

Recordati S.p.A

“2017 First Nine Months 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 2017 First Nine Months 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: Good afternoon or good morning to everyone and thank you for attending the Recordati conference call today. Fritz Squindo, our CFO will be presenting and commenting upon our first nine months 2017 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: Okay, thank you Marianne. Good afternoon or good morning to everyone. We are pleased with our first nine months results which confirm sales and margin growth and underlining the first six month result.

Consolidated revenue is €63.8 million, which are up by 11.8%. These sales include €47.8 million coming from the consolidation of Italchimici and Pro Farma the Italian and Swiss company acquired last year and also consolidated respectively as from June and July last year as well also the Metoprolol-based product of sales the Metoprolol-based product was acquired from AstraZeneca in the second quarter and sales are consolidated as from June July of this year.

All these to say that like-for-like sales growth is 6.2% which means that more than half of our growth is due to the organic development of our

portfolio, then solid Pro Farma in the portfolio and important contribution from the product and company acquired. These excellent sales performance has driven further improvement of our margins. EBITDA is now at 35.5% of sales is €340 million during the period and which are up by 22.1% compared to last year.

Operating income at 31.9% of sales is €07.5 million here we have an increase of 21.8% and net income at 22.3% of sales is €19.10 million, an increase of 20.6% over the same period of the preceding year. But let me underline again that we continue to expand our margins.

Regarding financial position, we continue to have a very solid financial position, as at the end of September net debt is €21.7 million, this is clear we have an increase of €123 million compared to last year end but let me underline that we have paid dividend distribution and the acquisition of the products from AstraZeneca as an overall disbursement of €39 million. Then excluding this exceptional operation and the payment of the dividend, we continue to have strong cash generators.

Before commenting our data for the first nine months, let me underline some and remind you some important initiatives undertaken in this year for the development of our company. First to draw up, we have Cystadrop, an orphan drug which is indicated for the treatment of the ocular manifestations of cystinosis was approved by EBA in January.

Then an important agreement was signed with Meyer Pediatric Hospital in Florence for the development of treatment of retinopathy of prematurity. An agreement was signed with MimeTech for the development and subsequent global marketing development of a new compound for the treatment of neurotrophic keratitis. These are important projects in our

business for the treatment for rare diseases with the objective to reinforce and enhance our pipeline.

In the prime specialty care clearly this is important to underline that we have...in May we have acquired the European rights of AstraZeneca Metoprolol based products which will contribute to significant reinforcement of our presence in all the European market and as I said the sales of MimeTech product has been consolidated as from July of this year and even most important in July, REAGILA the novel antipsychotic product and the license from Gedeon Richter for Western European market was approved by European Medicine as you see and we expect to start launches in 2018. Then we are very pleased by both performance in term of financial result and also initiative undertaken for a further development of the company in these nine months of 2017.

Regarding financial results Slide # 3, corporate product sales of the most important corporate products, we are very pleased and satisfied with the positive performance of our corporate products to which the Metoprolol based product acquired were added as from July. Let's start as usual with lercanidipine and Zanidip.

Zanidip lercanidipine had great growth by nearly 7% when we continue this positive trend in the lercanidipine sales. Sales of Zanipress, Zanipress is the combination of lercanidipine and enalapril are up by 5.8% and here let me underline the generic and in Italy and in Germany not yet in France. The overall sales of the lercanidipine franchise in the first nine months are nearly €150 million.

Urorec silodosin generated in the period sales of €69.5 million up 9.9% due to good performance of the product in all the main markets in which we continue to increase and to gain market share from competitors. Sales

of Livazo in Spain, Portugal, Ukraine, Greece, Switzerland, Turkey and Russia which means that this is not a product for all the European markets but is a product for selective European market but sales of Livazo in the period are €29.2 million which are up by 8.2% and here again, we have good performance in all the market in which we have launched the drug.

At the end of June the agreement with AstraZeneca was signed and now product Seloken®/Seloken® ZOK and Logimax in Europe are sold by Recordati. Revenues generated by this product in this market are consolidated as from July of this year and are in the third quarter €22.7 million. And let me underline again that this product contributes significantly to the growth of our subsidiary mainly in Germany, Poland, France, Czech Republic and Romania.

The other corporate product grew overall by 15.6% this growth is a bit lower than what we have achieved in the first six months but this is due that in this line a very important contribution of some Russian products which had been also, which had a positive impact from the currency effect in the first period of the year.

Overall, these are the corporate products comprise 21 products sold in multiple territories 8 of which are OTC products. Then our specialty indicated for the treatment of rare and orphan diseases generated sales of €61.3 million during the period with an increase of 14.7% due to the performance of the business in all the areas and which is in line with our expectation to continue to have in our business for the treatment of rare diseases a double-digit growth in sales.

Slide #4, this graph shows the breakdown of revenue by type of product. No major changes. The only very important change is now the addition of Seloken and Logimax in our corporate products franchise.

Slide #5, sales in all our main markets show continued growth and we have let's say a balanced trade in which all our market excluding North Africa in which we have some limitation in the importation of some product in Algeria are growing, which is not...we have not our business which is driven by one market but overall you can find a balanced growth in all our business.

Then starting from sales in Italy let me underline that include the revenue generated by Italchimici, which were consolidated as from 1st of June last year. Pharmaceutical sales in France are up by 8.2% and this is due to maybe the good performance of the Urorec, Methadone and Zan-Extra which are products sold in France in addition to the sales of Lercan the second brand of lercanidipine which is now sold directly by our subsidiary following the termination of the license agreement with PHARMA. To those we are adding in the third quarter also the sales of metoprolol product as I said acquired by AstraZeneca. Overall, we have also...I would like also to underline that also the treatment for rare diseases in France are growing strong. Then overall a very good performance of the current portfolio plus metoprolol in our French business.

Sales performance even better in Germany, sales are up by 19.7% and this is also pertaining to growth of sales of Zanipress and Ortoton and it's important also the contribution of metoprolol sales in our Germany business.

The Group pharmaceutical business in the USA it's all dedicated to the treatment...the marketing of product for the treatment of rare diseases and in the first nine months is growing, this business is growing by 7.7% and by 8.3% in local currency. Then we are pleased by the record of our

business and the growth of our business indicated for the rare diseases in the USA.

Revenue generated in Russia, Ukraine and the other CIS market is €79.3 million which are up by 41.3% compared to the same period of the preceding last year and includes also a positive estimated positive currency exchange [ph] of €9.8 million mainly driven by the exchange rate between ruble and euro at the beginning of the year. But is also to underline that sales in Russia in local currency continue to grow significantly and in overall are up by 22% compared to 2016. Then solid and growing performance driven by all our major brand in the Russian business.

Sales in Turkey are slightly down but this is only due to the negative currency effect which could be estimated in €12.9 million. And here again, the local currency sales of our Turkey subsidiary grow by 21.9% driven by both corporate product and local product is...then we continue to have a very solid performance of our business in Turkey.

Sales in other Western European country include direct sales in Switzerland following the acquisition of Pro Farma in 2016. And also to the direct sales to the market always in Switzerland to have a corporate product which are premierly sold by licensees and also in the other CIS country we are growing by 28.8% and this is due to the contribution mainly by the metoprolol, metoprolol is important for all our market but in particular is significant...is a significant contribution in Poland, Romania and Czech Republic and Slovakia and you will see immediately the strong increase of our business in these markets.

On Slide #6, this graph shows geographical breakdown of our pharmaceutical revenue. No major change but you will see that we are

progressively reducing our presence in Italy and increasing the presence in which we are now starting selling metoprolol product.

Slide #7, regarding here we are commenting our first nine months P&L results. And it is important to underline that we have a further margin growth regarding sales we have already analyzed our revenue for the period.

Let's now move on the gross profit, gross profit is €76.2 million but it's important to say we have a margin of 70.2% on sales which is an improvement, which is due to the further growth of product in our margins but also to the positive effect in our gross margin of the metoprolol-based product acquired from AstraZeneca consolidated as from 1st of July.

Selling expenses increased less than sales and are therefore down as a percentage of revenue compared to the preceding year thanks to the increased efficiency of the Group commercial organization, we continue adding new product and growing the current portfolio to leverage the commercial organization and therefore improving our margin.

R&D expenses are €72.1 million and our R&D expenses are growing by 19.8% and this is due to different reasons. First of all, to the initiation of the new development program and due also to the agreement that we have signed with MimeTech for the development of subsequent marketing on a global basis of the new compound for the treatment of neurotrophic keratitis and this new program that we are adding to our pipeline in particular the agreement with MimeTech, with the agreement with MimeTech we paid a total payment of €7 million in the second quarter which was fully charged on the P&L. And we are also increasing in the quarter our...in this quarter our P&L expenses due to the amortization of the acquired product from AstraZeneca. Then overall we are growing for

new program and that also due to the amortization of the rights that we have acquired.

G&A expenses are up by 3.3%, but reducing as a percentage of sales to 5%, here again we are leveraging also our changing organization. Net other expenses is significantly reduced as compared to the same period of the last year due to extraordinary costs incurred in 2016 following the acquisition of the company Italchimici of the acquisition of the company Italchimici and pro forma. Extraordinary charge in 2016 no extraordinary cost expenses in 2017.

Net financial charges are €11.8 million, an increase of €3.1 million compared to 2016 and this is due to the interest rate...interest which we are paying for new medium long-term loans granted in the period but also due to higher currency effect rate losses that we have had in these 2017 nine months.

The effective tax rate during the period is 25.7, which is in line with our taxation slightly above rate of the same period of the preceding year and let me finish with net income which is now at 22.8% of sales at the present margin is €19.8 million and we are increasing in the period our net income by 20.6% which means very strong performance and we continue to enlarge our march.

Regarding our margin on Slide #8, you will find our margin by segment and we showed a split of revenue at EBIT between our business segment and in particular EBIT margin for the rare disease segment is 45.8% and this margin includes this €7 million cost which are appreciated with the MimeTech development agreement.

On the Prime line Specialty Care business, we are also in this area continuing...increasing our margin and now margin is at 29.1% for this business segment. Group performance involves the two segments. Financial provision as I said at the beginning of the presentation, we continue as a very solid net financial position that at the end of September is €21.7 million.

And we have with an increase of 123 compared to last year and which is only due to distribution of the dividend and the acquisition of AstraZeneca product for an overall investment of €39 million. Having said that, Slide #9, for our inventory, the target, the financial projection for the full 2017 year, the Group business continues to perform very well also during October and then from the full year 2017, we confirm our targets which include also the consolidation of the metoprolol sales.

And based on the performance of the Group in the first nine months and the good performance in October, we confirm that our expectation for the full year is to achieve sales of between 1 billion 290 million and 1 billion 300 million and in term of margin our expectation regarding EBITDA is to achieve EBITDA of between €450 million and €460 million, EBIT of between 400 and 410 million and a net income of between €90 million and €95 million.

We confirm our expectation and we are confident we will be able to achieve these targets. Here, I finish my presentation and I am available for any questions you may have.

COMPANY REPRESENTATIVE: Yes, operator, could you please open the question and answer session.

Q&A

OPERATOR: Thank you, this is the Chorus Call Conference Operator, we will now begin the question and answer session. Anyone with a question may press “*” and “1” at this time. The first question is from Jo Walton with Credit Suisse. Please go ahead.

JO WALTON: Thank you. I have got a few questions. Firstly, on the growth margin, you are now up to 71% growth margin and I appreciate that some of this came from the first time consolidation of Seloken. Is this now a sustainable margin that we should think of going forward that your business mix will now support that level of gross margin. My second question is on the Rare Disease portfolio. In the US so far, you had about 8% growth year to date. I know you have said that you believe that Rare Diseases should grow in double digits. Is that just the Rare Diseases overall and we should expect that the US is a little lower and ex US is a little higher or could we see a further rebound in the fourth quarter to bring the US also up to double digit rates of growth. My next question is just on R&D and the level of R&D expense going forward. I know that there was a onetime element of your payment. Perhaps, you could tell us what the ongoing amortization charge for Seloken is that is being put through that R&D just so that we can get a sense of how to model quarterly R&D as we go forwards. Those are my questions please.

FRITZ SQUINDO: Thank you Jo for the questions. First of all, regarding gross margin, we are very pleased by the gross margin that we have achieved in both the first nine months and also in the third quarter which is close to 70% - 71% which is also driven by the consolidation of the metoprolol product but let's say that we have a portfolio now, portfolio with a mix of product.

We will be pleased to keep 70% of the gross margin going forward but as user, our objective are not at gross margin level but at operating margin

level and that we believe that what we have achieved in the nine months are absolutely sustainable. Then based on the current needs we can continue to have the 70%-71% but there is a change in the mix we could, as you know, our business is not only driven by the existing portfolio.

We continue to add product and then the gross margin is driven by the gross margin of the product that we are able to acquire but and the target is not to be dilutive at EBIT margin and we have no specific target in term of gross margin but having said that, I don't want to have an engagement to keep 70% gross margin going forward, but based on the current portfolio, based on the consolidation of metoprolol or what like been achieved in the first...in this quarter, in the third quarter, could the gross margin sustainable going forward excluding new acquisition.

Then regarding the Rare Disease we are very pleased by the performance of the Rare Disease in this quarter but as you know we consider the quarter not very able to represent significantly the real trend of the business and then we are in line with our expectation for the Rare Diseases which is to achieve a double digit growth overall in the business in 2017, in local currency, our US business to grow high single digits.

Then if we are able to achieve double digit we are very pleased but today the trend is in line with our expectations where in the US business for the full year high single digit growth which is in line with or which I announced in the last conference call. R&D now in the quarter was around 8%. The cost related to the amortization of metoprolol is in the quarter €3.5 million, then you can add this multiplied by four to have an idea, which is the cost in terms of R&D linked to the amortization of this right we have acquired. Is it enough?

JO WALTON: Yes, I apologize, I think you gave this number but my connection was not good. What was the contribution of acquisitions to your revenue growth in the third quarter, is it just the effect of the first time contribution of Seloken?

FRITZ SQUINDO: No, no in the first nine months I have said in the news and our like-for-like growth was 6.2%, then we have had a contribution due to consolation of Italchimici and Pro Farma mainly in the first five months and then in the last three months we have been adding to the business also the AstraZeneca, the metoprolol product. And overall, the organic growth and like-for-like is 6.2 that we can compare to 11.8 and the different is due to the contribution of the product and company acquired.

JO WALTON: Thank you.

FRITZ SQUINDO: Okay.

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

JO WALTON: As I have the opportunity, could I just understand when we saw the original deal with AstraZeneca I thought that the price was about \$290-\$300 million but the total disbursement seems to be €39 million. So, where does the extra expense come? And could I also just ask about the Italian market, if I back out Italchimici it looks like that market is now slowing and that all of the growth that you have had has been through acquisition, I know it's still an important market for you, it's not, you know, a complete driver. But, I wonder if you could just tell us a little bit about the market dynamics in Italy?

FRITZ SQUINDO: Okay. Then, regarding the expenditure, extraordinary expenditure in the period during the conference call I had underlined that €39 million are not only due to the acquisition of AstraZeneca product but we have also included that the dividend that was paid in the period. And then, I confirm that the deal of our acquisition of AstraZeneca product the deal was \$300 million. Then, we have added also the dividend just to give you a clear idea what is the cash generation of the business excluding extraordinary expenditure and dividend payment.

Second point was linked to the Italian savings market, I agree with you, if we exclude the Italcimici the Italian bases is slightly growing. But, we on the other hand we have now selling, we are now selling all the portfolio of Italcimici using our existing sales force and we have strongly reduced contribution of Italcimici's organization for selling their product.

Then we are let's say if we exclude Italcimici, we are flat or slightly growing in terms of sales, but we are increasing significantly our margin leveraging organization because we are adding Italcimici sales without getting all that increase in our sales in our cost base. Regarding the market, then we have no, we have solid brand portfolio in the Italian market, which is not significantly growing but we believe could remain stable going forward and the business itself is only growing in the hospital part of the business. We are not in this part, we are in the pharmacy channel business, which is essentially stable and our performance is slightly better than the market.

JO WALTON: Thank you.

FRITZ SQUINDO: Correct. We don't expect that the Italian business, the current portfolio to be a driver for the growth. This was also one of the reasons why we had deciding to raise first our portfolio. Metoprolol is not a way for inserting

significantly our business in Italy because metoprolol sales in Italy are very low.

OPERATOR: The next question is from Martino De Amibroggi with Equita. Please go ahead.

MARTINO DE AMIBROGGI: Yes, good afternoon everybody. Just a follow up on the like-for-like growth because you mentioned 6.2% in the nine months probably I missed it, if it's so I am sorry, but what was the like-for-like growth in terms of sales in Q3 and standalone and in terms of EBIT in Q3?

FRITZ SQUINDO: Okay. Like-for-like growth we have disclosed sales of Metoprolol in the quarter, which is 22.7 then the other part is essentially 22. The growth in the period was 38.4 and then of which 22 is driven by the Metoprolol addition and the other linked to the organic development of our business.

MARTINO DE AMIBROGGI: Okay, perfect. In terms of EBIT?

FRITZ SQUINDO: We have never, we will continue to never disclose the EBIT on the organic and the contribution of the addition, this is because it is part of our business model to be able to add addition without adding the same level of cost that we had today in our cost organization. The value of the company is also linked to our capacity to add let's say gross margin which are linked to the addition of the new product or addition to the new company and to have an increase in our operational costs, which is lower than the average cost in our business. It's not possible to identify, we don't want to identify the contribution of Metoprolol because Metoprolol now will become the product in our portfolio to be promoted in different way country to country. And then it's become now part of our portfolio, we disclosed that for is a clear indication of our organic capacity to grow this contribution of sales level not at the margin level.

MARTINO DE AMIBROGGI: Okay. On the R&D costs, the €7 million let's call them one-off referring to the agreement with MimeTech. If we set aside this amount, the R&D cost were just a 6% on sales. Could you provide us some color or what could be the trend of R&D costs going forward?

FRITZ SQUINDO: Okay. These are not extraordinary.

MARTINO DE AMIBROGGI: Yes, I know, you don't like the extraordinary word.

FRITZ SQUINDO: It's innovation and then we can spend or in internal development or we can pay the upfront payment for having right for selling and developing new product, then what I can say is, also including the Metroprolol amortization we could think and also based on the decisions, strategic decision to arrange first the pipeline in the outcome this R&D expenses could be expected to be in the region of 8% going forward even a bit more if we are able to add and this is also our objective the program in our development and pipeline.

MARTINO DE AMIBROGGI: Okay. Taking the same issue from another point of view, the €7 million was charged to the Rare Disease profitability. So, okay, you also already underlined the profitability on a quarterly basis, doesn't make a lot of sense, but, if we set aside this €7 million, the margin was 60 plus percent. Am I right in making this calculation?

FRITZ SQUINDO: Sorry, now this has been the €7 million has been charged in the P&L in the second quarter, not in the third quarter.

MARTINO DE AMIBROGGI: Okay.

FRITZ SQUINDO: That's the reason why if you analyze quarter-by-quarter the margin of our or from there even you would find higher margin in the first and in the third quarter.

MARTINO DE AMIBROGGI: Okay. Perfect. And the last, is there any market you are worried about? You discussed the Italian one. But referring to the global picture?

FRITZ SQUINDO: What, no we are not worried about. We are...we know that there are markets which are growing significantly based on our current portfolio and this is the case of some emerging market. We continue to grow 20, more than 20% in the Russian market, in the Turkish one we have some, the presence also in some western European countries in which we want to add product into our business development primarily because we believe these markets are not growing double-digit and now we are very pleased by the performance although this market we are telling about France, Germany and Spain and the other in the western European part of the business is significantly growing also thanks to the contribution of metoprolol.

And we are aware that there are different growth trends double-digit in emerging markets, single-digit in the western European markets and behind this there is a strategy in terms of M&A, we have to focus mainly our M&A and the business development activity in reversing some European market and these are the case of metoprolol acquisition and in particular metoprolol is now adding significant sales in some markets, which we believe to be low in terms of critical mass of sales and we are talking about as I said in the conference call, Poland, Romania and Czech Republic is the luck. No major concern, but different scenario country by country.

MARTINO DE AMIBROGGI: Okay. Actually the calculation on the nine months for the margin X the €7 million could be in the region of 50%, which I can consider as a reasonable trend going forward?

FRITZ SQUINDO: No, because this we have also clear statement in term of development of our Rare Disease business to enhance the pipeline. Then, you can pay €7 million 1 year when you have access to the right and then next year we expect to pay comparable cost for the development of the right to acquire then. We believe that what we have achieved now in terms of margin is something which is sustainable because on the other hand we want to continue to invest in R&D.

MARTINO DE AMIBROGGI: Okay. Thank you.

FRITZ SQUINDO: All right.

OPERATOR: The next question is from Harry Sephton with Jefferies. Please go ahead.

HARRY SEPHTON: Hi there. I just have one question. Can you give us an indication as to what your plans are to deploy your cash position and any potential timing for these plans?

FRITZ SQUINDO: Sorry.

MARIANNE TATSCHKE: Sorry.

FRITZ SQUINDO: Could you repeat the question? Could you repeat, please?

HARRY SEPHTON: Of course, can you give us an indication as to what your plans are to deploy your cash position and any potential timing for those?

MARIANNE TATSCHKE: [Indiscernible].

FRITZ SQUINDO: Okay, then we confirm our strategy then. We have a cash position; we have even red money from the bank system. Thanks to very favorable condition in terms of interest rate, we have signed the period from a contract with some international banks to increase our cash availability and the use of this will be in the same direction as in the past, we are scouting new opportunity for bolt-on acquisitions both products and companies mainly as I said in the western European part. The objective is to write first the business with the opportunity to grow the business and mainly to leverage existing organization. Then the business strategy in terms of M&A and business development continue to be the same we had over the last 15, I don't know 15, 10 years.

HARRY SEPHTON: Okay. Thank you.

FRITZ SQUINDO: Okay.

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

KC ARIKATLA: Hi, I have one question on the Rare Disease business. If I look at the first nine months, you have already done €161 million in sales and if I look at your guidance that's roughly say €200 to €205 million in sales for the full year. Is there anything that we should be aware of in 4Q because that would mean a significant downside or is the business tracking well ahead of your expectations? Thank you.

FRITZ SQUINDO: Okay. Regarding our Rare Disease we have announced not an absolute value, we have always announced the objective to continue to grow double-digit business with today different performance even more than

10% in the near business and something a bit less than 10% in local sales in the U.S. market then, we are not concerned. There is...and then, we expect this to be our objective for the full year 2017. And no major concern for the last, for the next quarter of our business in the rare diseases.

KC ARIKATLA: [Inaudible].

FRITZ SQUINDO: Okay. Is it enough?

KC ARIKATLA: Perfect. Thank you.

FRITZ SQUINDO: Okay. Bye.

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

MARIANNE TATSCHKE: Okay.

FRITZ SQUINDO: All right. Thank you very much.

MARIANNE TATSCHKE: Then, thank you very much for attending the call. Goodbye.

FRITZ SQUINDO: Goodbye to everyone.