Q3 2014 results

Strategic overview - Sir Andrew Witty, CEO

Q: You're announcing your third-quarter results today. So from a strategic point of view, how well positioned do you feel that GlaxoSmithKline is now?

Sir Andrew Witty: I think the strategy that we've been following for the last several years has really delivered on many fronts, particularly from an R&D perspective. So we're now well into the beginnings of the launch waves of our first wave of new six products. But already we can see a substantial set of opportunities coming right behind them. In fact, we have about 40 new molecular entities in late-stage development across the Group. So that piece is moving forward very well.

Now it's important to remember that launching new products in 2014/15 is quite different to 1999. Launch take-offs tend to be slower and there is more challenge around price. But from a strategic perspective, I think our R&D capability continues to be very reassuring for me.

Now secondly, we've been working very hard during the last 18 months or so to strengthen all three of our businesses. And the Novartis transaction, which hopefully will close during the first half of 2015, really gives us that opportunity in the case of Vaccines and Consumer to take two strong businesses and really establish them as global leaders. That's a key element of our strategy.

We have R&D to replenish Pharmaceuticals. And then through this transaction it gives us the chance to really strengthen Vaccine and Consumer. So I feel like we're on track very clearly in terms of the structure of the Group. We know that there are important synergies that run between those three big businesses.

Now one of the things that we're dealing with in the short run is the beginnings of shifts in pricing pressures, particularly in the US… but not just in the US. For many years we've seen an increasing pricing pressure in Europe, and in the last two years we've begun to feel more of it in Emerging Markets and in America. Now that's affected our trading over the last nine months or so, particularly as we've seen the respiratory market repriced in America. Now we now have greater visibility and we would expect as we go forward to see our volumes in the US begin to recover. But over the short run we'll continue to see that price pressure. So we wouldn't expect to come back to growth in our Respiratory business globally until 2016, so as we go through this '14/'15 period.

Now that's key though, because the Respiratory business is critical to the future of GSK. We've been market leaders for 40 years. And with the new portfolio of medicines we have, in addition to the residual businesses which we will have, I think, going far into the future, we're very confident that we can remain market leader and, as I've said, move back to growth from 2016.

So overall, strategically, R&D feels very successful actually over the last several years. And when we look at the delivery from those pipelines, we see opportunity coming forward. We see a strengthening of Consumer and Vaccines through our Novartis transaction. But we have to react to the pricing pressures, particularly those we've seen in America most recently. And that's why we've announced today a further level of restructuring in the business.

Now that really is in direct response to the transaction and the changing shape of the Group that that drives, and of course the price pressure. What we've seen and we can identify are a number of opportunities to significantly reduce the cost structure of the organisation. And we believe that's the right responsible approach to make sure we strike the balance between investing in our strategic priorities, making sure that we launch those new products successfully, but that we also deliver the appropriate return to shareholders. And that's exactly what we're focused on.

Q: So you're currently in the midst of your Novartis transaction, but you've also announced that you're looking at your options when it comes to ViiV. So what's the thinking there?

Sir Andrew Witty: Well this really reflects, certainly from my perspective, a focus that I've been trying to drive into our Group strategy and Group thinking for GSK, which looks at not just the short-term earnings potential and growth potential - and the opportunities and challenges that you see there - but also thinks about how we can create the most flexibility to create value overall for our shareholders. So the Novartis transaction is all about bringing scale to our Consumer and Vaccine business. But of course it's also critically about crystallising $16bn of value for our Oncology business. And just think, seven years ago we had almost no Oncology business and we've created that business in the last few years, almost entirely from our own research efforts and now we're crystallising a significant gain from that.

And that's a good example, I think, of how I like to look at the Group. Yes, there are ways in which we can develop products and businesses and over many, many years develop streams of earnings and sales. But there might be also situations where you look at an alternative way to bring that value forward to shareholders. Oncology's a very good example, where we're bringing forward, in my view in a risk-free way, a very substantial amount of opportunity for our shareholders.

Now when you look at ViiV, I think when I announced that structure five years ago - and in fact the fifth anniversary is just coming up - it surprised everybody that we could create such an organisation. The focus that we've been able to bring has been extraordinary. Combined with the successful development of new medicines, we've now got a very fast-growing, very substantial specialist business within GSK and with our partners at Shionogi and Pfizer.

So the question really is is that absolutely the right structure to capture the best value for our shareholders or should we be open to alternatives? And that's exactly what I've kicked off today, in terms of asking the question; could we create more value for our shareholders by exploring a partial IPO of the ViiV business? And we'll see how that analysis goes over the next few months. But again, it simply signals an open-mindedness, if you will, around how we deliver value for the shareholders. Sometimes it will be in the more traditional Pharmaceutical model. But sometimes it might be in the way we've worked in Oncology, or perhaps, if we conclude this is the right thing to do, with something like a partial IPO for ViiV.

Q3 performance - Simon Dingemans,CFO

Q: What would you pick out as being the key aspects from these third-quarter results from your point of view?

Simon Dingemans: Well I think many of the factors that were important in Q2 have also continued to drive Q3, especially the pressure that we're seeing in our US Respiratory business. And despite a number of important contract wins in this space, we are seeing significant price pressure, which has led to overall US sales down 10% for the quarter. However, that shouldn't obscure a number of important contributions elsewhere in the Group, really as a result of the many investments we've put behind our Emerging Markets, Japan, and ViiV businesses - to just pick out three particularly strong contributors in the quarter. This really demonstrates the breadth of growth drivers that we're now building out across the Group. And remember, that was a very central part of the strategy and remains so.

So alongside the broader geography and business contributions that we've been building into the top line, we are also seeing an increasingly important contribution from our new products. Tivicay, inside ViiV, amongst the best launches in the HIV space that we've seen, and really beginning to build very strong momentum behind that. And in the quarter we've just launched Trii, the new STR [single-tablet regimen] from ViiV, and we'll see how that develops. But I think it's a broader portfolio that is really driving the momentum in ViiV.

Similarly in Oncology, where we've been building a portfolio over the last several years. And the most recent introductions, MEK and BRAF, continuing to perform strongly alongside Votrient and Promacta, really showing the portfolio benefit.

And that's really what we're trying to build now in Respiratory as we move forward to transition from Advair and the existing products into Breo and Anoro and some of the other pipeline products that we have behind. And that's really the approach that we've taken across our new products, to build into portfolios that will give us more balance in those launches as we go forward. And they're already beginning to make a significant contribution as a whole. And the portfolio of new products in total is contributing nearly £1bn of sales so far this year in 2014.

I think the other key feature of the quarter was the cost performance, where, over the last several years, we've been building in significantly greater flexibility to our cost base. And we've talked a number of times about how we're moving costs around, how we're able to reallocate without increasing SG&A. And in fact, in this quarter we've clearly been able to target a number of very specific cost savings to respond to the pressure that we're seeing in the top line and have been able to take SG&A down 6% overall in the quarter, which is an important contributor, alongside the structural savings that we'd previously identified, and the financial efficiencies to delivering an earnings per share number for the quarter up 5% in constant currency terms, despite a top line down 3%.

Q: And when it comes to your cost savings, can you give us a little bit more detail on which areas in particular are being targeted?

Simon Dingemans: Well there's not one area in particular, but we are working hard on procurement and we've lifted our overall procurement saving levels from probably 2% or 3% of indirect spend to 3% or 4% of indirect spend, and we've got further to go there.

But I think one of the areas I'd particularly call out is, as we've talked about a number of times before, we've been identifying much more the allocation of expenses to individual products so that we can manage the individual P&Ls of those products with better data from the new systems we've been putting in, from more flexible sales resource that we can use across products. And as we've seen pressure in the top line in various parts of the portfolio, we've been able to move resources around or withdraw it so that we are making sure that we particularly protect the investments we need behind our new launches, which are obviously key to the future momentum of the Company going forward.

And it's that flexibility that's really going to leave us well placed now to reiterate the guidance we've given people today for the year as a whole; that we expect our earnings per share for 2014 on a constant currency basis to be broadly similar to the levels we reported in 2013.

Shareholder returns - Simon Dingemans, CFO

Q: You're maintaining the dividend at 19 pence per share. So how does that fit into your wider thinking when it comes to shareholder returns?

Simon Dingemans: Well we've always been clear that the dividend is front and centre and a key priority for us in our overall return strategy for shareholders. So when we looked at the dividend for the third quarter, we've also had to reflect the significant currency headwinds that we've been experiencing during the course of the year, but also the need to protect our flexibility to make sure that we can really invest behind those launches, but also behind the integration of the Novartis transaction when that closes and the new restructuring programme that we've announced today.

And so for a variety of reasons we've decided to hold the dividend in Q3 at 19 pence per share and we're planning to do the same in Q4, which will leave a total pay-out for 2014 of 80 pence per share. That's still up 2.6%, nearly 3% for the year as a whole. But it also led us to indicate, as we've done today, a forward view into 2015 when we're planning to hold the 2015 dividend, for the same reasons, at the 2014 level so that we protect the flexibility. However that is, of course, alongside the £4bn that we intend to return to shareholders when we close the Novartis transaction.