STADA Arzneimittel AG

Conference Call on H1/2018 results

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Transcript

Speaker Key:

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MK	Mark Keatley
CA	Claudio Albrecht
OP	Operator
SK	Sahil Kapoor
NM	Naveed Mukhtar
BV	Bruno Vanderstichele

Frank Seiler

Good morning, everybody, and welcome to our conference call on STADA's first half-year 2018 results. My name is Frank Seiler. I'm the head of investor and credit relations. With us today is our CEO, Dr. Claudio Albrecht, our CFO, Mark Keatley, and, as representative of Cinven, Christopher Anderson. In the following presentation, our management board will give you a short update on STADA's business development and point you to the key highlights of our half-year results.

As always, we will be happy to answer any questions you may have in the Q&A session at the end of our call. In the course of this, we kindly ask you to focus your questions on STADA only. Before I hand over, I would like to remind you of our usual disclaimer that can be found in the presentation. Please also note that this call will be recorded. A replay and a transcript will be available on our investor relations website by tomorrow. It is now my pleasure to give the floor to Claudio and Mark.

Claudio Albrecht

Good morning, everybody. This is Claudio Albrecht speaking. Thank you for attending STADA's half-term 2018 conference call. Before Mark will take you through the detail of this first six months, let me give you a quick summary of the highlights of the first half of 2018:

In terms of revenues, the business developed very nicely, with an increase in adjusted group sales in both segments, in brands and generics. You will hear more details from Mark. It grew about 5% which is, I think, compared to industry, slightly above industry average.

It is important to mention also that all our strategic alignment activities are developing and evolving very nicely. They clearly show very good results and have, here, especially a very positive impact on all the core processes of the company. This, of course, leads to a strong improvement in costs.

Looking, in this case, at the group earnings, and this is a result of the positive outcome here, we achieved significant improvement with double-digit increase in both reported and adjusted EBITDA, and considerably much improvement especially in generics. In terms of net income, we also see significant growth in the reported and adjusted number.

As I said before, Mark will take you through this in more detail, and afterwards he will be happy to answer all your questions. Let me give you a few more strategic highlights of the first six months: We continued our brand repurchase program, so we managed to buy back our anti-lice medication, Hedrin. We purchased a few more country-wides from Sanofi.

We were also very successful in negotiating our rights back from Grünenthal for APO-go. We've got it back now for Germany; Scandinavia will follow soon. Then, we manage APO-go ourselves, directly. APO-go, which is the substance apomorphine, a product used in late-stage Parkinson, is our most important product we have in the group.

Another highlight for the first six months definitely was the purchase of the anti-dandruff product, Nizoral, in Germany also known as Terzolin. We acquired this product from Johnson and Johnson. You might have picked up some other activities which clearly are post-balance sheet events, so let me just mention them very quickly, but they did not enter these first six months yet, but they will have, of course, a long-term effect on STADA.

We entered a co-development agreement with Xbrane, a Swedish biological company, for the development of a biosimilar for Lucentis, which is Ranibizumab. We managed to buy back Ladival from the Ladival GmbH & Co. KG. We are the full owners again of the Ladival brand.

We launched an equivalent to Lilly's Alimta, which is Pemetrexed STADA. We nullified the patent and launched. So this is a very, very big product in Germany, with more than 100 million euros, and we were first to market. And last, but not least, we acquired the majority stake in BIOCEUTICALS, the major shareholder in the production joint venture for our fifth most important product, Erythropoietin, which is a very important move too.

So these were the highlights in the first six months and some outlook already on what you will hear more in detail in the third quarter call[1]. In any case, having said this, I would like to pass on for more details to Mark. Mark, please?

Mark Keatley

Thank you, Claudio, and good morning, ladies and gentlemen. I'm pleased to announce the results of our first six months, which we have published this morning. And for those of you who have access to the slide deck, I'm going to comment first on slide four, which refers to the financial overview.

1 Correction by the Company: Following the change of the sub-segment of the stock exchange from Prime Standard to General Standard, the Company's post-listing obligations like certain reporting and publication requirements fall away. This will also include a conference call on the Q3 results.

We are summarizing, on this slide, our sales, our EBITDA and net income. The sales, according to our accounts, show a slight reduction. Just to comment on this, we did make a change on the status of our joint venture in Vietnam at the end of last year.

We announced that with our final results. We have deconsolidated that. That had a significant accounting effect, so in order to present the growth of our sales on a consistent basis, I draw your attention to the line Sales adjusted, where we are showing sales of 1.17 billion in the first six months, which represents a growth of 5% over the prior six-month period.

This 5% number is adjusted for currency as well as adjusted for changes in our portfolio, and this is therefore representative of our true growth trend. And this is a good number. This is clearly higher than the industry average for other generic and OTC companies. I'll go into a bit more details on that in a moment.

With EBITDA, our EBITDA for the first six months has been slightly over 260 million. We are, again, showing two comparisons. Compared with the EBITDA reported in the first half of 2017, it is higher by 18%, but we have to bear in mind there were some special items recorded in the first half of 2017, and we disclosed at that time they were related to the sale of the company; they were mainly due to advisory costs. So a more fair way to show our trend of EBITDA is the line called EBITDA adjusted. On that basis, it's an increase of 10% which is reflecting better our underlying trend line. And again, I'll comment in a moment on what is influencing that.

In terms of net income, again we present this in two ways. The net income on the face of the accounts is 165.3 million, a growth of 83% over the prior year. This is a very large growth and, therefore, I want to point out to you it's affected by an accounting transfer relating to the treatment of deferred tax, and this is a technical accounting adjustment arising from the adoption of the DPLTA earlier this year. A more fair way to show the trend of our evolution of net income is the line called net income adjusted, where you see a figure of 149.7 million for the first six months, representing a growth of 31%. I'll comment now on the net income factors. Part of it is the growth of the underlying business and the operating profit; I'll go into more details in a moment.

In addition, we have had a very beneficial evolution of our tax rate. If you look at the details of the accounts we've published today, you'll see our effective tax rate in the first six months has been just over 21%; in the equivalent period in 2017, it was 27%. So a six percentage point improvement in our effective tax rate, this represents a very significant part of the growth of net income.

Why we had this beneficial evolution again is linked with the DPLTA and our consolidation with the Nidda group of companies in Germany. This allows more consolidation of interest expense and tax deductions and results in a lower effective tax rate, which is beneficial.

I'll now go on to the details of our two main business areas, starting with generics. For those of you who have the slides, it's slide number five, segment results generics. Generics represented, in the six months, again, the largest part of our business, with 660 million euros of sales on an adjusted basis, and again our focus is on the trend of adjusted sales and EBITDA because it gives you the true picture of the evolution of our business.

So generic sales have increased by 4%. This is, for sure, higher than the average of our peer group in Europe. What has been driving that? First of all, we have had several significant launches in the last six months, including Rosuvastatin, which went off patent in the early days of this year, which we have launched in several European countries. And secondly, in general, we continue to do well in winning tenders in Germany and benefiting from sales under previously-won tenders.

And we also see, in general, in our European business, a positive evolution of product mix, with more sales of higher-margin products, so it would not be significant to single out any single country, because we have had very strong growth both in Germany, and also in all of the main western European countries and southeast Europe, where we sell generic products.

The improvement in sales and also the improvement in product mix has led to a very significant improvement in EBITDA, which was increased by more than 20%. Our EBITDA margin for generics has grown from 22% to 27%. In addition to the factor of product mix and launches, we begin to see the first contribution from our cost-saving program, which was one of the main initiatives launched by new management after the change of ownership of STADA, and a particularly strong focus is on purchase materials, which is very important for the generic business.

This program lasts many years, and so it takes time to have the full effect, but the first results began to make themselves felt in the six months we're reporting. This contributed also part of the improvement in margin.

I now move on to our branded products activities, and this is on slide six, for those of you who have the slide deck. So here we are reporting a very significant growth of sales of 7%. Our adjusted sales for the six months are 453.9 million euros.

Again, what were some of the highlights here? In Germany, we have had very successful sales of our branded products, notably Ladival where, as mentioned previously, we have repurchased the trademark and relaunched new formulations of the product which have met with great success from the consumers. But it's fair to say all our OTC products in Germany do well.

In addition, in other countries where we have a strong presence of branded products such as the UK, such as Russia, such as southeast Europe, we experienced also good trends with our OTC products. In addition, our Apomorphine business continues to do well. So overall, good trends in the business.

In terms of the EBITDA margin, you see, on an adjusted basis, it is fairly flat. The EBITDA margin is very good by the way, but it has not increased, it is around 25% to 26%. One factor affecting this is that in Russia the rouble has weakened compared with the prior period. The rouble has been around 74 to the euro; in the equivalent period of the prior year, it was in the region of 60 to 65. So that is a change of 10% to 15% in the value of the rouble, which has affected the EBITDA margin of the OTC products that we sell in Russia, but notwithstanding that, a very good margin in the branded business.

So I'll now move on to talking about our cash flow, and for reference, it's slide seven. First of all, our operating cash flow has increased by 6%. We have a very good conversion ratio of EBITDA growth into cash flow growth. Some factors particularly influencing that is that we have had a focus on inventory to optimize the level of inventory we carry, and, as a result, our inventory, as a percent of sales, has reduced and we also continue to make very good progress with collections. We have no significant bad debt issues, so the flow of income from the business is good. So the operating cash flow was 95 million euros in the first six months.

In terms of our expenditure, the largest single item was in the area of R&D and intangibles. We can tell you that within this line is the amount we have paid for the acquisition of Nizoral, of the product rights which has been mentioned earlier by Claudio. I'm not disclosing the exact number we have paid, because this is confidential, but it was the largest part of what is reported on this line, which was, in total, 181 million euros; the other items on this line are our expenditure and R&D and product development.

In terms of our investment in the factories and the supply chain, it continues to be strong. It was 16 million euros in the first six months. It was slightly lower than the same period last year, but there it is fair to say the early 2017 period was exceptionally busy because of the completion of our production facilities and quality labs in Serbia, but we continue to invest aggressively in our business and we continue to see good opportunities for return on investment by growing our production base.

Finally, on this line, we have the line acquisitions and disinvestments, which is a positive of 3 million. The reason for that is we are getting a flow of dividends from our joint venture in Vietnam. Even though it has been deconsolidated and is, therefore, not in our sales or EBITDA, it contributes positively to our cash flow. So these were the main factors influencing our cash flow.

As for the rest of the year, we expect that the positive trends in our business will continue and, in particular, we expect, in the coming six months and in the coming year, that we will see further good results from our cost-saving programs. Just to comment briefly on that, as we've mentioned in previous calls, we have been addressing all aspects of our business to look for more efficiencies. The largest opportunities are in purchase materials, by consolidating contracts with suppliers around the lowest source and, in addition, by improving our supply chain processes, reducing back orders and destruction costs and a number of efficiency programs in our factories.

So we expect that will make an even stronger contribution in the coming six to 12 months. So, ladies and gentlemen, those are the comments, and with this, we would like to go back to the operator and open the call for your questions.

Operator

Ladies and gentlemen, at this time, we will begin the question and answer session. Anyone who wishes to ask a question may press star followed by one on their touchtone telephone. If you wish to remove yourself from the question queue, you may press star followed by two. And if you are using speaker equipment today, please lift the handset before making your selections. Anyone who has a question may press star followed by one at this time. One moment for the first question, please. The first question comes from the line of Sahil Kapoor of Fidelity International.

Sahil Kapoor

Hi and good morning. Thanks a lot for the update for the first half and congrats on a good set of results. Can you provide color on two things? Do you see any impact of Russia sanctions? Can you give more details on that? How is the production being taken care of? Is it primarily all in-sourced in Russia? How is that taken care of? And the second one would be what's the total debt level on Nidda Group, as of the first half of 2018 end? Thank you.

Mark Keatley

Sahil, thank you very much for your question. Your first question was about sanctions, so I guess you were referring to Russia?

Sahil Kapoor

Yes.

Mark Keatley

The sanctions announced by US government and other governments affecting certain individuals and certain aspects of the government of Russia have not impacted our business. We do not have significant direct sales with government agencies in Russia. The majority of our sales are to wholesalers, and we have not noticed any impact on the trend of our wholesaler business owing to sanctions.

The one significant external effect we've experienced in Russia is due to the exchange rate, and it may be the exchange rate is, in some way, related to sanctions and international pressure, so in that aspect, there might be an indirect effect, but in terms of direct impact, we do not see any impact. And indeed, in terms of consumer behavior in Russia, that does not seem to be a significant factor so far.

In terms of Nidda, I just want to repeat what Frank Seiler said at the start. This call is for the benefit of equity investors in STADA. We do respect, fully, our reporting obligations to the bond-holders and debt-holders in Nidda, and so will be publishing, separately, today the first half-year results of Nidda, and we will have a separate call, early next week, where we will specifically address questions on Nidda, including the question you asked. So a very fair question but please bear with us and you will have the opportunity to go into that in a couple of days.

Sahil Kapoor

Thank you.

Operator

Next question comes from the line of Naveed Mukhtar of PGIM.

Naveed Mukhtar

Hi, guys. Thanks for the presentation. A few questions from me: Can you just give a bit more detail about the brand division particular in the quarter, because looking at the results in the quarter, EBITDA seems to be down, and I'm not too sure I understand why?

And linked to that, you mentioned about the Russian rouble impacting the EBITDA in the branded, and I'm just trying to understand why that would impact the adjusted EBITDA, because I thought that would have taken the FX out of it? And then, a second question after this?

Mark Keatley

Regarding the branded business, we adjust for currency factors with the sales; with the EBITDA, we do not adjust for currency factors because that is quite a complicated calculation. Just going, for a moment, into the technical factors, there is the translation effect and the transaction effect, both of which were negative in this sense.

First of all, one rouble of sales is worth less euros than it was a year ago, that's the translation effect; there is a second effect, the transaction effect, is that the cost of supplying the materials to Russia is mainly not in roubles, it's mainly in euros, because many of these products are coming from Germany or from western European sources. And, therefore, there was a double-whammy, and this is typical, what happens for a business where the products are imported.

By the way, we are not relaxed about this situation; we are taking steps to address it. We have mentioned in the past, we have a strategy to make more products in Russia, in fact we have already invested in a program to manufacture in Russia one of our biggest branded products, which is the nasal spray, Aqualor, and we will be transferring other products into our Russian factories in the future.

So this is a way to insure ourselves against this factor, but that was a significant effect affecting the margin. But we have to say, a margin of almost 26% we consider is a very good outcome. So I think that is addressing both of your questions, but you said you have another one?

Naveed Mukhtar

Yes. Regarding the situation with the bond-holders and the promissory loan-holders at STADA, I note that you basically have scheduled meetings. I don't quite understand exactly where you are in the process and why this is taking so long, so

	maybe you could just talk me briefly though the whole process, and what you expect to sort the situation out?
Mark Keatley	Sure, we're happy to speak to that. At the time of the change of ownership of the company, STADA had already debts to previous Schuldschein holders and noteholders, dating back over some years. We have an agreement with the lenders to Nidda that we will enter into an inter-creditor agreement which will regulate matter in a normal way between the Nidda lenders and the STADA lenders.
	This is the normal kind of inter-creditor agreement that is set up to respect the rights and obligations of both sets of lenders. This is going through an administrative process and it takes time, mainly because there is a large number of institutions that are participating in the old STADA debt. This debt was placed very widely in Germany, with a number of financial institutions, and even some retail investors, and therefore it takes time to communicate and to organize meetings. A meeting has been organized for September. The lenders in the old STADA facilities have already appointed a trustee to represent them, and therefore there is an organized process underway, and we do not expect this should be a controversial process. The feedback we hear from the lenders is they see us communicating with them in a very responsible way and, therefore, we expect this process will run its course and it will lead to a harmonious agreement. So it's simply a normal process in this situation.
Naveed Mukhtar	Sure and on the September meeting, you expect to have enough quorum to agree to the changes that you require?
Mark Keatley	This subject isn't one we're discussing in public forums, because it's a matter that we're handling with the debt-holders, but suffice to say that we expect the process will be completed harmoniously.
Naveed Mukhtar	Okay, thank you.
Operator	As a reminder, to ask a question, please press star then one at this time. Next question comes from the line of Bruno Vanderstichele of Bain Capital Credit.
Bruno Vanderstichele	Hi. I just wanted to ask for a bit more detail on your cost-savings program, and where you stand versus expectations.
Mark Keatley	Bruno, thank you for the question. The answer is we are on track. We are on track with the program. I mentioned already the areas we're addressing. The largest single area is purchase materials.

	There, we've made significant progress in our discussions with major suppliers of APIs and finished dosage form products.
	In addition, with our supply chain processes, we have invested in new software and created new processes to speed up ordering and order management within STADA. And we have launched a number of efficiency programs in our factories, particularly our large factory in Serbia, at Vršac, and also our factories in the UK and Germany. So we're very pleased with the progress. We are on track, as we expected to be.
Operator	There are no further questions at this time.
Frank Seiler	Thank you for your attendance of our conference call. Should you have any questions or follow-ups after this call, investor and credit relations will be happy to help you. Have a good day.