

THOMSON REUTERS STREETEVENTS

EDITED TRANSCRIPT

VRX.TO - Q1 2012 Valeant Pharmaceuticals International, Inc. Earnings Conference Call

EVENT DATE/TIME: MAY 03, 2012 / 2:00PM GMT

OVERVIEW:

VRX.TO reported 1Q12 total revenue of \$856m, which increased 52% YoverY and produced 1Q12 cash EPS of \$1.14. Mgt. gave increased guidance for 2012 revenue of \$3.4-3.6b and 2012 cash EPS of \$4.45-4.70.



CORPORATE PARTICIPANTS

Laurie Little *Valeant Pharmaceuticals International Inc - VP, IR*

Michael Pearson *Valeant Pharmaceuticals International Inc - Chairman, CEO*

Rajiv De Silva *Valeant Pharmaceuticals International Inc - President, COO- Specialty Pharmaceuticals*

Howard Schiller *Valeant Pharmaceuticals International Inc - CFO*

Mike Pearson *Valeant Pharmaceuticals International Inc - Chairman and CEO*

CONFERENCE CALL PARTICIPANTS

Marc Goodman *UBS - Analyst*

Chris Schott *JPMorgan Chase & Co. - Analyst*

Corey Davis *Jefferies & Company - Analyst*

David Risinger *Morgan Stanley - Analyst*

Gary Nachman *Susquehanna Financial Group / SIG - Analyst*

David Amsellem *Piper Jaffray & Co. - Analyst*

Doug Miehme *RBC Capital Markets - Analyst*

Annabel Samimy *Stifel Nicolaus - Analyst*

Tim Chiang *CRT Capital Group - Analyst*

Juan Sanchez *Ladenburg Thalmann & Company Inc. - Analyst*

David Steinberg *Deutsche Bank - Analyst*

Michael Tong *Wells Fargo Securities, LLC - Analyst*

PRESENTATION

Operator

Good morning, my name is Michelle and I will be your Conference Operator today. At this time, I would like to welcome everyone to the Valeant Pharmaceuticals first-quarter 2012 earnings conference call. All lines have been placed on mute to prevent any background noise. After the speakers' remarks there will be a question-and-answer session. (Operator Instructions)

I'd now like to turn the call over to Ms. Laurie Little, Vice President of Investor Relations. Please go ahead.

Laurie Little - *Valeant Pharmaceuticals International Inc - VP, IR*

Thanks, Michelle, good morning, everyone, and welcome to Valeant's first-quarter 2012 financial results conference call. Joining us on the call today are J. Michael Pearson, Chairman and Chief Executive Officer; Rajiv De Silva, President and Chief Operating Officer of Specialty Pharmaceutical; and Howard Schiller, Chief Financial Officer. In addition to a live webcast, a copy of today's slide presentation can be found on our website under the investor relations section.

Before we begin, certain statements made 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 actual outcomes.



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. Finally, the financial guidance in this presentation is effective as of today, May 3, 2012. It is our policy to update or affirm guidance only to broadly disseminate public disclosure. And with that, I will turn the call over to Mike Pearson.

Michael Pearson - *Valeant Pharmaceuticals International Inc - Chairman, CEO*

Thank you, Laurie. Good morning, everyone, and thank you for joining us. On today's call we will cover the following topics. First, I will review our first quarter results and performance, then I will touch on our emerging market segment. Third, Rajiv will touch on our Specialty Pharmaceutical update. Fourth, Howard will provide a financial update. And finally, I will discuss our updated financial guidance for 2012.

This morning we reported Valeant's first-quarter results for 2012, which again showed strong growth, profitability and cash flows. Total revenue in the first quarter of 2012 was \$856 million as compared to \$565 million in the same period in the prior year, an increase of 52%. Product sales increased 54% to \$768 million in Q1. Our first-quarter cash EPS was \$1.14 per share, or an increase of 84% over 2011.

Excluding one-time items, the divestiture of Cloderm in 2011 and the divestiture of IDP-111 and Generic Efudex in 2012, cash EPS was \$0.99 in the first quarter of 2012 as compared to \$0.56 in the first quarter of 2011, an increase of 77%. Adjusted cash flow from operations was \$322 million in the quarter, or an increase of 58% over the same comparable quarter in 2011. It was \$265 million excluding the alliance and royalty revenue related to the Dermatology divestiture.

Organic growth is an important metric for our Company and we are pleased to report an overall organic growth rate in the first quarter of 11%. With the exception of the US Neuro and Other segment which is composed of a diverse set of primarily non promoted (inaudible) products, all of our business segments showed strong organic rates at or close to the double-digit level.

Of particular note is the strength of our Canadian and Australian business which grew 22% over the prior year. Our emerging markets segments which includes Latin America, Central and Eastern Europe and Southeast Asia and South Africa delivered overall 12% organic growth. This breaks down into Central and Eastern Europe delivering a 10% organic growth, Latin America delivering a 19% organic growth, and Southeast Asia and South Africa with a combined 9% organic growth rate.

Our deal flow in 2012 has been very strong so far. We have closed eight transactions and announced another three deals that are expected to close by mid year. Our announcement earlier today of our agreement to purchase AcneFree and certain assets from University Medical will be another strong addition to our US OTC franchise.

Each of these transactions brings with them a different strategy and growth profile to value. Whether it is expanding our OTC presence in Russia and Brazil through the Natur Produkt and Probiotica deals or enhancing our branded generic portfolio with GL in Russia and the CIS countries and Atlantis in Mexico. Each of these deals will contribute nicely both to our overall product portfolio and to our growth objectives.

We also completed the acquisitions of Eyetech and Pedinol, two specialty pharmaceutical companies focused on the Ophthalmics and Podiatry spaces. In Ophthalmics, Eyetech adds critical mass by expanding our offerings now to [run] specialist. In the case of podiatry, Pedinol announces -- allows us to build a new platform in the US and helps us prepare for what we hope will be an eventual launch of IDP-108, our onychomycosis compound.

In total, these transactions were made at a total price of roughly \$600 million and represent approximately \$280 million in revenue run rate in 2012. We continue to maintain our discipline with the prices we are paying. We paid an average of 2.1 times 2012 sales for these transactions and expect that they will drive significant returns for our shareholders. Our deal pipeline remains very robust and we would expect to continue to be active throughout 2012.

During the quarter we also acquired assets from Ortho Dermatologics in both Brazil and Canada and divested Bioskin, a small contract research organization in Europe that we inherited through our (inaudible) in 2008.

We provided an update on our synergy target for 2012 on our last call, having achieved a run rate of \$135 million at that time and expecting to achieve a \$200 million run rate by the middle of 2012. We are now at a run rate of \$165 million and still expect to be at the run rate of \$200 million by mid-year. Once we have the expected synergies for our recent transactions, coupled with exceeding our original estimates for the Ortho, Dermik and iNova transactions, we expect to be at a synergy run rate of at least \$230 million by the end of the year.

When we originally provided guidance for the year in January, we expected total revenue for our emerging market segment to exceed \$1 billion in 2012. With the addition of our recent acquisitions, Probiotica, GL, Natur Produkt and Atlantis, we expect our revenue run rate to exceed \$1.2 billion in emerging markets in 2012.

We also mentioned on our guidance call that we expect to launch more than 250 products in Europe this year. To date, we have launched 73 products. We also remain active in signing distribution contracts with other pharmaceutical companies and have recently signed two new contracts for rates in many of our territories in Central and Eastern Europe. Valeant Europe is becoming a partner of choice with our significant market presence in Central and Eastern Europe and we hope to expand the number of partnership efforts going forward.

In Brazil, we recently launched Regederm, a biological wound healing product, and initial physician feedback has been very positive. The Brazilian government has expressed interest in the product since diabetes-related complications are a substantial issue in Brazil. We will be providing more detail on our emerging markets business and the rest of our overall portfolio at our upcoming Investor Day on June 21. Now I will turn the call over to Rajiv.

Rajiv De Silva - *Valeant Pharmaceuticals International Inc - President, COO- Specialty Pharmaceuticals*

Thank you, Mike. As we mentioned in January, we expect our US Neurology and Other segment to continue to decline in the range of 5% to 15%. In the first quarter, this segment declined 10% versus the prior year. But this decrease was attributable to three products, Wellbutrin XL, which as we have mentioned many times is continuing its slow decline, and two other products, Cardizem CD and Ultram ER, which both lost patent protection on certain remaining doses at the end of 2011.

If these products excluded from the calculation, the rest of the US Neuro and Other portfolio, which we call the Core Neuro Portfolio, actually increased 6% year over year. We are pleased with the performance of this Core Neuro Portfolio. As the year progresses, we expect the Wellbutrin XL, Cardizem CD and Ultram ER declines to have a smaller and smaller impact on the overall Neuro and Other growth rate. We now expect decline in Neuro and Other to be around 10% for 2012.

Moving now to Dermatology. Our core growth assets from legacy Valeant continue to show double-digit growth on a moving annual total (inaudible) basis. Atralin, Zovirax and CereVe all showed greater than 25% volume growth versus Q1 2011. Acanya growth at 12% MAT has been impacted by the declines in the market for fixed-dose BPO clindamycin products.

In addition, the comparison for Acanya for the month of March was also impacted by an unusually high prescription volume in 2011. Both Acanya and Atralin grew market share within their respective categories. Fixed-dose BPO clindamycin combinations and (inaudible). Our strategy to promote Elidel to dermatologists continues to bear fruit, but consistent TRx growth in that segment in Q1 2012.

Turning now to our recently acquired brands. We are managing the Tretinoin portfolio, Atralin and Retin-A-Micro to transition the business to Atralin over time. And finally, BenzaClin continues to decline as expected due to generic erosion.

For our prescription brands, we monitor many metrics to measure success. TRx volume growth, share growth, net sales performance and cash flow. Ultimately, our most important metric is cash flow. We utilize co-pay assistant programs as do many of our competitors. Comparative dynamics have rendered certain segments of the market uneconomic to service with these programs.

We have taken steps in the last several months to scale back the benefits of these programs to certain types of customers. We expect that these changes have also contributed to lower TRx growth rates. However, the positive impact on cash flow far outweighs the slightly lower rates of TRx growth.



Let me also comment briefly on the regulatory environment related to Zovirax ointment. The FDA recently issued drop guidance indicating that a potential generic could either follow an in vitro or in vivo pathway. We have been following this very carefully. In public comments made by the FDA as late as last fall, the agency has maintained that the only way to establish bio equivalence for a topical product is through a clinical (inaudible) evaluation for the vast majority of semisolids such as creams and ointments.

We continue to believe that the in vivo and clinical endpoint approach is the only appropriate way to establish bio equivalence for Acyclovir ointment to ensure ongoing safety and efficacy. We expect to submit comments and scientific arguments to the agency on this topic shortly and to engage in a constructive dialogue.

We have recently received several inquiries regarding the recent scrip brands in the Dermatology market and wanted to use this opportunity to provide our perspectives on the topic. In deed, one element that also impacted Q1 TRx performance was an unusually weak market across all key categories within Dermatology.

As this slide shows, there was a marked weakness in market growth in March versus the market growth for the rest of the quarter. We have no reason to believe that this weakness has carried into April. In fact, co-pay coupon redemption data for April would indicate much more robust growth versus 2011.

Now to round up our discussion on operations, we have several developments I want to highlight. In Canada, we have recently launched Sublinox and Lodalis and the physician response has been positive. Although it is too early to judge the success of these brands, we have high expectations for these products.

Given the reimbursement environment in Canada, we expect that these launches to ramp up slowly. These launches and several other launches we expect in the future will go a long way towards minimizing the decline in Cesamet sales that we expect this year.

A generic version of Cesamet has finally launched and is now beginning to be available in all parts of Canada. Erosion so far has been minimal, but we expect it to pick up as the year progresses. We have built in this eventually in our budget and we have in place several strategies to mitigate this impact. We are prepared for this generic entrant that Cesamet was only expected to be 10% of Canadian revenue in 2012. While several years ago, Cesamet made up almost 65% of Canadian sales.

We are excited about the particular launch activities with (inaudible) in April. Potiga is planned to be commercially available on a broad basis in the US on May 9. And we are excited to achieve this watershed moment with our partner GSK. As we said in our previous calls, our \$45 million milestone payment will be realized in Valeant's second-quarter financial results.

We expect minimal profitability from Potiga in 2012, but post the first commercial launch, we are no longer bearing the negative impact of expenses for R&D and commercial activities which we have been incurring in the past four quarters.

And finally we recently received positive feedback from the FDA on IDP-108 in our pre-NDA dialogue and are progressing ahead for NDA filing later this year. There are no additional clinical or non clinical legal requirements that need to be completed prior to the submission.

Although many of you asked about the release of clinical results, we continue to focus on maximizing this compound in the market with the appropriate publication in the science journal, our presentation of the right for medical conference as we believe those are the right venues to access the scientific and medical communities. We will update you as to our progress in the months to come. Now I will turn the call over to Howard.

Howard Schiller - *Valeant Pharmaceuticals International Inc - CFO*

Thank you, Rajiv. Today we reported our first-quarter 2012 results. Michael already touched upon our top line and bottom line growth, but I wanted to provide some further detail at some of our other P&L items. Our cost of goods sold for the quarter was 26% compared to 27% in the first quarter of 2011. I will give more detail on our cost of goods sold later in this presentation.



We continue to maintain a tight rein on our expenses. SG&A expenses as a percentage of sales has decreased to 19%. We expect SG&A as a percentage of sales to remain in this relative range. R&D expense was \$22 million for the quarter, or a bit less than 3% of product sales. We expect R&D expense to stay in this range for the remainder of the year.

And operating margin was significantly higher than prior-year's levels but below Q4 2011 levels due to slightly higher cost of goods sold percentage and lower amount of service and alliance revenue this quarter.

Bottom line, we achieved cash EPS of \$0.99 and adjusted cash from operations of \$255 million when you exclude the alliance and royalty revenue recognized in connection with the Dermatology divestiture. Total adjusted cash flow from operations was approximately \$322 million, more than 50% higher than Q1 2011. We will address working capital in the later slide.

Our fully diluted share count was 316 million as compared to 333 million one year ago, a decrease of over 5%. The combination of strong organic growth, business development activities and the declining Neuro and Other segment has significantly transformed the composition of our revenue base. Our current US revenue is approximately 52% of total revenue, which compares to 65% of revenue in the first quarter of last year.

As we stated earlier this year, we have a strategic objective to increase our non-US revenue to approximately 50% of total revenue by the end of 2012. We continue to believe that our diversity, both from a product perspective and geographic perspective, is a real strength of the Company.

As mentioned on our Q4 call, our cost of goods sold is an area that we do not typically target for synergies immediately after a transaction is closed, but we continue to target for improvements over time. We shared with you on our last call that we expect gross margins to improve over time, but we continue to expect margin improvement will fluctuate from quarter to quarter due to seasonality, product mix, acquisition activity and other factors.

In the first quarter, there were several items that negatively impacted cost of goods sold. This is the first quarter that the full impact of the contract manufacturing business we acquired through Dermik is included in our results, and this business obviously has a lower margin profile than the rest of our business.

In addition, the mix of business in Europe and the US impacted overall margins and unfavorable exchange rates in Europe increased product costs as well since we buy significant amount of ATI and partner products in euros which strengthen against many Central and Eastern European currencies. Also, we have yet to finish consolidating plants acquired as part of acquisitions including plants in Brazil and Mexico.

We remain confident in our ability to continue to reduce cost of goods sold throughout 2012 but a long-term objective is to improve to at least 80% gross margins at some point in the future.

To wrap up our discussion of the first quarter of 2012, we provided the following waterfall chart depicting the inflows and outflows of our cash. We ended 2011 with a cash position of \$164 million, brought in \$322 million in adjusted operating cash flow in addition to incurring another \$350 million in additional net debt during the quarter. We bought back \$113 million in securities and paid out approximately \$300 million for acquisitions.

The remaining \$107 million in capital expenditures, restructuring, legal and integration expenses along with some miscellaneous expenses gets us to a cash position at the end of the quarter of approximately \$330 million. Our current cash position is approximately \$285 million.

In addition, we still have an undrawn revolver of \$270 million that could be accessed for additional (inaudible) activities. We are very comfortable with our liquidity position, and as has been our past practice, we will actively manage our balance sheet to deliver superior returns to our shareholders while maintaining strong access to the credit market.

We will continue to manage our businesses to maximize results in local currencies, but we obviously cannot control currency fluctuations. Although currency rates have improved so far in 2012 on a year-over-year comparison, foreign exchange rates negatively impacted our revenue by about \$20 million.



As mentioned earlier, cost of goods sold was also negatively impacted by changes in exchange rates, especially in Europe. We have listed all of our major currencies in the chart on your screen, and as you can see with the exception of Australia, all of them declined as compared to the first quarter of last year.

Working capital as a percentage of the last 12 months revenue decreased from 35% in Q4 2011 to 30% in Q1 2012 driven mainly by a decrease in accounts receivable day sales outstanding from 75 days at December 31 to 72 days at March 31, which was partially offset by an increase in inventories related to stock built in advance of technology transfers in Latin America and United States.

We've remained active in our securities repurchase program so far in 2012, repurchasing over two million common shares at an average cost of \$54 a share. We also repurchased 1.1 million face value of our remaining convertible securities and it is our intention to redeem the remaining \$18 million in August when they can be redeemed.

Also want to take a moment to highlight our current share account, which was approximately 316 million on a diluted share count basis at the end of the quarter. This is a significant drop from last year when our share count was 333 million and a direct result of our securities repurchase program activity. I will now turn the call back over to Mike.

Michael Pearson - *Valeant Pharmaceuticals International Inc - Chairman, CEO*

Thanks. We are pleased with the way our base business and acquisitions continue to deliver strong operating performance. Due to our recent acquisitions, coupled with the outperformance of our base business versus our budget in the first quarter, we are pleased to be in the position of increasing our financial guidance for the rest of 2012. We believe that our annual revenue will be in the range of \$3.4 billion to \$3.6 billion in 2012.

We are raising our cash -- our 2012 cash EPS guidance from \$3.95 to \$4.20 to a range of \$4.45 to \$4.70 per share. This increase takes into account the strong performance in the first quarter as well as our recent acquisitions and the first quarter divestiture which was not anticipated. Finally, based on this projection, we believe that adjusted cash flow from operations should be in excess of \$1.4 billion in 2012.

In summary, the first quarter of 2012 begins another year where delivering solid operating performance, generating strong cash flows and producing significant bottom-line results for our investors is our focus. Through organic growth, margin improvement and acquisition strategy, I believe that we are delivering on our goal to return significant value to Valeant shareholders and provide our employees and patients with a strong future. With this, we will now open up the line to questions. Operator?

QUESTIONS AND ANSWERS

Operator

(Operator Instructions) Marc Goodman from UBS Securities.

Marc Goodman - *UBS - Analyst*

Yes, good morning. Maybe you could just give us a little more color on some of the emerging markets, and just the underlying growth rates there, in eastern Europe and Latin America and the Asian markets, just a little more color. Thanks.

Mike Pearson - *Valeant Pharmaceuticals International Inc - Chairman and CEO*

Sure, well, we gave you overall growth rates, both Mexico and Brazil continue to have a strong double-digit organic growth rates, Brazil is probably slightly ahead of Mexico, but both well above 10%. In Asia and South Africa, we're just still getting our arms around this business. South Africa in particular grew quite well in the first quarter, but we actually feel very good about our prospects in Southeast Asia. In Europe, across central and



eastern Europe, Russia was probably the strongest growth rate in the first quarter. But we had good solid growth in some of our core markets like Poland and Serbia as well.

I think one of the reasons for our growth rates in these markets is about 70% of our total revenues across all of the emerging markets is cash pay. So, less than 30% is sort of reimbursed volume, which certainly helps from -- given governments, even in these countries, are looking hard at pharmaceutical prices.

Marc Goodman - UBS - Analyst

And when you talk about the growth in Mexico and Brazil over 10%, just to start there, is that because those markets are growing that fast, or are you gaining share, are you launching more products, how is it working there?

Mike Pearson - Valeant Pharmaceuticals International Inc - Chairman and CEO

Well, the data's a little sketchy. In both looking at IMS and looking at some of the local groups, we are gaining share. We're growing faster than the markets both in Brazil and in Mexico, and quite frankly have for the last two or three years.

Marc Goodman - UBS - Analyst

And is that also the case in central, eastern Europe?

Mike Pearson - Valeant Pharmaceuticals International Inc - Chairman and CEO

I can't tell you by market; I don't have the data. I can say in Poland we've certainly increased our share substantially. And Russia, we're probably just -- we're just too new to it to have a comment. And Serbia, we certainly have. And the rest, I just can't give you that answer. I suspect we are, but I cannot give you a percentage there.

Marc Goodman - UBS - Analyst

And one other question on slide 5, you have this deal update, and then there's this other transactions down at the bottom, where you said you divested Bioskin and you acquired these other assets. Can you just give us a flavor for how that impacted -- how much was the divestiture impacted, and the acquired assets?

Mike Pearson - Valeant Pharmaceuticals International Inc - Chairman and CEO

In terms of bottom line, the divestiture was zero, it was sort of at its basis. And the -- it was pretty late in the quarter that we picked up the Ortho products in Canada and Brazil, so, the sales for the quarter would have been less than \$1 million.

Marc Goodman - UBS - Analyst

But what kind of run rate and revenues would those products --?

Mike Pearson - Valeant Pharmaceuticals International Inc - Chairman and CEO

Probably close to [\$5 million].

Marc Goodman - UBS - Analyst

\$5 million on a -- for a full year?

Mike Pearson - Valeant Pharmaceuticals International Inc - Chairman and CEO

Yes, \$5 million [year] on a full-year basis.

Marc Goodman - UBS - Analyst

For both the Canada and the Brazil?

Mike Pearson - Valeant Pharmaceuticals International Inc - Chairman and CEO

Yes.

Marc Goodman - UBS - Analyst

Okay, thanks.

Operator

Chris Schott from JPMorgan.

Chris Schott - JPMorgan Chase & Co. - Analyst

Great, thanks very much. First question was on the 80% gross margin target that you've referenced the last couple quarters. Can you just elaborate a little bit more on the drivers that will lead to this improvement, just mostly facility consolidation, is it bringing products in house, is it mix, is there one of the business segments driving all of this?

Mike Pearson - Valeant Pharmaceuticals International Inc - Chairman and CEO

Well, yes, so, it's a little bit of all the above, let's talk about it a little bit. First of all, the first time we raised that target was -- or we talked about our long-term goal was just our last call, so, it has not been the last couple quarters. It was, I think, our guidance call in January. And what's driving that is largely getting manufacturing synergies that sort of trail our acquisitions by a year or two. We are very, very careful in terms of plant consolidations. Running out of supply, given the high gross margins we have in the first place, is not a risk we want to take. So, we are very, very careful, but there clearly are opportunities. So, we're going in Mexico from four facilities to one, and Brazil from three facilities to one. In Europe, from five facilities to two, and those are just examples.

In terms of the mix of margins, in terms of our products, that largely depends on acquisitions. And on acquisitions, we don't make acquisitions to either improve or hurt our gross margins. We make our acquisitions to create value for shareholders. So, it's all around cash flow returns. So, some will have better margins, and some will have worse. But we continue to make good progress, and we do think that 80% is a very realistic goal for ourselves.



Chris Schott - *JPMorgan Chase & Co. - Analyst*

Okay, thanks for that. Can you also just talk a little bit more about Russia? I know you touched on that in the last question, but the opportunity you see for Valeant following your acquisitions this quarter, can you just maybe give us a sense of how large of a business this is for the Company at this point? And do you feel you have critical mass in the Russian market at this point?

Mike Pearson - *Valeant Pharmaceuticals International Inc - Chairman and CEO*

Well, across all CIS, and Russia is probably 90%, I think our run rate, once we close Natur Produkt will be about \$180 million on an annual run rate basis, but it's also -- we're projecting growth of 15%-plus in that market. I don't feel us as we're gaining mass, but we're not at critical mass yet. We think it's a huge opportunity. If you think about healthcare in Russia, it's for a developed -- for what was formerly pretty developed country. The average male slightly -- lives slightly beyond 50 years, and females are sort of in the late 50s. So, it's not a healthy nation. And we believe there's a huge opportunity in Russia. So, as we mentioned in the last couple calls, it's going to be an area of focus for us.

Chris Schott - *JPMorgan Chase & Co. - Analyst*

All right. And then final question, you've been very busy on the deal front this year, a lot of these have been smaller in terms of dollar size. Are these smaller deals really remaining your sweet spot, in terms of what you're looking for? And what type of opportunity are you seeing for larger transactions in the market? Thanks.

Mike Pearson - *Valeant Pharmaceuticals International Inc - Chairman and CEO*

Sure. So, we're not driven by size of deal; what we're driven by is return. And I think that over time you're going to see some larger deals sprinkled in with the smaller ones. What we have been able to do is actually decrease our average cost to about 2.1 times revenue, which allows for a very, very short paybacks. We also are emphasizing buying assets to the extent we can, because those are quite efficient from our corporate structure standpoint. But certainly we'll continue to make a lot of smaller deals, but we continue to work on and are looking at slightly larger ones. So, again, it's all based on the return that we're going to get, cash on cash return, because that's the key metric for us.

Chris Schott - *JPMorgan Chase & Co. - Analyst*

Thanks so much.

Operator

Corey Davis from Jefferies.

Corey Davis - *Jefferies & Company - Analyst*

Thank you. First question on your guidance raise, how much of the raise is from the acquisitions that you've done since January, and how much is from the base business performance? I'm already stripping out the \$0.15 from the Derm divestiture this quarter?

Mike Pearson - *Valeant Pharmaceuticals International Inc - Chairman and CEO*

Right, yes, you should take the \$0.15 out because that was not something that we expected when we -- we thought that deal would close last year originally, so, that was not in our original guidance. So, \$0.35, and I'd say it's probably half and half.



Corey Davis - *Jefferies & Company - Analyst*

Okay, great. And Raj, thanks for your comments on the generic Zovirax, and I realize that even if someone were to start today, it's still probably years away, but at some point does it make sense to get more aggressive with what you're going to do with a Xerese launch?

Rajiv De Silva - *Valeant Pharmaceuticals International Inc - President, COO- Specialty Pharmaceuticals*

Thank you, Corey. So, the short answer to this is that we have many different lifecycle management strategies have been working on for Zovirax, which includes Zovirax itself, as well as Xerese. So, Xerese is currently available only in the cream form, and it's been a very well received product from an efficacy standpoint. So, absolutely, we look at this as a franchise, and we expect to increase our promotion of Xerese going forward, and also to continue to focus on many different lifecycle management projects that they have ongoing.

Corey Davis - *Jefferies & Company - Analyst*

And last question, the 38% growth in Zovirax grams that you saw in the quarter, was the revenue growth higher or lower than that?

Rajiv De Silva - *Valeant Pharmaceuticals International Inc - President, COO- Specialty Pharmaceuticals*

Do we -- let us just take a quick look for you.

Mike Pearson - *Valeant Pharmaceuticals International Inc - Chairman and CEO*

We'll get back to you on that, Corey.

Corey Davis - *Jefferies & Company - Analyst*

Okay. No problem, that is all I had. Thanks.

Rajiv De Silva - *Valeant Pharmaceuticals International Inc - President, COO- Specialty Pharmaceuticals*

Thanks, Corey.

Operator

David Risinger from Morgan Stanley.

David Risinger - *Morgan Stanley - Analyst*

Thanks very much. I have a number of questions. I guess just to start out, Mike, I was hoping that you could frame for us, number one, what we should expect at the June 21 Analyst meeting, if you could preview that? And second, you mentioned IDP-108 -- could you update us on the timing for you to file, and also describe the differentiation you see of that compound versus the alternatives?



Mike Pearson - *Valeant Pharmaceuticals International Inc - Chairman and CEO*

Sure, so, in terms of our investor meeting, it's going to focus probably on the markets outside of the United States where you probably have a little less familiarity. We'll bring our General Managers from the different markets, and they will talk a little bit about the overall market and our position, our products, and give more detail in that area. We'll probably have an update on our R&D or some of our work out at Petaluma. And that's probably the main highlights of that.

Second question, IDP-108, as Rajiv mentioned, we will be filing it later this year, is the plan. I can't give you a precise month, but there's not that many months left, so, it's got to be one of them. And in terms of the data, we won't say it's significant, but as Rajiv said, we would like to communicate that through a publication and/or conference or both, and that's our plan.

David Risinger - *Morgan Stanley - Analyst*

Okay, that's helpful. And then with respect to your guidance, obviously Potiga has been in your guidance since January 6. In your new updated guidance, do you have any other future divestiture -- do you have any other major one-timers or divestitures in the new revised guidance?

Mike Pearson - *Valeant Pharmaceuticals International Inc - Chairman and CEO*

No, we have nothing -- we have no new business development, we have no new divestitures. The guidance is all based on either things we have acquired already this year, and an assumption that the outperformance we saw in the first quarter versus our budget will be continued.

David Risinger - *Morgan Stanley - Analyst*

Okay, thank you very much.

Operator

Gary Nachman from Susquehanna Financial.

Gary Nachman - *Susquehanna Financial Group / SIG - Analyst*

Hi, good morning. Mike, first question, what have the operating margins been for most of these smaller deals that you did recently? 2.1 times seems pretty attractive, but I'm curious about the profitability of those, since you haven't really disclosed that.

Mike Pearson - *Valeant Pharmaceuticals International Inc - Chairman and CEO*

Yes, well, when we buy a company, the current profitability of the company is largely irrelevant, because what's relevant is the synergized operating margin. And most of them are not making a lot of money, that's why we're able to buy them at these kinds of prices. But in most cases, we are keeping very little of the infrastructure, and folding it right into our business. So, the operating margins become quite, quite substantial. So, the payback, which is a very crude cash-on-cash metric, are consistently well under five years.

Gary Nachman - *Susquehanna Financial Group / SIG - Analyst*

Okay. And any update to specialty areas that you're focused on, in terms of adding to your business? Are you still excited about Ophthalmology? Do you still see further opportunity for consolidation in Dermatology, and are you still committed to Neuro? And then, any others that you really have your eyes on at this point?



Mike Pearson - *Valeant Pharmaceuticals International Inc - Chairman and CEO*

So, we are -- continue to be committed to Ophthalmology; we're obviously very committed to Dermatology. We have others that we are very interested in; we added Podiatry, which we think is a very good market, especially given IDP-108. And we do have others that we're looking at but -- which we think will be (inaudible) markets, but once we announce deals in those areas, you'll find out what those are.

In terms of Neuro and Other, I think what we're pleased about is that the decline has largely been driven by a small set of products, two of which just had generics enter, and now there's not a whole lot of products left that have potential generic competition, and Wellbutrin. And what we're beginning to see is that sort of the core Neuro business continues to chug along quite nicely. But we're not -- don't expect us to make another big Neuro acquisition with a sales force and all that type of thing; that's not an area that we think is a good fit with our capabilities.

Gary Nachman - *Susquehanna Financial Group / SIG - Analyst*

Okay, and then a couple more quick ones. What will growth in Canada look like this year, factoring in generic Cesamet? And then, I guess this is for Howard, what's the right cash tax rate we should be using for the full year? It was hard to tell from the first quarter. Thanks.

Mike Pearson - *Valeant Pharmaceuticals International Inc - Chairman and CEO*

So, growth in Canada, especially in the first quarter, was quite high. That had more to do with a quarter-to-quarter comparison of 2011. If you go back to the end of 2010, there was actually, in the third quarter, a Cesamet shortage. And so what happened is, in Q4, there was a big buy-in in 2010 of Cesamet, which -- and then we had light sales in 2011 of Cesamet, and then this year strong sales. So, that had an impact on the quarter. Going forward, the Canadian/Australian segment, we continue to believe double-digit growth is -- which is what we committed to at the beginning of the year, is what we'll continue to see.

Gary Nachman - *Susquehanna Financial Group / SIG - Analyst*

And you could do that with generic Cesamet, the double-digit growth?

Mike Pearson - *Valeant Pharmaceuticals International Inc - Chairman and CEO*

Yes. That has been built into our original forecast.

Gary Nachman - *Susquehanna Financial Group / SIG - Analyst*

Okay.

Howard Schiller - *Valeant Pharmaceuticals International Inc - CFO*

Yes, our cash tax relief for the first quarter was around 4%, and we're comfortable with that rate going forward.

Gary Nachman - *Susquehanna Financial Group / SIG - Analyst*

Okay. All right, thanks.



Operator

David Amsellem from Piper Jaffray.

David Amsellem - Piper Jaffray & Co. - Analyst

Thanks, just a couple. So, on Acanya with your last Orange book patent expiring in 2015, I believe, and then Atralin with the last Orange book patent expiring in 2014, I believe, are you assuming that there are Paragraph 3 filers out there on the products? And can you talk about what kind of lifecycle management plans you have on Acanya and Atralin?

Rajiv De Silva - Valeant Pharmaceuticals International Inc - President, COO- Specialty Pharmaceuticals

Thank you. I think for obvious reasons, we don't want to get too detailed, but I can assure you that we have many different lifecycle management ideas and programs that we are working on for both Acanya and for Atralin. And to answer your question on Paragraph 4 filers, we're not aware of any.

David Amsellem - Piper Jaffray & Co. - Analyst

Okay, and then second question, can you just go through for us what the other income line of, I believe, it was \$24 million for the quarter was -- what drove that?

Howard Schiller - Valeant Pharmaceuticals International Inc - CFO

The biggest driver of that, as we mentioned in the press release, was the \$30 million gain from the way the iNova transaction was constructed. As we've mentioned before, we've got a global business, we've got -- exposed to lots of different currencies. And like this quarter, we had a hit on the revenue line, a hit on the cost of goods sold line, and now we have this gain here. Couple quarters ago, there was a loss in that other income line as a result of some inter-Company movements of cash. So, these are hard to predict, and will happen quarter-to-quarter, but that is -- as detailed in the press release, that was the bulk of it.

David Amsellem - Piper Jaffray & Co. - Analyst

So, just to be clear, that gain is in the cash non-GAAP EPS calculation?

Howard Schiller - Valeant Pharmaceuticals International Inc - CFO

Yes.

David Amsellem - Piper Jaffray & Co. - Analyst

Okay. And then, just last question on the European launches in 2012, can you go through with us which countries you're having the most launches in, launch activity in other words? And maybe quantify what kind of impact the launch products would have on the European business, either in terms of dollars or growth for 2012?



Mike Pearson - *Valeant Pharmaceuticals International Inc - Chairman and CEO*

Yes, I would suggest you show up to the Investor day because that's the type of thing we'll be covering. We'll have [Pavel] who runs our European -- central and eastern European business, go through some of those details.

David Amsellem - *Piper Jaffray & Co. - Analyst*

Thank you.

Operator

Doug Miehm from RBC Capital Markets.

Doug Miehm - *RBC Capital Markets - Analyst*

Thanks. Mike, maybe you could talk about the decentralized operations of the Company, and what sort of turnover you've seen in management. You've made a lot of acquisitions, and I'm sure that you're upgrading management along the way, but maybe you could speak to that a little bit?

Mike Pearson - *Valeant Pharmaceuticals International Inc - Chairman and CEO*

Sure. Some of our key management positions are clearly the sort of the GMs or the Presidents or the Heads of our different decentralized businesses. Over the last 12 months, a number of changes have been made, some of those are based on people retiring and some of them are based on different factors. So, in Europe, we have a new leader in Europe, we have a new leader in Australia. We have a new leader in US Dermatology compared to on some time before. On the other hand, we have some people that continue to do terrific jobs, like in Canada and Mexico, Brazil and [neuro].

Doug Miehm - *RBC Capital Markets - Analyst*

Okay, great. Opportunities in southeast Asia you mentioned that could be some significant growth there -- are there many companies that you could look to acquire in that part of the world?

Mike Pearson - *Valeant Pharmaceuticals International Inc - Chairman and CEO*

Yes, it's very much like the rest of -- or like most of the other emerging markets that we're in today, highly fragmented. Many, many private companies, tend not to be public companies. So, the same kind of landscape that we see in Brazil and Mexico and in Russia, we also see in terms of the southeast Asia market.

Doug Miehm - *RBC Capital Markets - Analyst*

Okay. And then just to wrap up, again, on acquisitions, there have been some larger acquisitions I'd say across the board. We saw one last night by Novartis. Are you going to tend to try to stay away from those, just given that you'd like to keep the sales multiple below 3 times, and try to get a reasonable payback time or good payback times?

Mike Pearson - *Valeant Pharmaceuticals International Inc - Chairman and CEO*

Well, what we do is we avoid auctions, and in some of these larger cases, they tend to be auction processes. And too, as you mentioned, Doug, what we are really focused on is return to our shareholders in terms of cash-to-cash returns. But we're also quite -- there's certain markets we like



and we don't like. And for example, generics in the US and western Europe, which has been where a number of acquisitions that -- we're just not interested in those markets. We don't think, for us, they're good long-term markets. So, there's that factor as well. So, it has to be in the right business and the right geography and the right return on investment for us to participate in making that transaction.

Doug Mieh - *RBC Capital Markets - Analyst*

Okay, great. Thank you.

Operator

Annabel Samimy from Stifel.

Annabel Samimy - *Stifel Nicolaus - Analyst*

Thanks for taking my question. I just wanted to get a little bit more granularity on the guidance that you provided. You said it was 50% basis and 50% acquisitions, so, can you tell us specifically which acquisitions have included, is it only ones that are closed, the ones closing by mid-year, all the ones that you've acquired? And can you say the same for the operating synergies that you expect, and which acquisitions are included in that?

Mike Pearson - *Valeant Pharmaceuticals International Inc - Chairman and CEO*

So, in terms of the guidance, all the deals that we've announced are included, with the exception of AcneFree, which we did late last night. So, we didn't change our models and stuff based on that. And in terms of all the others, but some of them are not going to contribute very much this year since a number of them haven't even closed, and we've taken appropriately conservative assumptions about when acquisitions will close.

In terms of operating performance in the first quarter, obviously since we outperformed in the first quarter, every -- those were all sustainable outperformances, so, we felt we could build that in, in terms of what we're going to do the rest of the year. To the extent that we improve on that, we improve on it.

Annabel Samimy - *Stifel Nicolaus - Analyst*

Okay, great. And then in the Derm business, we noticed that you had some pretty decent price increases in some of the products, and you've said in the past that you wouldn't really take that many price increases as part of the strategy. Is that changing a little bit based on prescription trends that you're seeing right now?

Mike Pearson - *Valeant Pharmaceuticals International Inc - Chairman and CEO*

We take, like most pharmaceutical companies, as products get to the end of their lifecycles, and generics are coming in, we do take more aggressive price increases. So, things like Benzaclin, you will see that, which is pretty standard practice in the area. But in terms of our core products, again, we've had this discussion before -- one needs to think about net prices, not gross prices. And some of the ways that we price our products is through these discount cards to consumers, it's discounts to managed care, it's incentives to distributors. So, the net price increases actually in Dermatology continue to be quite low -- low single digit.

Rajiv De Silva - *Valeant Pharmaceuticals International Inc - President, COO- Specialty Pharmaceuticals*

And also what one -- one additional comment, which is obviously when we acquire brands, we look at competitive pricing of competing brands when we do our price increases. And that also guides some of our activities around the time of closing a transaction.



Annabel Samimy - *Stifel Nicolaus - Analyst*

Okay. And then, one more question on FX, in the past you've talked a lot about how you've been naturally hedged, and we are seeing some bigger FX swings than we would have expected. Is this more translational, or is there a greater mismatch between the revenues and the expenses now, and how does that look going forward?

Howard Schiller - *Valeant Pharmaceuticals International Inc - CFO*

Well, we are susceptible to translations. We tend to reinvest our cash flows in the regions where it's generated, and we manufacture in those regions, so we tend to be hedged. But we will have some currency fluctuations, for instance in Europe, because we buy some API in euros and we buy products from some partners in euros, and then we can sell it, we could sell it in Poland or other central eastern European countries. And in this quarter, the zloty for instance weakened against the euro, so we get hurt in that regard. But net-net, we're susceptible to movements in currencies, but we do have a significant hedge.

Mike Pearson - *Valeant Pharmaceuticals International Inc - Chairman and CEO*

Yes, and our experience so far over the last four years of being involved in many of these markets, is some quarters it's a help, and in some quarters it hurts. And over time, we measure our performance, our business units based on local currency, and that's what we expect them to deliver -- to grow share in local currency, and to grow cash flow in local currency.

Annabel Samimy - *Stifel Nicolaus - Analyst*

Okay, thank you.

Operator

Tim Chiang from CRT Capital.

Tim Chiang - *CRT Capital Group - Analyst*

Hi, thanks. Mike, I wanted to get your thoughts on the M&A space this year. I guess you've bought, what, almost seven or eight companies already this year; I think you bought nine last year, or more. Certainly you guys have done an incredible job getting value out of the transactions; I think you talked about, what, a multiple around 2 times sales. I mean, is that something that you think you'll get some pressure on, in the transactions you're looking at in the future? Also I wanted to ask Howard about the balance sheet, but I'll ask him after you answer this question.

Mike Pearson - *Valeant Pharmaceuticals International Inc - Chairman and CEO*

Sure. Well, we chart multiples we pay, both sales multiple, which is a very crude measure but is in some ways maybe the best measure from an external standpoint, given often the profitability of what we're buying, as we talked about earlier, is not particularly high when we buy it, but is quite high after we've integrated it. We've looked over the last four years, four-plus years that I've been here, and it's actually a little bit lower now than it has been. I think on average over those four years, it's probably about 2.5 times sales. So, we've been fortunate in the first quarter to actually be a little bit lower. But we think between 2 and 3 depending on the gross margins, the nature of the business, the growth prospects, that's really the area that we try to operate in. Sometimes we get below 2, and that's great. And sometimes we'll pay a little bit more than 3, but that's only if there's very high margins and very high growth expected.

Your balance sheet question?



Tim Chiang - CRT Capital Group - Analyst

Yes, Mike, I think you've talked about building or acquiring at least one additional growth platform. Have you already done that, in these Russian acquisitions, or is that still more to come?

Mike Pearson - Valeant Pharmaceuticals International Inc - Chairman and CEO

Well, I think the answer is yes and yes. I would think that our two -- really, Russia is going to be an important growth platform for us, and a year ago we had no sales in Russia. So, that's happened over three acquisitions, first Sanitas, which got us into the country, and then with the two that we made this quarter. We believe Pedinol, which is one of the best-selling companies in the field of podiatry introduces us into that segment, which we think is a great opportunity. I'd say both of those are new growth platforms for us, so, I would be highly disappointed that, if by the end of the year, if we've not added another one or two to those growth platforms as well.

Tim Chiang - CRT Capital Group - Analyst

Okay, great. And Howard, I wanted to ask you a couple capital structure questions, if I could. Looking at the debt, how much flexibility do you think you'll have in terms of, one, lowering your borrowing costs. Could you talk a little bit about that? And also, the debt-to-equity ratio is actually coming down, or not going up, and is there an optimal debt-to-equity ratio that you guys are focusing on this year?

Howard Schiller - Valeant Pharmaceuticals International Inc - CFO

Well, we stated publicly that we would like to keep our leverage below the 4 times level on an unadjusted basis. The way, and our covenants read, we get credit for the acquisitions and most of the synergies, so, we're comfortably below 4 right now. And we think at that level we can execute our acquisition strategy and maintain strong access to the credit markets at attractive pricing, and that's our goal. The key for us, as Mike's talked about, is going to be maintaining discipline in terms of cash-on-cash returns. Because as you've seen, the business generates an enormous amount of cash. So, as we're spending money on acquisitions, we're generating an enormous amount of cash from operations. And the combination of discipline and the cash-generative ability of the business will continue to -- it will allow us to maintain a strong balance sheet going forward.

Tim Chiang - CRT Capital Group - Analyst

Howard, I'm just going to ask you one last question, what is the cost of your debt right now?

Howard Schiller - Valeant Pharmaceuticals International Inc - CFO

For the last financing that we did was a term loan, it was in the term loan B market, and the all-in cost to us was around 4%, including the fees and the original issue discount. So, there's very, very strong appetite for our paper; we're still more heavily fixed than we are floating. The spread between fixed and floating is quite significant; I think we'd feel comfortable adding more floating right now, given that spread. But the appetite for our paper was quite strong.

Tim Chiang - CRT Capital Group - Analyst

Okay, great. Thanks a lot, Mike; thanks, Howard.



Operator

Juan Sanchez from Ladenburg.

Juan Sanchez - *Ladenburg Thalmann & Company Inc. - Analyst*

Hi, thank you, just a couple of short questions. The first one is -- from the acquisitions that show as closed in your presentation, which ones, if any, closed after the quarter? And if that's the case, what would be your current cash position?

And the second question is on Potiga, my understanding, maybe I'm [outdated with], my understanding was that Potiga was only going to contribute to your P&L once the P&L with Glaxo become profitable. Is that still the case or that has changed?

Mike Pearson - *Valeant Pharmaceuticals International Inc - Chairman and CEO*

Right. So, the only -- of the closed transactions, Pedinol closed after the end of the quarter, but only really Probiotica and Eyetech were there for any substantial period of time at all.

In terms of the arrangement with Glaxo, is in three territories -- the US, Canada and Australia. It's a profit sharing arrangement. So yes, until the brand becomes profitable, there will be no impact on our P&L. Now, between the period of approval to close, we were continuing to bear, 50/50, the cost of developing and commercializing this product, preparing to commercialize the product. So, the net impact on a go-forward basis, as Rajiv was mentioning, is actually positive because it's an expense reduction from the commercial and the R&D side, since that's now all incorporated into the P&L of Glaxo.

Juan Sanchez - *Ladenburg Thalmann & Company Inc. - Analyst*

Got it, thank you.

Operator

David Steinberg from Deutsche Bank.

David Steinberg - *Deutsche Bank - Analyst*

Thanks very much. You touched on the recent Podiatry acquisition in part as laying the groundwork for your future IDP-108 commercialization strategy. And I was just curious, given the framework you've laid out, and we haven't seen all the data but it sounds like IDP-108 could be your biggest product down the road. Assuming approval, is your current sales and marketing infrastructure right-sized for the opportunity, or upon approval will you expand it or add on with acquisitions? And then secondly, you indicated you're going to file before the end of the year in the US, could you just update us on your exUS regulatory strategy for IDP-108?

Mike Pearson - *Valeant Pharmaceuticals International Inc - Chairman and CEO*

Sure. So, in terms of the infrastructure now, it's not close to being what would be required to launch a major onychomycosis product in the US. So, it will need a lot more support than what we currently have, whether we choose to do that ourselves or we find partners or CSOs, we have not -- we don't want to get the cart before the horse; let's get this thing approved first. But we're obviously thinking about it.

In terms of the rest of the world, we have a partner, [Kockan], who is responsible for Japan, and in fact has all the economics in Japan, it was their compound originally. And then the rest of the world, we have rights to large portions of the rest of the world, and we are actively working on our

regulatory strategy there, and we can update you in more detail. I'd rather have Sue Hall do that, who's our head of R&D, at the Investor Day Conference.

David Steinberg - *Deutsche Bank - Analyst*

Okay, and then one question on Brazil. It's a bit down the road, but as I understand it, in early 2014 the government's mandating that all generics that have not undergone bioequivalency studies have to be removed from the market, and it sounds like there are hundreds of these products. Is this a major opportunity that you think you can capitalize on?

Mike Pearson - *Valeant Pharmaceuticals International Inc - Chairman and CEO*

Well, it certainly won't hurt us because we do have full bioequivalence approval on all our products. And if they actually implement this, and it will obviously help all those companies in the market that have bioequivalence already established. So, it is an opportunity, if the government follows through on that initiative.

David Steinberg - *Deutsche Bank - Analyst*

Okay, thanks.

Operator

Michael Tong from Wells Fargo.

Michael Tong - *Wells Fargo Securities, LLC - Analyst*

Thanks. Michael, just one, and make sure I don't misunderstand you, your new guidance is based on first quarter being \$1.14 rather than \$0.99, is that correct?

Mike Pearson - *Valeant Pharmaceuticals International Inc - Chairman and CEO*

I'm sorry, could you repeat the question?

Michael Tong - *Wells Fargo Securities, LLC - Analyst*

Yes, your new 2012 EPS guidance, is it based off of first quarter being \$1.14 rather than \$0.99?

Mike Pearson - *Valeant Pharmaceuticals International Inc - Chairman and CEO*

Yes, what we did is basically we had the extra \$0.15 gain, which was not anticipated. So, if you want to look at it from that way, we have raised our guidance for the rest of the year \$0.35 from where we were before because we got that additional \$0.15 in the first quarter. So, we think that, compared to our original budget, we're expecting over \$0.10 improvement in each of the following three quarters based on our operating results in the first quarter and the deals we have done. And that, as I mentioned earlier, is roughly a 50/50 split between the two.



Michael Tong - Wells Fargo Securities, LLC - Analyst

Okay, thanks for clarifying. And then the two questions for Howard. Number one, the \$20 million revenue hit that you mentioned, how well was that absorbed as that revenue hit travels down the P&L line as part of your operational hedges? And then the \$30 million FX gain, why wasn't it kind of netted out as part of -- since it's an inter-Company loan, why wasn't it netted out as part of inter-Company transfer as part of preparing for the consolidated financial statements?

Howard Schiller - Valeant Pharmaceuticals International Inc - CFO

Well, the second question, we'll tackle that first. It was a dollar-based loan from an Australian-based company, and that's not their functional currency, so, the accounting convention is for us to recognize gains or losses.

And in terms of the \$20 million, it depends on the region. For the most part, we are mostly hedged as I mentioned, because we will operate in the same region, we'll manufacture in the same region where we're selling. So, we're exposed really to the profits, which we also tend to reinvest in those regions, so, it tends to be more translation. But as I mentioned in Europe, where we're buying API in euros and we're buying products from partners in euros, and then reselling them in zlotys and other currencies, we do have some real currency exposures that we saw this quarter as the euro strengthened against those currencies.

Michael Tong - Wells Fargo Securities, LLC - Analyst

Okay, so, if you were to take a stab, maybe you could absorb it like -- you could absorb 50% of that hit within the P&L?

Howard Schiller - Valeant Pharmaceuticals International Inc - CFO

I don't have that number. Certainly the majority of it, if you look at our average margins, we should be able to, but I don't have a specific number for you.

Michael Tong - Wells Fargo Securities, LLC - Analyst

Okay, thanks.

Mike Pearson - Valeant Pharmaceuticals International Inc - Chairman and CEO

Okay. So, thank you. Rajiv, I think you have the answer to Corey's question?

Rajiv De Silva - Valeant Pharmaceuticals International Inc - President, COO- Specialty Pharmaceuticals

Right, so, Corey, the answer to your question on Zovirax, the question was whether the net sales growth is going to be higher or lower than the volume growth. The answer to that is going to be lower, and the reason for that is, as you will recall, we began our (inaudible) on the 15-gram to the 30-gram cube last day in the first quarter, so, there was loading of the channel that will probably reverse itself when you look at our second quarter results.

Mike Pearson - Valeant Pharmaceuticals International Inc - Chairman and CEO

Good. And with that, we will close out the call, and we thank you for all participating, and we'll look forward to talking to you next quarter.

Operator

Thank you, everyone, and this concludes today's conference call. You may now disconnect.

DISCLAIMER

Thomson Reuters reserves the right to make changes to documents, content, or other information on this web site without obligation to notify any person of such changes.

In the conference calls upon which Event Transcripts are based, companies may make projections or other forward-looking statements regarding a variety of items. Such forward-looking statements are based upon current expectations and involve risks and uncertainties. Actual results may differ materially from those stated in any forward-looking statement based on a number of important factors and risks, which are more specifically identified in the companies' most recent SEC filings. Although the companies may indicate and believe that the assumptions underlying the forward-looking statements are reasonable, any of the assumptions could prove inaccurate or incorrect and, therefore, there can be no assurance that the results contemplated in the forward-looking statements will be realized.

THE INFORMATION CONTAINED IN EVENT TRANSCRIPTS IS A TEXTUAL REPRESENTATION OF THE APPLICABLE COMPANY'S CONFERENCE CALL AND WHILE EFFORTS ARE MADE TO PROVIDE AN ACCURATE TRANSCRIPTION, THERE MAY BE MATERIAL ERRORS, OMISSIONS, OR INACCURACIES IN THE REPORTING OF THE SUBSTANCE OF THE CONFERENCE CALLS. IN NO WAY DOES THOMSON REUTERS OR THE APPLICABLE COMPANY ASSUME ANY RESPONSIBILITY FOR ANY INVESTMENT OR OTHER DECISIONS MADE BASED UPON THE INFORMATION PROVIDED ON THIS WEB SITE OR IN ANY EVENT TRANSCRIPT. USERS ARE ADVISED TO REVIEW THE APPLICABLE COMPANY'S CONFERENCE CALL ITSELF AND THE APPLICABLE COMPANY'S SEC FILINGS BEFORE MAKING ANY INVESTMENT OR OTHER DECISIONS.

©2012, Thomson Reuters. All Rights Reserved.