Group financial review continued

Reporting framework

Presentation of Group results

Our Group financial review discusses the operating and financial performance of the Group, its cash flows and financial position and our resources. We compare the results for each year primarily with the results of the preceding year.

We use a number of adjusted, non-IFRS, measures to report the performance of our business. These measures are used by management for planning and reporting purposes and in discussions with and presentations to investment analysts and rating agencies and may not be directly comparable with similarly described measures used by other companies. Non-IFRS measures may be considered in addition to, but not as a substitute for, or superior to, information presented in accordance with IFRS.

Total results

Total reported results represent the Group's overall performance. However, these results can contain material unusual or non-operational items that may obscure the key trends and factors determining the Group's operational performance. As a result, we also report Adjusted results, which is a non-IFRS measure.

Adjusted results

As announced on 11 April 2017 in the 'Change to financial reporting framework' press release, from 2017, core results have been renamed Adjusted results and, instead of all legal charges and expenses, only significant legal charges and expenses are excluded in order to present Adjusted results. All other legal charges and expenses are included in Adjusted results. Significant legal charges and expenses are those arising from the settlement of litigation or a government investigation that are not in the normal course and materially larger than more regularly occurring individual matters. They also include certain major legacy legal matters. Any new significant legal matters excluded in order to present Adjusted results will be disclosed at the time.

As a result of the enactment of the US Tax Cuts and Jobs Act on 22 December 2017, GSK has recorded charges on initial application which reduced Total earnings by £1.6 billion, as set out on page 68. Due to their magnitude, GSK has reported these charges as Adjusting items in 2017 so that they do not obscure the key trends in the Group's operational performance for the year.

Adjusted results now exclude the following items from Total results: amortisation and impairment of intangible assets (excluding computer software) and goodwill; major restructuring costs, including those costs following material acquisitions; significant legal charges (net of insurance recoveries) and expenses on the settlement of litigation and government investigations, transaction-related accounting adjustments for significant acquisitions, and other items, including disposals of associates, products and businesses and other operating income other than royalty income, together with the tax effects of all of these items and the impact of the enactment of the US Tax Cuts and Jobs Act in 2017.

GSK believes that Adjusted results are more representative of the performance of the Group's operations and allow the key trends and factors driving that performance to be more easily and clearly identified by shareholders. The definition of Adjusted results, as set out above, also aligns the Group's results with the majority of its peer companies and how they report earnings.

Reconciliations between Total and Adjusted results, as set out on page 67, including detailed breakdowns of the key adjusting items, are provided to shareholders to ensure full visibility and transparency as they assess the Group's performance.

Contingent consideration

GSK has recognised a significant liability for contingent consideration (£6,172 million at 31 December 2017 on a fair value discounted basis) of which £5,542 million represented the estimated present value of future amounts payable to Shionogi relating to ViiV Healthcare, discounted at 8.5%. The payments to Shionogi are calculated based on the sales performance over the life of the relevant products, principally dolutegravir, as described on page 59. The effect of the required IFRS accounting treatment is that GSK recognises these fair value liabilities on the balance sheet, with remeasurement charges reflected immediately in other operating income. These charges are adjusted from Total results to present Adjusted results. GSK will make cash payments in the future to discharge this liability which will not be recorded in the profit and loss account and future earnings.

Free cash flow

From 2017, adjusted free cash flow is no longer being reported and the free cash flow definition has been amended to include all contingent consideration payments made during the period.

Free cash flow, which is a non-IFRS measure, is now defined as the net cash inflow from operating activities less capital expenditure, contingent consideration payments, net interest and dividends paid to non-controlling interests plus proceeds from the sale of property, plant and equipment and dividends received from joint ventures and associates. It is used by management for planning and reporting purposes and in discussions with and presentations to investment analysts and rating agencies. Free cash flow growth is calculated on a reported basis. A reconciliation of net cash inflow from operations to free cash flow is presented on page 71.

Free cash flow conversion

Free cash flow conversion is free cash flow as a percentage of Total earnings.

Working capital conversion cycle

The working capital conversion cycle is calculated as the number of days sales outstanding plus days inventory outstanding, less days purchases outstanding.

CER and AER growth

In order to illustrate underlying performance, it is our practice to discuss the results in terms of constant exchange rate (CER) growth. This represents growth calculated as if the exchange rates used to determine the results of overseas companies in Sterling had remained unchanged from those used in the previous year. CER% represents growth at constant exchange rates. £% or AER% represents growth at actual exchange rates.