

FINAL TRANSCRIPT

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Nov. 03. 2011 / 2:00PM, VRX.TO - Q3 2011 Valeant Pharmaceuticals International Inc Earnings Conference Call

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PRESENTATION

Operator

Good morning. My name is JoAnne, and I will be your conference operator today. At this time, I would like to welcome everyone to the Valeant Pharmaceuticals third-quarter 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)

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I would now like to turn the call over to Ms. Laurie Little. Ma'am, you may begin your conference.

Laurie Little - *Valeant Pharmaceuticals International Inc - VP - Investor Relations*

Thanks, JoAnne. Good morning, everyone, and welcome to Valeant's third-quarter 2011 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 Pharmaceuticals; and Phil Loberg, Interim Chief Financial Officer. In addition to a live webcast, a copy of today's live 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 these forward-looking statements to reflect events or circumstances after the date of the 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 only as of today. It is our policy to update or affirm guidance only through broadly disseminated public disclosure.

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

J. Michael Pearson - *Valeant Pharmaceuticals International Inc - Chairman and CEO*

Thank you, Laurie. Good morning, everyone, and thank you for joining us. We are pleased to discuss our solid financial and operational results for the third quarter of 2011. On today's call, I would like to review our third-quarter results, second, address recent investor questions, and finally, I would briefly like to discuss our updated guidance for the remainder of 2011.

As expected, each of our businesses again delivered solid results that contributed to both the top-line and the bottom-line performance. On the top line we delivered total revenue of \$601 million. Our cash EPS for the third quarter came in at \$0.66.

Our adjusted cash flow from operations was \$208 million for the third quarter. This number was depressed by the fact that we had an inventory drawdown in the early part of the quarter, and so it will be a significantly larger number next quarter. The average share count for the quarter on a weighted average basis was 322 million, but our current share count at the end of the quarter was 318 million shares. The difference is attributable to the timing of the buy-backs initiated in the third quarter. I will discuss our repurchase program going forward shortly.

While we are very pleased with our operational results this quarter, I want to take this opportunity to address investor questions and concerns that have developed after our second-quarter call this past August. These concerns manifested themselves in various reports that have been published, so we would like to provide more transparency on the following. First, our organic growth. Second, pricing versus volume growth in our business. Third, Valeant's profitability by geography. Fourth, the performance of our past acquisitions. Fifth, the health of our European business. Sixth, Valeant's access to capital. Seventh, an update on our Dermik and Ortho acquisitions. Eighth, our repurchase program going forward, and finally, the impact currency has had and will have on our business.

First, organic growth. Last quarter, we changed the methodology of how we measure organic growth to better depict how our underlying business was performing. In the past, we excluded any impact from acquisitions until they had been part of our portfolio for 1 year. But as we began to acquire and consolidate larger acquisitions into the Valeant operations, this methodology became less relevant. For example, once we merged with Biovail, the pro forma numbers from the previous year were more relevant than just reporting the Biovail numbers, so on a stand-alone basis for 4 quarters.

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Our European operations are another example, as roughly two-thirds of the business now consists of recent acquisitions, and it is our belief that investors would like to better understand that the growth of the overall business, rather just the one-third, which would be just the legacy Valeant operations for the next year. 1 other change to our methodology for organic growth will be including our portion of the sales for joint ventures where we are playing an active management role. These would include our joint venture products with Meda in Canada, for example the oxalis and Sublinox launches, and retigabine in our collaboration territories. For these products, we will include 50% of the net sales in our organic growth calculation because we receive 50% of the profits in these territories.

In the third quarter, and the rest of the year in 2011, this change to methodology will have no impact, or very little impact, on organic growth. But in 2012, we would hope and expect that this will have an impact on organic growth. We have now applied this pro forma methodology so that acquisitions greater than \$20 million will be reported on a pro forma basis.

While there are many of you that might be skeptical about this change, we thought it would be important to demonstrate, this quarter, the difference between our old methodologies and new methodologies. Using the new methodologies, you can see in the chart our organic growth for the quarter was 15%. If we just used our old methodology, the organic growth would have been 13%. The reason for the increase is that our significant acquisitions, Sanitas and PharmaSwiss, are actually performing better than our overall base business. But whether it's 13% or 15%, you guys can decide which you like better. We still think it's pretty strong organic growth.

On a year-to-date basis, we have now delivered 8.1% organic growth, and you can see that every one of our divisions are reporting double-digit organic growth with the exception of US Neuro and Other. While Wellbutrin continues to decline year-on-year, the rate of decline is decreasing due to less aggressive behavior by our competitors.

Turning to our US Dermatology segment, we continue to see very strong growth in all of our key brands, and we expect this trend to continue. And Acanya and CereVe continue to put up very solid growth numbers, and we are optimistic in terms of continuing to build these growth brands.

This brings us to the overall Company organic-growth profile. The portion of our portfolio that is demonstrating positive growth has increased each quarter of this year. We expect this trend will continue for the rest of the year and into 2012. We will continue to manage our operations and products for maximum growth and expect that the growth drivers in the business will cover for the expected declines certain products will face in the future.

Finally, our 8% annual organic growth objective for 2011 is just 1 metric that we use to measure our business. While top-line growth is very important to the overall health of the business, we do not manage our business to achieve a certain organic growth measure a quarterly basis. Our general managers are not incentivized to get to a certain organic growth number each quarter. They are incentivized to achieve top- and bottom-line results on an annual and longer-term basis and are primarily measured on a return-on-capital metric.

We have provided the external community a quarterly score card in order to provide transparency to our results in the face of multiple acquisitions, which we know can complicate quarterly results. Our main focus as a management team is to increase cash and to earn a rate of return on our investments of over 20%. Top-line growth is just a piece of that equation. We are comfortable with our previous guidance of achieving 8% organic growth for 2011 and believe this quarter's result demonstrate that we are on track to realize that goal.

Next, price versus volume. Much has been made about the break-down between price and volume and the organic growth calculations and some questioning the quality of our growth is somehow less than it should be and may not be sustainable. It is interesting to note that the only segment that has really been able to realize any price increase this year is the US Neuro and Other segment, which has realized an 8% increase this year. These price increases are offset by a 13% volume decrease, as well as other price decreases, which we have had to absorb from rebates and other government programs, something that is not picked up in most of the external data.

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In the Derm business, we launched Elidel at a higher price from day 1 than Novartis was selling it at, with the prices in mind with competitive offerings. In the case of Zovirax, we replaced the 15-gram tube of Zovirax ointment with the 30-gram tube. Zovirax ointment is used for the initial outbreak of genital herpes and has historically been prescribed at 30 grams per prescription. So in other words, when we had 15-gram tubes, the prescription the doctor wrote for an initial outbreak of herpes was for 30 grams and 2 tubes were supplied. This change made our product format consistent with prescription behavior. In doing this change, we maintained the per gram price of Zovirax ointment, and we kept it flat.

The most interesting metric is that if the US Neuro and Other segment is excluded from the calculation, 94% of our product portfolio is driven by volume increases, and only 6% is attributable to price increases. This trend will continue, and we will manage our US Neuro and Other segment with an appropriate mix of price increases to balance potential volume decreases in certain products. The vast majority and the rest of Valeant's business is expected to grow through volume increases, as the rest of our business does not have much flexibility to set price due to economic and reimbursement factors in these regions.

A final note on our price-volume variances. Many of you use IMS data, which we do not believe is a very good predictor of our performance. IMS data does not reflect commercial rebates, government discounts, and consumer discounts. We believe that as a Company, we use these levers more aggressively than most of our competitors, which therefore makes IMS data less relevant for us than other players in the industry. Finally, as you all know, IMS data is an audit of a subset of data providers, and thus, it's only an estimate.

Turning to profitability by geography. We have also seen reports that the vast majority of our profits come from our US business. We have broken down our revenues by geography to demonstrate that our profits are generally in line with the same proportion of revenue represented by each geography. The US represents approximately 52% of our revenue and contributed the same amount of profit. Our Canada and Australia segment actually represents a bigger portion of our profits when compared to top-line contribution. As our branded generic businesses are slightly lower in terms of profitability, but it'll be interesting to note that as we capture synergies in Europe, we expect our European profit percentage to increase.

Turning to our performance of our acquisitions. In the past, we have provided this chart that details each of our acquisitions and how are they performing. Like in past years, some of our acquisitions are performing very well, and some have not delivered as expected. All in all, though, our acquisitions are delivering a compounded annual growth rate in the double-digit range of 22%, and that is about where we would expect it to be. Another important metric, and perhaps the most important metric of deal performance, is the cash flow that has been realized from these acquisitions, as compared to our original deal model. There are only a few deals that have underperformed in this regard, while all the rest of our deals are either in track or ahead by more than 10% in terms of actual cash-flow generation.

Turning to Europe, we have been very busy with full-integration efforts since we closed Sanitas in mid-August. We have placed a new management team -- we have put in place a new management team, and we have replaced a number of country general managers as appropriate, and the entire top management team now reports to [Mariusz], who many of you have met. We have also identified which markets will be a strategic focus and which ones we will minimize and/or exit. We have identified more than \$75 million in synergies that we expect to realize by the end of 2012. Achieving these synergies will take a little bit longer than it took us in the Biovail-Valeant merger, due to union and government requirements that necessitate a lengthier process of headcount reduction. Therefore, most of the savings will be realized in the back half of next year.

We have also set up a launch program schedule, where we've combined the pipelines of legacy Valeant, PharmaSwiss, and Sanitas. We are targeting to launch 10 to 14 new products in each country in Europe in 2012, for a total of more than 250 product launches next year. With respect to our representation business, where we sell on behalf of other pharmaceutical companies in the region, we have lost 2 relationships since the beginning of the year, but we have added 11 new deals, and we have 9 more in active discussions. So again, that segment of our business will continue to grow. With our broader infrastructure, we are tracking new partners that are nervous about competing or selling in these territories.

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Lastly, although several companies have mentioned both pricing and reimbursement pressures in Europe, we have not found the environment significantly different than in the past. In Serbia specifically, the main difference between Valeant and other companies is that we actually distribute our products directly and do not use distributors. We continue to receive payments from the Serbian government and other customers in the country on a timely basis.

Bottom line, our business in Europe continues to grow, even with the added distraction of integration activities. It is a true testament to the strength of our team in Europe that they continue to meet and exceed our expectations. As I mentioned, we have performed an analysis of each of our markets in Europe and have developed a strategic priority list. We have several high-growth markets that we will endeavor to expand in, such as Russia and the Ukraine, while others, such as Romania, Greece, and others, we will minimize and possibly exit over time.

Since our last quarterly call, many investors were concerned about Valeant's ability to raise capital in these turbulent times. We announced on October 21 that we raised \$2 billion for acquisitions and other corporate purposes. This financing was the largest term loan A raised to date this year and lowered our average cost of borrowing from 6.91% to 5.34%. The financing was upsized from our previous intention to provide us more flexibility in the future for future deals and securities repurchases and is a strong testament to Valeant's attractive position with the credit markets. Our total debt today is currently \$5.6 billion, which does not include the \$500 million delayed draw or the \$270 million revolver, which we have not accessed. We will use the remaining debt to pay off the dermatology deals that will take about \$770 million to close.

With this new debt, S&P upgraded us to a BB, and Moody's reaffirmed their corporate rating at Ba3. While many of the issues that concern equity investors also concern our lenders, I think our lenders appreciate the diversified cash-flow generation profile we have and the lack of [patent class]. With this new debt in place, Valeant's leverage ratio stands at approximately 3.6 times, which includes the \$500 million delayed draw, although we have not yet used it. This leverage ratio is well within our comfort zone of less than 4 times. But calculating a traditional leverage ratio for Valeant does not actually capture the benefit that we have with a lower tax rate than other companies. With an implied 35% tax rate factored in, we actually have a comparable leverage ratio of 2.9 times.

The Dermatology deals. We are moving along with our integration planning for combining Dermik and Ortho with our existing Valeant businesses. As part of the planning process, we have put in place the transition agreement that included co-promotional efforts between the companies. Elidel is now being promoted by the Dermik sales force, and Acanya is now being promoted by the Ortho sales force. This will help us evaluate the effectiveness of each of these sales teams and provide us broad exposure in our marketing efforts. We have had many productive discussions with the FTC as we head into final agreement. We are discussing the possibility of a few small divestitures, but all of this is within expectations. We are still planning on closing these deals before the end of the year.

In terms of our repurchase program, so far this year, we have purchased -- repurchased over \$200 million face value of the legacy Biovail converts, leaving less than \$20 million face left to repurchase. We've also purchased -- repurchased an additional 1.8 million common shares in the third quarter, bringing our total share count reduction to 13.7 million shares in 2011. These activities account for approximately \$1.5 billion of the \$1.8 billion securities repurchase program we have authorized. With the upcoming expiration of our current plan on November 7, Valeant's Board of Directors has approved a new repurchase program of \$1.5 billion that will be effective November 8 for the next year.

Since our last call, currency fluctuations have moved in the opposite direction and will have a negative impact on our business for the remainder of 2011. Valeant is better prepared than some to manage through these headwinds, as our businesses are naturally hedged, because we do all the manufacturing and all the selling in our local locations. With the recent currency movements, if we just looked at what our guidance was at our last earnings call and recalculated it using current currency rates, our top line -- the \$2.4 billion in top line would be reduced to \$2.3 billion, and our cash EPS would (technical difficulties) and will not change our guidance because of currency factors.



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Moving to guidance. With this quarter, we have a completely clean representation of our business without any one-time event, such as divestitures, milestones, or investment gains. On a sequential basis, our cash EPS has shown an improvement from the first quarter of \$0.54, the second quarter at \$0.57, and this third quarter at \$0.66. Our updated guidance for the fourth quarter is now \$0.80 to \$0.95, despite negative headwinds and the inventory drawdown. Part of that inventory drawdown has continued into October, but we now think that our inventory levels in the distributors will now be stable. The retigabine milestone, which was part of the top end of our guidance last quarter, we now know will occur in the first quarter, because the launch is now planned for end of January, beginning of February of Potiga in the United States.

The key assumptions underlying our guidance. There are a number of key assumptions that we're making when we're putting our guidance together. One, is we're assuming exchange rates do not deteriorate further, that our inventory drawdown is now complete, that Potiga will be launched in the first quarter and not the fourth quarter, and that finally, that we will not realize any revenue or earnings from Dermik or Ortho in 2011. So, that helps you understand what's in and what's not in, in terms of our updated guidance for the year.

Finally, we intend to maintain the target of 8% organic growth, which we should -- we believe is attainable, as we currently stand at 8%, and our business continues to perform very strongly. In addition, we still expect to realize over \$900 million in cash flow from operations in 2011. We expect to announce our 2012 guidance during the first week of January, as we have for the past several years. This will allow us to have better insight as to the timing of the Dermik acquisitions and their financial impact of our business.

With that, we'll now open up the call for questions.

QUESTIONS AND ANSWERS

Operator

Thank you, sir.

(Operator Instructions)

Annabel Samimy, Stifel Nicolaus.

Annabel Samimy - Stifel Nicolaus - Analyst

Just want to dig into Europe a little bit more. You mentioned that you are at an advantage because you have direct -- you're selling direct rather than through distributors. Is there anywhere -- way other than that aspect that you feel that you have an advantage or disadvantage that would potentially impact you if you are continuing to deteriorate?

J. Michael Pearson - Valeant Pharmaceuticals International Inc - Chairman and CEO

In terms of direct distribution we do that in Serbia, not everywhere. By market, we decide if it makes sense to use distributors or to not use distributors. In Serbia, we were concerned about the financial health of the distribution, and we decided to do it ourselves. And that turns out to have been a good decision. I think our real advantage in Europe is 2-fold.

One is our products tend to be quite low-price products. Quite frankly, the market's moving toward our products and away from some of the higher-priced products. I think that helps, that in a sense we're going with the grain in terms of our product portfolio versus what the countries are trying to do.

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I think our decentralized model is hugely helpful to us. In most of the countries, there's negotiations that occur between the government and industry. And almost every country we are represented on those -- in the industry panels. The fact that we employ a lot of people and do manufacturing, we are viewed more like a local player rather than an international company. And therefore, we have significant influence in terms of how any regulations or pricing or anything else is affected in those countries. And again, most of the governments, while they want to reduce the prices and cost of drugs, they also are very worried about employment, and we are big employer in all of these countries. I think those are the 2 things that will allow us to outperform most other companies in these regions.

Annabel Samimy - *Stifel Nicolaus - Analyst*

You mentioned that there was some products in the future that face decline. Can you give us a little bit more detail on which products specifically and what kind of impact that would have that you would have to offset?

J. Michael Pearson - *Valeant Pharmaceuticals International Inc - Chairman and CEO*

In every country and every region there's some, but the only ones that really are of any great significance are in our Neurology and Other category. The biggest is obviously Wellbutrin, which continues to decline. That decline rate has slowed, but we expect it to continue to decline, so that will continue to hurt us. There's also a set of other legacy Biovail products that were partnered with other people that we have no impact on their sales and marketing, pricing, et cetera.

Our partners include companies like Teva and Forest and Lundbeck. And those products, again, we expect will continue to decline. The good news is each quarter they represent a smaller and smaller piece of the total, as we tried to show. So the overall impact in terms of overall growth rates goes down every quarter.

Annabel Samimy - *Stifel Nicolaus - Analyst*

Anything on the new derma assets that you have that might go away?

J. Michael Pearson - *Valeant Pharmaceuticals International Inc - Chairman and CEO*

Since we are in discussions with the FTC, I will prefer not to comment specifically on those acquisitions. Once we close them, we're happy to talk about them.

Operator

Chris Schott, JPMorgan.

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

Can you quantify the impact of wholesale or destocking in the third quarter? Was it as much as you expected based on your updates from last quarter?

J. Michael Pearson - *Valeant Pharmaceuticals International Inc - Chairman and CEO*

The total impact was expected -- it was in lines with expectations. Unfortunately, a piece of it happened in October, too. So probably \$10 million in third quarter, \$10 million in October. And we now think that's behind us. That's stabilized. In terms of

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third-quarter results, it was probably a little bit less than we expected. Fourth quarter, more than we expected. In total, what we expected.

Chris Schott - JPMorgan Chase & Co. - Analyst

Given than comment, can you run through some of the drivers of the earnings step-up that you're looking at when we go from 3Q to 4Q? And as we're thinking about 4Q, is that a reasonable way, as we start to look out in 2012 in terms what your business could look like?

J. Michael Pearson - Valeant Pharmaceuticals International Inc - Chairman and CEO

So the major improvements, first is fourth quarter, for almost every pharmaceutical company and certainly ours, is usually our best quarter. Usually, it's maybe 10% better, and third quarter's one of our weaker quarters. So, there's some of that. As you think about next year, you have to account for that. Some of it's just the fourth quarter is larger. Unfortunately, people get sicker winter than in the summer. And people go see doctors more. In the summer, they -- both doctors and people are on vacation. So there's a piece of that, I estimate around 10%.

I think we have a full quarter of Sanitas. We only had a month of Sanitas in the third quarter, so we have 2 more months of Sanitas in the fourth quarter. We've now also closed on Afexa, so those are incremental to our third quarter. But also our product growth. Our products are continue grow, so there's quarter-on-quarter growth in a lot of products.

And finally, we're going to begin to see some cost savings coming out of Europe, and as we are integrating those 3 acquisitions, we held off on a lot of the integration until we closed on Sanitas, because it didn't make sense to restructure Poland 2 times in 6 months. It just made sense to restructure it once. And then finally in Brazil, we are midway through our plant consolidation, and we'll start seeing some positive impact next quarter or this quarter on that. Those are some of the major drivers.

Chris Schott - JPMorgan Chase & Co. - Analyst

When we think about share repo or finishing the convert repurchase, how is that stacking up right now relative to business development with your stock at these levels? And can you comment on what type of capacity you feel you have right now to continue stock repurchase at this point?

J. Michael Pearson - Valeant Pharmaceuticals International Inc - Chairman and CEO

I didn't answer your last question. In terms of last year in total, I should comment on that. So, the fourth quarter's a little larger than average. But also remember next year we have 2 acquisitions that have not yet closed, and we'll have the launch of Potiga in the US, which will have to be built into next year.

In terms of stock repurchase versus acquisitions, the lower a stock price, the more attractive it becomes. We've been pretty aggressive in terms of -- to the extent we are able to buy back shares and also converts, which obviously has a huge impact on our diluted share count. The biggest governor on how much we can buy back is covenants in our long-term bonds and our RP basket. Each quarter, our RP basket increases, so that gives us some new capacity to go out and repurchase.

So there's lots of things we're thinking about. You can always renegotiate covenants. You can do different things. So depending what happens to our stock price. But the other thing that's happened is our price has gone down, as everyone's well aware, but so has the price of other assets. So, it's also a unique opportunity in terms of the cost of acquisitions is lower than it was 6 months ago as well. That also enters in. But I think you should expect us to continue to be active on both fronts.



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Operator

Tim Chiang, CRT Capital.

Tim Chiang - CRT Capital Group - Analyst

Could you comment a little bit about the cash tax-rate guidance? Do you expect it to change much heading into year end? Is it pretty much mid-single digits into next year as well?

J. Michael Pearson - Valeant Pharmaceuticals International Inc - Chairman and CEO

We probably were a little bit conservative this year. I think we said it was about 8%. It's probably closer to 5%, and we do not expect that to change at all.

Tim Chiang - CRT Capital Group - Analyst

In terms of margins, it seems like you're continuing to have very high sustainable margins. Where do you think these margins are going to go once you close these 2 additional dermatology assets?

J. Michael Pearson - Valeant Pharmaceuticals International Inc - Chairman and CEO

Again, I'd like to answer your questions -- this is everyone -- in terms of Dermik and Ortho but because we're in the middle of FTC discussions, I just can't answer any questions specifically on those business.

Operator

David Amsellem, Piper Jaffray.

David Amsellem - Piper Jaffray & Co. - Analyst

Can you talk more specifically about the key drivers in Canada? Any color on the potential for generic competition on Cesamet? And also provide an update on where you are with new launches on the fran side for the fourth quarter and for 2012?

J. Michael Pearson - Valeant Pharmaceuticals International Inc - Chairman and CEO

The drivers in Canada, I think there's 3. One is we just have a great team up there. And they continue to just grow our products across the board. The organic growth rate in Canada, I just give credit to our team, because we certainly are outpacing the market, consistently outpace it. And so they have quite a track record, and congratulations to them.

Second is we do have 5 launches of significance that we've talked about. Onsolis we launched in the summer. We have Sublinox that will be launching in November, which we think will be significant. It's a long acting Ambien, and there is no Ambien approved in Canada, so that could be a significant product.

We have a number of derm products that we'll be launching (technical difficulties), the Zuacta, and the product from Allergan, (technical difficulties). So we do have a number of product launches. We also obviously will be acquiring, as part of the Dermik acquisition, a very nice set of derm products. So that's what's going to drive the growth.

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In terms of Cesamet, we expect a generic will come on. In terms of the timing, that's always our expectation. As we've had no competition in 5 years, even though we don't have patent protection, we do hear rumors that one might be coming. Certainly in terms of our planning for next year, we will assume a generic is going to be on the market. If it doesn't come, that'll be an upside. Because of all of our product launches and acquisitions, I think we feel very comfortable with continued overall growth in Canada, even with the Cesamet introduction, which is a long way from where we stood 3 years ago.

David Amsellem - Piper Jaffray & Co. - Analyst

Regarding Latin America, can you provide more specifics on how many launches we'll see in the generic business in Brazil and Mexico through the end of this year and next year? And any comments on how the pricing environment in those 2 markets could shape up next year?

J. Michael Pearson - Valeant Pharmaceuticals International Inc - Chairman and CEO

In Mexico, I think we have somewhere between 10 and 15 launches next year, somewhere in that vicinity. We have a whole line of ophthalmology products that we are going to be launching there and a couple of other significant launches. In terms of the rest of this year, to tell you the truth, I don't know. We may have 1 launch or something.

In terms of pricing in Mexico, there tends to be a shift from higher-priced products to lower-priced products that we're seeing in all of the emerging markets, we're seeing in all markets, I guess. With our Tecnofarma acquisition, which has provided us a whole portfolio of lower-priced products, we're seeing huge (technical difficulties) business right now. So I think we're well-positioned. The mix might actually hurt us in terms of pricing, but less than a reduction of price per item.

In Brazil, we have less launches next year. ANVISA is completely backed up. We have a lot of launches pending, but we're assuming less launches, but we do have a couple what we believe could be significant launches in terms of the size of the products. But they're -- we're anticipating less launches, probably more like 4 or 5, in Brazil.

David Amsellem - Piper Jaffray & Co. - Analyst

Any changes in your appetite for acquisitions down in either Mexico or Brazil? And how active are you looking? And what should we be thinking about over the next 12 months in terms of business development in those markets?

J. Michael Pearson - Valeant Pharmaceuticals International Inc - Chairman and CEO

We continue to be quite bullish on Latin America, Brazil, and Mexico. Some of the countries we're not bullish on. We think those are the 2 countries that are really good ones. Colombia, we might do something (technical difficulties). That's actually turning out to be quite a good market. Peru, maybe, and Chile. Those would be probably the only 5 that we would consider.

But most of our activities are focused on Mexico and Brazil. Prices, markets have come down a lot, especially in Brazil, given what's happened to hyper markets. So we are actually quite active in both countries. And we're going to stay disciplined. We like to say about 2 times sales or less, but you shouldn't be surprised if we're active in those 2 areas.

Operator

Marc Goodman, UBS.

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Marc Goodman - UBS - Analyst

Can you talk about Poland? When we tried to back out the numbers, it seemed that Poland was particularly strong in the quarter. So can you talk about that first?

J. Michael Pearson - Valeant Pharmaceuticals International Inc - Chairman and CEO

Yes, Poland was strong, but they -- that's no change. They're always pretty strong.

Marc Goodman - UBS - Analyst

But it seemed like this quarter was much stronger than last quarter. Was last quarter unusually weak there?

J. Michael Pearson - Valeant Pharmaceuticals International Inc - Chairman and CEO

Last quarter was a little weaker. But again, it's -- a lot of it has to do with -- it has nothing to do with actually demand in terms of scrips and things like that. It has a lot to do with orders at the end of the quarter and into next quarter. And we don't manage that. These guys aren't incented on quarterly results.

I think the last quarter, people wanted lot of discounts, and we just said no, and we'd wait to the third quarter. It's those types of things. We try to stay disciplined, and maybe it's a criticism of me that maybe I should worry more about the quarter-by-quarter performance than we do, but I don't think that's good way to run the business. There's no fundamental shift. It probably has more to do with products were actually shifted and revenue was actually recognized.

Marc Goodman - UBS - Analyst

On the destocking, you gave us numbers, which is great. Is it more neuro? Is it derm? Is it about half and half as far as the \$10 million hit this quarter and the \$10 million you expect next month or in October?

J. Michael Pearson - Valeant Pharmaceuticals International Inc - Chairman and CEO

Yes, it's across the board. It's basically wholesalers. We were at about 1 month, and now we're down closer down to half a month, and it's across all products.

Marc Goodman - UBS - Analyst

And it was 1 particular wholesaler?

David Amsellem - Piper Jaffray & Co. - Analyst

No. It was across the board. We'll be a little bit more than -- I've been told. Yes, it is -- more than -- not quite that. 2 weeks of reduction, roughly. But it's across all of the wholesalers, but the 2 biggest ones, especially McKesson and Cardinal.

Marc Goodman - UBS - Analyst

Was it they that wanted to take it down, or was it you that wanted to take it down?

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J. Michael Pearson - *Valeant Pharmaceuticals International Inc - Chairman and CEO*

They wanted to take it down. They've been doing this across the industry. It's also part of our -- when we talked a while ago in terms of redoing the distributor contracts when we merged with Biovail, one of the ways we got lower rates, i.e., lower discounts, was agreeing to take down the inventory levels, which we knew would be a one-time hit, but again, it doesn't fundamentally affect the business.

The reason we'll stay a little higher than other companies is we tend to have smaller products. If you have a big product, obviously, you manage to more of a 2-week level. For some of the smaller products, it -- just because you don't want to ever stock up, they tend to be a little higher. Now, the fact that we're growing, also, what's 2 weeks? It kind of depends if you look backwards or look forward. They tend to look backwards, not forward. To the extent that we're growing products, if they continue to grow, that'll help us in the future.

Marc Goodman - *UBS - Analyst*

On gross margins, can you talk about first, obviously, the derm was very strong. Is this the new normal run rate, or can it get any better? And then talk about the Latin America and the Canada, Australia, which looks like it trended down the past quarters. Is that going to reverse in the fourth quarter? What's going on there?

J. Michael Pearson - *Valeant Pharmaceuticals International Inc - Chairman and CEO*

Dermatology, significant improvement. We might actually get a little bit better, but I'd say that's a pretty good run rate. Canada and Australia, there was some specific one-time impacts this quarter. I think it jumped 2% or something in terms of COGS. You would expect that to go back to normal. It was some expenses we had in our Steinbach facility, which were one-time in nature. So that's Canadian, Australia.

And Latin America, it's all Brazil. And we are in the midst of closing the Bunker facility and moving that all into the Delta facility. So we've had some redundant capacity, things like that. And it may last for another quarter, but probably not as much, and then you'll start seeing improvement there.

Operator

Gary Nachman, Susquehanna Financial.

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

The price versus volume chart was very helpful. On the US derm, though, I was a little surprised. You said no real pricing power, but we've seen some big price increases recently. You mentioned Elidel. We also saw Zovirax and Zeris recently. Are you not realizing those to the full extent? I always thought that was one of the benefits in the derm space. We see it with other companies as well. I was struck by the fact you've only seen about 1% pricing benefit in that business.

J. Michael Pearson - *Valeant Pharmaceuticals International Inc - Chairman and CEO*

Let me be specific. Elidel, we raised the price the day we launched it. So we didn't count that as a price increase because we launched at that price. We believe Novartis was underselling, and if you compared it to Protopic, was its main competitor. So we priced it in line with Protopic. How do you want to calculate it? Is that a price increase or not? We never increased the price other than that's what we launched it at when we got our hands on it. So that's that one.



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There's some been recent increases in Zovirax and Elidel. Those have happened in the fourth quarter, not the third quarter. So those wouldn't be in these numbers. But again you see our gross price increases. And we are a much more aggressive user of discounts than other companies. I think it's part of our secret sauce in terms how we compete. We do a lot of things with consumer in terms of pricing, with managed care in terms of pricing, that in a sense, make up for the fact we're a smaller company than some of these.

So you can say we're more generous. We like to share the economics and get everyone incented the right way. Our net price increases, compared to our gross, there's a big difference in our Company. It's part of how we do business, and I believe it gives us a bit of an advantage.

But the specific ones on Zovirax and Zeris that you just saw, those are fourth quarter. Those would be included, so that would have an impact next quarter in terms of our price volume. But we want to situate those 2 products correctly, because we want to be -- if you look at what we are doing and try to understand it, we're -- hopefully, it makes some sense.

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

SG&A came down more than we thought in the third quarter, even after adding a little Sanitas. How should we think about the ramp in 4Q? I'm assuming it'll go higher with a full quarter of Sanitas in there, but maybe there are more synergies in there that kick in more than we thought?

J. Michael Pearson - *Valeant Pharmaceuticals International Inc - Chairman and CEO*

We're not talking about the old Biovail-Valeant synergies any more. I think last number we gave, it was 310 or something like that. We're still continuing to get them. We're shutting down facilities in California and Toronto. So those continue to help. We'll continue to realize synergies from that. You'll begin to see synergies in SG&A. They're going to come through our European when we have those put together.

There'll be a little bit in Sanitas added, but it's not going to be huge. Quite frankly, we don't need a lot of their G&A. And there'll be a little bit for Afexa, but quite frankly, we don't need a ton of their G&A either. So, there'll be a little bit. And we try to run the business well. We're always re-evaluating where we're spending our money and whether it's -- we're getting a good return on that.

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

Should it be up sequentially up in 4Q, given all those factors? Doesn't sound like it.

J. Michael Pearson - *Valeant Pharmaceuticals International Inc - Chairman and CEO*

I don't want to give guidance on line items. You have our guidance in terms of our bottom line. And I don't want to give guidance on line items.

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

And lastly, a point of clarification on your European integration update. You said \$75 million plus in synergies identified. The slide says end of 2013. I think you said end of 2012, so I wanted to be clear. It sounds like it will be by the end of next year. Just wanted to confirm that.

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J. Michael Pearson - *Valeant Pharmaceuticals International Inc - Chairman and CEO*

Yes, it'll certainly be by the end of 2013, too. But it will be by the end of 2012, also.

Operator

As a reminder, please try to limit your questions to one per queue. David Risinger, Morgan Stanley.

David Risinger - *Morgan Stanley - Analyst*

With respect to the US profitability and that calculation, can you explain if that reflects the US corporate overhead applied to it and also the US debt applied to the US profits? How will future divestitures be calculated for purposes of your organic-growth calculation, please?

J. Michael Pearson - *Valeant Pharmaceuticals International Inc - Chairman and CEO*

Yes, divestitures, we should have mentioned that. I apologize. We take out divestitures. If we sell something, we just take them out. We take out the history, and we take out the future. In a sense, we do the -- consistent with acquisitions, right, where we add the history and add the future. That's how we treat it. We think that's the right way to do so.

In terms of the profitability in the US, we include the debt in the US, in that calculation. The overhead in the US is we have -- we're decentralized. The majority of what we have in the US does apply to the US, because we don't have like a US headquarters and a corporate headquarters. We actually don't have much of a headquarters. What we try to do is calculate what would be the fair amount to the US business.

Operator

Louise Chen, Collins Stewart.

Louise Chen - *Collins Stewart - Analyst*

More broadly speaking, could you outline your key objectives for the remainder of 2011? And also, as you look into 2012? And then on the deals that you're exploring currently, are they going to be building upon your current therapeutic areas and geographies, or could we see something new as we head into 2012?

J. Michael Pearson - *Valeant Pharmaceuticals International Inc - Chairman and CEO*

2012, we're not going to comment on this call, as I mentioned. In early January, we will give you our thoughts in 2012 in terms of our priorities, like we always do strategically, as well as our numbers. And 2011, we're going to try to make our numbers that we just talked to you about, and we'll continue to do what we always done. We may do another deal or 2. We'll see. I think that the preponderance of our deals will be in our current geographies and therapeutic areas, but -- as we continue to grow.

Sometimes when -- like when we bought Sanitas, we got into Russia. The biggest part of Sanitas was Polish. That was 65% of their sales were in Poland, but it came with a EUR20 million Russian business, which we think we can build on. It's going to be more like that. We may get into some adjacent geographies through deals. When we picked up PharmaSwiss, we also picked up a very small business in Israel and a very small business in Greece. Neither of those markets are particularly attractive, and some of them we'll pick up, but that doesn't mean we're going to be in them in the long term. It just means we picked them up, and we may get rid of those.

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Operator

Gregg Gilbert, Bank of America Merrill Lynch.

Gregg Gilbert - BofA Merrill Lynch - Analyst

Can you give us the revenue for PharmaSwiss and Sanitas in the quarter? What's your latest thinking on the CFO position and making it permanent? What are the risks to your tax structure, if any, in the shorter and longer term that you think about, given the importance of that asset and how low your rate is in the industry?

J. Michael Pearson - Valeant Pharmaceuticals International Inc - Chairman and CEO

Start with tax structure. We actually feel quite comfortable. The good news is we're building lots of redundancy. Barbados is the prime one for North America, but we have [Zuc] for Europe. We have Ireland that we're not using to any great degree, but we have it. We also have Luxembourg, and we're creating other. We feel actually quite comfortable, and that's why, in answer to the other question, we feel a little bit more comfortable with 5%ish in terms of our ongoing cash tax rate for the foreseeable future.

In terms of PharmaSwiss revenues, Sanitas, PharmaSwiss was roughly between \$55 million and \$60 million, would be right in there. I don't have a precise number. Sanitas was \$15 million, \$16 million, something like that for the quarter. Those are rough numbers within \$1 million or \$2 million, I'm sure. And the interim CFO question, I'm not going to address on this call.

Gregg Gilbert - BofA Merrill Lynch - Analyst

Can I sneak one more in on the royalties to Meda? They reported \$25 million from Valeant. Can you help us understand how the royalty obligations are determined and how you're booking those payments to Meda?

J. Michael Pearson - Valeant Pharmaceuticals International Inc - Chairman and CEO

Well, they are determined based on the contracts. So --

Gregg Gilbert - BofA Merrill Lynch - Analyst

Share any color about what's within that royalty rate or any other metrics? The number was bigger than we would have guessed, and obviously we guessed incorrectly.

J. Michael Pearson - Valeant Pharmaceuticals International Inc - Chairman and CEO

I don't know how Meda does their accounting. That's why I'm having difficulty with this question. I didn't hear their earnings call, what they include and what they don't include in their numbers. I do not want to say anything that has any negative impact on our partner, who is a great partner.

Gregg Gilbert - BofA Merrill Lynch - Analyst

Okay. We'll follow up off-line.

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J. Michael Pearson - *Valeant Pharmaceuticals International Inc - Chairman and CEO*

We've reported our financial results accurately, and I'm sure they have, too. Like I said, you'll just have to figure it out.

Operator

Corey Davis, Jefferies.

Corey Davis - *Jefferies & Company - Analyst*

Thanks for walking us through the EPS step-up from Q3 to Q4. It's still a fairly big range, \$0.15 in Q4. Now that the milestone payment won't hit until Q1, is there anything obvious I'm not thinking of that drives the bottom end of that range versus the top end?

J. Michael Pearson - *Valeant Pharmaceuticals International Inc - Chairman and CEO*

The way we're thinking about it is there's a fair amount of turmoil, as we're all aware of, in the world. Currency is all over the place and changes wildly day to day. And who knows what will happen in Europe and stuff like that. The bottom end number is a number that we feel hopefully very, very confident we'll make; the top-end number reflects what we hope to make. It is a bigger range, but it has a fair amount to do with more the world's uncertainty.

We had a very, very good quarter in terms of organic growth. Part of that, which I should mention, is we had an easier comparable, because if you recall in the second quarter I said we had a bad comparable. Part of that, if you look over that period of time, the last 6 months, that's for comparison.

We've had some outstanding growth this quarter, if that continues. But if it moderates a little bit, then that's going to have an impact. We hope it's sustainable. Some of the things that we have in place, and we have some interesting new ideas. Yes, it's broad. We didn't want to give you a number that we would miss; on the other hand, we don't want to just so over-deliver. You say, well, why didn't you give us -- so I'm probably not being very articulate, but maybe you get a sense of how we're thinking about it.

Corey Davis - *Jefferies & Company - Analyst*

It sounds like mostly from factors outside of your direct control. On Potiga, have you figured out the accounting on that yet and how the profit split in the US is going to work? You cited it as a growth driver for 2012, but most new drugs aren't profitable in their first year of launch. Forgetting about the royalties coming from Europe, but just the US, how are you going to account for what I presume will be operating losses for at least the initial stages of the launch?

J. Michael Pearson - *Valeant Pharmaceuticals International Inc - Chairman and CEO*

The way the agreement is written is that as soon as that product is launched -- right now, the investment in R&D -- continued investment in R&D and in sales and marketing in the US, we are paying our share, which is 50%. So that's imbedded in our P&L this quarter, last quarter, until it's launched. We expect it to be launched, it's planned to be launched next quarter. As soon as it's launched, we can never take a loss on the product. All the R&D costs and other things, even if the product's losing money, the way the contract's written, we will not get the big hit of launching a new drug in the early quarters, if it is a big hit.

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So when I said it was going to drive our growth, it's going to drive our top-line growth, because we believe that half of the sales of that product should belong to us because we get half the profits. Once it turns profitable, then we will start to collect profits on it. Since it's a specialized sell and we don't have big primary-care sales forces going against it. We have no overhead that counts towards it. It's only direct selling costs that go to the P&L.

We'd be hopeful that certainly it'll help the top line and then hopefully, we'll get some bottom line from it as well. It'll immediately have a positive impact, because the current expenses we're putting against it will stop. At minimum, that will help our bottom line, right? Even if it's not profitable at all for the first year, it will be a profit improvement for us versus this year.

Operator

Lennox Gibbs, TD Securities.

Lennox Gibbs - TD Newcrest/Waterhouse Securities - Analyst

Back to Central Europe quickly. Can you provide us with some perspective regarding the pricing reviews that are pending in Poland? As you think about your capital allocation strategy and M&A, how does the economic instability affect your ranking of Europe as target geography going forward?

J. Michael Pearson - Valeant Pharmaceuticals International Inc - Chairman and CEO

There's a lot of discussions in Poland in terms of pricing. We think the net impact in terms of economics for us next year will be basically neutral. There are some price reductions. There's some prices going in on growing products. There's also reductions in expenses because they're specifying what distributors get paid. So there's lots of puts and takes. But our net analysis of our team is -- we basically had a 0% price increase decrease in Poland this year, it was slightly positive and next year, we expect the same.

Excellent question in terms of how does the instability affect capital deployment. It does. Obviously, we'd like to see Europe settle down before we probably deploy a lot more capital in that region. And so that probably does influence us somewhat.

Operator

Michael Tong, Wells Fargo Securities.

Michael Tong - Wells Fargo Securities, LLC - Analyst

In terms of expenses, on the last quarter's call, you led us to believe that both SG&A and R&D are going to be up relative to the second quarter. What happened in the last 7 weeks of the third quarter that showed a pretty dramatic reversal? On your FX slide, seems like taking into currency fluctuations your revenue and your EPS would have declined by the same amount. I was wondering if you have any operational hedges in place that could blunt the impact of currency movements.

J. Michael Pearson - Valeant Pharmaceuticals International Inc - Chairman and CEO

I think what I said, and maybe I was not very articulate last quarter, is that we would have increases, some increases over second quarter of some of our R&D line item and sales and marketing, specifically Glaxo and Potiga. And that as we're ramping up for the launch, and the fact that we had actually some good results on our [MR] formulation, so that program's getting accelerating, that the expenses that we are getting charged by Glaxo --

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We have people. They have people. We do it together. We add it up, divide by 2, but the net payment goes from us to them, because they have more people, more expenses than we do working on these programs. That actually did increase in the third quarter. What we did is we figured out ways to offset that with managing our expenses more tightly in our areas of the business that we fully control. We like to make our commitments, so that's what we did.

In terms of currency, we are naturally hedged. In Europe, we do all of our manufacturing in Europe. We have all our sales force, and we even have, in a sense, our corporate functions are in Europe for Europe. Our decentralized model helps a lot in terms of currency fluctuations. The only costs that come outside of the regions are API, which sometimes has to be -- depends where you're sourcing your API. Similarly, Latin America.

If it's US, the US manufacturer, or a Japanese manufacturer, the API's the only one. We do not participate in hedging activities, our treasury department. We just -- it's a lot of work; it would require a lot of people. It would cost a lot of money, and we don't think it's -- maybe we should. But we don't hedge in terms of taking bets on currencies and try and do that. Maybe we should, but we don't.

Operator

Alan Ridgeway, Paradigm Capital.

Alan Ridgeway - Paradigm Capital - Analyst

Could you comment on how you think about using the repurchase program when buying back shares next year versus retiring some of the term loan? And how you come to those conclusions?

J. Michael Pearson - Valeant Pharmaceuticals International Inc - Chairman and CEO

In terms of our shares, we -- just like many of you have models in terms of what we're worth, we have our own model. And so we have a pretty good view of what we think we're worth. We can calculate a return on investment on buying our stock versus making an acquisition, et cetera. These days, we think it's an awfully good investment, so that influences us. But we also want to reduce our debt.

The term loan, I don't want to talk about Dermik and Ortho in any detail, but they will both substantially increase our cash flow, and our cash flow's actually improving. So we'll have a lot of cash. So we'd like to, in a sense -- our intent to reduce that term loan next year. We have a commitment to reduce it by a certain amount, but my guess is we'll reduce it significantly -- we'll reduce our debt significantly next year, because we always want to be in the process of de-levering, which then puts us in a position to make more acquisitions.

So how we deploy our capital is a really important thing that I spend a lot of time thinking about, our Board spends a lot of time thinking about, but we don't have a specific formula per se. Hopefully, we're thoughtful and we're opportunistic, and that's what we'll try to continue to be.

Operator

David Steinberg, Deutsche Bank.

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David Steinberg - Deutsche Bank - Analyst

I know you don't comment much on the more innovative compounds in your R&D pipeline, but you seemingly have a couple in late stage in the dermatology area for both onychomycosis and acne. Could you comment on are those programs on track? When will some of the key data read out? And any thoughts on what peak sales may be?

J. Michael Pearson - Valeant Pharmaceuticals International Inc - Chairman and CEO

Both programs -- our 108 onychomycosis topical program, the study's basically done. We'll get the data and we'll analyze it, and early next year we'll see the results. Our Phase 2, whatever it is for the oral acne product, it's in the same time frame. Early in the first quarter, we will know that -- if we have something. We hope we do. We aren't building in anything for them because we don't bet on R&D. We bet on management. If they work, they'll be substantial, right?

Penlac was what, a \$300 million product at peak sales, which was an oral -- I mean a topical onychomycosis product, and it didn't have great efficacy. It was 6% to 8%. Our efficacy was way, way, way higher than that in terms of Phase 2. It could be a significant product. Oral acne, SOLODYN, what's that? \$600 million to \$700 million? Just in the US? But we don't put high probabilities on them, and if they happen, we'll all enjoy the upside.

Operator

Thank you, sir. There are no further questions at this time. I hand the call back over to you.

J. Michael Pearson - Valeant Pharmaceuticals International Inc - Chairman and CEO

All right. Thanks everyone, and we'll see you next quarter.

Operator

This concludes today's conference call. You may now disconnect.

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