# Simon Lowth
# FY 12 Analyst Script – 31st January 2013

**Slide 28:** Simon Lowth

Thank you, Briggs. .

I will cover 6 topics:

I will recap the headline numbers for the Full Year and the Fourth quarter.

I will cover our Core operating performance …with an emphasis on the key drivers of operating profit and margin.

I will update our progress on phase 3 of our restructuring programme.

I'll describe our cash performance, and our decisions on shareholder distributions.

I will make the bridge from the Core P&L on the old basis, to our new definition of Core financial measures.

And using this new Core as the baseline, I will close with our thoughts on guidance for 2013.

**Slide 29**: Headline results for FY 2012

Pascal covered the overview of the full year performance in his opening remarks. To complete the picture, we bridge from Core EPS of $6.41 to a reported EPS of $4.99 with the usual adjusting items for restructuring, amortisation, impairments and legal provisions. While Core EPS declined by 9 percent, reported EPS fell by 29 percent. The faster decline in reported EPS is due to higher restructuring and amortisation costs in 2012, and the $1.08 benefit in 2011 from the sale of Astra Tech.

**Slide 30**: Headline results Q4 2012

I don't intend to go into any detail on the fourth quarter accounts. The revenue picture is similar to the full year. Core EPS, however, benefited from the favourable adjustment to deferred tax balances related to the reduction in the Swedish corporation tax rate.

**Slide 31**: Core financial performance

I will now turn to the P&L for the full year. 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.

Core gross margin was 81.2 percent of revenue. That is down 90 basis points compared with last year, which benefited from the settlement with PDL Biopharma in the first quarter. For 2012, there were benefits from the absence of Astra Tech and Aptium. There was also a small uplift in the second half from the accounting treatment of the Merck second option. Countering the upsides was an unfavourable impact from product mix.

Core SG&A expense was down 12 percent compared with last year. Restructuring benefits and spending discipline were partially offset by increased investment in Emerging Markets and the inclusion of the amortisation expense related to the Amylin intangible assets acquired in the expansion of the diabetes alliance. The excise fee imposed by the enactment of US healthcare reform measures amounted to 2.8 percent of Core SG&A expense for the year.

Core other income for the year was up 24 percent, reflecting the $250 million from the sale of Nexium OTC rights.

Core Pre-R&D operating margin was 53.2 percent of revenue, 90 basis points lower than last year, as the benefit form higher Core other income was more than offset by higher Core cost of sales and Core SG&A expense as a percentage of revenue.

Core R&D expenditures were down 11 percent to nearly $4.5 billion. We did absorb new spending on in-licensed, acquired or partnered projects during the year. However, these were more than offset by restructuring benefits and by significantly lower intangible impairments in 2012 compared with last year. This volatility related to impairments is one of the reasons we moved to our new definition of Core measures.

Core operating profit was $10.4 billion, 18 percent lower than last year. Core operating margin was 37.3 percent of revenue, 160 basis points lower than last year.

**Slide 32:** Productivity/Restructuring

Turning to our Productivity programme, for the full year we have incurred $1.6 billion of costs associated with the third phase of restructuring that we announced back in February 2012. Add in the $261 million that was charged in the fourth quarter of 2011, and that means we have around $300 million left to go against the total programme estimate of $2.1 billion. Most of this will be taken in 2013.

Actions involving around 6,300 of the estimated 7,300 positions that will ultimately be impacted have been completed.

Total annual benefits of $1.6 billion by the end of 2014 are targeted from this phase. We estimate that around $350 million were achieved by the end of 2012.

**Slide 33:** Headcount movements

Bringing together all 3 phases of restructuring, we have reduced gross headcount by around 27,000 positions. After reinvestments, we have achieved a net reduction of over 15,000 positions.

**Slides 34:** Cash generation

Cash generated from operating activities was $6.9 billion for the year, compared with $7.8 billion in 2011. Lower tax payments only partially offset the lower EBITDA for the year.

**Slide 35:** Cash application

Cash outflows on externalisation activities were $5.1 billion, chiefly the related to the purchase of the Amylin intangibles and the $1.1 billion acquisition of Ardea.

We ended the year with a net debt position of $1.4 billion.

**Slide 36:** Cash Distributions

Turning to Cash distributions to shareholders.

The second interim dividend is $1.90, which brings the dividend for the full year to $2.80, maintaining the same dividend as last year.

This is consistent with our progressive dividend policy, by which we aim to maintain or grow the dividend each year. It is a policy that we are committed to going forward,

We have revised the basis by which we assess dividend cover. Previously, the dividend cover target was 2 times based on reported earnings before restructuring costs. With the adoption of our new definition of Core financial measures, the dividend cover target is now 2 times based on Core earnings on the new definition. We believe that this new Core earnings measure is a better indicator of the cash cover for the dividend.

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.

Prior to suspending the 2012 share repurchase programme we executed net share repurchases of $2.2 billion.

The Board will continue to keep under review the opportunity to return excess cash to shareholders through periodic share repurchases, however, the Board has decided that no share repurchases will take place in 2013 in order to maintain flexibility to invest in the business.

**Slide 37: New Core financial measures**

As we announced last quarter, beginning with the first quarter 2013 we will be updating our definition of Core financial measures. The principal change is to exclude all intangible asset amortisation and impairments, with the exception of information systems related intangibles. We provided the reconciliations for the four quarters of 2011 and the nine months of 2012 back in November. In today's press release, we have included the reconciliations for the fourth quarter and full year 2012. I know that many of you have already adjusted your 2013 models, but others have yet to do so.

Just to be absolutely clear, here is the Core P&L for 2012 reconciled to the new basis.

I will not take the time to go all the way down the accounts here. The one thing I will point out is the Core gross margin. Against this new basis, I would expect to see some decline for 2013. [reason?]

The other item I will call out is, of course, that the new Core EPS figure is $6.87, versus $6.41 on the old basis.

I will now turn to our guidance for 2013, and it is in the context of this new Core baseline.

**Slide 38: Future Prospects/Guidance for 2013**

The financial performance for the full year 2012 was defined by the significant revenue decline associated with the loss of exclusivity for several products. *Seroquel IR* alone declined by $3 billion; regional losses of exclusivity for *Atacand*, *Nexium* and *Crestor* combined for a further negative impact of more than $1 billion.

Against this revenue profile, spending discipline and restructuring benefits can only be expected to partially mitigate the impact on Core profits and margins, particularly as investments to drive future growth and value are to be made. A larger decline in Core EPS for 2012 was averted by the favourable impact of two tax-related items ($0.19 from the tax provision release in the second quarter and $0.18 from the adjustment to deferred tax balances in the fourth quarter) and $0.16 from the sale of OTC rights for *Nexium* in the third quarter. Together these amount to a 53 cent per share headwind as we move into 2013.

For 2013, challenging market conditions will persist, including continued government interventions in price. The revenue impact from the loss of exclusivity will continue to affect our performance, with the first quarter particularly challenging since *Seroquel IR* and *Crestor* (in Canada) have not yet reached the twelve month anniversary since generics entered the market.

For the full year 2013, the Company anticipates 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. These will provide the necessary headroom to invest behind key growth platforms and in progressing the pipeline, with the aim to hold Core operating costs (combined Core R&D and SG&A expense) in 2013 to a slight increase compared with 2012 on a constant currency basis.

Core other income is expected to be under $600 million for the year.

The reported tax rate for 2013 is anticipated to be around 23 percent.

With a revenue and operating cost profile in line with our guidance, Core EPS will decline significantly more than revenue in 2013.

In January 2010 the Company outlined planning assumptions for revenue and margin evolution for the period 2010 to 2014. With 2013 guidance now in place, and in the context of an update to Company strategy, these planning assumptions for the remainder of the period have been withdrawn.

Financial guidance for 2013 has been based on January 2013 average exchange rates for our principal currencies, and takes no account of the likelihood that average exchange rates for the remainder of 2013 may differ materially from these rates.

**Slide 39**: Pascal Soriot

I will now hand back to Pascal.