DiaSorin Inc

ñFirst Semester 2015 Results Conference Callò

Thursday, July 30th, 2015, 3.00 PM (CET)

MODERATORS: **CARLO ROSA, CHIEF EXECUTIVE OFFICER**

PIER LUIGI DE ANGELIS, CHIEF FINANCIAL OFFICER

OPERATOR: Good afternoon. This is the Chorus Call conference operator. Welcome and thank you for joining the DiaSorin First Semester 2015 Results Conference Call. After the presentation, there will be an opportunity to ask questions.

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

CARLO ROSA: Thank you, operator, and ladies and gentlemen, good afternoon and welcome to the quarter 2 conference call. As usual, I will comment on quarterly sales, and then I will leave the floor to Mr. De Angelis, who will take you through the financials and the numbers.

Let me start by highlighting the key successful steps that we have undertaken during the first semester of 2015. First, we signed a commercial agreement with Quest Diagnostics for the commercialisation of our Vitamin D in the US, and that has been a successful endeavour for us. All the instruments have been installed and the customer is now up and running with our Vitamin D. And thanks to this agreement, we are able to stabilize as you have seen our Vitamin D business in the US by increasing volumes that can more than compensate the price pressure that we continue to see with the underlying business.

Secondly, we obtained the approval of Vitamin D in Japan, we waited a long time as you know and finally we got it. We managed to enter the country with our LIASION XL that were installed as we speak by the three largest private laboratory chains in Japan. And we are waiting now for the authorities to grant their reimbursement code, we expect the reimbursement code before the end of the year. So we expect to start selling Vitamin D in Japan by the end of this year, latest beginning of next year.

And third, as you know, we presented on May 12 the long-term plan to the financial community. In our plan, let me remind you, we foresee an annual compound growth rate of 8% in revenues, 9.5% in EBITDA and 10% in net profit. And last but not least, which has been the object of a press release recently, we have signed with Beckman Coulter, a partnership in China where Beckman will start commercialising immediately our HIV and Hepatitis products on the XL connected to their track systems and namely the Power Express that is the latest track system that Beckman has successfully launched worldwide. So we are very keen about this partnership, it will allow us to get into the large hospital labs in China whereas we will continue independently with our own organization to install the LIASION XL in the mid-sized hospitals and in the regional hospitals.

Now looking to the quarter 2 results, as you have seen, it has been a very good quarter. We had outstanding sales with a growth of 15% at current exchange rate versus last year and 6% at constant exchange rate. The performance was reached thanks to the continuous success of the Clia ex-Vitamin D products worldwide and in particular of infectious disease, the pre-natal screening and our 125 flagship product which was launched if you remember last year in April. It has been approved by the FDA by the end of last year and is gaining a lot of traction in all the major labs, allowing us to convert our existing RIA (ph) business and to gain a lot of new business coming from competitors.

Now let's focus on Vitamin D, and let me highlight a very important news on this quarter, which is the impact of, again, Vitamin D on total revenues. After almost four years, Vitamin D sales registered a positive contribution to the Group total turnover growing 14% at current exchange rates and pretty much in line with last year at constant exchange rates. This result is

a consequence of the agreement signed with Quest Diagnostics in the US that we announced during Investor Day. And this agreement will be in the force for five years, itôs valid in all Quest Labs and allow us as said, to stabilize our Vitamin D franchise as we have foreseen in ouré in the plan that was presented to the financial community.

As said, this impact of the Quest agreement is particularly visible in the US a market that is highly penetrated by Vitamin D. Only in quarter 2, North America grew almost 33% at current exchange rates with an acceleration when compared with the previous quarter and by 27% in the semester.

Furthermore, let me remind you that in the US, our CLIA ex-Vitamin D sales including Vitamin D 125 are growing high double-digit thanks to the successful strategy in the North American market where we are consistently addressing the mid-sized hospitals and labs, thanks the LIASION XL success and the broad CLIA menu available on our systems. So as far as the US is concerned, I think we need to report a stabilization of Vitamin D and then continuous growth of our franchise out of Vitamin D and that allows finally the US after a few years, to start growing again.

In Europe, the business is growing as expected, and at current exchange rate we grew almost 7% in the quarter and 5.5% in the semester following the steady growth of infectious disease, again hepatitis, endocrinology and the new stool test which were approved starting from last year.

In particular, let me highlight the success of our Vitamin D in Italy and Germany together with the endocrinology products and stool testing, so Vitamin D continues to be a growing franchise in certain geographies where we can successfully push demand and usage, and thus complement the growth of the rest of the catalog in these geographies.

In Europe, the only black eye is France where we continue to see a negative impact vis-à-vis last year or the fact that the Vitamin D reimbursement has been changed. And there has been a drastic reduction in the number of tests that have been performed in the French market. However with quarter 3, we will pretty much reach the bottom of the curve and quarter 3 pretty much will be flat vis-à-vis quarter 2, so starting from Q3, we are not going to see the drag in France as we have seen so far. So overall, in Europe, I would say everything is going well as planned [indiscernible] the market is certainly not growing.

We are experiencing success in Germany, we keep growing in Italy notwithstanding itôs a very difficult market. We are exceeding expectations in Spain and this is due to the recovery of the market, the fact that the government did reforms and started again to pay the suppliers and therefore, we have high expectations from the Spanish market, going forward. And then last but not least, the Nordics are doing very well and the strategy in the Nordics as you know has always been driven by the specialty products, high profitability specialty products and now itôs pretty much paying out.

Now letôs move Asia Pacific, in Asia Pacific, we grew 26% in the quarter and 31% in the semester. This relevant result in the region has been driven by the success of our installation of systems in China where LIAISON XL placements are growing at a strong pace and where as of June 2015, they exceeded 700 units in the field of which 170 are LIAISON XL.

So China continues to grow. We have a lot of success in the mid-sized hospitals as said before, with the alliance with Beckman Coulter we will be able to penetrate the significant hepatitis and HIV market in China in

the high-end of the market where as it happens in other regions, customers need more automation and combination of a very strong position in clinical chemistry of Beckman, and as well as our strong immunoassays in hepatitis will for sure continue to fuel double-digit growth moving forward in China in the next foreseeable future.

On top of all this, let me also highlight the successful trend we are experiencing in China with all the CLIA products, so not only the hepatitis. In the second quarter of this year, we grew in China 36%, thanks to the contribution of the catalog overall. So this strategy definitely as it has been laid out is working for us. For the future, we foresee an annual growth for the Chinese market of roughly 22%, which include increase in sales also due to the partnership with Beckman Coulter.

Now letôs move to Latin America, and Latin America for us has been difficult, also in the previous quarters. And the main reason for that is Brazil. As far as Brazil is concerned, we have seen an issue with the public segment of the market and where we were heavily skewed vis-à-vis our business model problems with payment and collection have driven us to stop distribution of product to certain accounts. We draw system from customer base and refocusing our business into the more lucrative and stable private sector.

We expect the business pretty much in Brazil now to beé and so theé to be flat. And yes, we have seen this over the last two quarters. And we still compare negatively vis-à-vis last year, simply because we are comparing to a situation where the sales were still relatively high. And we have a neutral outlook vis-à-vis Brazil. It really depends what is going to happen with the country vis-à-vis its ability to pay, especially in light of the Olympic Games which is going to happen next year. And we hope they are not going to be too disruptive vis-à-vis the rest of the business.

As far as Latin America is concerned, the rest of the region is doing okay. Mexico is fine and itôs a very solid franchise for us, still growing in theé on the reagent side and the rest of the South American countries. Australia opportunistic, but still growing double-digit for us.

Now, as a final comment before I will let Pier Luigi driving through the numbers, ouré at constant exchange rate, our revenues grew 5% in first half 2015, 6% in quarter 2. And this is positioning our Group in the highest part of the revenue guidance for 2015, so we feel good about the guidance we gave to the market for fiscal year 2015.

Now, Idl pass the microphone to Mr. De Angelis and when he is done, we are going to takeé we will then open the Q&A session. Pier Luigi.

PIER LUIGI DE ANGELIS: Okay. Thank you very much, Carlo. Ladies and gentlemen, good afternoon. Let me start by highlighting the good marginality of the Group in the quarter and in the semester. As for profitability is concerned, our Group EBITDA grew by 22.4% reaching a margin of 37.9% in the quarter and 37.3% in the semester. This outcome benefited from the increase in gross profit, the lower incidence of operating expenses on revenues and the euro depreciation.

As for our net profit, we registered a growth of almost 30% in the quarter and more than 20% in the semester, thanks to the Group positive performance and to the tax rate that in the period was equal to 53.9%, a reduction from the 56.6% of the second quarter of last year. The difference in the tax rate is the consequence of the Italian fiscal reform and the lower amount on non-deductable taxes withheld on dividends that the Group parent Company receive from foreign subsidiary, especially from the States.

The net financial position of the Group at June 30th, 2015 is positive by very close to ú200 million, increasing by ú29.6 million from the end of 2014 net of the payment of dividends in May 2015. This successful number has been generated once again by the strong cash generation and by the sale of shares from the exercise of some tranches of the 2010 stock option plan.

As for the net working capital, during the semester, we registered an increase of ú15.8 million, mainly due to the growth of sales and the foreign exchange rate impacts.

Concerning the cash flow, it is worth mentioning the outflow coming from the payment of dividends in May, the investment of ú1.4 million for the setup of our new Polish subsidiary and the investment of ú30 million in time deposit.

Carlo already mentioned that we are positioning ourselves in the highest part of our revenues guidance for 2015. Let me confirm that the same achievement for the EBITDA in the LIAISON and LIAISON XL placement over this year.

Now, letôs open the floor to the Q&A session. Thank you very much.

Q&A

OPERATOR: Excuse me; this is the Chorus Call conference operator. And we will now begin the question and answer session. The first question is from Mr. Patrick Wood with Morgan Stanley. Please go ahead, sir.

PATRICK WOOD: Okay, thank you very much for taking my questions. I have three, if I may. The first would really be on the Quest agreement. Am I right in understanding that, that only really started mid-Q2? I guess Iôm just trying to get a sense of how we should we thinking about the impact from that through the balance of the year. The next question was really, and I think you kind of highlighted it yourself; you guys are tracking guidance both on the constant currency EBITDA number and also on the organic sales growth. Given the Quest contracts are now up and running, and given, you know, the LabCorp pricing schedule is sort of rolling off in the comparison base, do you think this is looking a little bit conservative or there are some incremental costs that we donôt know about which are coming into the second half of the year? The final question would actually be on Vitamin D, and there was a panel at AACC this year, which was talking about some mass spec essentially trying to claim that more and more people are moving to mass spec for Vitamin D. I find that very odd given Quest just went the exact opposite direction and given your results. But could you just sort of confirm that you are not actually seeing any of that because that sounds very strange to me? Thanks.

CARLO ROSA: Thank you, Patrick. First one, let me start with Vitamin D. I donôt know, you know, there isé I keep saying that there is space for mass spec, but certainly there is no space for mass spec for Vitamin D testing when it comes to routine usage, and especially when it comes to their hospitals and certainly for private labs. And the reason is that mass spec isé it does require a lot of hands on time, it is not simple to standardize. And eventually itôs much more expensive to operate in a traditional immunoassay. And again, this is as demonstrated by Quest, and as demonstrated by a lot of other customers. So honestly, I donôt see a threat for (ph) mass spec. However, I see mass spec as a very powerful technology for certain esoteric testing.

When it comes to your second question on guidelineé on the guidance, I donôt know if Iôm conservative or not, Iôm just pointing out the fact that as far as the first half, we are on track with guidance vis-à-vis the top-line vis-à-vis the EBITDA and placements and for the time being we reiterate the concept that this is the expectation for the Company for 2015 year-end.

And then, first question regarding Quest, Quest has beené I cannot get into many details. But Quest has not been fully operational in the quarter. So in the quarter, you see just some of the revenues coming from Quest. And quarter three itôs going to be fully operational. So the Q3 is going to be the first quarter where you see full impact of the total Quest opportunity on Vitamin D.

I have to say it has been a very successful implementation, all the labs now are up and running. And now, clearly it is management objective toé as we did with LabCorp to develop our franchise at Quest behind Vitamin D. So Vitamin D is a given, the customer is happy, letôs see if we can sell more products to this very relevant customer in the US.

PATRICK WOOD: Thatôs perfect. Thank you. And maybe just one very quick follow-up, if I may, the Beckman agreement in China, do we know very roughly when you are going to expect that to begin to sort of start rolling out?

CARLO ROSA: Different from the Roche situation, the Beckman and DiaSorin platforms are connected, both the old platform and also the new platform that they launched last year, so the Power Processor and the Power Express. So there is no connective issue, all the products are approved in China. So the rollout is immediate and we will see the effect of this in the second half of the year and then clearly going forward.

PATRICK WOOD: Perfect. Thank you so much.

OPERATOR: The next question is from Romain Zana with Exane BNP Paribas. Please go ahead.

ROMAIN ZANA: Yes, good afternoon, gentlemen. Thanks for taking my question. The first one would be on the gross margin, and can you give us more granularity on the break-down of the gross margin improvement, especially the improvement coming from favorable FOREX, and then the part coming from the operating leverage rather better purchasing conditions. So one question will be on the cash flow and the cash conversation especially, the free cash flow is flat if Iôm right for the first semester compared to last year. Should we expect any seasonality H2 versus H1, and I mean do you see the business becoming more CAPEX intensive or not. And the last question would be very quick on Japan and LIAISON XL. I mean, is your 2017 plan already include the opportunity if there once you will have the reimbursements? Thank you.

CARLO ROSA: Yes, Romain. I think I can cover this quite quickly. As far as Japan, the answer is, yes. The plan was in fact envisioning the availability in Japan of Vitamin D starting from the end of this year. As far as the cash flow, youôre right, itôs flat, but for a simple reason actually the working capital last year in the secondé in the first half we had roughly ú5 million payment by the Spanish government. You know, Spanish government has been paying the suppliers in tranches. And one big one came in the Q1 or Q2 last year but in the first half. And this explains the difference in the cash flow between H1 this year and H1 last year.

As far as gross margin, no, we do not provide the granularity you are requiring. However, let me say that the improvement in gross margin is a combination of the two effects, but donôt expect that is only related to exchange. There is also a component that has to do with mix, and with the

volume increase in manufacturing and improvement in the absorption of the manufacturing expense (ph).

ROMAIN ZANA: Okay, perfect. And just following up on the cash flow, basically you expect a catch up of the cash conversion in H2?

CARLO ROSA: Yes, we do.

ROMAIN ZANA: Okay. Thank you very much.

OPERATOR: The next question is from Anastasia Karpova with Kempen. Please go ahead.

ANASTASIA KARPOVA: Good afternoon. I have a very short question on Quest. Given that you most likely gave the prices, and you saw a significant volume increase in Vitamin D sales. In regards to Quest, how you seen a significant stockpiling, a one-off purchase of abnormal volumes of Vitamin D test or shall we expect that the volume increase that we saw in this quarter reflects the real demand of Quest for Vitamin D that will go forward.

CARLO ROSA: I'm a little confused about the comment on discount of Vitamin D, because we were not supplying Quest before, so there has been no discount. As far as stock-filing, as I said before, the quarter two reflects partial Quest volume which is a combination of usage, and clearly initial inventory. Keep in mind, that usually customers of that size donôt keep more than a couple of weekôs inventory. So as I said the Q2 does not reflect the full potential of the Quest Vitamin D volume.

ANASTASIA KARPOVA: Okay. Thank you very much for taking my question.

OPERATOR: The next question is from Peter Welford with Jefferies. Please go ahead.

PETER WELFORD: Hi, yes, thanks for taking my question. A few please, firstly, just with regards to Japan Vitamin D. I wonder if you can remind us to the typical pricing for these sorts of diagnostics in Japan relative to the rest of the world, appreciating obviously the reimbursement is yet to be granted, which, I guess could have an impact? Secondly, then just with regards to the cash part; I know this is a question that comes up again and again, and obviously itôs up to the Board. But I am just wondering if there are things that currently management are discussing and reasons perhaps why itôs prudent to keep large cash balance at this time, whether it is just thaté I guess, opportunities are challenging to come by at the moment and succeed? And finally, then just two quick financial questions, I wonder if you could give us the EBITDA margin or EBITDA effect from the molecular diagnostics business. And also the rational for the relatively high other operating income in 2Q, itôs relatively high negative charge during the second quarter. Thank you?

CARLO ROSA: Okay. So let me start from the last one. For the EBITDA, the molecular contribution is very minimal. So I think in the quarter it is negative by a million something like that, so itôs becoming negligible, and itôs always been by the way vis-à-vis the Group results. As far as other operating, there is one-time hit of 1.1 million, which has to do with the fact that we have as I said before in Brazil situations with certain customers that went bankrupt because they didnôt get paid by the government. And therefore, we took a write-off on receivables. So roughly ú1.1 million, which was recorded in the Q2 results.

As far as the cash part you know, we are having this surreal discussion, I think in every conference call. Yes, in fact, we do have a lot of cash. Yes, in fact, we put an effort into M&A activities and looking into opportunities as we have discussed several times, the US is the area where

that for us would makeé .is very appealing, because itôs a stable market, because there are certain pricing structure because itôs a predictable market, because we feel that we have a very good positioning but on certain segments of the market, like the hospital market we are underpenetrated and it would make a lot of sense to that critical mass there.

However, as you know, the multiples today are not cheap, and there isé the market is very hot vis-à-vis certain asset, so we are prudent. And I honestly prefer to haveé to explain to you, have a lot of cash in the bank rather than having to go after opportunities, paying a price that doesnôt make sense. Then it is going to beé in order to anticipate your next question, itôs going to be the Boards responsibility eventually by year-end to consider what to do with cash if management is not able to put in front of the Board a credible opportunity for an acquisition.

As far as Japan pricing is concerned, Japan as you know, isé well firstly we donôt operate directly in Japan, we operate through our distributor. And our distributor in Japan is a diagnostic Company, which is part of the Kering (ph) Group, you know, the foodé the bigger food conglomerate Group in Japan. These are diagnostic companies specialized in bone and mineral metabolism, so Vitamin D fits very well their strategy..

As far as end-user pricing is concerned. The end-user pricing in Japan is very high because the reimbursement is very high. However, the distribution channel is not a traditional one because even our distributor is going to go, is going to sell through some local wholesaler. To make a long story short, we envision that because of the price structure of Japan, we are going to transfer to our distributor in Japan productsé Vitamin D products. At the same end-user price today we enjoy in the US or in Europe in regular customer, so ex-LabCorp, ex-Quest do have a special

treatment (ph) because of volumes. So it is going to be a very profitable business for us because we donôt have any operating cost locally. We sell at end-user pricing. And last but not least, we do sell all the equipmenté all the LIAISON XLs needed to do business there to the distributor.

PETER WELFORD: Thatôs great. Thank you very much.

CARLO ROSA: Youôre welcome.

OPERATOR: Mr. Rosa, Mr. De Angelis, there are no more questions registered at this time.

CARLO ROSA: Thank you operator. Take care.