GLAXOSMITHKLINE

SECOND QUARTER RESULTS 2014
PRESENTATION TO ANALYSTS

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Sir Andrew Witty (Chief Executive Officer): Thank you. Good afternoon, and welcome to today's call to everybody.

GSK's performance in the second quarter provides evidence of the very significant changes that are taking place in the Group's portfolio. As you know, our strategy over the last six years has been fundamentally to reshape the Group and our R&D operations in particular, so that we can replace the significant sales being lost to generics, and ensure that the company can succeed in an environment where our biggest product *Advair* faces increasing competition.

It is clear that we are now in that period of transition, and this is a critical moment to ensure that we make the right strategic choices, particularly around investment for the long-term health of GSK in the new products. This is reflected in some of the decisions we have taken during the quarter.

Group sales for the quarter declined 4% to £5.6 billion largely driven by lower sales in the US, where we are seeing earlier and more significant generic competition to *Lovaza* than expected, and continued pricing and contracting pressure in the Respiratory market, including for *Advair*. However, while *Advair* sales are now likely to continue to decline, we expect new Respiratory products – *Breo*, *Anoro* and *Incruse* – to generate new sales growth. Already we are seeing some recovery in our overall Respiratory volume share as new launches progress, albeit at lower price points. These assets, together with the six other Respiratory products in development, will diversify and strengthen our Respiratory portfolio, and we remain confident we can maintain our leadership position in this therapy area well into the next decade.

Outside the US, performance was more positive with Emerging Market sales up 11% driven by a very strong Vaccines performance in the quarter, up 26%. Europe, with flat sales, also performed strongly in a tough trading environment with continued negative price pressure. Japan was down 7% in the quarter, reflecting a destocking following the consumption tax increase, and sales for the year to date are up 5%. I was particularly pleased by the performance of our HIV business, ViiV Healthcare, where sales grew 13%. This has been driven by the extremely strong launch of *Tivicay*, our new integrase inhibitor, which is on course to be one of our best launches so far.

As flagged in the last quarter, our Consumer Healthcare business has been affected by some supply interruptions to several brands, particularly in the US and Europe, and this led to a sales decline of 4% in the quarter. The supply situation is beginning to improve and for the year we expect total Consumer sales to be broadly flat.

Strategically, we have decided to maintain support for and investment in our substantial portfolio of new product launches, as this is essential for the future health of the company. Ongoing investment behind these launches, combined with lower sales, led to earnings per share down 12% in CER terms.

Taking all factors into account, it is unlikely that we shall now deliver sales growth for the year, and we now expect full year core EPS on a constant exchange rate basis to be broadly similar to last year. The dividend is up 6% this quarter to 19 pence. Therefore, we are clearly in the part of our long-term investment cycle where we are seeing the delivery of significant new product flow from R&D. What is critical is for us to stay focused on ensuring the launches of the first six products are successful.

Looking ahead, I believe that this existing strength will be supplemented both by further delivery from the pharmaceutical pipeline, and the anticipated completion in the first half of 2015 of the three-part transaction with Novartis that we announced in April. Opportunities in the pipeline for our core therapy areas remain extensive.

In Respiratory, we filed *Breo* for asthma this quarter and expect to file our first Respiratory biologic, the anti-IL5 monoclonal mepolizumab, in the second half of the year. We expect to be first-in-class in that particular case.

We also began Phase III studies for the first triple combination product for COPD in the quarter. In HIV we received a positive CHMP opinion for our combination HIV product *Triumeq* and we expect an FDA decision on this asset in the second half of the year. Overall, we have over 40 new molecular entities in late stage development and, across the R&D pipeline, we believe there are a total of 30 drugs with the potential to be first-in-class in areas such as immuno-inflammation, epigenetics and cardiovascular disease. This should lead to a regular flow of new product introduction over the next few years.

The three-part transaction with Novartis provides the opportunity to reshape the group and strengthen our positions in the long-term growth businesses of Vaccines and Consumer Healthcare. Post-completion, these businesses will represent around half of Group revenues over the coming years, and should be capable of generating mid-single digit sales growth on a consistent basis.

To give you more details on the quarter, I would now like to hand over to Simon Dingemans, the CFO.

Simon Dingemans (Chief Financial Officer): Thanks, Andrew. This has clearly been a challenging quarter but one that has made us even more convinced that our strategy to build a more balanced set of growth drivers across the Group is both the right one and one that is showing visible progress, despite the significant headwinds we are currently facing.

The most significant step forward in the quarter was the agreement with Novartis of a major three-part transaction, which we believe accelerates our strategy significantly and strengthens the long-term durability of our key franchises. We continue to expect the transaction to complete in the first half of 2015 subject to regulatory and shareholder approval.

More immediately, our core results in the second quarter were particularly impacted by the shift in US pricing and contracting that we have been discussing with you for some time. This has especially affected *Advair*, which has now seen a step change in its outlook, exacerbated now that the transition to our new Respiratory portfolio is underway.

Reported sales for the quarter were also impacted by a number of other factors, including supply interruptions impacting several parts of our Consumer business, which we now believe will take somewhat longer to fully resolve than we originally anticipated, and earlier and sharper generic competition to *Lovaza*. The impact of these issues on the quarter masked important momentum in other parts of the business. We continue to deliver strong growth in several strategic areas where we have been investing: emerging markets, ViiV, vaccines – especially in the emerging markets, and our oncology portfolio also delivered further progress.

We have continued to see greater stability from the business in Europe and our portfolio of new products is starting to make a material contribution, with *Tivicay* and *Mekinist* and *Tafinlar* doing particularly well, and *Breo* and *Anoro* are beginning to build. While the respiratory launches are clearly developing more slowly, we always expected that it would take time and investment to build them to their full potential, compared to the relatively rapid uptake of our more speciality launches.

In the meantime, looking at the second half of 2014, as always there are a number of variables that introduce a degree of uncertainty, quarter-to-quarter, including stocking patterns and securing and delivering on large tenders. At the same time, we expect *Advair*

in the US, the consumer supply issues and *Lovaza* to continue to impact our reported growth. As a result, and given where we are year-to-date, we no longer expect to grow sales this year.

We continue to manage our cost base tightly and still expect to deliver at least £400 million of incremental restructuring savings during 2014, including the benefit of the structural savings of £200 million I have previously highlighted. It looks likely that these will now fall into Q3.

As we have discussed in the past, our plan has always been for most of these savings and other cost control measures to be reinvested behind our new launches and other growth opportunities, as well as in new capacity and technology for our manufacturing operations. Continuing with these investments is key to delivering the full potential of our pipeline and securing the future growth drivers for our key Pharma, Vaccines and Consumer businesses. As a result, given our revised sales expectations, we now expect full-year core EPS to be broadly similar to 2013 on a constant currency basis and ex-divestments.

Before commenting on the detail of the Q2 core performance, I should point out that the sustained strength of sterling against most currencies is negatively impacting our reported top line growth. Given that a large proportion of our manufacturing and R&D cost base is located in the UK, the negative impact of currency is even more pronounced on our earnings. It is also impacting our sterling cash flows.

We currently estimate that the full year adverse impact of currency, if rates remain at their current levels, to be around 7% on the top line and around 12% at core EPS level. This is a little lower than the first half negative currency impact, in part because in the second half of last year we had exchange losses of around £63 million.

Turning to the quarter, Group sales were down 4%, reflecting the challenges we have already discussed. In particular, in the US, US Pharma and Vaccine sales were down 10% in the quarter and this primarily reflects a 21% reduction in the underlying performance of *Advair*. Price pressure remains significant, with price impacting *Advair* sales in the quarter by 7%. Volume reductions of 14% reflected the contracting changes we discussed at Q1, but also the early impact of our new launches which, together, have adjusted *Advair* onto a new trend line that will likely see it continue to decline in sales over the next two to three years while we transition to our new Respiratory portfolio.

Oncology sales in the US continue to do very well, growing 42% in the quarter.

In Europe, Pharma and Vaccine sales were flatter than last year, despite increasing competition in the Respiratory market particularly. Growth from Oncology products –

Avodart, Benlysta and Volibris – all helped to offset lower *Seretide* sales, which were down 4%, mainly due to price reductions. Vaccines were down 5%, due in part to a number of shipments for several products that are now expected in the second half.

In emerging markets, total sales of our Pharma and Vaccines business grew 11%, or 15% excluding the 'China effect'. Sales in China were down 25%, including the established products, showing further stability in the quarter-on-quarter trend that we have reported on over the last several quarters. Growth in the region was led by a 26% growth in Vaccines, with significant tender wins for *Synflorix* and paediatric vaccines.

In Japan, sales were down 7% as a result of wholesalers destocking following their Q1 stock bill, they had the tax increase, and, year-to-date, Japan is up 5%, despite a weaker allergy season.

Turning to ViiV, ViiV Healthcare sales grew 13% in Q2, in large part due to the very successful launch of *Tivicay* in the US. The launch of *Tivicay* is now just getting started in Europe and Japan and the business is also awaiting regulatory decisions in the US and Europe for its new three-in-one STR, *Triumeq.* If all goes well, this could be launched in some markets during the second half of the year.

For Consumer, the business was down 4% in Q2 in reported terms and sales in all three of its regions were impacted by supply disruptions, particularly for smoking cessation products. We now have in place remediation plans for these issues and the supply position is beginning to improve. Overall, we expect the Consumer business to be broadly flat at the top line for the year.

Looking at our operating costs, the operating margin, excluding currency effects, was down 3.2 percentage points. The margin decline partly reflects the impact on cost of goods of an adverse shift in mix, particularly given the US decline in Respiratory sales, but the primary driver was the increase in the quarter in SG&A as we reinvest cost savings to support our new launches, particularly in the US, Japan and Europe.

We delivered further financial efficiencies in the bottom half of the P&L with interest down from £183 million in Q2 last year to £156 million this quarter, reflecting the improved funding profile of the Group and our effective tax rate was also down two percentage points from Q2 last year to 22% for the quarter, in line with our expectations for the full year.

Turning to cash flow, fundamentally our business remains strongly cash-generative and we continue to focus on improving the conversion of earnings into cash. Cash flow in the first half has however been impacted significantly by currency with the strength of

Sterling costing us around £500 million of the £1 billion pound decline in cash flow relative to the first half of 2013.

The remainder reflects the disposals we made last year and the decline in operating profit reflecting the impact of trading, particularly in the US.

First half cash flow is generally a bit lower than the second half looking at historic patterns with working capital a negative factor given seasonal and other requirements, particularly in Vaccines.

New launches have added to the pressure this year and inventory is the main driver of the increase of approximately 14 days in working capital compared to Q2 last year.

Inventory days in particular are likely to remain higher over the balance of the year and leave working capital at the end of 2014 slightly higher overall than last year overall in days terms as we ensure supply behind the roll-out of new products and launches.

Our focus on longer-term improvements in inventory and other working capital efficiencies is unchanged.

Net debt at the end of the quarter was £14.4 billion, £1.3 billion lower than a year ago, but £1.8 billion higher than the year-end 2013 number. This increase since the year-end is due to £0.7 billion spent on increasing our shareholding in our Indian Pharmaceutical company and cash returns to shareholders, mainly dividends.

We continue to prioritise the dividend in our returns to shareholders and the 6% increase in the dividend to 19p for the quarter reflects our confidence in the momentum across the business despite the near-term challenges we are addressing.

We have repurchased 238 million of our own shares during the first half. We will keep our share repurchase programme in place but given the net impact of currency on our cash flows, share repurchases over the balance of the year are likely to be immaterial.

Any proceeds from disposals including any from our Established Products Portfolio will be retained in the short-term to ensure our flexibility to invest behind the new launches, our manufacturing enhancements as well as the continued restructuring of our cost base but longer-term, we will continue to consider share buy-backs alongside the dividend where those repurchases offer an attractive return.

With that I will turn it back to Andrew for questions.

Sir Andrew Witty: Thanks, Simon and if I could ask the operator to start the Q&A session please.

Question & Answer Session

Graham Parry (Bank of America Merrill Lynch): Thanks for taking my question. Firstly kicking off with questions on *Breo* and *Anoro*, can you just give us an update on what percentage of product is not being picked up in the Rx data, so how much sampling is still there and what are the pharmacy rejection rates for each product?

Secondly on *Advair* the negative price of 7% year-on-year in the US has been fairly consistent across first and second quarter, so is this just a one-off step down? Your release today seems to indicate that you expect further pricing pressures so should we read that to be that second half pricing impact would be greater than 7% and to what extent do you think we can expect this to annualise as we enter 2015?

And then thirdly on the shape of the margins into 2015, this year it's clear there is no margin recovery but next year how do we think about margin dilution from the asset swaps along with cost savings and margin leverage from the new portfolio playing into how your margins might progress into 2015? Thank you.

Sir Andrew Witty: Thanks very much, Graham. Just on the first question, the initial launches, what we are seeing is less rejection of *Anoro* than we saw with *Breo* so in the first month and I am talking really about Medicare Part D which is really the key part for this COPD market, so if you look at the initial months of launch of *Breo* we were seeing about between 55% and 60% of scripts being rejected and then another 20% being reversed, so that is, a patient who could have had the opportunity but at a very high co-pay and chose not to go forward.

We are seeing the rejection rate for *Anoro* more like the 44-45% but again we are only in the first four to six weeks so very, very early data but looks significantly better.

We also have substantially more coverage on *Anoro* at this point of the launch, in the case of *Breo* at this point we had basically 3% of Medicare Part D. As of today, we have about 27% coverage of Medicare Part D for *Anoro*. That kicked in 1 July, so we have seen a much more rapid pick-up on *Anoro* in terms of access.

In terms of sampling, both continue to be very heavily sampled, so substantially more samples being put into the marketplace than are being prescribed. We also, as you know, have various voucher schemes which are also offering patients the opportunity to start the medicine; so quite a bit of product still not within the audit.

Having said all of that, if you look at *Breo* in particular for the US, we have seen some very encouraging trends over this quarter. One of the leading indicators that we use is NBRx – that is "new to brand prescriptions", so this is not NRx/TRx data that you are used to, but more NBRx so this looks at the really dynamic part of the marketplace. In COPD about 12% of the market is dynamic where you have people really changing drugs. That is a relatively small proportion compared to some other categories, particularly in speciality, but that is what it is for COPD.

We already have a 12% market share of pulmonologists in that NBRx section, so if you look at the behaviour of specialists in the dynamic section we have seen very good uptake. In fact, one in two pulmonologists in the US have now prescribed the drug – about 14,000 physicians altogether have prescribed the drug, so we have seen quite good movement there first of all.

Secondly, we are seeing continued upward trajectory of the NBRx performance. That is important because, typically when you look at primary care launches, after the first 10/15 weeks you tend to see the performance on that leading indicator being to plateau. We have not seen that with *Breo*; we continue to see an upward trajectory. That is a very encouraging sign and if you look at all products launched during 2013, *Breo* now is looking like the fifth or sixth best performer so far and continuing to improve, whereas the vast majority of launches have either not performed as well as *Breo* or are flattened out. That may surprise all of you, but it is very reflective of the change in the marketplace in US primary care launches – big difference between specialty and primary care. The signals for *Breo* look encouraging. When we last spoke we had something like 1,000 prescriptions a week; we are now well over 5,000 prescriptions a week in terms of NRx; looking encouraging.

We are seeing similar encouraging signs on *Anoro*, but as I have said it is extremely early days. If you were going to characterise it you would say that *Anoro* was tracking a better trajectory than *Breo* was and we feel okay about *Breo*.

In terms of the price effects, what you are seeing essentially on price is the effect of increase in discount rates playing through and obviously neutralising any price increases. You are quite right, the effect is broadly similar across the two quarters.

My expectation is that you probably see a broadly similar trend going forward; whether or not there are further step downs in that really depends on the various contracting cycles. Clearly what you would want to see is, as you start to step down, if indeed you start to step down, that should re-acquire volume market share, so you should be seeing some

offset in the volumes, whereas this phase we have just been through has been a little bit more of an adjustment to competitor dynamics.

As you look forward you should start to expect us to see more puts and takes around price and volumes swinging back and forth. We have certainly been winning a number of contract over the last few weeks, which gives us quite good confidence overall for our respiratory volume position going forward.

I make the final point that if you look at volume market shares, *Advair* plus *Breo*, what you see is over the last three months we have stabilised and been growing the total GSK volume market share; everybody else is essentially under pressure for share. While that is very early days, that is exactly what we want to see. What we want to see is, at a volume level, that we can build off the existing *Advair* volumes and that is where the sustainable business sits. Clearly that is at a different price point to the prices we were achieving two/three/four years ago, but that is the adjustment that we are going through over this period. What is encouraging is that although there is a price adjustment, we are seeing the acquisition of incremental volume into the marketplace. There are very encouraging signs that, as you think about *Anoro* and then *Incruse* and then the rest of the products being loaded into that portfolio, the opportunity for us to grow share back is very substantial; that is where our confidence sits for long-term leadership in the respiratory marketplace.

Next question?

Tim Anderson (Sanford Bernstein): Thank you; I have a few questions. On respiratory if we are seeing price competition with *Advair* why won't we end up seeing the same thing over time with newer products, like *Anoro*, where in that case the LABA/LAMA category will become more crowded?

The second question is on your GLP-1, *albiglutide*: at least on a list price basis you seem to have entered the US market at a very big price discount relative to the competition, which is something that you don't ever see drug companies do, especially with new drug launches. Any comments behind your decision on that would be appreciated.

The last question: on the basket of products you are considering for sale does that represent an opportunity for tax inversion for the acquirer? Also why not sell off more than just the £1 billion that you referenced?

Sir Andrew Witty: Thanks, Tim. Let me just nail the EPP point first of all. A billion pounds – it's mostly Europe and the US. As I have described previously, we have split the EPP into the separate reporting category to give you clarity of what is going on in

the business but also to give us focus as far as how we can streamline that business to take complexity out. There is a huge programme going on in GSK to strip out SKUs and brands, something like 200 brands being deleted, so the smallest products around the world, in order to take out complexity as we bring in the new products, as we want to make space in the organisation for those.

However, as we have also said, there are opportunities for disposal which, practically speaking, are resident in Europe and America. This represents between a third and a half of the European and American tail business, so EPP business, so it is a substantial part of that business. We are not close-minded to doing more but the reality is that, as far as finding those clusters of brands and businesses which are reasonably straightforward to disconnect from GSK, not everything is reasonably straightforward. Therefore, as I have guided repeatedly, the idea of a block sale for the whole thing is, frankly, not practical.

Where you can get this sensible ring-fence and it is relatively straightforward to disconnect, you can generate decent reward. I do not know whether or not somebody will look at this as an inversion opportunity. We are not particularly interested in that, or have a priority on it but, of course, in this current environment, there are plenty of potential buyers for these blocks of business, some of whom might have that in their mind. Others have very different agendas. I am pleased with the level of interest we have there and we shall pursue that.

Tim, I would also remind you that we have divested a number of tails over the last four years: we divested our Consumer tail; we divested our Drinks business; we divested *Fraxiparine* and *Arixtra*; we divested *Treximet*; and we exited *Prolia* in Europe. This is another on a long journey and, if you look back at the amount of tail we have taken out, it is very substantial but we have done it in a practical way.

I know there was a lot of talk about divesting tail but it is quite elusive to create that magic bullet block transaction. What we have done is execute, we have delivered it and we continue to do so.

On *Anoro* price competition, yes, there will be *Anoro* price competition. We priced *Anoro* at a discount to the marketplace and there will be a significant negotiation in that space just like in any other primary care space. Whether you look at the LABA/steroid combinations or you look at the LAMA marketplace, there will be degrees more competition than we have had historically. I would anticipate that we may get some of that with *Anoro* and I believe that you will see it across the board in primary care. You are certainly seeing it in diabetes. You have seen a significant amount of price pressure build up in the diabetes marketplace in the last six or nine months.

Frankly, the pricing strategy for *Tanzeum*, our GLP-1, we believe is exactly resonant with what is going on in the US marketplace. Not surprisingly, we have had a tremendous response and level of interest from payors when you are offering something so substantially more value-based than perhaps they have seen. Therefore, it will be very interesting to see how that shakes things up.

I don't believe that it is particularly sensible of us to sit on calls and tell you that there is more price competition and then not think about using price as part of our own competitive set. That is exactly what we are doing and you will see more of that from GSK.

Alexandra Hauber (UBS): I have three questions please. First, if you are selling a billion pounds worth of product, that would be 4-5% of your gross profit. Conceptually, how should we think about your corporate costs and your R&D budget: will this decline or will you compensate the impact from the lower gross profit through cuts elsewhere?

Secondly, regarding your increase in SG&A, can you give us a little more colour on exactly which franchises and which geographies are benefiting most from that, and also in what form the increased SG&A is coming? It is probably not salesforce, so what is it?

Finally, a follow-up on the *Advair* pricing issue: the 7% decline increasing discounts. Is that a uniform 7% increase in the discount, or is it more something like 14% decrease in the discount on 50% of the contracts? So will this be uniform or very discrete?

Sir Andrew Witty: I'll deal with the last question, Alexandra, and I shall touch on the first but I shall let Simon really cover the first and second points. On the first, let us see whether or not we sell this business. We have made it very clear that we shall only sell it if we achieve the value that is commensurate with the profitability of that business, so, first of all, I just want to reinforce that caveat.

Remember that next year, if all goes well, the proposed transaction with Novartis will also take place next year, which will have a much more significant effect as far as the margin structure of the Group. Therefore, the right time to describe to you where the ongoing margin structure of the Group will be is after those events, or when those events are real and we can give you that detail.

I would also remind you that, obviously, when you look at, for example, Pharma R&D, with the proposed transfer of the Oncology business to Novartis, there is a significant proportion of GSK R&D cost embedded around Oncology, which of course goes with that business. I just want to make the point that you will see a great many puts and takes

through the portfolio and not just EPP, and actually much more so around the Novartis transaction. I will ask Simon to cover more of that when he get on to those first two questions.

As far as the *Advair* pricing is concerned, it is not a uniform phenomenon, but there are different movements going on in the different classes of customers, depending on the competitive situation. Much of this has been driven by payer consolidation over the last 24 months, with much of it around provider controlled levels and those sorts of things. Some of it has been driven by competitive dynamics. As I have just talked to Tim about what we are doing with the GLP-1s, we all know some companies that have been aggressive discounters in the respiratory market, and these things come around. That is the dynamic we are dealing with but the good news is that we have many new products coming into these markets and that is what you want when you have this kind of noise: having a new product, where you are able to position your price and where you want to be for the medium-term is a great place to be. Clearly, however, the transition is not painless and that is obvious to everybody.

Let me ask Simon to cover the detail on the margin and perhaps comment more on the ongoing structure.

Simon Dingemans: On EPP, as we have talked about before, these are relatively high margin products. One of the reasons we separated them out was so that we could focus the business on running them for profit and cash. When we think about the disposal, we are really looking at the value that we release from those and the cash contributions that we might expect over the next several years from those products, rather than necessarily the profitability or the P&L impact. Almost by definition, as you sell out these products, they are likely to be diluted in the short term, but that frees up resources for us to be able to invest in the growth drivers for the company, going forward.

That is what you are already seeing in some of the shift in SG&A that you touched on in your second question. Where is that investment going? Some of it is going in sales force, but it is also going in marketing support, in promotional spend, in evidence generation, R&D support and making sure that we have all the tools at our disposal to be able to optimise those launches. We have put a great deal of flexibility into the system and, given the discussion we have had before, we don't see a significant step up in SG&A, but quarter-to-quarter we will see some pressure as we invest in the US, Japan and Europe in particular, where the launch is the furthest advanced. However, that is probably keeping SG&A at broadly similar levels to where we are today, rather than a big move upwards, as you have

challenged us on in the past. That is really the benefit of the flexibility we have built into the cost base over the last several years.

That is the overall profile but, from a margin perspective – and I know Graham asked on this question earlier – at this point, we need to reach the stage of closing the transaction. At that point, we will be able to give you a much more comprehensive view of the significant shifts in the margin mix, and the trends that we will see in profitability as you bring in significantly larger Consumer and Vaccines businesses, which tend to be lower margin relative to the total. We will be taking out EPP products which are higher margin relative to the total, plus Oncology which is obviously also a significant profit contributor, reflecting in the valuation that we achieved for that business when we agreed terms with Novartis. We will give you that when the transaction closes.

Sir Andrew Witty: Thanks, Simon. While Simon was talking, I was reflecting on how things have changed in the Group. If you think back to the creation of GSK in 2001, over the last 13 or 14 years, in the pharma business we have really had three big brands which have been built during that period. There is obviously *Advair, Avandia* which had its own destiny, and *Avodart* or *Avolve,* so you had those three big brands. From the peak of the promotional capability of the company in terms of costs, from the peak of size of sales force in America and Europe, we have about 50% less sales force than we had at that peak when those three brands were the story of the company. As you know, much of that SG&A cost was invested in building up the Emerging Markets business, which has become a very substantial business which grew 11% in this quarter and 15% excluding China.

We are now sitting in a very interesting situation where, over 13 years we essentially had three big brands to build but, in the last 12 months alone, we have launched six brands which have very substantial potential. Looking forward, we can see perhaps three on average a year, every year, going forward: it will not be the same every year, but it will be something like that. Thus the ability of the company to be able to support that with, as Simon said, with a broadly similar SG&A spend, reflects the structural changes of the company. When you look at what we are now doing, even in the launch of *Breo*, just to contrast for you, when *Advair* was launched at the end of the nineties, it took seven years to get from the first European launch to the Japanese launch: it is now taking seven months to get Europe, Japan and America launched. The same is true with *Anoro*, and the same is true with all the other products more or less. So what you are seeing is a much more successful globalisation, so you have more countries coming on-stream simultaneously than we have ever had in the history of the group, you have more products coming on-stream simultaneously and we are more or less holding that with an SG&A base which is essentially

the base after the significant downsizing following (a) the genericisation of the old portfolio and the loss of *Avandia* and (b) the investment in the emerging markets.

But it is inevitable that on a quarter-to-quarter basis there may occasionally be the need for us to invest a bit more here and there to make sure that we have it absolutely right and that is really the pattern you are seeing.

I think when you contrast that to various alternative ways of dealing with the big cyclical moves of pharmaceutical pipelines, this approach is the right strategic approach which we have stuck to for the last six or seven years has put us in a good shape for going forward with this pipeline.

Next question.

Andrew Baum (Citigroup): Three questions if I may. Firstly regarding China, given the pressures on your infrastructure in China is GSK the right company to directly distribute its products within that territory or is some kind of licensing an alternative here that you would consider?

Second, with regard to your LATITUDE trial with losmapimod, could you talk us through it because obviously you have just had two negative, expensive, sizeable Phase III trials in cardiovascular, not necessarily a core area for GSK in the past, which have read out negatively and you have just initiated another 25,000-patient trial here with another new mechanism, so perhaps you could talk us through the rationale and the confidence behind this significant commitment.

And then finally, on the Consumer business, you cite the manufacturing issues regarding the toothpaste as being partly responsible for the posted sales. Certainly it seems to me that your competitors within the toothpaste space seem to have stepped up their promotion of rival premium brands so perhaps you could comment for us on the relative market shares within the toothpaste segment to help us understand how much is manufacturing versus market share issues? Thank you.

Sir Andrew Witty: Thank you very much. Listen, on China we remain very committed to China as a business for us both in our Consumer and Pharma Vaccine business. As you have seen in the quarter you have seen the continued stabilisation of the business there. Obviously we want to work with the authorities to resolve the issues that we have there. I have nothing more to say on that subject.

As far as the ACS programme, losmapimod, basically we are moving this forward into Phase III as you know. The clinical evidence shows that the drug reduces systemic and

vascular inflammation, improves vascular blood flow and has the potential to reduce major adverse cardiovascular events in patients who have suffered a heart attack. That is the basic belief.

The drug has been designed as an acute short-term, 90-day treatment so we are looking at a very different kind of approach to this treatment area than we have seen in other approaches to ACS and as a result targeting the high rate of inflammation that occurs following an initial cardiovascular event which is the period we think where the patient is most at risk of a further event.

Very differently to the darapladib studies, this is specifically focussed on a short-term – we are looking to try and demonstrate the effect of this in a short-term period.

Now obviously it has to have a high number of patients to get the power but it is a short-term treatment programme. We feel good about it, we think the profile looks good but again, like all major R&D particularly when you are looking at first-in-class opportunities, there is obviously going to be risk.

As far as the Consumer business is concerned, you are quite right we are seeing a good recovery from the various supply issues in a number of the areas where we have had some disruption, particularly in the toothpaste business. We see that recovery continuing through the rest of this year when we see the overall Consumer business being flat for the year.

In terms of the performance of our toothpaste business, it continues to be very strong but you have to think about our Consumer Oral Care business in two parts, Andrew.

The first is the premium business, so this is the *Sensodyne*, *Parodontax* denture, dry mouth business. This is the high margin business. That represents 76% of our portfolio. The rest is more the *Aquafresh* business; it's more the business that we compete with the general toothpaste market. That has continuously shrunk as a fraction of our business. Our priority is that premium *Sensodyne*-led business.

The CAGR for that business over the last four or five years has been 13%, has outgrown basically all our competitors. It is clear that we have created the category and actually as we look at other entries, our market share has remained very, very robust. We continue to see good underlying growth, occasionally disrupted by supply issues but *Sensodyne* not too bad and overall we feel very, very robust about that.

But it's important and over time that business will become really very much that premium *Sensodyne*-led business. It started the other way round with *Aquafresh* being the bulk and *Sensodyne* the new idea but now it's all about the *Sensodyne*, *Parodontax*,

denture, dry mouth business and I am very proud of the performance of that business. We have seen continued good consumption numbers in the US over the last six, eight weeks. It looks fine.

Next question.

Mark Clark (Deutsche Bank): Good afternoon, gentlemen. I just wanted to ask a little bit about the dividend. If we assume the second quarter growth rate of 6% is as good a guess as any for the full-year outlook and we take your guidance on earnings and currency, then it does imply that pay-out ratio is pushing 90%; in the high-80s at least. Can you talk to us about whether you have some kind of a ceiling, or is there a point at which you would seek to hold the dividend? I am not suggesting you would ever cut it, but certainly hold the dividend rather than continuing growing in the mid-single digit growth rate that we have seen, or mid-upper single digit growth rate rather that we have seen in recent years? Thank you?

Simon Dingemans: Thanks, Mark. As I said in my comments, the dividend remains our priority in terms of our shareholder distributions. There is no change to the policy. Over the last couple of years we have been paying out relatively high amounts as we go through this transition period and, clearly, decisions for the future are for the Board of the time. We have laid out our stall on that front and there is no change in the policy.

Sir Andrew Witty: Thanks, Simon. Next question?

James Gordon (JP Morgan): Hello, thanks for taking my questions. Two questions left, please? One was on R&D, which was presumably R&D on respiratory is now reducing and R&D has fallen every year for the last two years and was down about 10% year-on-year todate. Can we think that you are going to be able to get some real leverage over R&D because you are going to be able to cut that quite a bit further? If you are more focussed on vaccines and consumer, which don't require as much R&D, is GSK just going to be less focussed on innovation now?

The second question was just to clarify on consumer and the oral care issues and *Aquafresh*. Sales were down quite a lot today, but in Q1 it sounded like the manufacturing issues had been fixed for toothpaste. What is the issue and why did it seem to be fixed and now isn't fixed?

Sir Andrew Witty: The oral care manufacturing issues are essentially fixed and they were at the end of Q1. What you have seen is it takes time to refill the supply

chains; that is basically the difference. As you progress further and further through the year the ripples, if you will, from the disruption, just diminish. Obviously it takes time to re-fill pipelines and the like. Nothing dramatic there at all, James.

In terms of respiratory, our spend on respiratory will not go down, I suspect in the next few years. Why? First, we have a number of more products coming through the R&D pipeline, so I am talking about the pre-approval pipeline. We have the triples, we have some of the very earlier novel mechanisms coming through, some very cool stuff coming out of the DPUs which you will start to hear more about in the next two or three years. We continue to be very active in the traditional R&D space, if I can call it that.

Then, of course, as we have taken one, two, three, hopefully four, five, six into the market you are now going to see more Phase IIIb/Phase IV work going on and there is quite a shift in terms of our R&D spend in that direction. I don't think you should look for respiratory to be a sort of reduced R&D cost. Assuming the Novartis transaction goes through, as I have said already on this call, the transition of oncology from GSK to Novartis will have a significant impact in terms of reducing R&D cost.

The second area which we have been a leader on over the last six or seven years is, as we have developed new technologies, as we have developed new approaches, our utilisation of a lot of the traditional costs of R&D have diminished. If you look at, for example, our efficiency in pre-clinical use of animals, we are remarkably more efficient today than we were four or five years ago. Something like 30% more drugs in development all the way through the system using more or less the same resources we were using six years ago. You are going to see more and more of that over the next two years. You will see continued harvest of efficiency from R&D. You will see some of the bigger landmark studies – unfortunately *Darapladib* didn't make it; that has been a big piece of the cost base. You will see that drop out. You will see oncology transfer out subject to the transaction. All of these net-net give us a lot of confidence around how we can manage this R&D number going forward.

Thanks James. Next question?

Steve Scala (Cowen): Thank you. I have a few questions. What can you tell us about turnover in 2014 other than it won't grow? Are constant exchanges more likely to be flat, down modestly, down significantly? I appreciate there are lots of moving parts, but based on how those parts are lined up now how would you answer the question?

Second, on *Advair*, Simon, you noted the decline over the next two to three years, why did you put a qualifier of two to three years on your insight? Is that because of the 2016 patent or some other reason? Is *Advair*'s decline seen recently – 12% to 14%ish - a good metric for extrapolation or would you expect an acceleration?

Lastly, you called out Vaccines up 26% in the quarter in Emerging Markets. What tenders drove that and what is the outlook for the second half? Thank you.

Sir Andrew Witty: I will ask Simon to answer the questions you directed to him. What I would say about the sales outlook for the year is we expect it to be broadly similar, which is the guidance that we've given. Obviously, we're doing everything we can to deliver the best sales result we can but, as Simon said on the call, given where we are at this point in the year, this feels like the sensible guidance to give you.

As far as the other aspects, Simon will comment.

Simon Dingemans: On the turnover point, we said what we said in the comments quite specifically: there are a lot of moving parts in the top line at the moment, which is why we are always focused on guidance being around the bottom line. I would remind you that is what we are ultimately aiming to deliver for the year.

On *Advair*, also to repeat what I said in my remarks, a couple of quarters do not necessarily make a trend but our view is that it is much clearer now what the likely rate of decline is over the next two or three years. I didn't really call that any further from a visibility point of view, rather than any particular hook related to patent expiries or other factors, so it is more just looking as far forward as we can to try to give you some sense of how *Advair* progresses. It is mainly a US comment, as clearly the dynamics in Europe and EMAP are somewhat different, so I hope that is helpful.

Nicholas Guyon (Morgan Stanley): I have two questions. The first is on *Anoro*. I appreciate that these are still early days but could you tell us where the prescriptions are coming from, i.e. whether these are new starts, switches from Spiriva or LABA/ICS combination?

My second question is a follow-up on OTC: could you be a little more specific on what the supply issues are in smoking cessation and why you are so confident that you will be fixing them by the end of the year, especially since your full-year guidance of flat sales for Consumer implies 2% growth in H2? Thank you.

Sir Andrew Witty: The confidence is because, as I have already said on the call, and going back over the last couple of months, we have already seen recovery of

supply. We are making good progress in the smoking control arena and our current expectation is that we ought to be able to see further improvement there, which is that combined with robust underlying demand. If you look at our underlying demand in the Consumer business, this is running at something like 5%, so we know that there is a really good position there and, as we go through the next few months, we anticipate being in a better position to supply those things.

The bottom line on *Anoro*, and I said it is very early days, is that it is coming from a mix of sources, which is exactly what you would expect. It is way too early to call a trend on that, I would say, Nicholas. Perhaps next quarter and at the end of the year will be the right way to look at that. I am sorry to sound like a broken record but I really am in the place that it takes nine, 12, 15 months to figure out where these primary care launches are going. We are seeing that with *Breo*, and regarding the absolute fixation with the first few weeks, the market has moved on a lot in terms of the way these products enter the marketplace.

Next question?

Keyur Parekh (Goldman Sachs): Good afternoon, I have three questions please. The first one is on financial planning, the second is on cash and a third on Respiratory. On financial planning, is there something peculiar about the process that GSK uses at the start of the year when you issue guidance: is there more unpredictability about the GSK businesses that has led to operating profit guidances being cut three years in a row?

Secondly, relating to cash, given your statements today, can you reconfirm that the cash from the Novartis transaction, if it closes, will be distributed as special dividends, or is that given where FX might be and where business cash flows might be?

Thirdly, on Respiratory, how much of your guidance on long-term leadership is dependent on a positive outcome from the SUMMIT study, so *Breo* showing a mortality benefit? If that does not work, do you still expect to be in a leadership position come 2017? Thank you.

Sir Andrew Witty: Thanks very much for the questions and let me see if I can knock those off. As far as the guidance, my recollection last year is that we delivered our guidance, and I do not believe there is any special phenomenon that goes on at GSK other than we have a lot of very big moving parts. There are some very big drug companies that only have one or two products, and there are a few drug companies like ours where you have many big bits of the business. You can look at that in two ways. I look at it from the

perspective that says you have lots of big bits of business and that gives you a stabilisation, a diversification benefit, which gives you a broad confidence in delivering.

If you look at this company's performance over the last seven or eight years, we have been able to absorb all the genericisations of the old portfolio, we have been able to absorb *Avandia*, and we have been able to deliver a sustained dividend and earnings for the company, nothing exciting obviously but we have delivered that, versus many other companies that have had one or two big issues and have had to go through corporate level reductions of 10, 20, 30, 40% in terms of business size, I think that really reflects that benefit.

Now the downside is that if you have an issue in one of those big business it can just knock the varnish off the top of the company. So if you think about what we are talking about here, we are talking about a year where we hoped we would grow somewhere in the four to eight range and we are now saying we are going to be broadly flat, or broadly similar year-on-year.

So we are talking about a handful of percentage points on a company of £28 billion turnover. What that is driven by is you have a phenomenon going on with our biggest product, *Advair*, you have a phenomenon going on with a big product going generic, *Lovaza* and then you have some friction, if you will in the Consumer business. The three things together add up to something which puts us in a position where we either decide to cut costs on our new product opportunity or we re-guide.

The totally sensible thing to do is to re-guide. It makes absolutely no point for us to be making short-term investment decisions simply to hit a quarter or a guidance when you have these three events which, two of the three are essentially to do with the older business, when you have those three events which just knock off your potential to get to where you originally thought you would get to. Nobody likes to do those sorts of things but it is the reality of a business like this.

But the plus side of this business is we haven't said to you in any time in the last seven years 'By the way, product X is going generic or product Y has disappeared and sales are going to be down 25%'. That is a fundamentally different proposition. We have not seen that kind of volatility of the delivery.

Now you can argue that those companies or those stocks which go through very significant downturns then have the benefit of very significant growth from the bottom but the reality is the shareholders who are in those stocks when they go down are the ones who bear the cost of that. We have avoided that, we continue to believe that is the right

approach even if it makes us somewhat less racy than some other companies might appear to be.

So that's the first thing I would say. The second thing I would say just to this whole point on *Advair* is that for as long as I have been Chief Executive I have been having to answer the question about when would *Advair* go generic and what would we do after *Advair* and when is all that going to happen and that is a very big question that everybody has had.

My views on genericisation of *Advair* haven't changed; they are exactly as they were the last time we spoke – no change on that. But what we are seeing is a product which is now 14 or 15 years old, is a very substantial product, a market-leading product coming under inevitable price pressure, competitive pressure in a world where the environment has changed fundamentally and where there are more products in the marketplace, not least from ourselves.

And so you are inevitably going to see that kind of pressure. Now I think what that tells you finally is now is the moment to start thinking about what this group looks like post-*Advair.* It's not about the generics and about the patent expiration. It's about the transition that we are now engaged in where you are going to see a somewhat gentle, albeit probably continued downward pressure on *Advair* driven by this pricing competition offset by our ability to bring new products into the market.

Your question on *Breo* again gives me the opportunity to restate something I have said on every earnings call I think for seven years which has never been and neither does it remain our strategy to replace *Advair* with *Breo.* It's our strategy to build on *Advair* with the five, six, seven new respiratory products we have coming and then to build growth for the group with all the other products from outside of respiratory.

That strategy is absolutely clearly active. The products are now there, the products are being rolled out. As a cumulative group of products we are ahead of business plan in terms of the performance of the new products. We are seeing a range of extraordinary performances in areas like HIV and cancer obviously and we are seeing the beginnings of good, relentless progress in the respiratory marketplace and that's exactly what we plan to do and we will continue to prosecute that strategy.

It's not about one product and therefore it's not about one trial like SUMMIT. SUMMIT is an important study. If it's successful it will be an extremely important additive asset for *Breo* but the whole strategy isn't about *Breo.* The strategy is about the portfolio of products which we brought through to market.

And then finally just to confirm, absolutely if the Novartis transaction is blessed by the regulators as we fully expect in the first half of 2015, then the cash proceeds will be repatriated through a special dividend as we previously announced.

We have time just for one last question which I am sure will be in three parts, so go ahead.

Seamus Fernandez (Leerink): Thanks very much for the question. Maybe I guess – and I will make it one question - just as we are hearing it from US-based physicians, the promotional effort from GSK is simply fundamentally different from the competitors, so not only are the competitors taking advantage of a change in reimbursement strategy but they are also taking advantage of a difference in promotional effort from GSK.

The specific point being that even sampling programmes are different and that actually is limiting the ability to prescribe *Breo* on some level and also to prescribe *Anoro* on some level, or at least to get patients interested because the availability of the competitors' products is just that much higher and easier to distribute for an initial 30 or 60 days.

How are you going to respond to that? Are you working through changes in your current promotional strategy to step up your efforts in that regard as your reimbursement improves for *Breo* and for *Anoro* over the next six to 12 months? It seems like that is going to be the key to re-establishing and further growing those key franchises.

Sir Andrew Witty: Thanks, Seamus. I agree with one aspect of what you have said – I am not sure whether I agree with the other. There is no doubt that as we build access, so 60% of the COPD lives/sit within the Medicare Part D marketplace. As we have built access into Medicare Part D then that creates the opportunity to pull through the product and to build that over time, bearing in mind that the dynamic sector of this marketplace is not as big as you see in some other categories. There is no doubt that, as the access opens up, we have to do everything we can to try and make sure that patients have the appropriate opportunity to try the medicines. That is exactly what we are focussed on.

All of the evidence we have around share of voice, share of sampling, presence of sampling, having personally ridden with sales reps in the US, if there are particular physicians you want to send the name of to make sure that, for whatever reason, we haven't got there and given them some samples, I don't believe that is an issue, but there is no doubt that as we now move into the phase of greater access, as we saw with *Breo* where we have seen in the last quarter a 53% increase in prescriptions for *Breo*, as access began to

come online, and remember, at Q1 everybody was saying “We haven’t started to see the movement. Is it ever going to move?” We said “Wait for the access to open; we will then start to see movement”. We saw access open, scripts are up 53%.

As I explained at the beginning of the call, *Breo* is one of the very few products which is showing an upward trajectory at this stage of launch on the most dynamic sector, which is absolutely the lead indicator for long-term performance. We feel good about that. We are constantly looking at how we can do better in our execution of day-to-day promotion. Of course we will look at those. If there are particular customers who you think we need to spend more time with I’d love to hear – let me know off the call and we will make sure they get a visit from a highly trained professional GSK representative.

With that I would like to thank everybody for their attention on this call and the IR team are available at your disposal if you want to have any follow-up conversations. Thank you very much.

[*Results presentation concluded*]