Recordati S.p.A

"2018 First Half Results Conference Call"

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OPERATOR: Good afternoon. This is the Chorus Call conference operator. Welcome and thank you for joining the Recordati 2018 First Half Results Conference Call. After the presentation, there will be an opportunity to ask questions.

At this time, I would like to turn the conference over to Ms. Marianne Tatschke, Director of Investor Relations and Corporate Communications of Recordati. Please go ahead, madam.

MARIANNE TATSCHKE: Hello, good afternoon or good morning to everyone, and thank you for attending the Recordati conference call. Fritz Squindo, our CFO will be presenting and commenting upon our first half 2018 results. For a better understanding of his presentation, please access the set of slides available on our website www.recordati.com, under the Investor Section and presentations tab. At the end of the presentation, we will answer any questions you may have. Please go ahead, Fritz.

FRITZ SQUINDO: Thank you, Marianne and good afternoon or good morning to everyone. We can start with the Slide 2, with the first half '18 highlights. And we are pleased with our first half 2018 results which are in line with our full year target and confirmed base and margin growth.

Let's start with our consolidated revenue, its €696.1 million and our sales are up by 6.9% compared to last year. Sales in the period include €50.4 million from the metoprolol based product which we have acquired from Astra Zeneca and integrated in our portfolios from July last year, as well as also an estimated negative currency effect estimated in €20.1 million excluding €27.1 million, sorry. Excluding these two items, growth would have been of 3.4% in line with our expectation of the organic growth of the business.

A further improvement of our margin is correct in the first half. EBITDA at 37.4% of sales in the period is €250 million and our EBITDA is up by 16.1%. Operating income at 33.3% of sales is €271.9 million. As for the operating income, we have an increase of 14.1%. Net income at 23.6% of sales is €164.2 million with an increase of €11.7 million over the same period of the preceding year. Then very solid financial result, increasing margin and we are very pleased by these results.

In term of financial position, at the end of June, net debt is €556.4 million, with an increase of €174.7 million compared to last year and…but let me underline that this increase in Q essentially to the share buyback for an overall disbursements of €169.8 million. We have also in the period paid dividend for an amount of €87.1 million. And in June, we have the acquisition of…we have acquired Natural Point, the company in Italy for a value of €75 million. Then excluding this extraordinary item and the payment of the dividend, we continue to generate solid free cash flow with the cash conversion together with our net income which continued to be around 1 to 1.

Regarding our corporate development initiatives, during the period an agreement was signed with Mylan for the acquisition of the right to Cystagon in Europe and other territories and this is part of our…of the treatment of rare diseases and Natural Point, this Italian company specialized in the food supplement has been acquired in the month of June. Solid financial result and as usual [ph] some corporate initiatives to further enhance [indiscernible].

Slide #3, here we comment our main product sales and here again the performance of our corporate products is in line with our expectation. Zanidip lercanidipine sales are essentially stable. Sales of Zanipress are down due to the competition from generic pressure, but this 9.1%

reduction is considered very solid performance considering that today we have a generic competitor in all our European markets.

The overall sales of lercanidipine franchise in the first half of the year are nearly €103 million, which we continue to have a solid franchise in our product of…containing lercanidipine. Urorec is the brand for…say one of the major brand for selling silodosin generated sales of €51.2 million during the half and sales are up by 10% due to the good performance of the product in all the main markets.

Sales of Livazo, Livazo is the brand for selling pitavastatin in the major market are €24 million and sales are up by 23.4%, and this is due to the good performance of the product in particular in Turkey, but let's say we have a good performance in all market where the product has been launched.

Then at the end of last year, the agreement with AstraZeneca for the acquisition derived of metoprolol in euro was concluded, and starting from 01st of July, we…revenue has been consolidated in our…back in our P&L.

Sales in the first half of '18 are €50.4 million and this product contribute significantly to the growth of our subsidiary mainly in Germany, in Poland, in France, in Czech Republic, in Romania. This result is…we are pleased by this result because this means that we have stopped the erosion of…which was the trend of the product when we have acquired product from AstraZeneca and we expect possible further growth going forward.

Other corporate products are down overall by 5.7%, and this is due mainly to competition from generic version of Rupatadina, base brand, but also to the weak flu season, as well as, the negative exchange rate effect in Russia because an important part of our corporate product is represented by our product sold in the Russian market.

Let's now comment on our product for rare diseases, our specialties indicated for the treatment of rare diseases has generated sales of €110.1 million during the period with an increase of 5.8%.

Sales in US are down by 9.2% this is due to a negative currency effect and also to the initial competition from the generic version of [indiscernible], but even with these two negative impacts in particular in the US market we continue to grow our business in the treatment of rare disease.

Slide #4, this graph shows the breakdown of our revenues by type of products. Then corporate products, we can underline that corporate products including the rare disease now, because these drugs now accounts for 15.2% [ph] of revenue. With the inclusion of metoprolol franchise that we have acquired from AstraZeneca which means that we enlarging our product which are sold on a multi territorial basis that we consider to be our corporate products.

Slide #5, this slide shows sales performance by geographies, sales in Italy are up by 1.8% due mainly to the good performance of Urorec and Cardicor, the significant growth of the treatment of rare diseases in this market and also to the integration in the portfolio as from July 17 of the metoprolol base brand acquired from AstraZeneca.

In Germany, sales are up by 26.3%, mainly thanks to the sales generated by the metoprolol base product in this market. Sales, in France are up by 9.1% and here worth mentioning is, is the good performance of Urorec and Methadone, and here again the integration of the product portfolio of the metoprolol base brand. And also to the inclusion of the gastrointestinal product Transipeg and Colopeg that we have acquired from Bayer in December 2017.

Also in France the treatment for rare diseases are growing strong. The Group pharmaceutical business in the USA dedicated only to the treatment of product for rare diseases, sales in the first half 2018 are €49.7 million which as I already comment are down by 9.2% which is mainly due to the negative exchange rate and the initial competition from the generic version of Cosmegen [ph]. In local currency the business in the US grew by 1.6%.

Then revenue generated in Russia, Ukraine and CIS countries is €48.6 million which are down by 13.8% and here again include the negative currency effect impact which could be estimated in €6.3 million. Sales in Russia in local currency are also down by 7.4%, and this performance is not only linked…the decrease is not only linked to the currency effect, but also linked to a decrease in local currency which is mainly due to the sales reduction of the products for the seasonal disorder, due to a much weaker flu season than last year. Last year there was an incredible good first half performance which was essentially driven by product for seasonal disorder in particular in the first quarter. In Russia, the corporate products Urorec, Zanidip and Livazo and Procto Glyvenol are performing well.

Sales in Turkey are down by 5.1% and include a negative currency exchange effect estimated to be of €10.5 million. In local currency sales of our Turkish lira grow by 19.7. Then in Turkey, we have a negative impact due to currency affect, but we continue to have a solid performance in local currency and in the local business. As I said, the business grow…our business in Turkey grew by 19.7%. And we have also our sales in the Central and Eastern European countries, which benefit significantly from the consolidation of the metoprolol based product, as I said acquired from AstraZeneca from 1st of July, 2017.

Slide #6, this graph show the geographical breakdown of our pharmaceutical revenue, which remain essentially stable compared to the same graph that we had last year.

Slide #7, first half 2018 result, the P&L in which you will see a further margin growth. We have already analyzed and commented our revenue for the period.

Let's move on the gross profit, gross profit is €493 million with a margin of 70.8% of sales which is an improvement over the rest of the proceeding year, even due to the further growth of product with higher margin and also to the positive effect of the metoprolol-based product acquired from AstraZeneca.

The consolidation of metoprolol is important not only in terms of addition of sales, but also as improvement of our margin mainly in terms of gross profit.

Selling expenses at 24 per day…percent of sales…increased less than sales, and are therefore down as a percentage of revenue. Thanks to the increase efficiency of the Group's commercial organization, we are adding product in our portfolio without any major changes in our infrastructure. This is also…it is also a reason why we have our G&A which are diminishing as a percentage of sales, now our G&A are 4.8% of sales.

While in the R&D expenses here, yes, we have an increase in our R&D expenses. In the period R&D expenses are €53.6 million and are up by 13.7%, due to the initiation of new development programs and this in particular in the treatment of rare disease building our part in which we are announcing a building, a new pipeline and this is also linked to the amortization of the acquired right [ph] the metoprolol-based product.

Net financial charges are €8.5 million, an increase of €1.5 million due to the increase of the new medium long-term loan granted for financing the acquisition that we closed last year.

The effective tax rate during the period is 26.5%, which is higher than that on the same period the preceding year and what…and also higher than what is our expectation in term of tax rate for the full year, but this is due to a one-off issue links to the adjustment of the tax risk provision, which is also…having part compensated by tax credit in Turkey, with an overall one-off net effect of €4.4 million. We are not…we don't expect deterioration in our tax rate, this is just linked to one-off effect mainly driven by the tax provision that we had included in the second quarter of 2018.

Net income at 23.6% of sales is €164.2 million and even if this increase in the tax rate that we continue to have double-digit growth of our net income. In the period, net income increased by 11.7% over the same period of the preceding year, [indiscernible] financial results with a farther margin growth.

Slide #8 is, are…the slide shows the split of revenue and EBIT, between our two business segments. And EBIT margin are 48.5% for the rare disease segment and 30.5% for the primary and specialty care segment. It's important to underline that both segments show margin improvement.

Slide 9, net finance…our net financial position on end of June, the net financial position show a net debt of €556.4 million compared to the net debt at the beginning of the year of €381.3 million, but it's important to say that during the year, we have say €10 million for a milestone for the license agreement with Gedeon Richter [ph], we there was our on-share purchase for an amount…overall amount of €169.8 million, dividend was distributed for an amount of €87.1 million.

And then in June we have acquired Natural Point, the Italian company for a value of €75million. As I said at the beginning, we continue to be…to generate solid free cash flow which have been used for development of the company particularly following the acquisition based…due to this acquisition for Natural Point, this company in Italy, mainly in the OTC [indiscernible].

Then our last slide, Slide #12 which represents our target for the full year and these are the targets for the full year 2018 which are in line with what we have already announced. In particular, the expectation is to achieve sales of between €1,350 million and €1,370 million. This is in line for our previous expectation. We see in term of the margin, we expect the margin to continue to improve and we confirm that we expect to achieve an EBITDA of between €490 million and €500 million.

We expect to achieve an EBIT of between €430 million and €440 million and a net income between €310 million and €350 million. Then good performance in the first half and we confirm and we are confident to be able to achieve our target for the full year 2018. Here I stop, I finished my presentation. I am available for any questions you may have.

MARIANNE TATSCHKE: Operator, could you please open the question and answer session.

Q&A

OPERATOR: Thank you. This is the operator. We will now begin the question and answer session. The first question is from Jo Walton from Credit Suisse. Please go ahead.

JO WALTON: Thank you. I will start with 2, if I may. Looking at the US sales, you talked about the early generic competition. I believe it was for Cosmegen. To what level of generic erosion have we seen? Is this just starting and will we therefore be likely to see negative local currency US sales growth for the rest of this year and beyond, if you could just give us some help on that, please.

And then the second question, I know that it is not directly related to the company, but the change in ownership of the family stake, one of the public statements was that this would help accelerate the growth strategy of Recordati. I wonder if you could tell us what in practice you think the new ownership structure will do and how may change any of your tolerance for either incremental debt or potentially incremental risk. Whether this is going to give you an opportunity to do things that you have never been able to do before, but which you have been very keen to do in the past.

FRITZ SQUINDO: Okay. Thank you for the question. First question is we…the Cosmegen generic entered the beginning of 2018 then we have already had an important impact which is mainly due the price reduction due to entry of the generic. Overall, we expect…we confirm that we expect for the impact on Cosmegen sales for the full year to be in the region of $10 million for which we expect to be more important in the second part of the year rather than in the first half.

Having said that, we expect sales in the US for our orphan business to be lower…to be in line with last year or it could be bit less than what we have achieved in 2017 which in local currency, which is mainly driven by the full impact of Comsegen for the full year in the US market.

Regarding the acquisition, first of all, I would like to say clearly that I cannot comment in this conference call questions which are relating…regarding the agreement between the family holding company FIMEI and CVC [ph] covering the sales of the majority shareholding in Recordati.

There has been for this subject a press release issued by both FIMEI and CVC [ph] and then I cannot add any information regarding in addition to what is already public today. I can say that we expect for the company to…the strategy to be in continuity regarding what we have been doing.

Now, also because this is the CVC in the acquisition has confirmed the management with the name including Andrea Recordati as a CEO and myself as CFO and the strategy going forward would the same in continuity with the current strategy. Then we expect the Group strategy to be…is to continue to grow organically and through acquisition and this is not a public statement of CVC, but it's just something that has been commenting by some analysts. We can say that the new ownership may see an acceleration, under the new ownership we will see an acceleration in the future. But, this…let me comment on this, this is not only linked to change of the ownership, but it's mainly today driven by availability of targets in the market and financial strengths of Recordati. We have now in the M&A arena regarding, let me say, both OTC assets and some established products availability in terms of asset to be evaluated and we have some project under evaluation, it's very…it's becoming common for big pharma to divest some of these established product.

And we believe that if there are asset which fit well with our current portfolio which means that our asset belonging to the current therapeutical class or/and there are assets, which fit with our geographical foot print, which is mainly in large [ph] Europe. We are prepared to go ahead to analyze and possibly to sign new contract, I don’t believe that, the constrain in doing this deal is linked to financial availability, financial strength. We have possibility to increase our level of debt. Today, the level of debt even after the acquisition from Natural Point is close to unsigned [ph] EBITDA. We can increase this, but like I would like again and again to underline, that the real driver for the acquisition for us is not availability of financial resources this must be, but I think the strength of our balance sheet allow us to think positively in this direction, is quality of asset and how they think and they can contribute or to the growth or to the margin announcement. And, yes, there could be acceleration in our future M&A approach, but this is not only driven by the change of the ownership, it's mainly driven by availability of asset in the market.

JO WALTON: Thank you.

FRITZ SQUINDO: Okay.

OPERATOR: The next question is from Bruno Permutti with Banca IMI. Please go ahead.

BRUNO PERMUTTI: Hi, good afternoon. And I have two questions. The first one is on the buyback, if you can tell us if you plan to sell the shares or what else you are planning to do? And the second one is, on the EBITDA margin, we saw a quite high EBITDA margin in the first half. So the first quarter and the second quarter were more or less very, very strong, I was wondering if this is sustainable level for 2018 and for the following years.

FRITZ SQUINDO: Okay, then first question was linked to the buyback. We bought treasury shares for serving our stock option plan therefore we will use going forward to serve the stock option plan we have in place today, no, cancellation of the share for sure.

Regarding the margin, we are very pleased by the margins that we have achieved in the first half of this year, but I would like to underline that on a like-for-like basis our sales generally in the first half of the year are higher than in the second part of the year, and this is due to reason of seasonality for some product or in some geographies that margin also tend to be a bit higher in the first half.

Then…as we confirm that we expect a margin improvement, we have confirmed that today our expectation is to have EBIT in the region of 36%. We are pleased by the margin achieved in the first half, but we expect to keep at least what we have announced 36, which is already an improvement compared to what we have achieved in 2017, yes, this is sustainable. We could have achieved a peak in the first half, but overall the range of the margin that we have achieved in this half could be considered sustainable, not the peak achieved; let me say in the second quarter.

This is also linked to possible new deal, because for…in the M&A, for this product, mainly from the established product this could become driver for a further slight improvement in our margin. Then organically, we believe that we could…we will confirm the achievement of the current, let me say range of margin, a further improvement of the margins are linked to the type of business that we will buy going forward.

BRUNO PERMUTTI: Okay, thank you. If I may another question on Zanipress, do you believe that the decline…the revenue decline of the first half is something that we can extent to the whole year or I mean, not…if not the price…the price effect...the negative price effective is entirely on the market or you expect further deterioration in the future?

FRITZ SQUINDO: Zanipress in the…Zanipress, Lercanidipine and enalapril combination increase as a percentage of sale by 9.1%, we…this is linked to the progress and/or the generic during the first half. We are very pleased by how we are reacting and we are defending our friends, but for the full year, we expect further erosion, not important, but progressively further erosion because this is common in one market in which generic are progressing again.

These results are even better than what is…was expected for the generization [ph] of the combination, but we would consider going forward further small increase of the erosion for the second half of the year.

BRUNO PERMUTTI: Thank you.

FRITZ SQUINDO: Thanks.

OPERATOR: The next question is a follow-up from Jo Walton with Credit Suisse. Please go ahead.

JO WALTON: Thank you. I wonder if you would just tell us a little bit more about the market environment in Russia and Turkey, 2 markets that we don't have much exposure to otherwise. AstraZeneca earlier today highlighted not just seasonal problems but funding problems that they thought were depressing the Russian market. So I was just wondering if you were confident that it was purely a seasonal issue or whether there is just less money around for people to purchase in Russia. And what you think the underlying rate of growth of the Turkish market is, you are continuing to show a extremely strong growth yourself, are you showing that in local currencies, is that a reflection of the market growth or are you outgrowing the market?

FRITZ SQUINDO: Okay. First question was related to the Russia, then the main reason for the decrease in the first half in our portfolio…in our sales is due to the seasonal impact and to the very strong performance we have achieved in the last first, last first half period. And then it is mainly due to a comparison base, which is very strong. For the full year, let's say we expect to continue to grow, not to the extent that we have achieved let me say in ‘16 and ’15, then we expect one growth which is in the single-digit growth, but we expect locally to continue to grow. And then, we don’t see major risk in terms of funding, but the rate of the growth is not as it was in the past double-digit, it’s more in a single-digit range.

Regarding Russia…Turkish, sorry, this growth is driven by both our outperformance and also a solid growth of the business, then the business is growing and we are able to outperform by some percentage the performance of the market, that is not only due to our performance, we are not able to grow 20% in a stable market, it is a market which is growing double-digit and we are able to better performance in…and this is the reason for this 20%...range of 20% decrease.

JO WALTON: Thank you. And could I just also ask about your rare disease portfolio in the US. We don’t have much visibility of what the products are within it and therefore I guess I wasn't alone in not appreciating that Cosmegen was a more than $10 million product, which was facing patent expiry. If you could just tell us are there any other established product in that franchise that could experience patent loss in the next couple of years or is this pretty much a one-off event for that business?

FRITZ SQUINDO: Regarding…let's say this is mainly a one-off issue related to the generic of Cosmogen. Then for all the other, we don't expect a major impact from generic competition going forward.

JO WALTON: Thank you.

FRITZ SQUINDO: Bye.

OPERATOR: The next question is from KC Arikatla with Goldman Sachs. Please go ahead.

KC ARIKATLA: HI, thanks for taking my question. If I look at ex-US rare disease business, that has grown really nicely over the last few quarters. Can you let us know what's driving that?

MARIANNE TATSCHKE: Can you speak louder, please. We can't hear you.

KC ARIKATLA: Is it better now?

MARIANNE TATSCHKE: Yes.

FRITZ SQUINDO: Yes.

KC ARIKATLA: Sorry for that. So I was asking on the ex-US rare disease business that has grown really nicely over the last few quarters. Can you tell us what is driving that is that geographical expansion into areas where you were not there before is that volume growth in your current markets or is it just price increases? Thank you.

FRITZ SQUINDO: Okay, I agree with you. Ex-US our orphan business is doing very well and let's says the driver or both the volume growth essentially in the existing market. We are doing very well in all the European markets. I also underlined a good performance in our major market during my presentation and to which we are adding the geographical expansion.

But let's say both even today is more important, the consolidation and the growth driven by volume in the existing markets rather than the geographical expansion, geographical expansion is very important from a strategic point of view. It's very important because it allows us to think on a global base, we are now entering Japan, in Australia, and we have already our presence in Latin America. It's a driver for the growth, but it's not the only one. Ex-US business is growing essentially due to the enlargement of the patient [ph] in all the existing business.

KC ARIKATLA: Thank you.

OPERATOR: Ms. Tatschke, Mr. Squindo, there are no more questions registered at this time.

MARIANNE TATSCHKE: Okay.

FRITZ SQUINDO: Thank you.

MARIANNE TATSCHKE: Thank you. Goodbye to everyone.

FRITZ SQUINDO: Goodbye to everyone.