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FY 10 Results Script_v8_26 Jan_2000

Thank you Martin, and good afternoon everyone. Today I will cover six topics:

First, I'll briefly summarise the headline numbers for the fourth quarter.

I will then return to the results for the full year for my review of our financial performance in 2010, with a focus on the Core P&L.

I'll provide an update on our restructuring and productivity improvement programme.

I'll then touch on cash performance and the increased cash returns to shareholders delivered this year.

I will revisit the mid-term planning assumptions for 2010 to 2014.

And finally, I will review our financial guidance for 2011.

Headline Results: Fourth Quarter

Turning first to the headline numbers for the fourth quarter, we achieved revenue of $8.6 billion dollars, a 3 percent decline in constant currency terms...minus 4 percent if you include the negative impact of currency movements. The revenue decline in the US was 12 percent, as a result of the generic inroads and the H1N1 flu vaccine comparisons. This was only partially mitigated by the 5 percent growth in Rest of World.

Core operating profit for the quarter was down 2 percent at constant currency, slightly less than the decline in revenue, as a result of operating efficiencies and higher other income.

Core EPS was up 1 percent at CER, to $1.39. Lower net finance expense and fewer shares outstanding as a result of the buyback provided the uplift to Core EPS growth compared with the slight decline in Core operating profit.

Making the bridge from Core EPS to Reported EPS in the quarter, total net adjusting items in the fourth quarter 2010 were 11 cents lower than last year. Restructuring charges and intangible impairments—chiefly motavizumab--were higher than last year, but the increase was more than offset by the 40 cent gain related to retirement benefit changes that David mentioned earlier.

Net of these adjusting factors, the growth rate in Reported Earnings per share was 11 percent in constant currency terms, to $1.15 compared with $1.07 in the fourth quarter 2009.

FY 2010 P&L

I will now return to the results for the full year, for a review of the main elements of the P&L. I will focus here on Core margins and profit. The press release does, of course, contain the statutory numbers and a detailed reconciliation to the Core measures. When I refer to growth rates, they will all be on a constant currency basis.

The starting point is revenue, which for the full year was $33.3 billion dollars, unchanged compared to 2009.

Core gross margin, at 81.2 percent of sales, was 160 basis points lower than last year. You will recall that we took an intangible impairment on lesogaberan in the third quarter 2010, and there was a provision release that benefited the third quarter 2009. This large unfavourable variance in Q3 accounts for more than half of the full year decline. The balance of the decline in gross margin for the full year is due to higher royalties and an adverse regional and product mix that was only partially offset by operating efficiencies and lower Merck payments.

There will be further pressures on gross margin for 2011 as a result of the enactment of the excise tax on product produced in Puerto Rico, which will be recorded in Cost of Goods, not on the tax line. However, I still expect Core gross margin to be above 80 percent, consistent with our mid-term planning assumptions.

Core SG&A expense was just under $9.8 billion, 2 percent lower than last year, as investments in Emerging Markets and recent launches were more than offset by operational efficiencies across our Established Markets. As expected and flagged, this investment was weighted to the fourth quarter, but that said the fourth quarter spend in absolute terms was below the prior year quarter.

Core other income of $910 million was a touch under 2009. Last year we had the disposal gains related to Abraxane and the Nordic OTC business; 2010 included the royalties on Teva's sales of generic Pulmicort Respules.

Core Pre-R&D margin, therefore, was 53.5 percent of revenue, right at the top of our planning range, although lower than last year, as the gross margin decline was only partially offset by the efficiencies in SG&A.

Core R&D expenditures were 4 percent lower for the full year. Increased investment in Biologics was more than offset by lower project costs and operational efficiencies. The lower project costs are the result of several late stage projects completing their clinical trials. This was partially offset by the start of Phase III programmes for TC-5214 and fostamatinib in the second half of the year.

Core operating profit was $13.6 billion, unchanged at CER. Core operating margin was 40 basis points lower, with the impact of lower R&D expense and operating efficiencies only partially offsetting the decline in gross margin.

Productivity/Restructuring

I'll now turn to an update on the progress of our restructuring programmes.

The first phase of the restructuring programme is now complete, and it has delivered exactly as planned. We have achieved annual benefits of $2.4 billion by the end of 2010, and a gross headcount reduction, prior to reinvestment decisions, of 12,600 positions. The cumulative restructuring costs associated with phase 1, which were incurred over the 2007 to 2009 period, were $2.5 billion.

We kicked off phase 2 of restructuring with our financial results announcement last year. This included additional productivity improvement initiatives in the supply chain and SG&A in addition to the significant change programme within Research and Development.

When completed, these will result in the realisation of a further $1.9 billion in estimated annual benefits by the end of 2014. In terms of phasing, around half will be realised by the end of 2011, with most, but not all, of the remainder by the end of 2013. Of the estimated $2 billion in costs anticipated for this phase of the programme, we charged $1.2 billion in 2010; the remainder will largely be taken in 2011.

How has total headcount been affected to date as a result of our business reshaping efforts?

Well, through the end of 2010 we have reduced headcount by the 12,600 positions from the first phase, together with 2,600 from early returns on the second phase—amounting to a total of more than 15,000. This has provided the headroom to increase our investments in Biologics and Emerging Markets, leaving a net reduction in 6,400 full time equivalents. This has been an important driver of the more than 9 percentage point improvement in our Core operating margin over this period.

Cash/Capital Structure

Let me now turn to cash flow.

Net cash from operating activities would have been more or less in line with last year, were it not for the payments related to Seroquel sales and marketing practices in the US and the payment of the first instalment in respect to the UK tax settlement. These payments contributed to the $1.1 billion decline in Net cash from operating activities, to $10.7 billion in 2010.

For management purposes, we make our investment decisions on the basis of Pre-R&D post-tax cash flow. This is a non-GAAP measure, and amounted to $13.5 billion in 2010. Of this, we invested $3.3 billion in after-tax R&D expenditures, including the acquisition of Novexel and late stage in-licensing deals with Targacept and Rigel. There was $1 billion in Capital Expenditures, as well as the $647 million payment of the first Merck option.

This represents a reinvestment rate of around 37% of cash-flow to drive future growth and value. This is a bit under our planning assumption of a 40 to 50 % reinvestment rate, but that is taking a view over the entirety of the planning cycle, not a point estimate in any single year.

Our commitment to shareholder value is evidenced by the $5.5 billion in cash returned to shareholders—a nearly 2-fold increase in cash returns compared to 2009...a result of an increased dividend and the resumption of share repurchases.

After the increased levels of investment and returns to shareholders, the residual cash flow increased our net cash position to $3.7 billion at the end of 2010, compared with $535 million in 2009.

Our net cash position of $3.7 billion is comprised of gross debt of $9.2 billion and cash and cash equivalents of $12.9 billion. Let me put our net cash position in the context of the Board's thinking on capital structure. The Board intends to maintain a strong investment grade credit rating. It also believes that it is important to preserve balance sheet strength, particularly during periods of revenue transition.

Given our rating objective and pension position, we remain comfortable with carrying gross debt at the same order of magnitude as our current position. Alongside gross debt, we do need to hold a meaningful cash balance to meet operational funding needs and periodic settlements of liabilities. We don't have a fixed target for our cash balance—it will fluctuate with business needs, but the size of the current balance was clearly considered in the Board's decision to target $4 billion in net share repurchases in 2011.

Shareholder Returns

This was the first year of implementation for our progressive dividend policy, by which we aim to maintain or grow the dividend each year over the planning cycle.

With the announcement of the second interim dividend of $1.85, this brings the dividend for the full year to $2.55, an 11 percent increase.

You will recall when we declared the first interim dividend at the Half Year results, we said that the Board intended to rebalance the first and second interim dividends, with the aim of setting the first interim dividend at around a third of the prior year dividend. So I would expect to see this aim manifest when the first interim dividend for 2011 is declared in July.

As previously stated, we executed $2.1 billion in net share repurchases in 2010.

Based on its annual review of the cash position of the Group, our investment priorities and other anticipated calls on cash, the Board has approved a target of $4 billion in net share repurchases for 2011.

Mid-term planning assumptions

Last year, we outlined our planning assumptions for the 2010 to 2014 period, and over the course of the year I said that we would aim to review these on an annual basis... and assess the need for any mid-course recalibration.

In the main, our assumptions remain robust over the period.

The macro assumptions remain valid. There was a lot of attention last year on US healthcare reform and government interventions in Europe, and whilst these pressures remain a key factor in the environment, we still don't think of them as "step changes" that would require a material re-think of our assumptions.

Let me now review our specific assumptions for revenue, margins, cash flow and business reinvestment.

First, and most importantly, we continue to plan on the basis that total company revenue will be in the range of $28 to $34 billion over the 2010-14 period. The key drivers will continue to be strong commercial execution that will fuel the growth for our key brands that retain exclusivity and drive continued double-digit growth in our Emerging Markets; whilst patent expirations will be the chief source of downward pressure on the top line.

Not surprisingly, given the pipeline developments over the course of 2010, we have lowered our latest risk adjusted view of the potential revenue contribution from the recently launched and pipeline products. You will recall that our starting point last year was in the range of $4 to $6 billion...we have adjusted this down to the range of $3 to $5 billion.

It is important to keep in mind that pipeline estimates are dynamic. They fluctuate based on news flow from the data that is continuously being generated during the development programme, from regulatory actions, and from competitive developments in the market place.

If, in the end, it turns out that estimates for pipeline revenue stay in line with this lower planning assumption, then total Company revenue in 2014 is more likely to be around the middle of the $28 to $34 billion planning range. You will recall last year that our aspirations leaned closer to the top than the bottom of the range.

Based on continued strong execution on productivity improvement programmes and disciplined management of costs, we still plan for Core Pre-R&D operating margin in the range of 48 to 54 percent of revenue.

Our plans for driving strong cash performance over the period and the allocation between reinvestment for future growth and value and cash returns to shareholders remain firmly in place.

My last topic before handing back to David is our guidance for 2011.

2011 Guidance

Revenue comparisons in the US market related to Toprol-XL, Pulmicort Respules and pandemic flu vaccine should moderate over the course of the year. For Arimidex, however, we will feel the full effect of the generic competition in the US that started mid 2010, and beginning in February, in Europe as well. This would suggest a quarterly phasing to year on year performance comparisons that will be more difficult in the first half of the year than the second.

We will also have to navigate the full year impact of Healthcare reform in the US. Our latest estimate suggests around a $700 million impact for full year 2011. We estimate that between a quarter and third of this will hit the SG&A line via the excise tax, the rest will be absorbed on the revenue line. In line with recent experience, we also continue to expect a negative impact on revenue in Europe from government interventions that will be around mid-single digit levels.

On balance, we anticipate that revenue in 2011 could range from flat to a low single digit decline compared to 2010 on a constant currency basis. The extent of generic competition will be among the variables that could determine where we land within that range.

Consistent with what I said earlier, Core gross margin should be above 80 percent, but will probably be lower than 2010.

Core Pre-R&D operating margin should remain comfortably near the top of the planning range, but below 2010's level.

Net finance expense should be broadly in line with last year, and Core other income, barring any unusual items, should be around $800 million.

We expect the tax rate to be around 27 percent.

Our Core EPS target is based on the January 2011 average exchange rates for our principal currencies. On that basis, we anticipate Core earnings per share to be in the range of $6.45 to $6.75.

Of course, we are taking no view of the future movements for currency, so going forward, this guidance takes no account of the likelihood that average exchange rates for the remainder of the year may differ materially from the January 2011 average. As usual, I would point you to our currency sensitivity chart to help you flex your own estimates on the currency impact to sales and earnings.

So that concludes my review of 2010 performance and our outlook for 2011. I will now hand back over to David.