

Financial review 2008 continued

Selling, general and administration

SG&A costs, including legal charges, were 30.2% of turnover (2007 – 30.0%). At constant exchange rates, SG&A costs increased by 0.7 percentage points to 30.7% of turnover. Legal costs of £611 million (2007 – £255 million) included a £278 million charge announced in January 2009 related to the US investigation into GSK's marketing and promotional practices which originated in Colorado. Excluding legal costs, SG&A as a percentage of turnover fell 1.2 percentage points to 27.7% (2007 – 28.9%). This was a 3% growth in sterling terms, but a 4% reduction at constant exchange rates, reflecting the benefits of the restructuring programmes. Selling and distribution fell by 1%, advertising and promotion by 5% and general and administration expenditure, excluding legal charges, by 7%.

Research and development

R&D expenditure increased by 2% to 14.4% of turnover (2007 – 14.3%) as investment in the late stage pipeline was partly offset by restructuring savings.

Other operating income

Other operating income of £541 million (2007 – £475 million) included strong growth in royalty income to £307 million (2007 – £216 million). Product, intellectual property and equity investment disposals realised £230 million in 2008 compared with £90 million in 2007. The Roche litigation settlement was included in 2007.

Operating profit – results before major restructuring

Operating profit before major restructuring of £8,259 million for the year increased by 4% in sterling terms but decreased by 10% in CER terms compared with 2007. Pharmaceuticals operating profit was £7,427 million, down 11%, while Consumer Healthcare operating profit was flat in CER terms at £832 million. Excluding legal costs, operating profit decreased by 6%, which was greater than the turnover decline of 3%, primarily due to higher cost of sales as a percentage of turnover.

In the year, gains from asset disposals and settlements were £293 million (2007 – £213 million), costs for legal matters were £611 million (2007 – £255 million), fair value movements on financial instruments resulted in a charge of £10 million (2007 – income of £41 million) and charges relating to previous restructuring programmes were £20 million (2007 – £92 million). The impact of these items on operating profit before major restructuring was a £348 million charge in 2008 (2007 – £93 million).

Profit before taxation – results before major restructuring

Net finance costs

	2008 £m	2007 £m
Finance income		
Interest and other income	322	255
Fair value adjustments and hedges	(9)	7
	313	262
Finance costs		
Interest costs	(829)	(434)
Unwinding of discount on liabilities	(11)	(27)
Fair value adjustments and hedges	2	8
	(838)	(453)

Taking account of net finance costs and the share of profits of associates, profit before tax before major restructuring was £7,782 million compared with £7,790 million in 2007, a 14% CER decline but flat in sterling terms.

Taxation

	2008 £m	2007 £m
UK corporation tax	289	452
Overseas taxation	1,589	1,962
Current taxation	1,878	2,414
Deferred taxation	69	(272)
Taxation on total profits	1,947	2,142

The charge for taxation on profit before major restructuring charges, amounting to £2,231 million (2007 – £2,219 million), and represents an effective tax rate of 28.7% (2007 – 28.5%). The charge for taxation on total profits amounted to £1,947 million (2007 – £2,142 million) and represented an effective tax rate of 29.2% (2007 – 28.7%). The Group's balance sheet at 31st December 2008 included a tax payable liability of £780 million and a tax recoverable asset of £76 million.

The Group's main open tax issues are in the USA, Canada and Japan.

In July, following discussions with HMRC, the Group settled substantially all outstanding UK tax issues for all periods up to and including 31st December 2006.

Following its audit of the period 2001 to 2003, the IRS issued Statutory Notices of Deficiency to GSK asserting income and withholding tax deficiencies, and associated penalties, arising from its reclassification of an intercompany financing arrangement in those years from debt to equity, and its consequent recharacterisation of the amounts paid as dividends subject to withholding tax under the US – UK treaty. All amounts due under the financing arrangement were timely paid, with the final payment made in April 2008.

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The IRS commenced its audit of the period 2004 to 2006 in June 2008, and is examining the issue for these years. GSK disagrees with the IRS's position and, in August 2008, initiated actions in the United States Tax Court to contest the Statutory Notices of Deficiency. GSK estimates that the IRS claim for tax, penalties, and interest at 31st December 2008, net of federal tax relief, for 2001 through 2003 is \$864 million. GSK believes that this claim has no merit and that no adjustment is warranted. If, contrary to GSK's view, the IRS prevailed in its argument before a court in respect of the years 2001-2003, GSK would expect to have an additional liability for the five year period 2004-2008 in the amount of \$1,059 million in tax, penalties, and interest at 31st December 2008, net of federal tax relief for those years. In the event that the company is not able to resolve this issue with the IRS, a court decision would not be expected before 2011.

Lower courts in Japan have upheld claims by the tax authorities for Yen 39 billion (£177 million) relating to Japanese CFC legislation. The company has paid and fully provided for the full tax but is pursuing a claim for refund to the Japanese Supreme Court. In Canada a court decision in respect of transfer pricing in the early 1990s was completed in May 2008. GSK filed an appeal in June and a court date is awaited.

GSK continues to believe that it has made adequate provision for the liabilities likely to arise from open assessments. The ultimate liability for such matters may vary from the amounts provided and is dependent upon the outcome of litigation proceedings and negotiations with the relevant tax authorities.

Profit for the year

	2008 £m	2007 £m	CER%	Growth £%
Total profit after taxation for the year	4,712	5,310	(25)	(11)
Total profit attributable to shareholders	4,602	5,214	(26)	(12)
Basic earnings per share (pence)	88.6p	94.4p	(21)	(6)
Basic earnings per ADS (US\$)	\$3.28	\$3.77		
Results before major restructuring profit after taxation for the year	5,551	5,571	(14)	–
Results before major restructuring profit attributable to shareholders	5,441	5,475	(15)	(1)
Adjusted earnings per share (pence)	104.7p	99.1p	(9)	6
Adjusted earnings per ADS (US\$)	\$3.87	\$3.96		
Weighted average number of shares (millions)	5,195	5,524		
Diluted total earnings per share (pence)	88.1p	93.7p		
Diluted total earnings per ADS (US\$)	\$3.26	\$3.75		
Diluted weighted average number of shares (millions)	5,226	5,567		

Total results including restructuring costs produced a basic EPS of 88.6p compared with 94.4p in 2007. This was a 21% decline at CER and a 6% decline in sterling terms. Excluding major restructuring costs, EPS was 104.7p compared with 99.1p. This was a 9% decline at CER but a 6% increase in sterling terms. The 15 percentage point currency benefit arose from the weakness of Sterling against most major currencies.

Dividend

The Board has declared a fourth interim dividend of 17 pence per share resulting in a dividend for the year of 57 pence, a four pence increase over the dividend of 53 pence per share for 2007. The equivalent fourth interim dividend receivable by ADR holders is 49.4564 cents per ADS based on an exchange rate of £1/\$1.4546. The ex-dividend date will be 11th February 2009, with a record date of 13th February 2009 and a payment date of 9th April 2009.

Critical accounting policies

The consolidated financial statements are prepared in accordance with IFRS, as adopted for use in the European Union, and also with IFRS as issued by the IASB, following the accounting policies approved by the Board and described in Note 2 to the financial statements, 'Accounting principles and policies'. Management is required to make estimates and assumptions that affect the amounts of assets, liabilities, revenue and expenses reported in the financial statements. Actual amounts and results could differ from those estimates. The critical accounting policies adopted relate to the following areas:

- Turnover
- Taxation
- Legal and other disputes
- Property, plant & equipment
- Goodwill
- Other intangible assets
- Pensions and other post-employment benefits.

Information on the judgements and estimates made in these areas is given in Note 3 to the financial statements, 'Key accounting judgements and estimates'.

In respect of the Turnover accounting policy, the Group's largest business is US pharmaceuticals, and the US market has the most complex arrangements for rebates, discounts and allowances. The following briefly describes the nature of the arrangements in existence in the Group's US pharmaceuticals business.

- GSK has arrangements with certain indirect customers whereby the customer is able to buy products from wholesalers at reduced prices. A chargeback represents the difference between the invoice price to the wholesaler and the indirect customer's contractual discounted price. Accruals for estimating chargebacks are calculated based on the terms of each agreement, historical experience and product growth rates.