Recordati S.p.A

"2014 Second Quarter and First Half Results Conference Call"

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MARIANNE TATSCHKE, INVESTOR RELATIONS MANAGER

OPERATOR: Good afternoon. This is the Chorus Call conference operator. Welcome and thank you for joining the Recordati 2014 Second Quarter and First Half Results Conference Call.

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

MARIANNE TATSCHKE: Hello, good afternoon, good morning to everyone and thank you for attending our conference call today. Fritz Squindo, our CFO will be presenting and commenting upon our first half 2014 results. For a better understanding of his presentation, please access the set of slides available on our website www.recordati.com under the Investor's 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. Good afternoon or good morning to everyone. We are pleased to announce our result for the first half 2014, which shows sales growth and in particular significant margin improvement.

Let's comment on the sales. Consolidated revenue is €507.6 million, up by 6.3%. This sales include those generated by the Spanish Company, Casen Fleet and the Tunisian Company, Opalia Pharma, the two company acquired in October 2013 for an amount of €23.2 million and €8 million, respectively.

During…on the other hand, let me comment that during 2014 some currencies were significantly devalued, mainly the Russian ruble and the Turkish lira for an estimated effect of €20 million on sales. Excluding the contribution of the new acquisitions and the negative currency effect, sales growth would have been 3.6%. This is an organic development of our sales line.

As already stated, in the first half there is a significant margin improvement. EBITDA at 27.9% of sales is €141.9 million and is up by 18.2%. Operating income at 24% of sales is €121.8 million, here an increase of 18.8%. Net income at 16.4% of sales is €83 million, here an increase of 18.1% over the last…over the first half of 2013, then a very significant improvement in all our margins.

Let me also say that during the period, we obtained a new product Vitaros for the treatment of erectile dysfunction under license from Apricus Biosciences. And we have acquired a further 23% of Opalia Pharma in Tunisia. In July, our orphan drug Carbaglu was granted orphan drug designation by the FDA in the US for its use in the treatment of organic acidemias, a development which is in place for this drug in the…in USA.

Slide #3, here we are…we present the main product sales. Let's start with Zanidip our lercanidipine plain, Zanidip sales decreased by 4.6% as a result of generic competition, mainly in Italy and a negative currency effect in Turkey. In Turkey, Zanidip sales are growing, but in euro translation there is a negative impact. Sales are stable in France and grew significantly in North Africa mainly in Agile (Ph).

Sales of Zanipress are up by 6.5%, Zanipress is our combination between lercanidipine and enalapril and we have a good performance overall, but mainly we have a very strong performance on the product in Italy.

Urorec, here we are talking about silodosin, has been successfully launched in 25 countries with sales of €28.4 million in the first half of this year, up 25.4% mainly due to the performance of the product in Italy, in

Spain and in France and by licensees in other countries. Here again, we have a very good performance in Turkey, but with currency effect of the…due to the currency effect, it's not so growing as in the other markets that are…as I have underlined.

Let's move on Pitavastatin, sales of Livazo in Spain, Portugal, Ukraine, Greece and through a license agreement in Switzerland are €12.4 million, up by 11.2%. Our specialties, which are indicated for the treatment of rare disease or orphan disease, overall, generated sales of €60.3 million in the first half. The sales are down by 0.7% which is due entirely to the termination of the Adagen license in the main countries. Altogether, the other products in the portfolio grew by 14.3%. Therefore, we confirm a double-digit growth for our current portfolio for the treatment of rare diseases.

Slide #4, here we have a graph, which show the breakdown of our revenue by type of products.

Let's move on the composition of our revenue by geography. We are in Slide #5. And let's start with our Italian market. Sales of pharmaceutical in Italy are down by 0.8% compared to those of the same period of the preceding year due to the…due to the Adagen license termination. And starting from end of May, we have also the termination of the license of Entact, to escitalopram which was an important product in our Italian portfolio. All the other main corporate products are performing well. Pharmaceutical…then let's say that we have…in Italy we have a good performance despite these two important terminations.

Pharmaceutical sales in France are down by 3.4% mainly due to the sales decrease in the OTC line of product indicated for the treatment of ENT disorder due mainly to seasonal factors. Urorec, here silodosin and methadone are performing well.

In Germany, sales are up by 9.3%, thanks to the sales growth 6%...sorry, thanks to the sales growth of Ortoton, of Zanipress and of the orthopedic product lines. We expect a 10% growth in Germany and we are in line with our expectation.

Revenue generated in Russia and the other CIS countries is down by 11.3% compared to the same period of the preceding year mainly due to negative currency effect of €6.4 million. Sales in Russia, in local currency, to have an idea of the performance, we prefer to comment the performance in local currency, here in Russia sales are up by 1.3%.

As from…let me underline again that as from January 2014, the distribution of product in the Russian territory is handled directly by our subsidiary, it’s no longer through direct sales to importers. This has involved setting up of local inventory and the consequent reduction of stock held by distributor.

In the second quarter, sales grew by 16.2% which has…this performance has more than compensated the decrease in the first quarter due to this reorganization of the distribution channel. Then we had a very low first quarter which was mainly due to the reorganization of the distribution channel and starting from the second quarter, we are…we continue to grow our sales in local currency in the Russian markets.

In Spain, here we have a very strong performance, but let me underline that sales include €21.3 million which are generated by the Spanish…€21.3 million was generated by the company Casen Fleet acquired in the first quarter of 2013.

The Company main product is CitraFleet, a preparation for colonoscopy, which is part of our corporate product portfolio and CitraFleet is also marketed in other European countries. And we are progressively trying to sell directly through our subsidiary this product which is now a corporate product in all the major European countries. Livazo and Urorec, our corporate products in Spain are also performing well.

Sales in Turkey are down by 3.3% due to a negative currency exchange effect of €10.9 million in local currency. Here again, our Turkish…sales of our Turkey subsidiary grew by 20.2%, thanks mainly to the very good performance of the corporate products, Procto-Glyvenol, Urorec, Zanipress and of the main local products. Let me say that we have a very good performance locally by our…in our Turkish subsidiary.

The Group's pharmaceutical business (Ph) in USA is dedicated to the marketing of product for…only to the marketing of products for the treatment of rare diseases. Sales in the first half 2014 are €27.7 million, here up by 15.6%, very strong performance despite a negative currency effect.

Sales in North Africa are €19.8 million and comprised both the extra sales generated by Bouchara Recordati in these countries, in particular in Algeria which were previously shown under other international sales, and sales generated by Opalia Pharma, the Tunisian Pharmaceutical Company, as I said, acquired during the first quarter 2013. This Company sales are up €8 million in the first half.

Sales in Portugal are up by 15.1%, thanks to good performance of the corporate products, Livazo, TransAct and Urorec, as well as to the contribution of the products sold by the Portugal subsidiary of the newly acquired Spanish Company, Casen Fleet here for an amount of €1.7 million. Then as I said, we are trying to develop the current business not only in Spain, but in Portugal, in Germany where Casen…CitraFleet is an important product in our portfolio and progressively in the major European markets.

Let me finish with the other international sales which grew by 3.8% and comprise the sales to our licensees, for our corporate product Bouchara Recordati export sales and export of Orphan Europe worldwide excluding the USA which is treated together with our USA business.

On Slide #6, you can see the graph which show the geographical breakdown of our pharmaceutical revenue. And here it's worth mentioning our growing presence in Spain, in North Africa following our recent acquisition. But we confirm that we are reducing our presence in Italy, and we continue to develop the business outside Italy, in Europe with this new important business also in the USA.

First half 2014 results, Slide #7; we have already talked about revenue for the period. Let's move to the profitability. Gross profit is €336.6 million with a margin of 66.3% on sales, an increase compared to-date of the first half 2013, and this is due to a positive mix effect following the addition of…to the portfolio of the products belonging to the two company acquired mainly to the Casen Fleet portfolio, and the sales reduction of Adagen and Entact [indiscernible] which we had the termination…the contract termination with relatively low margin. We are talking…Adagen and Entact were relative low margin products.

Selling expenses as a percentage of sales, they are down compared to the same period the preceding year, and this is due to the overall containment in all markets and also to synergies obtained with the integration of the newly acquired company in Spain.

R&D expenses are €40.7 million. Here our R&D expenses are up by 7.2%. G&A expenses are up by 5.4% and are substantially stable as a percentage of sales. And then, thanks to in particularly to the higher gross margin and to the lower incident of selling expenses, EBIT in the first half increased to 24% of sales.

Net financial charges are €8.10 million. Here an increase of €1.1 million, due mainly to the interest accrued on a higher level of investments in particular related to the medium long term loans that we have raised at the end of 2013. The effective tax rate during the period is 26.5% substantially unchanged compared to that of the same period of the preceding year.

Finally, net income at 16.4% of sales is €83 million, an increase of 18.1 over the same period of this preceding year. Net income growth is slightly lower than the growth in operating income due to higher incidents of financial expenses. But our net income is increasing by 18.1%. I would like to underline this, very good and very good performance.

Financial position; Slide #8, at the end of June, the net financial position shows a net debt of €211 million, a reduction of €50 million compared to the end of last year. Let me underline, that during the period, there were some extraordinary payment in particular where there was a residual amount of €2.7 million paid for the acquisition of the Spanish company Casen Fleet, €1.8 million were paid as a upfront payment to Apricus for the Vitaros license agreement. Then we have a payment of €4.3 million due to the acquisition of further 23% of the share capital of Opalia Pharma, and even more important dividend was distributed for a total of

€22.4 million. Then very strong cash generation in the first half, in line with our expectation which is to have cash flow generation slightly above the net income of the same period.

Slide 11, here our objective or our target for the full year 2014, and we confirm our target for the full year. In particular, sales in 2014, despite two important license terminations, and the significant negative currency effect, our objective is to achieve sale of slightly below €1 billion.

Regarding margin, we expect also for the full year margin improvement. Thanks mainly to the better margin of the new business acquired relatively to the low margin of terminating product. Therefore, we confirm that we expect EBIT to exceed €220 million and net income to exceed €150 million.

Okay, thanks for your attention. And now, I am available for any possible questions you may have?

MARIANNE TATSCHKE: Could you please open the question and answer period.

Q&A

OPERATOR: Excuse me; this is the Chorus Call conference operator. We will now begin the question and answer session. The first question is from Ms. Eleanor Fung of Goldman Sachs. Please go ahead, madam.

ELEANOR FUNG: Hi, three questions, please if I may. Firstly, on SG&A spend; you've reduced your margins versus last year. Just wondering, if you could comment on how you've been able to improve this margin and how we should expect SG&A spend to evolve for the remaining quarters in 2014 and to the mid-term? Secondly, on the Russian, Poland destocking, just wondering when you might expect sale to normalize. And then, finally, on the recent tensions around the Russia CIS region; just curious, if you've seen any non-FX disruption to your sales channel and whether or not you expect any going forward? Thank you.

FRITZ SQUINDO: Okay. The first question was mainly to SG&A expenses, but I would like to comment mainly the selling expenses because we are with…G&A expenses are slightly in line as I said during the conference call in the previous year. We are reducing our selling expenses. Now, in the first quarter, as a percentage of sales…selling expenses were 28, how much is it…overall [indiscernible] 34.2 and selling expenses are…and we are reducing by 1% as a percent of sales our selling expenses. This is due to an overall good management in all our countries. We are increasing sales and we are not increasing, we are slightly reducing our sales organization, and with this what we can expect for the full year regarding selling expenses, let me say that we expect to have selling expenses in the region between 28%-29%. Also an important contribution was linked to the integration of Casen Fleet, and this is a clear direction that if we increase our sales in market we have already an existing presence we can leverage our selling expenses. There is not…nothing extraordinary. Let me say just, the overall control in all the market, and an important contribution mainly in Spain where we have a development of the sales force or of the sales line without a strong increase of our sales force.

Russia, and the policy here I told you during the conference call back in the first quarter, we have this reorganization, than…we in the second quarter, we increase our sales by double-digit growth, 16%. Then let me say that starting from the second quarter, we expect to have our business, our stock management system let me say normalize in Russia, then we expect for the second half to continue to have this level of growth. And for the full year, as I stated in the previous conference call for the first quarter result, we expect to grow by between 10% to 20%, because there is a good performance of our product in Russia.

Regarding the overall area, Russia and CIS market; let's say that for the time being in Russia, we haven't seen particular difficulties. Let me say also that parts of our product are produced in Russia and then there is no impact from any possible decision regarding partition of product in Russia. But let's say that, overall, we haven't seen particular tension in our Russian business, while in Ukraine we have now a stable business, and for sure the…here the impact is more important. We expected the growth; we have a very good portfolio in Ukraine. We expect it to grow significantly in 2014. For the time being, our expectation is to keep our business stable, then some impact on Ukraine for the time being not major impact in our Russian business.

ELEANOR FUNG: Thank you.

FRITZ SQUINDO: Bye.

OPERATOR: The next question is from Mr. Martino De Ambroggi of Equita. Please go ahead, sir.

MARTINO DE AMBROGGI: Yes, good afternoon everybody. Fritz, the first question is on the R&D cost were in the region of 8% also in Q2. If I remember correctly, the guidance factored in 9%, but maybe I am wrong, so just an update on this issue for the full year guidance?

FRITZ SQUINDO: It's the only question?

MARTINO DE AMBROGGI: No, I'll start with the first one.

FRITZ SQUINDO: Okay then, you want immediate answer?

MARTINO DE AMBROGGI: Well, by the end of the call.

FRITZ SQUINDO: Okay, then we are…we are increasing our index prices by 7.2% and then we are in the lower part of the range. We expect it to be 8%, 9%, then as usual, this is linked to the safety (Ph) development and then probably for the full year, we could be not at 9%, but a bit less, but in any case, we expect to remain between 8% to 9%. But there are some times some delay in the enrollment, some delay in some clinical development, and then this is…but overall, let me confirm that we think R&D expenses will remain between 8% to 9%.

MARTINO DE AMBROGGI: Okay, perfect. The second is on what…I don't know if you have any idea of what could be the potential impact of the…I don't know the stage of this cash and that for the price revision in Italy, there is some cost saving initiative starting from the Italian Authority. So I don't know if you have already an idea or….

FRITZ SQUINDO: Let's say that in…we frankly speaking, we don't expect a major changes in the way which authorities try to control the expenditure. Then in Italy, the major point is the expense in the hospital business, but we have no high important presence in this sector. And then we expect the pharmacy level of…in the pharmaceutical expenditure to be in line with the expectation. And then some possible deduct (Ph), but in line with what we have accrued and we have paid in 2013. Then no major changes in Italy. There are also some possible changes in France, but here again, there could be some impact, but this is the normal life for a pharmaceutical Company in this market. Then the usual cost controlling policy, but not something extraordinary for 2015.

MARTINO DE AMBROGGI: Okay. And on the currency effects based on the existing, the current FOREX, what is the expectation you have for the second half of this year?

FRITZ SQUINDO: We had €20 million. Let me comment again, on sales level we had a €20 million effect in the first half. We expect this €20 million to be less significant in the second part, because the depreciation, devaluation of the Turkish lira and the ruble started in the…at the end of the first half. And then we have…the comparison is not with very high level of ruble and Turkish lira as in the first quarter, in the first half 2013, but with the different level in the second half. Then we could expect half let me say of this impact in the second half compared to the €20 million in the first half.

On the other hand, we have also a impact in our selling and expenses because of SG&A expenses…because we have also organization and we have cost which are denominated in ruble and in Turkish lira. And then in overall, in the first quarter, the impact is not €20 million, but its €20 million less, one significant impact also in the cost denominated in these currencies.

MARTINO DE AMBROGGI: Okay. And the very last question on the Pitavastatin and Urorec, just to have an update on the sales trend for these two molecules products for the current year?

FRITZ SQUINDO: Okay. Regarding Urorec, now we have launched the drug in 25 countries. Sales are growing. Expectation in our business plan was to increase more than 25%, we are in line. We have a more higher level of sales in the first quarter. But this is just due to the normal trend in the market. We confirm the positive trend of Urorec. We are gaining market share. We are growing into the major markets. We are doing a very strong performance in Italy, also in France. And then, we are very pleased by the Urorec performance. And we are in line for achieving our medium and long term target.

For Livazo, here in the first half, the increase was 11.2%. The expectation was higher than 20%, but here it's not just this difference, it's the fact that we continue to believe that Livazo will be an important drug in some selected markets and not in the major markets as Urorec because we continue to have difficulties in obtaining in Italy and France a premium price for this drug. Then now, we have obtained the approval and the product in Greece. And this is the reason why we expect we are developing the…then developing the drug also in Switzerland. And then we continue to believe that this will be for a selective approach rather than an overall launch. And we could expect this kind of increase going forward and for a more significant increase we had to add other important markets. We expect the first one to be Turkish probably in 2015.

MARTINO DE AMBROGGI: Thank you.

FRITZ SQUINDO: Okay.

OPERATOR: The next question is from Mr. Chris Cooper of Jefferies. Please go ahead, sir.

CHRIS COOPER: Hi, there. Thanks for taking my questions. Just a couple left please. First of all, on the other international sales segment, if we look at it on a quarter-by-quarter basis, there has been quite a sharp sequential slowdown. I am asking just if you could elaborate a bit here please, and if you could give an idea about how we should be thinking about that for the second half of the year? And the second question please is really on the generics market in Italy. I have a strong understanding that things have improved quite a lot there with strong volume growth this year. I was just hoping to get your thoughts on how you can manage this and protect volumes in your off patent prescription business, and also maybe just your thoughts please as well on what kind of volume declines you see in there? Thank you.

FRITZ SQUINDO: Okay, then. Regarding the first question, our international sales are mainly sales to our licensees, then we…you could find in the quarter-by-quarter analysis some stock impacts because we are not talking mainly to sales in the market, which are completely controlled by our distribution policy. That is something that we supply our licensees and sometime they order once a year and then we could find one quarter more significant than the other. Then we expect overall these sales to increase for the full year, because the bulk, the business…the bulk of the business is represented by our sales of corporate products to licensees and we expect this business despite generic competition of lercanidipine to slightly increase for the full year 2014. Then we would prefer to analyze the other sales not on a quarterly basis, but on a yearly base, because there are some stock impacts which is not simple to be managed because it's based on the policy of the licensees.

Second point generic market, as I have commented during my conference call, we are very pleased by our performance in Italy because despite the…if we exclude the orphan business in which we had this important impact due to the termination of Adagen, the primary care business, let me call it this way, is growing despite termination of the license of Entact at the end of May. We are keeping our market share, then we are not concerned by the…by the generic competition, generics continue to increase. But let me say competition in the primary care business, competition to the GP (Ph) is becoming less aggressive, big Pharma try to exit from this business. We have decided to remain and our share of voice to GP is increasing even if we are reducing, slightly reducing our sales organization. And we are defending very well, even growing our branded generics.

Then we are not concerned from the generic competition and we believe that we can continue to maintain, even increase our market share, probably gaining market share more from the other branded generic not yet promoted, not promoted anymore and not to reduce our market share due to the increase of the generics.

Then in Italy, you can see that generic is increasing, some branded generic are increasing because they continue to be promoted and not promoted branded generic are reducing. We are in the second part in the branding that we promoted and we are growing our market share, not in all our major products, but in the major ones. Then for us, it's not a concern, the generic increase of…in the Italian market.

OPERATOR: The next question….sorry, if you wish to register for a question, please press "*" and "1" on your telephone. Okay, Mr. Squindo, Ms Tatschke, there are no questions registered at this time.

MARIANNE TATSCHKE: Okay, so we say goodbye to everybody and thank you for attending our call.

FRITZ SQUINDO: Goodbye.