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Valeant Pharmaceuticals International Management Discusses Q2 2013 Results - Earnings Call Transcript

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Operator

Good morning. My name is Matthew, and I will be your conference operator today. At this time, I'd like to welcome everyone to the Valeant Pharmaceuticals Second Quarter 2013 Earnings Call. [Operator Instructions] Thank you. Laurie Little, you may begin your conference.

Laurie Little

Thanks, Matthew. Good morning, everyone, and welcome to Valeant's Second Quarter 2013 Financial Results Conference Call. Presenting on the call today are J. Michael Pearson, Chairman and Chief Executive Officer; and Howard Schiller, Chief Financial Officer. In addition to a live webcast, a copy of today's slide presentation could be found on our website under the Investor Relations section.

Certain statements in this presentation may constitute forward-looking statements. Please see Slide 1 for important information regarding these forward-looking statements and associated risks and uncertainties. Readers are cautioned not to place undue reliance on any of these forward-looking statements. The company undertakes no obligation to update any of these forward-looking statements to reflect events or circumstances after the date of this presentation or to reflect the actual outcome. In addition, this presentation contains non-GAAP financial measures. For more information about non-GAAP financial measures, please refer to Slide #1. Non-GAAP reconciliations can be found in the press release issued earlier today and posted on our website.

And with that, I will turn the call over to Mike Pearson.

J. Michael Pearson

Thank you, Laurie. Good morning, everyone, and thank you for joining us. As you have read in our press release, we followed up our strong performance in the first quarter with another quarter of outstanding operating results. On today's call, I will review our second quarter results and performance and provide an update on Valeant's business. I will then turn the call over to Howard to provide an update on the Bausch + Lomb transaction, which closed Monday, and discuss the business going forward. After our remarks, Howard and I will be available for Q&A.

This morning, we reported Valeant's second quarter results for 2013, which were driven by strong organic growth and solid results across all of our operating units. Total revenue for the quarter was $1.1 billion as compared to $775 million in the second quarter of 2012, which excludes the one-time milestone payment of $45 million we received from GSK for the U.S. launch of Potiga in the second quarter last year. Product sales for the second quarter of 2013 were $1.06 billion as compared to $743 million in the same period in the prior year, an increase of 43%. Our second quarter cash EPS was $1.34 per share or an increase of 54% over 2012. Our cash EPS would have been $1.36 except for $0.01 for the pre-closing financing cost of Bausch + Lomb and a $0.01 negative impact for foreign exchange. Adjusted cash flow from operations was $423 million for the quarter or an increase of 61% over the prior year. We would also like to mention that our net income to adjusted cash flow from operations conversion ratio was greater than 1%, which has been our objective as we've talked about previously.

Organic growth continued to be strong for the company, even with the negative impact from the introduction of a generic competitor for the Zovirax Ointment. With this impact, our U.S. promoted business declined 5% on a same-store sales basis. But excluding the Zovirax Ointment and Cream, the rest of the promoted portfolio increased 7% on a same-store sales basis. We are not adjusting for any other generic products. As we expected, our neuro and other business returned to positive growth and increased 2% on a same-store sales basis, now that the impact of generic Cardizem CD and generic Ultram XR are largely behind us. Despite the continued headwind of generic [indiscernible] and a couple of other small products in Canada, our Canadian/Australian operations grew 4% on a same-store sales basis. Our Emerging Market segment delivered a total organic growth rate of 14% in the quarter, continuing the exceptionally strong progress seen in 2012.

I will touch on the key growth drivers on the next slide. There are several key drivers that are fueling our growth this year. For example, U.S. promoted products overall grew 7% on a same-store sales basis as OraPharma, our oral health or dental business, continued its stellar performance and once again delivered double-digit growth as it has each quarter since our acquisition. CeraVe also continued its positive track record and grew over 50% as compared to the previous year. I am pleased to report that our aesthetics franchise has its best quarter since Medicis launched its aesthetic products. In particular, Dysport had its best quarter ever and gained significant market share against BOTOX and ZMM. We expect that progress to continue as we roll out our new MMVP 2 [ph] loyalty program to physicians.

Our Emerging Market segment showed tremendous growth this quarter, which was driven by growth by several key markets. In Poland, we continue to grow faster than the market, which is growing 6% year-to-date according to IMS Health, while our operations are growing 11% and nearly double the market. In Russia, we increased organically 16% year-to-date, continuing to outperform the local market, which is growing at approximately 10%. Specifically, major products has delivered double-digit growth the past 6 quarters since we announced the acquisition. Our operations in Southeast Asia, South Africa continued their track record of quarterly double-digit growth. And our operations in Latin America have showed strength across the board, particularly our Probiotica business in Brazil, which has increased over 60% year-to-date. In addition, Mexico remains on track and has delivered 8% organic growth year-to-date versus the market growth rate of 3%.

We had another active business development quarter. And clearly, the highlight of the quarter was the acquisition of Bausch + Lomb, which closed on August 5. In addition, we significantly strengthened our aesthetic product offering with the acquisition of Obagi, a leader in the physician-dispensed skincare market. The co-marketing agreement with Mentor, which gives us access to the leading breast implants in the U.S., and the acquisition of Ideal Implant, a novel saline breast implant. We expect to gain FDA approval for the Ideal Implant in 2014.

We also continue to strengthen our business in Russia with the acquisition of certain products from CROMA for the local market, and Ekomir, a leading Russian OTC business. Finally, we gained entry into Vietnam, one of the fastest-growing emerging markets, with the acquisition of the majority share of Euvipharm. We plan to use of the Euvipharm platform to introduce other products into Vietnam. We continue to see interesting opportunities around the world and we would expect to be active with tuck-in acquisitions over the rest of the year.

As most of you are aware, once a year, Valeant overviews the performance of past acquisitions with our Board of Directors and our investors, reviewing key metrics to evaluate the success of our transactions. On the next 2 slides, we have analyzed all acquisitions that were over $75 million in purchase price and completed since 2008. As you can see, each of our acquisitions is performing extremely well as compared to the revenue forecasted in the original deal model with the exception of Afexa. Fortunately, Afexa and in particular, COLD-FX has rebounded dramatically in 2013. And from a cash flow standpoint, Afexa is now on track as compared to our deal model. I would also like to note the strong performance of Biovail, Sanitas, PharmaSwiss and iNova, which are among the largest transactions over the last 5 years. In aggregate, our acquisitions have grown organically at 12% compound annual growth rate.

Turning to Slide 8. Cash flows are clearly the most fundamental driver of a successful acquisition and the best measure of a deal's success. We are very pleased to note that all the acquisitions made since 2008 are either on track or well ahead of the deal model from a cash generation standpoint. In the aggregate, we are substantially ahead of the forecasted cash flows we modeled at the time of acquisition. We believe we are one of only a very few companies that has established such a track record based on both exceeding synergies but more important, overachieving on expected growth.

Despite our reputation for not investing in R&D at the same levels of our competitors, we believe we have a very exciting late-stage pipeline coming to the market over the next couple of years. Given some new news across a number of products, I would like to provide an update on this call. First, an update on efinaconazole or Jublia. As you know, we received a complete response letter in May. And I want to reiterate that there were no safety or efficacy concerns from the FDA regarding this compound. In July, Howard and I joined our team in Washington to meet with the FDA to discuss their concerns centered specifically on our container closure system. This week, we hope to reach a final agreement with FDA on a plan for addressing all of the same issues. And we expect to receive approval in the second or third quarter of 2014.

On Acanya, 2 pieces of good news. We have been able to extend the patent life for Acanya previously set to expire in 2015 up to 2029. This was a more specific formulation patent, which was granted. In addition, we have recently received Phase III results for a new formulation of Acanya, which demonstrate both improved efficacy and improved tolerability. We expect to file this new product with the FDA by the end of the year.

Luliconazole or Luzu has been filed and has a PDUFA date of December 11, 2013. We have engaged in positive discussions with the FDA and hope to publish Phase III data later this year. BV METROGEL, which we entered into a licensing agreement with Actavis earlier this year, now has a PDUFA date of May 24, 2014. Our dermatology R&D group is also working on several line extensions for CeraVe. And we would expect the CeraVe family of products to surpass $100 million in sales by next year. We have successfully launched CeraVe in Canada and plan to launch in Mexico, Brazil and Australia later this year. Finally, we have a robust pipeline of branded generics and OTC products across our emerging markets, which we expect to launch the remainder of this year and next.

To wrap up our discussion of the quarter, we have provided this chart, so you can track and compare our recent quarterly performance. I will not go over each line item, but note that our margins continue to be within expectations with gross margins of 77%, SG&A ratio of 22% and operating margins of 52%. There are 2 areas on our P&L that I did want to provide some overview. First, we recognized a noncash unrealized foreign exchange loss of $8.3 million on an intercompany loan this quarter that we excluded from our cash EPS calculation as we agreed to do at our last investor meeting. This related to the structure used by the iNova acquisition. Second, in the spring of 2012, the board addressed historical issues related to RSUs that have been previously issued to directors but would not be deliverable until after the director has left the board. Not wanting to encourage directors to leave in order to realize compensation, the board approved an acceleration of certain RSUs, which the company settled a portion of these awards in cash. And the resulting net economic impact was the same as the share repurchased by the company. This resulted in a one-time charge of $15 million in compensation expense.

With this, I would like to turn the call over to Howard.

Howard Bradley Schiller

Thank you, Mike. Now turning to our acquisition of Bausch + Lomb. It's been a very busy time since we announced the deal back in May. During this time, we have learned more about the business and the people who've made it successful. I am pleased to note that Bausch + Lomb has very similar culture to Valeant, which will be an important factor as 2 companies come together. B+L is performance-based, much like Valeant, and they're team-oriented with a strong willingness to wear multiple hats and accept change. We are very excited that so many of the Bausch + Lomb senior management will be joining Valeant. And I look forward to working with all of them.

Yesterday, Mike and I met with Fred Hassan, and we are pleased that he will be joining our board and actively advising us on the integration and ongoing operations of B+L. Our belief in the strategic rationale for the acquisition has only been reinforced through this process as well. Eye health is an attractive specialty both in the U.S. and globally. This acquisition expands our reach, not only in existing markets but now opens up new opportunities in territories, such as China, Turkey and the Middle East. And the fact that Western Europe and Japan are largely OTC contact lens and lens solution businesses and are profitable and growing, make our entry into those markets very attractive.

Finally, we've also been able to refine and sharpen our deal model and feel very confident that we can significantly exceed our $800 million synergy target. In addition, recently launched products, such as Lotemax Gel, Prolensa, the new IOLs and the Biotrue daily contact lens, have provided us with revenue upside. And we expect several of the pipeline products to provide us with new revenue opportunities in the future as we do not build pipeline revenues into any deal model. Furthermore, B+L was recently able to extend a patent for Besivance from 2021 to 2031, which was not included in our

As recently stated in the memo to both Bausch + Lomb and Valeant employees, we have already identified synergies in excess of $800 million. We will be reducing our combined headcount between 10% to 15%, which is a lower percentage than in other recent large pharma mergers. We will achieve these synergies with no impact in the North American field forces and less than 5% of the total synergies will be coming from sales forces globally. We expect to achieve at least $500 million in run rate synergies by the end of 2013 with the remainder to be achieved in 2014. Finally, we expect the cost to achieve these synergies will be significantly less than 1x full synergy target. And as always, we will update you on our progress.

The next slide gives you the percentage of our $800 million-plus synergy target by business or function. As you can see, the bulk of the savings are coming from cutting G&A expenses, combining the 3 B+L business units into 1 eye health business unit and eliminating the B+L regional infrastructure and merging the businesses into our decentralized structure, reducing marketing spend and rationalizing spend on R&D projects. We continue to be extremely confident in our ability to significantly exceed our $800 million target. And we will update you on our progress.

With the addition of B+L, we are extremely excited about the business mix and the opportunities it provides for both organic and inorganic growth. Now that Bausch + Lomb is closed, the U.S. represents about 50% of our sales with 2 leading specialty platforms: dermatology and aesthetics and eye health. We also have a very strong and growing Emerging Markets position, which represents about 25% of revenue. We have entered Western Europe and Japan with OTC contact lens and lens solution businesses. As I mentioned earlier, they are largely cash pay, profitable and growing. By type of business, branded Rx is still our largest category. But devices, which includes contact lenses, the B+L surgical business and aesthetics is now 20% of our business.

We're also diversifying from a product perspective with no 1 product representing more than 3% of total sales. The percentage of revenue from our top 10 products is around 21% and around 31% of revenue is derived from the top 20 products. This analysis demonstrate our diversification and has a unique position within our industry. Also given the pressures from governments around the world, we like the fact that 75% of our sales are either cash pay or private insurance.

In addition to the benefits of diversification, we have a very small percentage of our sales exposed to patent laws. As you can see on this chart, no more than 3% of revenue is at risk for generic competition in any 1 year. And in the case of Bromday and Lotemax suspension, new products have already been launched to sustain these franchises. We would expect to be able to implement life cycle management programs to extend the lives of other franchises as well. As you are aware, focusing on small, durable products has and continues to be a big part of our strategy.

We raised a total of $9.6 billion to finance the B+L transaction and retain some dry powder for tuck-in acquisitions. In June, we raised $2.3 billion in equity or added 27 million shares. Going forward, our diluted share count will be approximately 340 million shares. In addition, we raised over $7 billion of debt and our total interest expense will now be approximately $245 million per quarter. We continue to have an objective to have our debt-to-adjusted EBITDA ratio below 4x and expect to get there in the second half of 2014.

Before we get to our updated guidance for 2013, I want to remind everyone of our May guidance and our year-to-date performance. In May, we guided to $5.55 to $5.85 cash EPS for 2013. Year-to-date, we have delivered $2.64 cash EPS, which would imply, based on our May guidance, a $2.91 to $3.21 cash EPS for the second half of the year. With the B+L transaction now closed, we're updating our financial guidance for 2013, along with the quarterly breakdown for the second half of 2013 to provide greater clarity. Including this quarterly guidance is not a practice we plan to continue, but with the integration of B+L, we felt this was appropriate at this time.

We now expect cash EPS in the range of $6 to $6.20 for 2013. This guidance includes a negative $0.11 per share for the pre-closing cost of the B+L acquisition financing. That's both the interest expense and the impact of the additional shares pre-closing. Of this $0.11, $0.01 was recognized in Q2 and $0.10 will negatively impact our results in Q3. In addition, FX movements, which cost us $0.01 in the second quarter, will cost us an additional $0.05 per share in the second half of 2013. As you can see, we expect $1.33 to $1.43 cash EPS in Q3 and $2.03 to $2.13 cash EPS in Q4. We estimate the combined organization will deliver revenues between $5.8 billion to $6.2 billion in 2013. We also plan to update guidance on adjusted cash flow from operations at the appropriate time, but we also expect them to continue to be quite strong.

In closing, we are very proud of our quarterly results and our year-to-date performance. We are very excited about our future and believe that with a continued focus on durable assets and growing markets, we're laying a solid foundation to continue our performance into the future. With that, we'll now open up the call for questions.

Question-and-Answer Session

Operator

[Operator Instructions] Your first question comes from the line of Marc Goodman with UBS.

Marc Goodman - UBS Investment Bank, Research Division

First thing is in the past, you've talked about the accretion from Bausch + Lomb of 40%. As we think about -- actually, I was just curious. Given the change in interest rates and given the fact that you've got your equity deal done now and everything, can you talk about how you think about the accretion? Second thing is on Bausch, that was a pretty good detail of where the costs are going to come from. I was just curious. What's the extra cost-cutting that you found relative to your expectations? I heard a lot of comments about extra revenues that you found. I was curious. Where's the extra cost-cutting to get to the higher numbers quicker that you found? And then third, if you could just talk about Latin America specifically a little more. This has been an area that other companies have talked about as an area of weakness relative to expectations, and yet you continue to do really well there. So I was curious. How do you continue to do well? Just what's happening there and how to think about the growth there and how sustainable it is.

J. Michael Pearson

Okay. Marc, why don't we have Howard talk about the accretion, and I'll talk about the additional cost opportunities in Latin America?

Howard Bradley Schiller

Sure. Marc, as you recall when we announced the B+L deal, when we talked about the 40% accretion, it was -- we talked about how the deal closed on January 1, 2013, and how we've gotten all the synergies. That's what the accretion would be. As you mentioned, the interest rates we ended up paying were slightly higher than what we anticipated. We also issued a few more shares than we had thought, which would impact that a bit. Now with that being said, we also would expect the synergies to exceed our initial target. I think we feel very good about the progress we're making. And that analysis we did based on 2013 based on the new synergies is still roughly whole. But obviously, when we come out with our 2014 guidance, we'll see it be a much bigger impact of the synergy capture because we'll both, of course, capture much higher percentage of the synergies in 2014 than we will in 2013. But in 2013, the guidance represents the beginning of that capture. But again 2014, we'll see a much bigger impact from the synergies.

J. Michael Pearson

Yes, Marc. In terms of where we're finding some additional cost opportunities. And as you know, it's a pretty detailed exercise going sort of by region, by function, going through all the details. I think we've found quite a bit in purchasing, probably more in purchasing than we expected to find when you compare rates that both companies are paying for things, like car rentals and IMS data and bottles and things like that, that we think we can get some non-personnel savings there, quite a bit higher than what we had thought. I think the area of the G&A, it was actually a pretty expensive, heavy model that they had in terms of both the 3 divisions, the surgical, the contact lens and the pharma, and then the regional structures. So there's actually more G&A savings than we had expected to find. And we've also been able to leverage a lot of the commercial support functions that we had in our company with ones that they had. So for example, we'll now have a commercial support organization that will cover both the dermatology group, as well as the eye health group, which has led to more savings than we expected. But it's no one thing. And as we continue to look, the teams are doing a great job. They keep coming up with ideas and we continue to find incremental savings. And we're already well north of the $800 million. In terms of Latin America, our businesses -- I can't speak to issues other companies are having. But the market has slowed a little bit, both Brazil and Mexico. Brazil was growing at 15% plus, and it's down to probably about 10% or maybe even high single-digits in terms of the market. And Mexico was growing sort of high single-digits last year. It's down to probably about 3% this year. But we continue to outperform the markets. I think it speaks maybe to the types of products we

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