Simon Lowth
Q2 2013 Analyst Script

Slide 24: Simon Lowth

Thank you Pascal, and good afternoon everyone.

I am going to cover the second quarter P&L. I'll briefly touch on restructuring. I'll then cover cash performance and the first interim dividend. And finally, I will close with our thoughts on guidance for the full year.

Slide 25: Core margin 2Q 2013

I will now turn to the second quarter 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. As with sales, when I refer to growth rates, they will all be on a constant currency basis.

Pascal has already covered the revenue performance, which was down 4 percent to $6.2 billion.

Core gross margin in the quarter was 82.3 percent of sales. That is up 110 basis points compared with the second quarter last year. Core gross margin benefited from lower Core Merck expense related to the Second Option amendments implemented in the middle of last year. With the full year results I mentioned that we would expect Core gross margin this year to be below 2012, which was 82.4 percent, and that remains our view.

Core SG&A expense was up 6 percent in the quarter. It was down 2 percent in the first quarter, which I flagged as largely due to phasing—Core SG&A expense for the first half is up 2 percent. Investments in support of our growth platforms—particularly in Emerging Markets, Brilinta and the diabetes franchise—were only partially offset by benefits from restructuring and spending discipline in support of mature brands and in developed markets.

Core other income of $218 million was 19 percent higher than last year, including an increase in Pulmicort Respules royalty income.

That leads to a Core Pre-R&D operating margin of 49.7 percent of revenue, 160 basis points lower than last year, as the benefit from a higher Core gross margin and Core other income was more than offset by the higher Core SG&A expense as a percentage of revenue.

Core R&D investment in the quarter was $1,040 million. That is 1 percent higher than last year, and also a step up from the first quarter 2013. The second quarter was impacted by incurring some close down costs related to the fostamatinib programme. We continue to realise savings from restructuring programmes, but the step up in business development activity is starting to exert a real upward tension on Core R&D expenses as we look to the second half.

You will recall that we have previously guided to Core operating costs—that is combined Core SG&A and R&D costs—being held to a slight increase in 2013 in constant currency terms. With the investments in growth platforms and the larger project volume in R&D, we now anticipate for the full year a low to mid single-digit increase in Core operating Costs compared with 2012 on a constant currency basis.

Core operating profit was just under $2.1 billion in the quarter, 10 percent lower than last year. Core operating margin was 33.0 percent of revenue, 2.3 percentage points lower than last year.

Slide 30: Productivity/Restructuring

Just a brief word on restructuring. On this slide, you can see the scope of what we are now referring to as Phase 4 of restructuring, which combines the initiatives newly announced in March of this year together with the actions that remained to be implemented from the Phase 3 programme that we announced back in February of 2012.

Total programme costs are estimated to be $2.3 billion, and as you can see here we have charged $308 million to the P&L in second first quarter.

Slide 31: Cash and Dividends

Turning to cash. Cash generated from operating activities was $3.8 billion for the first half, compared with $2.8 billion last year. Lower tax and interest payments partially offset the lower operating profit in the first half of 2013, which included higher non-cash costs, whilst a lump sum pension contribution drove higher outflows in the prior year.

Cash outlay on acquisitions of business operations was $565 million, with other net capex of $762 million, which includes IT and Merck.

The Board has recommended a first interim dividend of $0.90. This amount is a reflection of the Board's aim of setting the first interim dividend at around a third of the prior year full dividend, which last year was $2.80.

We remain committed to our progressive dividend policy, by which we aim to maintain or grow the dividend each year.

The target for dividend cover is 2 times Core earnings over the entirety of the investment cycle.

When the Board adopted the progressive dividend policy, it recognised that some earnings fluctuations are to be expected as the Company transitions through this period of exclusivity losses and new product launches. The Board's view is that the annual dividend will not just reflect the financial performance of a single year taken in isolation, but reflect its view of the earnings prospects for the Group over the entirety of the investment cycle. Likewise, it recognises that dividend cover in any given year is likely to vary from the 2 times cover target.

Slide 32: Guidance

As we expected, the impact from the loss of exclusivity for several brands affected performance in the first quarter, and whilst this impact will be felt throughout the year, comparisons with prior year periods did moderate in the second quarter, a reflection that the 12 month anniversaries for generic competition for *Seroquel IR* in many markets, and for *Crestor* in Canada have been reached.

Whilst the revenue increase seen in Japan and in Emerging Markets in the quarter is a reflection of good growth in underlying demand, it is also somewhat flattered by soft comparisons with the second quarter last year--the destocking of *Nexium* in Japan and the impact of supply chain constraints in the Emerging Markets.

Our revenue outlook for the full year is unchanged. We continue to anticipate a mid-to-high single digit decline in revenue on a constant currency basis.

Productivity and efficiency programmes will continue to deliver their target levels of savings, providing the headroom to invest behind key growth platforms and progress the pipeline. Core operating costs (combined Core R&D and SG&A expense) in the first quarter were 4 percent lower than last year, but this was largely a matter of phasing. Core operating costs were up 5 percent in the second quarter, resulting in Core operating costs broadly flat for the half year.

As I mentioned in the P&L commentary, we continue to drive investments in our growth platforms, and the influx of projects acquired through business development is exerting an upward tension on Core R&D expenses in the second half.

So for the full year, we now anticipate a low to mid single-digit increase in Core operating costs compared with 2012 on a constant currency basis.

With a revenue and cost profile in line with guidance, the Company continues to expect Core EPS to decline at a rate that is significantly higher than the decline in revenue in 2013.

Financial guidance for 2013 has been based on January 2013 average exchange rates for our principal currencies. Whilst first quarter results were broadly in line with this currency assumption, movements versus guidance rates lowered Core earnings per share in the second quarter by around 2 percent, and may continue to impact Core EPS for the second half of the year if rates remain where they are.

I will now hand back to Pascal, who will chair the Q&A session.