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DiaSorin SpA *(DIA.IT)*

Q1 2008 Earnings Call - 5/15/2008

MANAGEMENT DISCUSSION SECTION

Operator: Good afternoon. This is the Chorus call conference operator. Welcome and thank you for joining the DiaSorin First Quarter 2008 Results Conference Call. As a reminder, all participants are in listen-only mode. After the presentation, there will be an opportunity to ask questions. [Operator Instructions] .

At this time, I would like to turn the conference over to Mr. Carlo Rosa, CEO of DiaSorin. Please go ahead, sir.

Carlo Rosa

Yes, thank you. Thanks a lot for joining us for this conference call. I would give you a brief summary of the results and then we'll turn to Mr. Senaldi, the area group Chief Financial Officer who will go through the presentation with your results.

Let's start now from a generous comment. It has been a very good quarter for the company as we received from all the different [indiscernible] (01:05). It start from revenues, there has been a strong that there has been a very strong acceleration of the revenue growth, notwithstanding a negative impact on the different currencies including the dollar of current exchange rate. The group has grown more than 15% which would have been almost 18% at a constant rate.

If we now look at different geographies, the U.S. continues to grow more than [indiscernible] (01:37) driven by, on one side, the Liaison [ph] treatment (01:42) and we continue to increase our stock base with the [indiscernible] (01:47) and the support of [ph] care demand (01:49), as well as growing demand for the [indiscernible] (01:54) and in this side, as we have commented on the last quarterly releasing. Say, we always said that there has been a little increase of a clinical evidence with a vitamin D associated with a variety of diseases and this clearly now is – actually there is awareness on practitioners in the U.S. and they've been trying hard. They've been [indiscernible] (02:21) into the labs.

We can – just one note, Roche is our only competitor so far in the U.S. [indiscernible] (02:35) after the approval of the product.

When it comes to a brief comment to Italy, Italy as you know represents almost 25% of our turnover is our domestic market. The growth in the quarter one is more than 16%, almost 17%, I believe. And this has been driven mainly by the fact that we are continuing to increase the revenues of the installed base of Liaison's. As you know, we have a very large installed base in Italy and continue to spend more products on the installed base.

For all other markets including the new initiatives, namely Mexico, Israel and China, we continue to have a very good growth following the historical trend that we did comment already in the last conference calls.

From the installed base perspective worldwide, we had installed 90 units in quarter one in line with our expectation. As you know, the indication were always given to the market and it's that our – we have an ability to place 400 units per year worldwide in terms of new installation. And it's so we're in line with that expectation.

When it comes to margin, we continue to have a margin improvement mainly – it's driven by the technology shift from [indiscernible] (04:12) today not represent almost 56% of our total turnover. Now, just one more comment in the OpEx. The operating expenses are clearly under control. The year represents, I think, 36% – I think over 36% of total turnover decreasing, percentage wise, over last year, it's in line of the fact that the group continues to invest [ph] to guarantee EBIT growth (04:51), but still control our operating structure [indiscernible] (04:56).

I would like to turn to Mr. Senaldi who's going to go to the presentation. And then at the end of this, we will be taking questions. Thank you.

Andrea Senaldi

Thank you, Carlo. Good afternoon, ladies and gentlemen. And as usual fashion I will take you through the presentation highlighting, first of all, the key elements of the P&L and then going to the details of the individual [ph] finances (05:19). So if I may ask you to turn to slide number 2 where the quarter one profit and loss is represented.

And [indiscernible] (05:29) from the development of the top line, you can see that the net revenues at €56.6 million [indiscernible] (05:37) to represent a growth as reported of 13.5%. And we can see that at because of the exchange rate particularly – with particular reference to the development of the U.S. dollar versus the euro, the growth accounted at exchange rate would have been 17.8% versus the same quarter of 2007.

If we then move the gross profit, the gross profit has grown 14.4% versus previous year, increasing also – not only driven by the development of the top line but also increasing its incident on the turnover from 64.1% to 64.6%.

Operating expenses, as Carlo has just mentioned has developed less than proportionally to the turnover. The incidence is now 36.6% versus previous year of 36.9. All in all – which has resulted in EBITDA development of close to 25% versus previous year and operating performance development or EBIT development of more than 30% to €15.7 million versus €11.9 million.

As you will recall on previous conferences, last year we recorded some items that we defined as the non-recurring nature which are linked to listing [indiscernible] (07:00) on the stock exchange of Milan. And last year we've had recorded exceptional cost of €1.4 million, so if we adjust EBITDA and EBIT for these non-recurring items, we would get a growth of EBITDA of 14.3%, €19.2 million versus €16.8 million last year and a growth at EBIT level of 17.8%, 15.7% versus 13.3%.

If you look at the net financial expenses, this quarter DioSorin recorded positive financial items, particularly due to the devaluation of the debt position being counted that the group have.

Tax-wise, the group has recorded a lower tax rate than in the previous quarter of this year and in third quarter in 2007, particularly linked to the reduction in that income tax in Italy and in Germany. And as a result of this, the net result has moved up by just 6% from €6.8 million to €10.1 million in quarter one 2008.

If you now move to slide number 3 where we see the key driver of our growth, we have already discussed the rates of the growth. This is clear that you either continue to see enlargements on the installed base on Liaison, which has moved up from around 2070 at the end of 2007 to 2160 at the end of the first quarter with placement rate of around 90 machines per year – in the quarter which is in line with what we've seen in quarter one 2007.

We continue leveraging the installed base of Liaison, which means we continue increasing the revenue per [indiscernible] (09:02), particularly as we have [indiscernible] (09:06) the asset portfolio that we can offer on the

Liaison. And as you know, since 2006, we have launched 13 new assays under CE mark, of which 10 specialties and [indiscernible] (09:23) 7 new assays were received – 7 new assays from the FDA of which specialties.

You would see in six months time, in the way the growth was driven by mainly the U.S. and the European markets. If we talk about the technology-driven [indiscernible] (09:45) underneath the sales growth on slide number 4, you can notice that as we've seen in the past that Liaison with the CLIA technology has been driving [indiscernible] (09:57) growth. CLIA sales grew in the quarter versus previous year 34%, and the weight of the CLIA technology overall with the portfolio of [indiscernible] (10:12) sales is now 56.6%. This comparable quarter of 2007 was close to 48% weight. And you may recall that on average, 2007 was just about 50% of our total quarter.

In terms of the geographical area which shows the growth on slide number 5, you can see that Europe as a market for DiaSorin has been growing by 14.3% with particular performance in Italy where the growth was close to 18% and I'm glad you mentioned Belgium 17.1%, the UK and Nordic which grew by far more than the average growth of the group.

It's worth mentioning that in quarter one, we also see the beneficial effect in the top line of opening up the new market in Europe which is Russia, where we had no distribution in quarter one 2007.

As far as North America is concerned, Carlo's already mentioned the growth as a total as represented on the consolidated numbers in the – on the U.S. market has been 23.2%, which however becomes a significant evaluation of the U.S. dollar versus the euro. In local currency, in U.S. dollar, the growth has been close to 41% [indiscernible] (11:41) producing basically, performance that we have at the end of 2007.

The rest of the world are the markets outside Europe and the U.S. had been just – just been growing just about zero [indiscernible] (11:56) in the first quarter and this is due particularly to two accounted facts. The significant growth on these markets where we have distributed, in particular, I would like to mentioned Australia has been offset by a delay on the Brazilian market in the achievement of one tender which we believe will be – how it was started in quarter two 2008.

And the growth that we recorded in China, on the Chinese market at the end of 2007 as you may recall because of the assignment of the Belgian last tender which also a bulk delivery in one solution only. All in all, this has resulted as I've said before in a growth of a total quarterly activity level of 13.5%.

Now aside from the top line, all the profitability in the CapEx have been growing. We have commented a few before as well. I would like to give you some more highlights on the gross margin. The gross margin has grown by 14.4% versus previous year and the incidence for the turnover by 50 basis points. This is driven and is continuously driven by structural factors like the change in the mix of products, shifting towards year long and [indiscernible] (13:28) with a high profitability on the average, and the leverage on the – the operating leverage on the installed base, therefore on the depreciation on the instruments we have on the market.

But since [indiscernible] (13:39), this in fact, has been partly mitigated by higher weights of sales of instruments which, again, has been above 11% versus previous year. And a higher royalty [indiscernible] (13:57) is fast which we have accrued in quarter one.

Interesting part is that the close of the signing of the contract at the end of the quarter and the fact that we could not reflect this in the price in that, that we will be able to do in the future what is what we believe a temporary effect and a temporary [ph] erosion (14:23) of the market which was indirect [indiscernible] (14:25) through the prices. In terms of EBIT and EBITDA, I believe we have already implemented the improvement 31% – minus 31% growth of the operating cost [indiscernible] (14:43) 25% development on the EBITDA level.

If I present – then we move onto the key items of the cash flow and the balance sheet. In quarter one of this year, we have delivered operating cash flow of €8.2 million before capital expense of [ph] 2.7 (15:06) so net €5.5 million versus quarter one 2007 of €7.5 million before capital expenditure of €35 million. So all in all, an improvement versus during the – at operating level of €1.5 million for the [ph] one (15:19) quarter.

As a consequence of this, the net debt which we carried at the end of 2007 at the level of €12.1 million negative has reduced to €6.5 million at the end of quarter one. And the cash equivalent at the end of – the cash and the equivalents that the group is holding at the end of the period was €13.1 million versus €12 million at the end of 2007, a [ph] 41.% (15:47) growth.

On the other side of the balance sheet, the net capital employed has increased from €132.4 million to €133.7 million, discounting also the devaluation of the dollar. All in all, the equity at the end of quarter one is €127 million versus €120 million at the end of 2007.

I think that in terms of financial, this is all I would like to say and preparing for the Q&A session, I would just like to anticipate what are the forthcoming events in terms of communication of the company. The next event is the participation on June 5 and 6 at the European Mid Cap Forum in New York, on August 8, we would have both approval of the 2008 half year report, and in September 3 and 4, we plan to facilitate the Goldman Sachs European Medtech and Healthcare Services Conference.

I would like now to leave the floor to a Q&A session. Thank you very much.

QUESTION AND ANSWER SECTION

Operator: Excuse me, this is the Chorus Call conference operator. We will now begin the question-and-answer session. [Operator Instructions] The first question is from Stephane Sumar of Exane. Please go ahead.

Stephane Sumar

Q

Hi, good afternoon. This is Stephane Sumar from Exane in Paris. I've got a couple of questions. The first one, could you please come back on what you have mentioned in your press release this morning regarding manufacturing wastes, sorry, which affects frankly the U.S. production? And could you please quantify these negative impact and is it likely to be recurring over the next few quarters?

And my second question is regarding high [ph] neutral (18:17) charges. Just which products – do you still take into account the impact of factoring in the financial – at the financial level or not? Thank you.

A

Okay. I'll take the question. First of all, let's put things in perspective in terms of the facts of the different components of the margins. As I've said before, there are two structural components which have impacted the margin improvement, which are the shift in the mix of products and the average on depreciation.

Now against this, a better part has been as I've said, partly mitigated by two things which we have mentioned in the press release. One is the renegotiation of an OEM contract in the related royalties which I already commented; and to a very minor extent to the increase in the waste coming out of the U.S. operation.

This is clearly related to the ramp up or the very steep ramp up of production of Vitamin D. And we do believe that this is particularly having put things in perspective [indiscernible] (19:35) the minor effect, we do believe [indiscernible] (19:37) or can be considered a one-off effect. Therefore, [indiscernible] (19:42). The second question, yes, indeed. We just [indiscernible] (19:45) and to the cost, the sectoring is recognized through the net financial expenses.

Stephane Sumar Q

And just to come back on the waste manufacturing, could you please quantify the negative impact it has on margin in Q1, please?

Carlo Rosa A

Sorry. This is Carlo Rosa. I don't think that we want to quantify this as a very – as a [indiscernible] (20:10) has a very minor effect as to the ramp up and I don't believe that we should focus on this [indiscernible] (20:20) in front of you that – unless the results of the quarter one has more impact.

Stephane Sumar Q

And just another question which is regarding your installed base...

Carlo Rosa A

Yes?

Operator: [Foreign Language] (20:34 – 20:36)

A

Hello.

Operator: [Foreign Language] (20:39 – 20:40)

Carlo Rosa A

No, listen, we were at a conference call with Mr. Sumar and we got transferred to the operator.

Operator: Next question is from Massimo Vecchio of Mediobanca. Please go ahead.

Massimo Vecchio
Q

Good afternoon to everybody. First of all, my compliments for the very good results. I have three questions. The first one, I've seen that there was a very – with respect to the first quarter of last year, a very strong growth in the instrument division and a reduction – a year-on-year reduction in Liaison. I was wondering if you can expand on that and also if you can say if this trend is going to continue in the next quarters.

Second question I have relates to the revenue per box. If I see your installed base [indiscernible] (21:35) installed base in Q1 and the revenues of CLIA, looks like the revenue [ph] per box (21:41) were really [ph] half (21:44) year-on-year. I'm trying to analyze, it looks like they are around €60,000 on a full-year basis. Are my calculation correct? What's the trend behind that?

And the last question, if I may, if you have an update on M&A and if you are finding lower multiples going around after the, let's say, stock market crisis? Thanks.

Carlo Rosa
A

Okay. I'm going to take one and three and then Andrea is going to explain to you the number two. When it comes to the strength of the technologies, I remember, unfortunately ELISA is a technology, is the one that is sold significantly in the U.S. So, when you see the reduction of sales in ELISA, pretty much lots of it has to do with exchange rate. The tender that we won in Brazil has been delayed from quarter one to quarter two, and by the way, the first shipment already happened in April. So instead of shipping in quarter two, is all ELISA and so we believe that we are going by year-end the decline that you see in ELISA technology today will be partially recovered. Still we will have the effect of the exchange rate on the ELISA technology.

Now, when it comes to M&A activity, as we've seen before, we are in a continuous search. We clearly have identified companies that we like. We like the management there. We like their product portfolios and we are working on those opportunities. We are not ready at this point to make any disclosure whatsoever when it comes to an acquisition and you clearly understand why. I will now turn to Andrea for your second question.

Andrea Senaldi
A

Yes. In terms of revenue per box, Massimo, you may have noticed that we do not disclose revenue per box only on yearly results and this is because on a quarterly basis, you cannot project. In fact the only thing you can do is to multiply by four what is the revenue update on shipping for the one that this could be providing you a distorted number. So we never comment on a quarterly basis on the revenue per box, although we do know and we do anticipate that the revenue per box will continue to climb back as compared to previous year.

Massimo Vecchio
Q

Thank you very much.

Operator: We have a follow-up question from Stephane Sumar of Exane. Please go ahead.

Stephane Sumar

Q

Hi, sorry that I've been kept from this conference call. I don't suppose you have listened to my last question but I was asking you about the number of instruments for the installed in the U.S. by Cardinal in the Q1 of the 90 you have mentioned.

Carlo Rosa

A

Sorry. 90 was the total number in – of the group worldwide. 15 systems were installed in the U.S. and, going by memory I believe, Cardinal is around 10. 10 systems by Cardinal and we expect that quarter two Cardinal is going to be most significant because the end of the fiscal year is June, and so [indiscernible] (25:26) is always the driving quarter two for them to achieve their targets. So there in another year is 1541.

Stephane Sumar

Q

And just to come back on the business done by Cardinal, could you please provide us with a little bit more details about the kind of product they are selling. Is it still essentially Vitamin D?

Carlo Rosa

A

What Cardinal says on the portfolio we are...

Stephane Sumar

Q

As in [indiscernible] (25:50) let me put this another way, what is the percentage – what is the contribution of the Vitamin D in sales done by Cardinal?

Carlo Rosa

A

I don't think I – to be honest with you, that's an information that I don't want to comment about. You understand that in the U.S., Vitamin D as I've told you before is a significant business for us and the market is booming. So you understand also that when it comes to Cardinal, that represents a good chunk of the opportunity that Cardinal is pursuing. So cardinal is selling the [indiscernible] (26:25) the ELISA as well as the LIAISON portfolio. In fact, we always focus on LIAISON but we also sought for an [indiscernible] (26:34) as in quarter one [indiscernible] (26:35)

Stephane Sumar

Q

Okay. And then I don't know if this question has been asked already, but in terms of guidance versus full year, are you sticking to your view of double-digit reported growth on 2008 alongside a 1 percentage point improvement at the EBIT level?

Carlo Rosa

A

I don't think that we have done – we have given any guidance. Although as a general comment, we believe that the quarter results that double-digit growth would be what we expect for 2008. And we think we grew more uncertain and would have been almost 18% at the constant exchange rate. So I think that the 10% [indiscernible] (27:24).

Stephane Sumar

Q

Given if the business is becoming a bit more demanding in H2 compared to H1?

Carlo Rosa

A

The what? Sorry, I can't...

Stephane Sumar

Q

The basis of comparison, frankly, is becoming much more demanding in H2 compared to H1.

A

Was demanding in terms of?

Stephane Sumar

Q

In terms of – let's say in H1 you were at 10% and 12% organically. And the H2 was at a 15%, 16% and almost 19% organically. So, my question was, in fact, about the ability for the group to extrapolate the trends in Q1.

A

[ph] Listen (28:00), to me, it would be very unfair in one way or the other to compare all this quarter to quarter in this business. I believe that we should look at a more longer trend to a point that I always caution everybody as I did in last quarter in 2007 that you should – we should really not consider 40% royalty in our U.S. business as a trend that you should use going forward.

So by the same [indiscernible] (28:33) I'm telling you that you asked me by year-end and I told you, yes. But I still believe that by [indiscernible] (28:39) we will have a double-digit growth. If you ask me if they're going to be also in quarter two, we're going to see each other in 90 days.

Stephane Sumar

Q

Okay. Thank you very much.

A

Thank you.

Operator: Next question is from Martin Wales of UBS. Please go ahead.

Martin Wales

Q

Hi. Good afternoon. Can I just clarify a few things and I apologize if I'm asking you things you already answered, but [indiscernible] (29:06) of the call. Firstly, in terms of your top line growth in countries such as Belgium, UK and Sweden, what [indiscernible] (29:13) is behind that and how sustainable do you see it?

A

Okay. Is this the only question, Martin?

Martin Wales

Q

In country such as the UK...

A

No, no, no. I understand the question. I'm just saying is this the only question?

Martin Wales

Q

No, no. I have a lot more, but let's start with those.

A

Okay. The driver listed in those countries, if we take UK and Sweden, pretty much where we started from almost nothing in Sweden and in UK was the base of R.E.A. and ELISA. The big driver is the Liaison. As you [indiscernible] (29:49) not only but especially in Scandinavia and Sweden is the Liaison with a specialty strategy in the area of infectious disease with the [indiscernible] (30:02) of bone and minerals clearly with Vitamin D and [ph] PTH (30:07) and [indiscernible] (30:08). So, our positioning in those markets were resilient [indiscernible] (30:14) instead we wanted to be recognized especially in Spain also very well as you have seen from the trend.

When it comes to Belgium, if you do a quick calculation on markets lines and business, in Belgium, we have the same penetration that we have in Italy pretty much. And the growth in Belgium where we have a substantial base of business, but in ELISA, again is driven by the Liaison which has been growing nicely and the fact that we are able to contain very well the current business based in R.E.A. and ELISA so on the Liaison business, it's new business, we don't cannibalize capitalize any R.E.A. and ELISA.

Martin Wales

Q

Okay. In terms of comp emerging competition in Vitamin D, obviously you had the fact that Roche owned in the United States, do you have any timing of when you expect that to happen?

A

As investor question, we don't because as you know, and in works also for DiaSorin sometimes, it's predictive the way the FDA reacts is impossible. I think that Roche was forecasting the first quarter of 2008 [indiscernible] (31:32), so I don't know how far they are. But to be honest with you, today in the U.S., I believe that [indiscernible] (31:41) mass spec, in the use of mass spec, it would be – have to be considered as a true competition to vitamin D. And I think it's public knowledge that we are one large [indiscernible] (31:52) mainly Quest Diagnostics is using mass spec. They don't use any immunoassay and so pretty much if you've already seen in the market today with the [indiscernible] (32:03) testing in mass spec and we are winning that battle, [ph] enjoying the growth (32:08). But, again, the R&D market is growing so substantially that I think there is a room for a lot of different technologies.

Martin Wales

Q

Talking about Liaison XL, what is the current thoughts on timing of that launch? Is it still the back end of 2009 or is it likely to be later than that?

A

You know, the timeline is quarter four 2009 by July and we are receiving validation units and we now have the [indiscernible] (32:42) units. Validation units will be shipped to the site to start with the validation effort which takes place in the summer, fall and the beginning – throughout next year and we proceed the launch in quarter four 2008.

Again, Martin, be aware of the fact that outside this – let me say, the financial community, if you go into the aerial market, we downplayed the level itself. So we're not announcing, we're not showing to anybody and we're going to launch it to our customers, show it to the customers at the [indiscernible] (33:17) in 2009 which is July 2, 2009. So, I keep saying guys know more about DiaSorin than our current customers because I want to make sure that they don't get cold feet on the CLIA, LIAISON installing business and waiting for the result.

Martin Wales

Q

Okay. And looking at your tests. You gave a numbers tests you've launched at the end of 2006. Can you tell us how many tests you've launched in 2008 and how many tests both especially in the general test with respect to a launch by the end of next year?

Carlo Rosa

A

Clearly speaking, the guideline last year, we did eight or seven. In 2007, we did the same rate [indiscernible] (33:56) so the last year – this year, by year-end, we are going to do four. We have the first one coming is bone alkaline phosphatase which will be launched, I believe by June in Europe – yes, June 1 in Europe. Then we have some infectious disease prerogative that will be launched for the U.S. market and [ph] one presumably (34:25) is for Europe.

We can't do them next year. As you know, next year, our plan is when you have [ph] so much time with a (34:35) fully validated menu and then the initial introduction of the HIV and the hepatitis C by year-end. I remind you that with the relevant patents for hepatitis C are in fact expiring by the end of 2009.

Martin Wales

Q

Okay. A couple of – [ph] last four (34:54) questions. Your tax rates, where – how do you see that going forward?

Andrea Senaldi

A

With that said, Martin, we are talking about adjustment of 37 percentage, I believe that this is now [indiscernible] (35:11) as low as we can go. And this – as I said, it's [indiscernible] (35:15) the change in the legislation from Italy and in [ph] general (35:22). So I don't see much state to go below 37%.

Martin Wales

Q

But you see it sustainable at that level?

Andrea Senaldi

A

We do see it stable, yes.

Martin Wales

Q

Okay. And your dividend policy going forward, obviously, you announced first dividend earlier this year. You have it approved at the AGM. Do you have a policy going forward? Are going to try and grow it in line with earnings, grow it at a double-digit level, you have a target ratio, how you think you have a dividend?

Carlo Rosa

A

Not really, we have no guidelines for who when it comes to dividends. We're excited to do it this year because it made a lot of sense for it and we have excess cash. I hope we can continue to do it going forward but we always stated as shareholders and including our main shareholders that we intend first to give priority to investments in the business and then if there is cash in excess, then we give it to the shareholders. I think that where we invest in this company is investing on growth rather than dividend.

Martin Wales

Q

Okay. Thanks very much.

Carlo Rosa

A

Thank you, Martin.

Operator: [Operator Instructions] Gentlemen, there are no more questions at this time.

Carlo Rosa

Thank you very much, everybody.

Operator: Ladies and gentlemen, thank you for joining. This conference is now over. You may disconnect your telephone. Thank you.