should it be appropriate.

As they become available, we will be updating investors and presenting them to the scientific community where appropriate and obviously the levels of capital we deploy in R&D will depend on these data.

Deliver competitive performance across all 3 businesses

Our second priority is a new company-wide focus on performance and it must be sustainable, ethical and over time as near-term pressures are digested, more competitive. We need to drive growth with competitive products and competitive commercial execution and more clearly internally aligned objectives across our businesses and fuel that growth by managing our costs and improving our cash generation.

A key change will be a stronger focus on execution driven first by much better internal alignment, including of incentives, with integrated strategies for each of our three businesses including across R&D, Commercial, Supply Chain and any Corporate support.

We will implement one P&L of one strategy with innovation, performance and trust priorities for each business. We will be much more disciplined in our focus on priority markets and make operating model changes where it will improve results. Simon is going to talk much more on our improved capital allocation later, but essentially we are prioritising resources to the strongest assets and geographies in our portfolio and moving capital and resources away from those that offer more limited opportunities for the company.

As you saw last week, we have initiated a strategic review of our cephalosporin antibiotic business with an option to sell and announced the divestment of some smaller nutrition brands in Consumer.

We have also decided to exit *Tanzeum*. We shall progressively withdraw support to allow us to complete necessary clinical studies and allow prescribers to transfer patients onto alternative treatments.

We have decided to terminate our rights to sirukumab as part of our efforts to focus our portfolio and reshape our Pharma business.

Across the whole company, we need to fuel our growth with renewed cost discipline. Overall, we believe we can generate a further £1 billion in annual cost savings from existing and new programmes, and a key part of this will be driven by improved efficiency in our supply chain. We have already announced plans to reduce our site network across the Group by nine sites, and we are continuing to review and look for further opportunities to simplify the network in coming years where it makes sense.

Simplifying our portfolio is a key enabler of improving our network efficiency. In the next 12 months, we expect to divest or exit more than 130 non-core tail brands within Pharma alone, brands that could create complexity for our supply chain, and these brands just in Pharma account for around £400 million in annual sales. The plans are already in place for 90 brand exits. Overall, we are looking for a 22% reduction in the number of

Pharma brands. We are also looking to reduce our overheads in manufacturing across the whole Group with a simpler network and improved productivity, and we will reduce our ~~supply~~ *supplier** base in manufacturing by 25% by 2020.

*post transcript edit.

We are also going to generate greater year-on-year savings through better procurement, which we are going to unify for the first time in a single company-wide procurement organisation across all three businesses.

At the same time, we want to invest in our performance. We intend to put commercial support behind our upcoming critical launches and we are deploying capital in our supply chain behind our core growth areas. As we announced last week, for example, we expect to invest more than £140 million just here in the UK at sites supporting production of HIV and Respiratory medicines.

Performance is, of course, driven by people. You will have already seen that we have made a number of new leadership appointments and I expect more to come across our top 200 leaders as we look to strengthen capabilities across the Group. One of the key capabilities I shall be most focused on is digital, data and analytics. Our priorities here are to improve clinical outcomes and reduce time and cost to discover and develop drugs. We are investing in several partnerships on large-scale genetics data and are seeing with learnings from the pioneering Salford Lung Study many possibilities in real world evidence and investing in digitally-enabled clinical trials.

We want to develop valued real world data at scale and, of course, step change our customer and consumer engagement across all of our businesses. This will be the starting point for a much wider intervention across the Group as we look to harness technology to improve our performance. I was very excited yesterday to announce the appointment of Karenann Terrell as part of my team as our new Chief Digital Technology Officer. She comes to us after being CIO of Walmart and will be a key partner to accelerate and modernise our capabilities here.

Changes to the pharmaceuticals business to improve performance

It is true to say that the biggest change in our company is going to be felt across our Pharma business, which didn't benefit from the catalyst for change that Vaccines and Consumer had with the 2015 deal. Of course, Luke, when he arrives, will layer onto this Pharma change in due course as he appoints his own new leadership team.

We are focusing our commercial efforts on driving an improved performance in the US which is, without doubt, the priority market but the biggest change geographically in fact is going to be about being more competitive in our Emerging Markets business. This has been an historic strength for GSK given our footprints, our strong brands and the very talented people we have working in these countries.

However, global and local competition have impacted our returns and we need to structure more effectively and efficiently for long-term profitable growth. We need a model that can competitively drive what is today a largely classic branded product business with brands like *Augmentin*, but also one that can successfully launch more new innovations such as the *Ellipta* portfolio or *Nucala*. To do this we are going to create a new, single, dedicated, end-to-end operating model for Emerging Markets spanning Commercial, Supply and R&D for life-cycle management. The Group will have its own dedicated governance model and the right commercial structure for each market whether that is a standalone business, a cluster of similar markets or a distributor-led model. Each market will be resourced accordingly and we remain very committed to the access of our medicines.

Cost discipline to fuel investment for growth

Successful delivery of our performance priority also requires an improvement in our cost base. The £1 billion of annual cost savings by 2020 will be used to support investments in strengthening the pipeline and commercial execution. The savings will also help protect our margins which we expect to face sustained pressure as a result of pricing pressure, in particular in our inhaled respiratory business.

Build trust in our operations and in the way we work

Our third and final priority is trust. We have to acknowledge there is a trust deficit in the world be that in governments or in business, and in our industry where trust matters more than most, if we don't close that gap, it will impact long-term value creation, and it has to start by getting our fundamentals right. The most important thing we can do for trust is to discover and make great medicines that people need. Then we must get our medicines to the people who need them, which means improving reliability of supply and our customer service levels.

Commitment to quality and safety across GSK is critical. We will continue to invest in people and capabilities to deliver competitive and top levels of performance here. After some difficult compliance issues in recent times, we are also committed across the company to doing our best to prevent breaches and, should they occur, to respond to them swiftly and transparently.

To build trust beyond the basics, the fundamentals, we are very focused on the way we engage with stakeholders, and our contribution and responsibilities to access to medicines. It is absolutely critical that our partners, customers and society trust our science and our intentions. The way we engage with health care professionals is something we are both proud of and believe in. We have evolved it already several times since its introduction and we will continue to do so, to make sure our engagement is competitive and trusted.

We also want to keep improving transparency with our other key stakeholders and that, of course, includes our investors. I have much appreciated your transparency with me as I begin this job, and the team and I look forward to building a constructive and transparent dialogue over the years ahead.

I have already referenced the tough pricing environment and it is clear that we have to deliver differentiated innovation to achieve value and returns in this context. When it comes to setting our prices, we have consistently taken a balanced approached with the recent launches of our new products. This will continue. We will look to support access where we can *and* generate sufficient returns.

We are very proud of our reputation and our long-term commitment to global health, but we will focus our resources to drive more global impact, especially in needs such as malaria and HIV.

And for our people, who are our greatest ambassadors and on whose talent and teamwork it all depends, to support their everyday engagement, we intend absolutely to increase efforts to adopt modern, progressive employer practices, focused on improving diversity and inclusion, supporting their personal wellbeing and being a flexible, life-friendly workplace.

Values and performance based culture to support delivery of priorities

Everyone in the room, or listening or watching, knows about the power and the importance of company culture. There are many special elements of GSK's culture which include very deep attachment to our values and our purpose, but there are also some dynamics that we have to change. To be successful, we need to have a culture that is driven in equal measure by competitive performance and strong values; a culture where we always bring the 'outside in' and we learn from the very best – wherever they are in the world - and a culture that is focused on better decision-making, and cost and cash discipline.

So there are some key changes that we will be making. This will include new appointments, some of which we have already announced, with more to come over the next 12 months. I have also highlighted some of the operating structure changes that we are making. We are changing how we set objectives internally and how we manage and measure performance. We will be introducing new company-wide incentives next year, better aligned to our IPT priorities and our overall business performance – for example, including cash flow measures across the company.

While we will be keeping our values, we will be changing the company expectations of employees, with four new expectations for everybody working at GSK. We will expect courage of decision making; accountability for results; the prioritising of people development, and effective teamwork. Expectations, of course, that have to start at the top of the house.

Capital allocation framework

Before I conclude, I want to outline our capital allocation framework. These choices will be key and, again, start with the IPT focus driving improved cash generation. Our priorities for use of cash are laid out here.

First, will be to invest in the business, in three key areas:

- The Pharma pipeline – organic, but also early stage inorganic;
- Realisation of the consumer put option, should come, which, as I said earlier, would strengthen our position in Consumer Healthcare; and
- Further investment to expand capacity in our Vaccines business.

Our second priority will be to deliver returns to our shareholders through payment of dividends. We continue to expect to pay a dividend of 80 pence for 2017 and we have also announced our intention to pay 80 pence in 2018. This is as part of a new dividend policy established for 2018 and beyond, where regular dividend payments will be determined primarily with reference to free cash flow, generated after meeting our requirements for investment in the business.

Lastly, we will use cash for business development purposes, with M&A obviously dependent on the right kind of return profile.

Our aim is to deliver benefits to patients, consumers and shareholders

In conclusion, we are setting out a clear path forward over the next three years. Across the whole company, we will prioritise and focus on innovation, performance and trust, and by striving to get the right balance of change and strong commercial execution. We expect to deliver the outlooks set out for 2020, with adjustments to the Pharma margin targets and the Consumer sales growth rates. This will reflect good execution of the plans we have laid out today, combined with investments we expect to make in R&D and the divestments and exits we have also outlined.

We will navigate some near-term pressures and the structural portfolio changes through the next couple of years especially, and at the same time build a new platform for future growth for the decade beyond that.

Our aim is to have all three of GSK's businesses delivering competitive performance with clear pathways for delivery of long-term, sustainable growth. Improved R&D and strengthened innovation will be at the core of this, using our science, technical know-how and our talented people to produce differentiated and much needed medicines, vaccines and brands that will make meaningful differences to patients and consumers, and achieve good returns for our shareholders.

With my colleagues here today, and on behalf of everybody else working at GSK, I want to say to our investors that we are committed to achieving this.

With that, I am going to hand over to Simon, who is going to take you through the detail of our Q2 performance and the financial implications of these longer-term outlooks.

Thank you. Simon, over to you.

Q2 and financial outlook

Simon Dingemans (CFO): Thank you, Emma.

Before moving to the outlook for 2017 and 2020, I am going to comment briefly on our Q2 results. As a reminder, I have covered these results in detail in a video issued alongside our press release earlier today, both of which you can find on our website, so I will keep my Q2 commentary over the next few minutes at a relatively high level in order that we can focus time on the future and the implications of the announcements we have made today on our financial outlook.

Headline results

So, first, on our total results, these include some significant charges that reflect better prospects for the Group and the implementation of our new business priorities. Specifically, we have again increased the estimated valuations of our Consumer and HIV businesses, as well as the level of contingent consideration we expect to pay to Shionogi in relation to the HIV business and to Novartis as the next vaccines milestone becomes more likely. Just as a reminder, this relates to non-US sales of *Bexsero* which are clearly growing strongly.

Total results this quarter also include charges of approximately £450 million relating to our decision to withdraw support for *Tanzeum* over the next 12 months or so.

The rest of my comments will be on our adjusted results.

The results we have reported today reflect another quarter of strong operational delivery as well as continued investment behind key future growth drivers in each of our businesses, particularly new product support and R&D investment in Pharmaceuticals.

Over the last several quarters we have stepped up Pharma R&D spending as we advance our pipeline. As Emma has highlighted, HIV is one of our core therapy areas and during the second quarter we took the decision to invest, for the first time, in a Priority Review Voucher to accelerate the FDA's review of a key asset – our first two-drug regimen in HIV. The £106 million cost of the PRV was charged to R&D expenses in Q2 and, with an impact of 5% on adjusted earnings per share in the quarter, was the key driver of the reported decline in adjusted earnings per share of 2%.

Sales growth

Turning to sales growth.

In Q2, sales from new products continued to drive good growth in Pharma and Vaccines, more than offsetting the declines from older products, including *Advair* and despite a 2% drag from divestments to reported Pharma growth in the quarter.

Consumer had a more disappointing quarter with sales flat overall after an estimated 2% impact from divestments and de-stocking in India ahead of the introduction of GST. The flat result was despite some strong performances from our power brands. However, this was not enough to offset a broader slowdown in consumption in key categories, particularly in International but also the US. Our US Consumer performance was also impacted by tougher competition in our allergy business, which particularly affected *Flonase*.

While we are taking steps to address these changed market conditions and improve our competitiveness over the balance of the year, we also expect to face additional pressure in the second half from the introduction of generic competition to one of our legacy Novartis products. The impact of this on second half sales is expected to be up to about £40 million and a full-year impact in 2018 will be around £80 million.

Given these various factors, we are not now expecting much growth at the top line from the Consumer business this year. Also, unless the market backdrop improves, we would not expect more than low single digit growth in sales next year, especially when you factor in the drag from divestments, GST and the ex-Novartis generic. The slower growth we are seeing this year and the impact on 2018 are key drivers of the updated outlook for the Consumer business out to 2020 where we now expect a top-line percentage CAGR over the five years of low-to-mid single digits.

We are controlling costs tightly, while ensuring we continue to invest in our power brands. We still expect to make significant progress this year towards our operating margin target for Consumer of 20%+ by 2020.

Adjusted operating margin

Onto operating margin more broadly for the Group.

As I have mentioned before, the PRV investment is a big one-off impact in the quarter, taking 1.6% percentage points off our adjusted operating margin for the Group in Q2 at constant exchange rates.

Across the rest of the cost base, we are driving operating leverage in the P&L, with a 90-basis point CER improvement excluding the PRV, by driving sales growth in Pharma and Vaccines in particular, as well as a benefit in mix and continued tight cost management in all three businesses, even while we invest behind our new product launches and priority assets in R&D.

In the quarter, royalties were up and we continue to expect around £300 million for the full year.

Improving cash conversion

From a free cash flow perspective we have driven an improvement of over £300 million compared to the first half last year, even after investing in the PRV. This has been through a stronger operating performance, tight management of capex, lower payments for restructuring and continued currency gains offset by some catch-up in dividend payments to minorities.

As we saw last year, the first half has seen a significant build in inventory as we prepare for seasonal sales but also this year an additional impact as we get ready for our upcoming launches, particularly in *Shingrix* and the closed triple.

We are continuing to improve the efficiency of inventory utilisation with working capital balances ten days lower than they were this time last year. As the inventory build unwinds, we expect free cash flow to be significantly higher in the second half of this year as we saw last year. This was very much the pattern and reflects the changing mix of the business post the Novartis transaction.

Updated 2017 guidance

So where does that leave us for the year? We did not want to fund the PRV by cutting back on other key priorities and drivers of future growth and as a result, the PRV and other accelerated launch spend for the two-drug regimen will impact our previous expectations for growth in adjusted earnings per share this year by around 2% and we are updating our 2017 guidance range accordingly.

With no *Advair* generic expected this year, we now anticipate adjusted earnings per share to grow by 3% to 5% in 2017 on a constant currency basis. If exchange rates remain at current levels then we would expect a full year FX tailwind of around 8% to adjusted EPS.

Looking further ahead, the commercial environment remains highly competitive, especially in our Respiratory business where we are also seeing continued pricing pressures. We are in the middle of the contracting round for 2018 and every indication suggests that as we move into next year, there is going to be no let-up in the pricing pressures we have been seeing for *Advair*, but also the new *Ellipta* Respiratory products as payers anticipate an *Advair* generic sometime in 2018.

Against this market backdrop it is critical we continue to invest to grow the market share of our recent launches as well as prepare for those that we expect to launch shortly if regulatory approval is given on the timelines expected. It is also important that we can continue to invest in the newly prioritised pipeline.

The financial architecture aligns our strategy to clear financial goals

We are going to use our financial architecture to ensure that the delivery of our strategic priorities of innovation, performance and trust translate into clear financial goals that we can embed across the company. The goals of our financial architecture are

- to drive stronger growth in sales through improved innovation across all three businesses
- to drive earnings per share faster than sales through better performance, driving operating leverage through the business from tight cost control and continued financial efficiencies; and
- to convert more of those earnings into cash which can either be reinvested in the business or returned to shareholders.

All of this achieved the right way, consistent with our values and our objective of building trust in GSK.

We will use the architecture and its common goals to help create a step-change in the alignment of our operations around three fully integrated businesses. This will enable new end-to-end emphasis on cost discipline and cash consciousness. It will also allow us to be clearer both strategically and operationally on how we invest and allocate our capital between our different businesses.

I would now like to run through each of these goals in a bit more detail.

Cost discipline to fuel investment for growth

Additional £1bn of annual savings at CER

We have already driven annual cost savings of more than £3 billion from our combined integration and restructuring programme. This has helped offset major headwinds over the past few years from pricing and the decline of profitable older products such as *Seretide/Advair*, *Avodart* and *Lovaza.* It has also allowed us to restructure our cost base to create significantly greater flexibility to reallocate our resources to where we see the greatest returns before we have to add additional funding.

The continued stability in SG&A expenses and the leverage that this produces, despite significant promotional investment going in behind our new products, is evidence of the effectiveness of these efforts but there is clearly more that we can do.

We anticipated at the time of the Novartis transaction that we would invest approximately 20% of the savings, and our tracking since that time suggests we have invested slightly more at around one-third of the benefits. This has gone mainly to promotional support and supply chain improvements and then more recently to R&D.

Two-thirds has been used to offset the margin pressures we have been experiencing from pricing and the decline of the older products.

We have now identified another £1 billion of annual savings from the same programme, primarily in the Pharma business through supply chain efficiencies, simplifying our operations, improved procurement savings and a more streamlined functional model aligned to the new business priorities that Emma has outlined today.

We again intend to reinvest approximately one-third of these savings into supporting our already launched new products, key near-term launches and the R&D portfolio. Similarly, the rest will be applied to protecting our margin by offsetting some of the pricing and competitive pressures we continue to face in the Pharma business.

Cost discipline

While those pressures will remain a meaningful drag on our operating margin over the next several years, particularly in the year in which an *Advair* generic in the US does arrive, we expect to begin to see a better balance going forward as the operating margin benefits from stronger sales growth for new products and the drag from *Advair* reduces.

Remember though that we have always said that we would manage the margin to deliver more sustainable earnings per share growth for the longer term, and so margins may move around quarter-to-quarter as we invest to drive that growth.

Cost discipline to fuel investment for growth

Funding new product launches, R&D pipeline and protecting margins

Important to delivering a sustainably better margin is that the tailwinds also go beyond restructuring benefits, even though those have been a significant contribution.

Across our three businesses as well as at the centre we plan to ratchet up cost discipline with a particular focus on improved supply chain efficiency to drive a more competitive cost of goods, tighter control of SG&A, including capping growth in functional and other support capacity and strengthening our procurement capabilities.

In our supply chains we are reducing complexity by divesting some of the tail, cutting the number of manufacturing sites and lowering the number of SKUs. Beyond our internal manufacturing network, we are also focused on simplifying the number of contract manufacturers we use, which will improve utilisation and contracting terms as we leverage better scale with the contractors that remain. Generating additional savings from procurement will be a significant focus for us, and we have announced today that we shall consolidate all of our procurement activities into one unified organisation to leverage scale and best practices, and we are targeting this organisation to deliver mid single digit percentage savings in material and indirect costs, as well as non-production spend, to improve our cost of goods and to allow us greater investment flexibility across the P&L.

In establishing our new business priorities, we have also identified opportunities to reduce non-working SG&A further, simplifying and hubbing the ‘back office’ elements of support functions including medical and regulatory, and to reinvest this behind customer or patient-facing SG&A. We expect that this will enable us to cap the growth of our non-working spend behind sales growth, improving operating leverage, to move us into a more competitive position relative to our peers and other relevant benchmarks.

To underpin this additional cost discipline, we shall govern the performance of each of our three businesses through a fully integrated P&L. While we have had this in place for Consumer Healthcare for the last couple of years, this is very new for Pharma and Vaccines and it has driven a step change in decision-making for Consumer and should do the same for Pharma and Vaccines, mainly by aligning supply chain, commercial, R&D and functional teams to a single set of objectives, and allowing clearer trade-offs, improving performance and profitability as a result.

Cash consciousness

We also need to improve our cash generation and to do so we shall build cash metrics more directly into employee incentives. We will also implement end-to-end cash flow accountabilities within each of the businesses to allow us to drive cash consciousness much deeper into the organisation. We will ensure that the three businesses have specific cash targets and are accountable for managing their cash flow directly. We will focus particularly on driving further working capital efficiency, managing our capex in a more integrated way -

more closely aligned to the priorities of the three businesses - and reducing restructuring spend.

As an example, we plan to reduce our holdings of inbound raw materials by more than 30% by 2020 by shifting to a much more vendor-managed or consignment stock model.

On capex, we are now prioritising pipeline investments and capacity expansion for new products much more directly, and turning off other investments around older products.

We have also recently established new ways of working in our procurement of capital to ensure not only competitive purchase costs but also more standard equipment and infrastructure. For example, we previously announced increased investments behind *Ellipta* and have leveraged our strong and strategic relationships with preferred suppliers for manufacturing equipment across all of our *Ellipta* producing sites. This drives better capital efficiency, ease of technical transfers and an improved capability with this equipment internally. As the equipment is now identical across all of our Respiratory sites, we know how it performs better, resulting in less deviations and waste and reductions in unit cost for each *Ellipta* device. We have a specific programme for *Ellipta* that is targeting a 20% reduction in unit cost for an *Ellipta* device by 2020.

Capital allocation

To strengthen our allocation of capital across the Group and ensure that it is allocated to where the best returns are available, we are implementing a clearer set of priorities for our capital and creating a new Board to govern the allocation of capital between our businesses.

To support this new approach, we have for the first time allocated all of our invested capital between the three businesses, so that we can track the overall returns each of them makes and be able to allocate between the three much more deliberately.

The priorities for the new Board are, first, to invest in the business and drive growth by

- strengthening the Pharma pipeline and backing winners as data read out;
- taking opportunities to strengthen the company such as the Consumer put, should it come; and,
- thirdly, expanding capacity in Vaccines, particularly in support of our new meningitis and *Shingrix* products.

Secondly, to improve shareholder returns, which I shall return to later and, thirdly, to pursue targeted business development focused on bolt-ons and partnering.

Managing these capital allocation priorities will all be done with the parallel objective of continuing to strengthen our credit profile and protect our target short-term ratings of A-1/P-1.

We will expand the use of cash flow-based return metrics beyond individual project assessments, which is how we have used them previously, and we have now introduced a consistent cash return on invested capital (CROIC) methodology to prioritise investment across the Group as a whole, so that we can compare the returns from each of the three integrated businesses as we allocate capital between them. We shall regularly benchmark ourselves to our peers.

R&D spend will be subject to the same allocation process to ensure we are looking at R&D returns in the context of the three integrated businesses. As a result, we shall no longer publish a separate measure of R&D returns.

5-year outlook to 2020 maintained at a Group level

Turning to the 2020 outlook, to start with at a Group level we are maintaining the overall outlook for sales and earnings that we gave you back in May 2015. This reflects the overall balance of positive and negative factors that we have seen since then, including higher new product sales, earlier delivery of the original integration and restructuring benefits and the extension of that programme, offset by greater pricing pressures in the Pharma business particularly in Respiratory, lower Consumer sales growth, as well as upward pressure on the tax rate. The benefits to the upside are also partly offset by the minority interest in the additional growth we have seen in HIV.

When reviewing this outlook, it is important to understand that we have kept the same goalposts. The 2020 outlook we are giving you today uses exactly the same methodology we used in May 2015, and that includes assuming that,

- the sales and earnings compound growth rates are at constant exchange rates over the five-year period;
- the exchange rates we have used to estimate the 2020 position, including the 2020 margins, are therefore 2015 rates.
- If sterling stays at current levels, we would estimate a positive tailwind to the five-year EPS CAGR outlook we have given you of around 5%.
- We are also continuing to assume *Advair* will encounter generic competition between now and 2020 and will only have £200-300 million of residual sales in the US by then.

Hopefully, this gives you a clearer idea of what has and what has not changed, but you should also note that this unchanged outlook is despite an impact on Group sales of around £900 million from divestments and exits over the period, including the withdrawal of *Tanzeum*.

Pharma 2020 outlook

Looking at each of the businesses briefly. Firstly, in Pharma we have made good progress with new products more than offsetting the decline in *Seretide/Advair* so far. We continue to expect this shift to continue over the five years, with a low single-digit CAGR for sales, despite higher headwinds from divestments and exits over the period than we originally expected.

We also originally expected 2020 margins to be flat at just under 30% at constant exchange rates, with leverage from sales growth being offset by other factors. We now expect that we can do better on margins and deliver low-30s at 2015 exchange rates, thanks to the additional cost efficiencies that I have already talked about, as well as additional leverage from new products performing ahead of expectations.

Vaccines 2020 outlook

Next, Vaccines continues to be on track with our original expectations, both for sales, growth and margin. You have seen the strong result Vaccines has driven over the first part of this five-year period. Looking forward, we have high expectations for *Shingrix* in particular, as we move through 2018.

This key launch will clearly require significant investments in both supply chain and the necessary sales support, which may impact margins in the short term but we still expect our 2020 margins will be 30%-plus. So that is an improvement of at least 5% compared to where Vaccines' proforma margin was in 2015.

Consumer Healthcare 2020 outlook

The Consumer business continues to be an attractive business, with clear synergies within the Group. However, given the expected impact from the market slowdown that I have already discussed, as well as the impact of shorter-term competitive challenges, divestments and GST, we now expect the five-year CAGR in sales to be low to mid-single digits.

Importantly, our margin: we are still targeting to get to the operating margin of 20%-plus that we previously indicated, by 2020.

Financial efficiencies

In the bottom half of the P&L, we are continuing to drive financial efficiencies. On tax, we now expect moderate upward pressure over the next few years and we have already seen some of that this year, given the Group's changing mix – particularly the geographical mix – and the more challenging tax environment.

Overall, we continue to expect adjusted EPS to grow mid- to high-single digits over the five years to 2020 in constant currency terms.

Dividend policy from 2018

We understand how important regular dividends are for many of our shareholders. As a result, returns to shareholders are a key priority for capital allocation, but after first meeting the investment requirements of the business necessary to support long-term future growth.

We continue to expect to return an 80 pence dividend for 2017 and we have also announced today an expectation that, subject to any material change in the external environment or our performance expectations, we will pay a dividend of 80 pence per share in 2018 as part of a new dividend policy for 2018 and beyond. This new policy sets out our objective to distribute regular dividend payments that will be determined primarily with reference to free cash flow generated after funding the investment necessary to support growth.

Over time, the Group intends to build free cash flow of the dividend to a target range of 1.25 to 1.5 times before returning the dividend to growth.

Starting in 2019, we will return to our previous approach of setting dividends on a quarterly basis, rather than continuing to provide a medium-term outlook.

Our aim is to deliver benefits for patients, consumers and shareholders

Going back to our overall vision out to 2020 and beyond, we will focus our efforts around new priorities to strengthen innovation, improve performance and build trust for all three businesses. Emma has set out some of the specific actions that we are taking to do this. Based on these plans, we continue to expect to deliver our 2020 financial targets at a Group level, reflecting the balance in upsides and downsides that we have covered.

Importantly, we are also laying a clear platform for growth beyond 2020, including continued cost discipline, a deeper cash consciousness across the company, and a clearer capital allocation framework to enable investment behind the continued success of our new products and the development of a stronger pipeline.

15 minute break: Q&A to follow

With that, thank you for your attention. We will now take a short break for about 15 minutes, after which we will return to take your questions. There are refreshments outside. Thank you very much.

- *End of Part 1* -