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H1 2023 Krka Business Performance Results Webcast

CORPORATE PARTICIPANTS

PANELIST:

David Bratož, *Member of the Management Board, Krka d. d.*

Brane Kastelec, *Finance Director, Krka d. d.*

HOST:

Gregor Gavranič, *Associate, Krka d. d.*

BUSINESS PERFORMANCE PRESENTATION:

Gregor Gavranič

Dear ladies and gentlemen, welcome to today's webcast on first half of the year results of the Krka Group. My name is Gregor Gavranič and I am hosting today this event, together with Mr. David Bratož, Member of the Management Board, and Mr. Brane Kastelec, Finance Director. Krka has released first half of the year results this morning and reaffirmed guidance for this year. Detailed interpretation of our performance and highlights for the first half of the year will be provided by Mr. Bratož and Mr. Kastelec. Both will be available during the Q&A session that will follow. We invite you to address your questions live. May I remind you that this webcast is intended for professional audience only, not media representatives and is being recorded. Mr. Bratož, the word is yours.

David Bratož

Good afternoon, ladies and gentlemen, it is my great pleasure to welcome you at today's webcast. I am David Bratož, member of the Management Board, and today I'd like to share with you the business results for the first half of the year. The Krka group operating results for the first half of the year are good. Sales increased in all 6 regions, and in most of our key markets, and also for all product and service groups. We generated revenue of 920 million euro up 7% on first half 2022. At the same time, we maintained high profitability of operations. The reported half-year operating profit is the highest to-date.

We achieved EBIT of 236 million euros, which is up 9% on adjusted EBIT for the first half of 2022. The rubble volatility affected the net financial result. Net profit of 170 million euros has exceeded one half of the planned 2023 full year net profit. However, it is down 28% compared to that of the same period last year, when we recorded substantial foreign exchange gains.

The gap between this year and last year's net financial result, which is quite large for the first half, is expected to narrow by the end of the year. I can say that results for the 6 months to June are encouraging. We assume that 2023 targets are realistic, and that we will reach the planned 1,755 million euros in sales and the net profit of around 300 million euro.

Krka is providing access to safe, effective, high quality and affordable medicines to patients on 70 plus markets worldwide. We are striving to reach highest standards of sustainability. We produce 17 billion finished dosage forms annually, and more than 55 million patients use our medicines on a daily basis. In the first half of 2023, we produced and sold almost 9 billion packages or 4% more than in the first half of last year. We operate in many low to middle-income countries, therefore we create substantial savings for patients and healthcare systems in such a way.

On this slide number four you can see our performance from 2005 to 2022. The green bars represent sales and the blue line represents the quantity sold per year. We can see that our sales and volumes have roughly tripled from 2005 to 2022. The average growth rate for both sales in euros and quantity sold is about 7%, even slightly higher. The average growth rate of net profit is 10% per year, which is also a very good result. The constantly increasing production output is also reflected in the growth of turnover and profitability. In summary, we can say that volume growth is very important for Krka. Furthermore, we have also outperformed the market growth during this period.

We increased sales in all 6 regions and in majority of individual markets. The increase was 7% or 63 million euro more compared to the first half of last year. Region East Europe recorded the highest sales representing almost one-third of Krka sales. Sales in the largest individual market for Krka the Russian Federation reached 180 million euro. This is up 4%. We recorded sales increases in all other markets of Eastern Europe and Central Asia, except in Ukraine, where we sold 39 million euros, down 16% on the same period last year.

Our activities in the Russian Federation have been running rather undisturbed. Our local production site located in Russia, in Istra, Moscow covers 76% of Russian sales, and we have the status of a domestic producer. We do not manufacture any products in the Russian Federation for sales in any other country outside of Russia. Krka is present there for more than 50 years, and 10 million patients use our medicines on a daily basis.

The Krka brand is very well known for its quality, safety and efficacy among physicians, doctors, and inhabitants. We are holding the second position among foreign generic producers and first in pharmacy segment and the leading position in Cardiovascular segment.

In Ukraine, where many people left the country and the distributors reduced their inventories, caused the pharmaceutical market to shrink to certain extent. Nevertheless, according to the most recent secondary sales data Krka has remained the second ranked foreign provider of generics in the pharmacy segment. The sales dynamics in the second quarter already improved, and it is also expected to pick up considerably in the second half of the year. On both markets everything is running smoothly, and we also can add that in the past sanctions have never been imposed on medicines, so we can assume that our products will not be placed on any trade restriction list in the future.

The second biggest region in terms of sales is region Central Europe representing 23% of total Krka sales and up 9% in the first half. Poland, with 93 million sales and 5% growth, remained the leading regional market and the second biggest individual market for Krka. Here we also have production located in Warsaw. We ranked third among foreign providers of generic medicines in the country. Sales increased in all other regional markets, such as Czech Republic, Hungary and others.

Our third-largest region West Europe recorded sales in amount of 181 million euro, representing one-fifth of total Krka group sales and generated an 8% rise. In Germany, which is the largest market in the region and the third biggest market for Krka, we recorded growth. In the second half of the previous year, we had successfully launched the gliptide products for treating diabetes. According to the most recent available data, Krka has managed to become the leading generic supplier on the market in this therapeutic group. We achieved sales growth in most other regional markets, among them the highest in Portugal, Ireland, and Finland.

Sales in the region Southeast Europe, plus region Slovenia represent together one-fifth of the sales and is actually comparable to the West Europe sales. Key markets are Romania, Croatia, and Serbia, the countries that contributed the most to the sales in this region, and all of them with quite a nice growth.

Krka holds a 7.4% share of the Slovenian pharmaceutical market in terms of sales value, and we are the country-leading supplier of pharmaceuticals. Volume wise, we have a market share of around 20%. Region overseas markets generated the highest relative increase among all regions, 16% increase. We recorded an impressive increase of sales in Far East and South Africa especially. I would like to underline the sales growth in Vietnam. In China we sold a bit less and this is mainly due to the dynamics of sales and in the second half of this year the sales in China are expected to exceed those of the first six months this year, with full year sales growing over 2022.

As far as the structure of sales is concerned, prescription pharmaceuticals remain by far the most important group of products for Krka as they generate 82% of the total Krka sales. We keep saying that this is our core business. If we do a good business here, then we have good results for Krka as well. In first half of this year's sale of Rx increased by 6%. We gained additional 45 million euros in sales.

Also, sales of non-prescription pharmaceuticals representing 9% of total sales increased by 6% as well. However, already on an elevated or relatively high base, because last year growth index of OTC was around 30%.

Sales of animal health products representing a good 6% of Krka sales, increased sharply by 23%. We gained additional 11 million euro in sales. Already 70% of animal health sales are for companion animals or for pets.

We have diversified product portfolio. Cardiovascular products represent more than a half, second biggest group are medicines for central nervous system, followed by gastro and pain relief, which represents more than 6% of our sales. We are also focused on antidiabetics, anti-coagulants, and on oncology products.

As far as R&D is concerned, I would like to underline that currently, we are working on 170 products in our pipeline, and our goal is, of course, to be among the first on the market after the patent expiration. This important objective of timely launches will enable Krka to increase market shares in the future as well. We invest up to 10% of sales for R&D year after year, and have more than 800 experts engaged in R&D. During the first half we added 5 new products to our portfolio. We also enlarged the product range in China. In addition, we obtained 263 MA's in the EU countries for products from established product range, and also the new one.

We are innovative branded generic producer with own R&D. Krka was the first generic company to introduce many single pill combinations. These are tablets containing two or three active ingredients in one single pill, and currently, we have more than 100 single pill combinations in our portfolio. We are number one among generics regarding our broad product range of SPC products. This is our competitive advantage.

Our medicines are available in many unconventional dosage forms. We are offering advanced pharmaceutical formulations that offer us an opportunity of differentiation from other originators and generics. By adding different single-pill combinations, we are tackling pricing pressures and other challenges, which are also important for the life cycle of our product. In this way, we give doctors and patients access to high-quality, innovative medicines, which firstly make it easier to

take and secondly enables better adherence to treatment. Therefore, this solution is much welcomed and accepted by patients.

We invested predominantly to increase and technologically upgrade production facilities and capacities for research and development and quality control. Planned Capex for this year is 130 million euros, we allocated less than half, 46 million euros, in the first half of 2023. Let us mention one important project, new facility for development and production of APIs in Slovenia. The 163 million investment is in line with our strategy of vertical integration. The plant output will be bigger than all our own existing API output. I would like to emphasize that regular investments are crucial for sustainable long-term growth of Krka.

We maintain our high profitability. For the first half of this year revenues went up by 7%. COGS decreased by 11%. R&D expenses increased by 6% while marketing, and sales costs remained almost flat. We achieved 236 million euros of operating profit, the highest to-date. In the first half of 2022 margins were strongly impacted by the significant appreciation of rouble, which, together with the increase of inventories and raw materials, bulk and products in the Russian Federation, affected the unrealized profits in inventories, and resulted in somehow lower gross profitability at that time. This effect was significantly reduced during the first half of 2023, where we saw robust sales which, together with the recent depreciation of rouble, led to a reduction of previously mentioned inventories, and translated into better EBITDA and EBIT margin, compared to the first half of 2022.

Due to rouble volatility, we generated net financial result of minus 29 million euros, and realized 170 million of net profit, which is more than a half of the planned full-year net profit. The effective tax rate is currently at 17.8% and is expected to gradually decline towards the long-term level which is around 15%. The reason for the current high level, is the strong net profitability in 2022 which forms the basis for the advanced income tax payments in 2023.

Regarding the changes in our balance sheet, I would like to point out the recent changes in cash and short-term investments. The only reason for this is that we have invested a significant portion of our funds in different Treasury bills from exclusively European sovereign issuers with the highest credit ratings. As the money market environment has changed, there are now many investment opportunities that offer an attractive yield, while at the same time maintaining high liquidity, low duration risk, and most importantly, low credit risk. Minor fluctuations in some other balance sheet figures and working capital are just part of normal business. Receivables increased by 8% due to rising sales. However, 95% of trade receivables have insurance coverage from a credit insurance company.

As we have already mentioned, exchange rates, especially euro rouble, have had a strong impact on Krka's financial results in recent quarters. After a significant appreciation in the first half of the previous year, rouble continued the downtrend from the second half of 2022 also during this year, falling 19.6% against euro in the first half of 2023. All resulted in the net financial result in the first half 2023 that was around 167 million euro lower than in the same period last year, when we

recorded plus 138 million euro in net financial result. We can expect that the difference will gradually narrow in the course of this year.

All margins are high, and this is primarily a result of sales growth, improved product mix, as well as cost control and productivity increase. Also economies of scales and diminishing effect of just mentioned unrealized profits in inventory from last year, which have reversed with depreciating rouble, had a positive effect on margins. EBITDA margin for first half is 31.4%, and this is above our five-year average at 28.5%, which is good for the generic industry. Right now, we have strategic goal of maintaining EBITDA margin above 25%.

Margins are expected to decrease gradually, due to obvious reasons, including inflationary pressures, rise of salaries, energy costs, etc. Nevertheless, we believe that we shall keep it well above strategic threshold also in the next quarters.

Slide number 14 shows the persistent and healthy growth of sales and EBITDA for the last 5 years. The compound average growth rate of sales for the last 5 years was almost 6%. And the average growth of EBITDA was around 10% annually for the past 5 years. We believe these are good figures, and we can summarize that revenue and profitability growth resulted also in significant earnings per share growth over the past 5 years.

We remain committed to our long-term and stable dividend policy, allocating every year at least 50% of profit for dividends. This resulted in the compound average dividend growth of over 15% annually in the last 10 years. We also started today the new share buyback programme for another 3 years. We are currently holding 5.6% of treasury shares.

We are listed on two Stock exchanges, on the Ljubljana and Warsaw Stock exchange, and we have around 47,000 shareholders. Our shareholder structure is rather stable. The biggest group of shareholders are individuals, Slovenian retail investors, holding almost 41 per cent stake, followed by the State, which owns 27% of the shares. On the third place, there are international investors, holding approximately 21 percent of shares. Current market cap is roughly 3.8 billion euro.

Regarding sustainability, we are presenting our 6 material ESG-topic groups which are essential for long-term operating success of the Krka group. These are product quality and patient safety, as the most important one, talent attraction & retention, good leadership & governance practices, accessible healthcare, which was already mentioned at the very beginning, planet & climate change and compliance, integrity & transparency with the engagement of different stakeholder groups. The ESG Policy of the Krka Group is a strategic document on sustainable governance. It is published on the Krka's website. As we speak, we are working on obtaining an ESG rating, from one of the esteemed international rating agencies.

On the slide number 18, you can see selected ESG metrics and KPIs. We were successful in reducing the paper use by 9 tonnes by optimising the patient information leaflet design. We also reduced our carbon footprint. As far as the social component is concerned, we are proud that 51% of management positions in the Krka Group are held by women and 60% of all employees are women. Also, we pay attention that 45 hours of average training per employee is always done within the year.

Coming to the last slide. I can say that we believe that our guidance for 2023 is realistic, especially on the back of strong current results and challenges we are all facing in current business environment. I mean inflation and supply chain challenges, looming recession and increased interest rates. We also see many opportunities on the market. We are on track to deliver strategic profitability in terms of EBITDA margin. This year revenue should reach 1,755 million euros, on the back of volume growth, new launches, and entering new markets. At the bottom line we expect net income of around 300 million euros. Of course, we cannot expect so favourable year in terms of foreign exchange movements as it was last year. Nevertheless, the 300-million-euro net income represents a decent five-year average growth rate as well.

Capital expenditure for this year is higher, especially as some significant investments will start in the second half of the year. The vertically integrated business model, which can also be seen on the right-hand side of this slide, will remain our key competitive advantage as we control the entire product life cycle. Thanks to this model, we can be flexible also in the future. Our lead times are very short, much shorter in comparison to some of our competitors, which can help us also in case of some shortages in the markets. It also enables us to adapt to special market circumstances very rapidly.

Dear ladies and gentlemen, we have reached the end of the first part of today's presentation. I hope you have gained a good insight into our first half results and current developments and operations. Let us now start the Q&A session. Thank you for your attention.

Q&A SESSION:

Gregor Gavranič

Thank you Mr. Bratož. We are now starting with the Q&A session. You are most welcome to address your questions live by raising your virtual hand, and you will be given a word.

Gregor Gavranič (Question from the chat by Dawid Gorzynski)

Congrats on solid results. Could you please explain why do you expect the gap between this and last year net financial results to close by the end of 2023, meaning euro 81 million gains in second half of 2023 despite further depreciation of rouble rate?

David Bratož

Thank you for the question, here we have again the slide where we show the fluctuation of the rouble rate. We can see that in the first half of 2022, our FX gains were really high and recorded significant positive net financial result due to strong appreciation of rouble. Starting already during the third quarter, but much more during the fourth quarter of the last year, rouble has started to depreciate, and this trend is still going on during the whole first half of this year. So, if the trend will be somehow similar also in the future, we can hardly expect such high difference between last year net financial result. As you can see further on the net financial results for the whole year 2022 was much lower than only for the first half 2022. It was on the level of plus 52 million euros. At the end of this year, we'll have to compare the net financial results of 2023 with 52 million, instead of 137 million, which was the result for the first half of 2022.

Brane Kastelec

Perhaps there was a misunderstanding in the interpretation of what we said. We are not saying that we will have the same net financial result this year as last year. We are only saying that the difference between this year's net financial result and last year's net financial result will be less at the annual level than in the first half of this year.

Gregor Gavranič (Question from the chat by Stephan Howaldt)

What is your current assessment of the risk of expropriation of Krka's assets in Russia?

David Bratož

As I have already tried to explain, we believe that Krka's business in Russia is quite stable, with a local presence for more than 50 years, with the status of a local producer. Based on this fact and our experience, we do not see any major risks in this matter. We believe that we can continue our business and presence in Russia as a very reliable producer of medicines that the Russian population needs.

Gregor Gavranič (Question from the chat by Stephan Howaldt)

Please elaborate any changes in your ability to repatriate cash from Russia. How high is your cash balance held in Rouble and in all currencies held in Russia?

Brane Kastelec

The situation regarding currency exchange and money transfer from and to Russia has not changed since our last webcast. We have no difficulties with either currency exchange or money transfers, and we maintain the minimum amount required for normal operations in the Russian Federation.

We are talking about a few million euros at most in different currencies. We have production facilities there, we employ about 2,000 people, we have marketing and sales activities in Russia, so we need some cash.

Gregor Gavranič (Question from the chat by Stephan Howaldt)

What is the amount of factoring used? And how has this changed in the last 2 years?

David Bratož

Actually, we do not disclose the precise figure of factoring. Thanks to the factoring we decreased our exposure in roubles quite significantly. Furthermore, this also helped us to decrease our credit risk as we are talking about non-recourse factoring.

Brane Kastelec

I would like to add that we have not used factoring before. We cannot compare today's factoring amount with that of two years ago, because we only started factoring in August last year and then built it up to today's amount.

Gregor Gavranič (Question from the chat by Stephan Howaldt)

The next question is, please elaborate on the deterioration in networking capital in particular, why both trade receivables and trade payables are moving against Krka. Is this development likely to reverse during second quarter of this year?

David Bratož

I was trying to explain during general presentation, that the receivables are growing by 8% due to the growing sales. We are happy with that, and we do not see any problems. In addition, 95% of receivables are insured.

Brane Kastelec

As far as trade payables are concerned, we do not see any extraordinary movement. Trade payables are stable, despite the growing sales. We try to take advantage of our strong financial position and from time to time shorten the payment terms with some of our suppliers to get additional discounts or to convince our suppliers not to increase prices. We always use the liquidity we have in our favour. That is business as usual.

Gregor Gavranič (Question from the chat by Bram Buring)

Can you please update us on the pipeline of new products registration in China?

David Bratož

In China, we are adding new products. On slide number 7 you can see some of them, for example Perindopril. Then we also successfully registered rivaroxaban and gliclazide in China in first half of the year. Those are antithrombotic and antidiabetics, which are important products. So far, we have around 10 products in our portfolio in China and we are adding some more. We believe that, according to our targets, this year we will have another good year. Last year, as you remember, we reached 13 million euros in sales. In this year we plan to go above the figure of 2022. The main reason is that we are enlarging our portfolio with new products. Some of them are listed on this slide number 7, regarding to cardiovascular diseases and diabetes predominantly.

Gregor Gavranič (Question from the chat by Bram Buring)

You mentioned some new opportunities. Can you please elaborate on which markets and which drug indications?

David Bratož

I mentioned some opportunities on different markets. One of them are shortages of products for instance. I cannot disclose on which markets but as I said, this will be utilized now during the next months. The opportunity is based on the deficiency on some of the markets, which are very well known, and here we step in, with some of the bulk that we have on stock, with very short lead times. Besides that, we are very active with the newly launched products. You already know that at the end of the last year, and on some markets in the beginning of this year, we successfully launched gliptins, the new group for diabetes treatment. On some of the key markets we are the leaders. We have some important products from this group in our development pipeline, some of them are just before the final stage of the registration procedure.

Dawid Górczyński

I want to also ask about the gross margin. Could you give us some more cover on the impact of the FX changes on the gross margin in the second quarter 2023, and if this current level, around 57% gross margin, is a good run rate for the coming quarters. Second question is about share buy-back. Do you consider buy-backs as more attractive opportunity to distribute cash to shareholders as compared to dividend at the current stock price, or this is the same attitude as in the previous years?

David Bratož

With regard to your first question, we have to know that the average exchange rate of rouble was actually much more stable in comparison to the starting and closing exchange rate. It was on the level of around +1.5%. And this is something (beside increasing sales and good product mix) that affects our gross margin the most if we talk about the influence of the foreign currencies that have a significant impact on our gross margin. Based on all of this, we were quite successful, because you can see that our gross profit went up by 25% year-over-year. We have to add that we have to know the situation a year before, what I was also previously trying to explain that actually at the end of the first and especially second quarter last year there was significant increase of inventories of the bulk, raw materials, and finished goods in our Russian subsidiaries. That was at the time when the exchange rate of rouble was extremely strong. For instance, I remember that it was on the level of 53 or 56 RUB for 1 EUR. So, based on this the gross profit at that time was impacted by unrealized profit in inventories, that translated to lower gross profit. Now we can say that gross profit margins are already comparable, and the inventories level from the last year actually decreased. Now we can say that the quarterly and the half-year results are, and can be, fully comparable with the previous periods. Gross margin is good, even if you compare it with this so-called adjusted EBIT or gross profit at that time. In comparison with adjusted EBIT due to the unrealized profits in inventories within intra group level we have a growth of 9%, which is even higher than the growth of revenues.

Brane Kastelec

The second question was about how we return money that we do not need at the moment to our shareholders. We talk with our shareholders and some of them prefer dividends, others prefer a share buyback programme for tax reasons in their countries. We have quite a generous dividend

policy with a pay-out ratio of over 50% and a dividend yield of around 6%. We believe that this extra money should be returned to shareholders through a share buyback programme. There are no new reasons for buying own shares. It is a continuation of the policy from previous years.

Gregor Gavranič (Question from the chat by Lojze Kozole)

We have time for one more question. Congratulations on the impressive operating results. What is the expected level of sales in China in this and the following years? And secondly, are there any developments in the M&A area?

David Bratož

Let me start with the last question. I can say that we are constantly working on different kind of long-term corporations, such as joint ventures, long-term partnerships or potential M&A projects. Of course, all of these projects are strictly confidential, we are not allowed to disclose at what stage we are. When there will be something in the very advanced stage of the process, then we will inform everyone at the same time. With regards to your first question, we have plans to increase sales in China this year. Unfortunately, we cannot disclose the exact figures market by market, so I cannot be very precise with the numbers. We are seeing promising development there.

Gregor Gavranič

We have reached the end of this today's webcast. Thank you again for your participation. In case of any further questions, do not hesitate to reach out to our investor relations team. The transcript of today's webcast will be available on our website in the following days. Thank you for listening. Have a nice rest of the day, and goodbye.

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