**Leerink Partners 5th Annual Global Healthcare Conference**

**with Simon Dingemans, CFO, GSK**

**Wednesday, 10 February 2016**

**Seamus Fernandez (Global Pharma Analyst, Leerink):** Good morning, everyone. I am Seamus Fernandez, Leerink’s Global Pharma Analyst. I am very pleased to be joined here today by GSK’s CFO, Simon Dingemans, as well as we have in the audience Tom Curry and Jeff McLaughlin.

GSK has really interestingly been one of the strongest performers in a very turbulent market. Over the last month and a half they’ve really been a stock that investors are clearly interested in, driven by a stable top and bottom line, high dividend yields of maybe around 5.6% I think is the right number, but beyond this the Consumer joint venture with Novartis, the HIV franchise, the Vaccines business really all should deliver good top-line growth. As far as we see, the operating leveraging and integration efforts also continue. Additionally, Glaxo’s flagship Respiratory business does face headwinds from an *Advair* patent expiry, and has seen some improved growth from *Breo* and *Anoro* in the US market.

By way of introduction, Simon has been Glaxo’s Chief Financial Officer since 2011. He is a member of the Board and the Corporate Executive Team. He joined GSK from Goldman Sachs, where he was a Managing Director and Partner, and served as Head of UK Investment Banking, and later as a leader of the European M&A business. Before joining GSK he also worked with the company on a number of strategic projects, so he certainly also knows the ViiV Healthcare story extraordinarily well.

So Simon, again, thanks for joining us. Maybe just to kick it off I will just jump right into Q&A because we don’t have a huge amount of time.

Since 2011 it has been a bit of a wild ride, during which GSK management have weathered significant criticism, actually, but, interestingly, as you come out the other side of the Novartis transaction, how do you feel about the company’s position? Obviously, people are starting to change their opinions with their money?

**Simon Dingemans:** Thanks, Seamus, and thanks for having us here today. I think to answer your question maybe in one sentence - a much better place. The last couple of years have clearly seen an enormous amount of transition and transformation inside the company, and particularly 2015 as we closed the Novartis transaction which accelerated and gave us a quantum leap forward in the strategy that we laid out some years ago to try and put more balance into the group, to put a different and broader range of growth drivers into the top line, and to deliver us a range of innovation and new products across all three of our businesses – Pharmaceuticals, Vaccines and Consumer. We had made a lot of progress on that organically but not enough, frankly, to offset the headwinds that were building out of the continual roll-off in our Pharma business of, frankly, some very old products, and in particular, the looming expiration or generic threat to *Advair,* our biggest single product which peaked in 2013 at over £5 billion of sales.

That’s a lot of headwinds to deal with so we were delighted when we were able to agree terms with Novartis for a very innovative transaction, and certainly you referenced my former life. I don’t think I’ve ever worked on a deal as complicated either then or now, but in terms of opportunity it has created for GSK I think it creates a very different set of capabilities and a very different mix of businesses. You can see that now beginning to emerge in the results we have just reported for 2015 with good pro forma growth in Vaccines, strong momentum in the Consumer business, growing margins in both of those businesses, allowing us also a lot of restructuring flexibility to reallocate resources to support the new products we have in the Pharmaceuticals business, but also to drop a very material amount of those benefits to the bottom line to offset the drag that we saw rolling through 2015 and 2014 from the end of *Advair.* I think that’s really showing the different shape that we are looking forward to delivering growth in EPS in 2016 reaching double digits. So I think it’s really about the balance in the group that allows us to get there.

**Seamus Fernandez:** Great, and just as we think about margins for GSK’s business I think one thing that we always focus on almost maybe sometimes too much is trough earnings, but trough margins also are something of interest. How should we think about 2015 and 2016? Was 2015 a year for trough margins, or is the change in the business, does that drive it? So that this year will be a little bit more of a trough year in 2016?

**Simon Dingemans:** I think 2015 was very much the reset year. We took out in disposing our Oncology business a very high profit business, one we captured a very significant valuation for, so we are very happy to have been able to crystallise that value up from, but in terms of the impact on the P&L clearly losing a very profitable business and we brought in from Novartis two sets of assets in their Vaccines and Consumer businesses that had, frankly, way too much cost, and that’s part of the opportunity, but in the short term, created some significant dilution. So in terms of then as we shift forward into ’16 there are a lot more reasons to think we have tailwinds to the margin, rather than headwinds. We are clearly still going to see the continuing roll-off of *Advair, Avodart* coming this last fourth quarter and rolling through 2016, and the established products still put a bit of headwind on the front, but we have growth in our new products. They will improve their margin as they go forward and build volumes. Consumer we have talked about a lot, and I am sure we can come back to that. We think there is a lot of momentum from supply chain improvements, and the transaction to move that margin forward, and the same with Vaccines.

So while I don’t want to get specifically into calling it a trough and it is forward always from there because I think it is important that we be able to move the operating margin around to invest behind the business at the right point, and at the right time to deliver more sustainable and better earnings-per-share-growth, but generally I think you can see the trend is pretty clear going forward here.

**Seamus Fernandez:** In terms of the effect that the international macro-economic uncertainty has had, and the volatility that we have seen elsewhere, how is this impacting your guys’ results, whether it be the Emerging Markets impact? Is it something that you expect to extend beyond this year, if there is any meaningful impact?

**Simon Dingemans:** I think it is showing most obviously in the Emerging Markets and across all three of our businesses. The International Division definitely saw slower growth last year than we have seen as a trend over the previous several. Places like Russia, obviously with the oil price down, currency down 50%, people trading down inside that market, impacting the Consumer business. Governments cancelling and delaying tenders all across Latin America. China where we’ve obviously had our own specific issues, but even inside the structural parts of the market you can see prices coming down significantly, and you have seen that across the board. So that is where it is probably sharpest.

I think the broader environment then leads to all of the pricing discussion that you’ve got going on here in the US, broadly in Europe and also in the Emerging Markets. So those two things are probably quite linked, but that will probably take longer to play out.

**Seamus Fernandez:** As we think about balance sheet flexibility can you just walk us through a couple of things that we get questions on? One thing is particularly, if Novartis moves to execute the put, how do you view the balance sheet’s flexibility in that regard? Also, walk us through a little bit of the structure of what happens if that put actually is exercised, because I think that may not be fully understood either.

**Simon Dingemans:** Maybe before we go there I think it is quite important to just go back to what we said at the time we announced the transaction. We identified then two priorities for our cash flow. One to fund the restructuring spend and accelerate it and get through it as quickly as possible, to drive the benefits more quickly, but also to reduce the uncertainty and get the company onto a more stable footing going forward, and we made very good progress on that this year; and second, to support the dividend at 80 pence a share over the bridge of transformation, if you like, ’15, ’16 and ’17, with a view that by the end of that period we will have dialled down the restructuring spend, capex would have peaked, we would be through the integration, sustainable cash flows from the business back into a more normal, supporting pay-out relationship with the dividends.

So there is a very clear bridge of transition. To do that we retained an additional amount of the Novartis proceeds to provide us with that protection and that cover, and we reduced debt in 2015 by nearly £4 billion, while still paying out that dividend and still paying out nearly £1.1 billion of cash restructuring spend along the way. A little bit more to come in 2016, but then we should see it dial down quite quickly. So you can see the transition on that side of it and I think that is what leaves us very comfortable that we can deal with the puts on either the ViiV business, or on the Consumer business as and when they arise, and frankly I am a buyer of both of those. At the moment there is no signal from any of the shareholders we have in those businesses that they have any intention of selling them. Novartis have no windows until 2018, by which time we are through the path that I have just described for you. Pfizer can exercise right at the moment, but I suspect they have their own preoccupations and Shionogi is now an enormous part of their business, so why they are going to exit – well, you should ask them, but I’d be quite surprised. So unfortunately, I am not sure I am going to get the chance to buy those assets, but I am very comfortable that if I did, we would like to and can absorb it onto the balance sheet.

**Seamus Fernandez:** As you think about some of the capital markets and the movement there, if you don’t have an opportunity to buy those assets then you’ve obviously still got plenty of balance sheet flexibility. As you look outside, in terms of business development outlook, has the recent environment changed your view at all, and do you expect industry M&A to actually increase on the Pharma side of the business?

**Simon Dingemans:** I think that personally I would still be quite surprised if there’s a lot of big scale M&A. There may be a few years down the track if the pricing environment plays out as some of the politicians would like to see it. That, rather like the Consumer world, what seems almost inevitably to lead to consolidation and the need to take costs out of combining them in larger businesses, I think short term I suspect you are going to see more of the same in terms of smaller pipeline in-fills and from our perspective, we have always had a much greater appetite for those at a very early stage than a late stage. I think we find the risk profile and the prices you have to pay to buy near approval or even marketed assets generally a poor trade. Maybe we’ve called that right, maybe we’ve called it wrong, but in terms of balancing it off also against the opportunity cost of what we have to do internally, that bar, if anything, has gone higher not lower given what I described earlier about how much is going on inside all three of our businesses.

But, we announced the BMS acquisition just before Christmas where we’ve strengthened the pipeline for the HIV business and we are very excited about that and the depth that it brings. We expanded the relationship with Adaptimmune just before our results last week, and I think expect us to look for and be doing things like that, rather than something bigger.

**Seamus Fernandez:** Okay. In terms of a post-election scenario, the US outlook is ‘entertaining’, I guess, is the best way to characterise it so far, but in terms of government regulation of US prices, do you guys have a view to that and is that something that you think is an inevitability or is it something that you are simply just prepared for should it occur, but it feels unlikely?

**Simon Dingemans:** I think we’ve been quite clear for some time that we see a reasonable amount of risk in the US pricing environment, and exactly how quickly it plays out that’s a lot less clear. Certainly from a political action legislation you have to imagine that’s going to take some time given current position in Congress, presidential election, etc. So I think we are less suspicious that’s where it comes from. I think we are much more worried that it creates an environment, however, which leads to much more wholesale change in the structure of the sector.

You have already seen the PBMs starting to throw their consolidated weight around much more aggressively, the insurers on the payor side also demanding a better deal, so those are probably the shorter-term pressure points to worry about. It is one of the reasons why we have followed the strategy we have, which is to say we want to be as exposed as we can be to the US market and Japan and other places that pay for innovation when we have innovation, but we are not going to put all our eggs in that basket. We want to have breadth and we want to have balance in the group so we want a decent size European business, we want Emerging Markets to give us the longer term play on those demographics and be able to manage the life cycle of our products into rebuilding those post-patent expiry, as we have done with *Ventolin*, *Augmentin*, where we now do probably double the volumes that we used to when the product first went off patent. It is clearly a different price, but it grows value, high single digits, double digits steadily year after year if you can get yourself into those positions.

So we are following a very different path, but people have often misquoted and misunderstood what we are trying to do. We are not giving up on the innovation end of the spectrum. We are just doing that and other things as well.

**Seamus Fernandez:** Right. If there are questions in the audience, please just raise your hand and we will have somebody come by with microphone.

Maybe just in terms of the Consumer business, let’s talk a little about the opportunity for growth sales. Particularly as Novartis rebounds, I don’t know if folks are modelling that correctly, or if you feel that folks are modelling that correctly, but you have a top line that can recover, you are integrating the businesses. I guess the one question is is it conceivable that you could achieve Reckitt-like margins? I know that that tends to be the question in the US!

**Simon Dingemans:** If you know what they actually are! I think seriously there are lots of reasons to believe that we can move the margin on the Consumer businesses. It sits today a long way forward, and we have set a business a target of getting to at least 20%, and then we will decide. As we said on the earnings call, if you look at the visible margin of the best peers, they tend to be between 20 and 25%, and somewhere in that territory you probably start trading growth off the margin. That maybe the right thing to do, depending on where you are in an innovation or an investment phase.

But, I think from our perspective the business showed very good progress this year. It put nearly 200 basis points on the margin. We obviously lost most of that to currency, particularly out of Russia, China and the Middle East in that business, but the underlying cost structure gives us a lot of leverage as those pressures start to ease and we will continue to address those costs that we have in areas where the currencies are vulnerable.

So whether the Reckitt’s margin is quite what the propaganda would have you believe of +25%, we will see when we get there, but between 11 where we are now, and 20-something and a top line growing at mid-single digits, that’s a very different business in three years from now, let alone five years from now, and it is one of the reasons why we are quite clear that now is not the time to start changing the structure of the group and disrupting that. It doesn’t mean that it isn’t a sensible question to ask, but it is probably a more sensible question when we’ve delivered quite a lot of that.

**Seamus Fernandez:** Great! Maybe just given what we have seen in terms of the strength of the ViiV business, and some of the questions and criticisms that are publicly stated out there from investors to break up the business, can you talk a little bit about what’s really your answer to investors calling for an immediate break-up of the business? I think you guys have answered this question a number of times but I think maybe some folks can’t hear it enough.

**Simon Dingemans:** Hopefully I just addressed the Consumer side of the discussion. I think on the HIV side we did go through a process a year ago of looking at whether we should IPO that business, and it is always interesting when you go and conduct a public process because you get some quite different feedback than often what you get in private pitch books. Having gone out there and validated what investors would value that business at and what they were prepared to pay for it, at the same time we were getting more visibility and more comfortable with the trajectory of that business, the momentum in it and the depth of the pipeline. Ultimately it seemed to us the right thing to do to fold it back into the business and to retain it for the very longer term.

Now again, never say never, but I certainly think for the very foreseeable future it is a core and central part of our Pharmaceutical business. That’s why we are going to stop reporting it quite so distinctly going forward because it was creating this slightly academic discussion about what the margin was on this product versus that product and we regard the ViiV cashflows as an important contributor to the dividend, R&D investment, the overall ability to drive the next waves of products across the Pharma business, not just in the HIV space. So I think it is very, very central to what we are trying to do and if it wasn’t we wouldn’t have done the BMS deal.

**Seamus Fernandez:** And in the calls to spin out the Consumer business, to me it doesn’t make sense at this point in time, but –

**Simon Dingemans:** I think it is a perfectly sensible question. It has been asked repeatedly over the years. It just isn’t the whole question. You have to ask if you spun off Consumer, what about the rest? Where does that leave the rest of the group? We are just at a point where, as I have described, all three businesses are, having been through 2015, significant restructuring in Pharma, integration going on in Vaccines and Consumer, why would you throw the structure of the group up and distract people from delivering the significant upside that we see there.

I think that is particularly true for the Consumer business and it is the reason we agreed with Novartis when we set up the joint venture a three-year lockout when no-one could do anything, because that was the last thing we wanted to have happen, and I think it is a bit of an easy reaction to some of the frustration, which I fully understand with the pace of our transition over the last couple of years, but now just seems like the wrong moment to ask that question and change things.

Maybe in a few years time that is a sensible question, and we are certainly open. We are not closed to it. It is just a ‘not now’ question.

**Seamus Fernandez:** Great. Perfect. I think that brings us to the end of our time. Simon, thanks again for joining us, and it is a real pleasure have GlaxoSmithKline here at our conference again this year.

**Simon Dingemans:** Thanks very much.

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