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Krka Group H1 2024 Business Performance Results Webcast

CORPORATE PARTICIPANTS

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HOST:

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BUSINESS PERFORMANCE PRESENTATION:

Uroš Ožbolt

Dear ladies and gentlemen, welcome to today's webcast on first half 2024 business performance of the Krka Group. My name is Uroš Ožbolt and I am hosting this event today, together with Mr. David Bratož, Member of the Management Board, and Mr. Brane Kastelec, Finance Director. Krka once again delivered robust top line growth and operating profitability. Detailed interpretation of our performance and highlights 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's my great pleasure to welcome you at today's webcast. I'm David Bratož, member of the Management Board, and today I'd like to present unaundited consolidated financial statements of the Krka Group for the first six months of 2024.

This year, we are very proud because we are celebrating our 70 anniversaries. Krka was founded back in 1954 from a small pharmacy with only 9 employees at that time. Today we are one of the world's leading manufacturers of generic medicines with almost 13,000 employees. We rely on our vertically integrated business model which provides us resilience and flexibility.

Krka has well diversified activities. We offer our high quality, affordable medicines in over 70 markets worldwide. More than 100 million people use our medicines on daily level in different therapeutic groups. Last year we manufactured and distributed 17.5 billion finished dosage forms, mostly tablets and tables. This year we plan increase of 1 billion. We operate in many low to middle income countries, generating significant savings for patients and healthcare systems. In this way we maximize our social responsibility by providing access to medicines, which is also an important part of our sustainable approach.

Let me start with the most important highlights related to first half of the year. We increased sales in all 6 regions, and most of our key markets. We achieved 7% sales growth and record sales and operating profit since Krka was founded. Net profit was 30% higher than in the same period last year. Margins remained high. We achieved a strong EBITDA margin of 28.8%, which is well above the strategic guidance. We obtained 11 new products marketing authorizations, and completed almost 600 marketing approvals in various markets. The results for the 6 months are encouraging, and we believe that we will meet our plans for 2024

Sales increased in all 6 regions and in most individual markets on the left hand of the slide you can see a pie chart, which, with sales by regions, and on the right the 5 largest and most important markets. The East Europe region recorded the highest sales, accounting for 34% of Krka sales and growing by 11%. Sales in the largest individual market for Krka, in Russian Federation, reached 195 million euro, an increase of 9% compared to 1st half of 2023. Sales in local currency rubles increased significantly by 33% with volume growth of 11%. The difference between the euro and ruble sales index is due to depreciation of the ruble. The average value of the ruble expressed in euros fell by 15% in the 1st half of the year compared to the same period of previous year. In Russian Federation we saw good growth in sales of cardio medicines, especially combinations. We launched combination of telmisartan and indapamide and also some others products. Products launched in the last 12 months contributed significantly to the good sales.

Competition is strong, especially from domestic manufacturers, but Krka is growing faster than the market in terms of both value and volume. We hold the second position among foreign generics, first in the pharmacy segment, and leading producer in cardio segment.

In Russia we have a production site that covers almost 80% of Russian sales, and we do not manufacture products in the Russian Federation for sale in any other country outside of Russia.

Also, collections of receivables runs smoothly transfers of Euros from Russia are without any problems. There is a demand for our products. We have increased our sales in local currency and in euros, and therefore also our expectations for the future remain unchanged.

Our goal is to continue to outperform the average sales growth in this important market. Growth was also recorded in most other markets, the highest in Ukraine and Uzbekistan. I'm still talking about East Europe region. In Ukraine we have recorded solid sales growth and the situation continues to have an impact on the unpredictability of the pharmaceutical market, where, according to the latest available data, we rank second among foreign suppliers of generics.

We are recording above market sales growth. The second largest region in terms of sales is the Central Europe region. Sales generated in Central Europe, account for 23% of Krka total sales, an increase of 7% compared to 1st half of the previous year, Poland remained the leading regional market, and the second largest single market for Krka, with an impressive growth of 17%. We ranked 3rd among foreign suppliers of generics in this country, and sales also increased in Hungary, Latvia, and Lithuania.

Our 3rd region West Europe, accounts for almost 19% of the Krka Group's total sales. In Germany, Krka’s largest market in this region, and the 4th largest at single market for Krka sales fell by 7% compared to the previous year. However, it should not be forgotten that we increased our sales in Germany by 20% last year. The base effect is in fact much higher than the year before. The situation on the market is highly competitive. Competitors are pursuing a very aggressive pricing policy. Prices fall particularly sharply when new products are launched on the market. Nevertheless, according to the latest available independent data, we are one of the leading generic suppliers of gliptin for the treatment of diabetes. We have achieved sales growth in most other regional markets. The highest in the Scandinavian countries and the United Kingdom.

Sales in the Southeast Europe, plus region Slovenia together account again for approximately 20% of Krka's total sales, which is comparable to the West European share. Romania, Slovenia, Croatia, and Serbia contribute the most to the turnover of these 2 regions.

Krka has a 7.5% share of the Slovenia market by value, and we are the leading supplier on the domestic market. One of 5 pharmaceuticals sold in Slovenia was manufactured and offered by Krka.

The overseas markets region is the smallest one and achieved growth of 5%. In China our growth was 18%, but in the Middle Eastern markets we recorded a slight decline in sales due to tensions that affected business activities in certain markets. Nevertheless, we recorded growth in 3 out of 4 sales offices in this region.

In terms of sales structure, prescription drugs remain the most important product groups because they account for 84% of total sales. This is our core business, and we have increased sales of prescription pharmaceuticals by almost 70 million euro or by 9%.

Sales of non-prescription pharmaceuticals, which accounts for 7.5%of Krka's total sales fell by 10% simply due to the absence of influenza virus in our most important markets, especially in East European markets. Sales of veterinary medicines, which account for 6% of Krka's sales increased by 4%. And it's important to note that more than 60% of animal health segments are for companion animals.

We can say that we have a diversified product portfolio. Cardio products represent more than half of our Rx portfolio. The second largest group are CMS products followed by gastro products and pain medicines, pain killers. We are also focused on anti-diabetes, which I mentioned before, anticoagulants and oncology products as well.

On the slide number seven, you can see our leading prescription pharmaceuticals in sales terms. We are the leading generic producer of sartans, statins, and ACE inhibitors on many markets. These therapeutic groups are important ones because there are a lot of people who are not yet treated on many Krka's markets. Our sartans are available in 60 markets across the world. We are the only pharmaceutical supplier in Europe that offers a sartan combination with a statin in single tablet. Here we are showing you also diabetes products, where we are becoming the leading generic producer of gliptins. Despite having decent market shares in all these therapeutic groups, in some cases market shares can be up to approximately 30 to 40%, we still see many possibilities for further growth in these therapeutic areas. Sales were drive in particular by product groups containing perindopril, rosuvastatin, valsartan and sitagliptine, first launched in 2022 and dabigatrane, first launched in 2023.

As far as research and development is concerned, we are currently working on 170 new products in our pipeline. Our goal is to be among the first generic suppliers on the market when the patent expires because this is the most important for us, as a generic company. We invest up to 10% of our revenues in R&D activities and more than 800 internal experts are involved in research and development activities. In the first half of 2024, we added 11 new products to our portfolio, and here I would highlight one new single pill combination. In addition, I would like to mention also that we added new products for Chinese market. In addition to these 11 new products, we also received almost 600 new approvals for products in established and new therapeutic classes that are important for future growth.

We are innovative branded generics producer with own research and development. We are proud that Krka was the first generic to introduce many single pill combinations. Today we have more than 150 single pill combinations in our portfolio, and we are number one generic in terms of number of single pill combinations. We believe that this is our strength and our competitive advantage. We are prolonging lifecycle of our existing brands. In this way we offer doctors, and above all patients access to high quality medicines by combining 2 or even 3 APIs in a single tablet, simplifying the administration of prescribed medicines and achieving better adherence to treatment, which is very much welcomed, accepted by patients, patient societies, and doctors as well. Beside that our medicines are available in different forms in nonconventional dosage forms, such as orodispersible tablets and bi-layer tablets. It's important to outline that we have more than 1,000 products in our portfolio, and all these together, I mean a lot of a lot of single pill combinations, and this unconventional dosage forms, many strengths, different packaging gives Krka a great opportunity to differentiate ourselves from competitors, being generics or originators, which is also important.

We invest in additional production facilities, technological upgrade of production facilities, capacities for research and development and quality control capacities. Planned CapEx for this year is on the level of 150 million euro, and are predominantly for strengthening and optimizing our vertical integration at all levels. In the 5-year period we plan to invest 700 million euro. On the slide, we have listed some upcoming investment projects in Slovenia I will not go into details.

On the slide number eleven, you can see our profit and loss statement for the 1st half of the year. Revenues went up by 7%, while volume growth was 3%. Cost of goods increased by 11%. Then gross profit went up by 4%. Research and development expenses increased by 7%, while marketing sales costs increased by 6%. We achieved 238 million euro of operating profit up 1%. Net financial result was plus 29.5 million euro. Profit before tax, 267 million euro with index 129, and net profit 221.6 million Euro with index 130.

The development of the ruble, US dollar and polish zloty exchange rates have a significant impact on the group's net financial result as you know, while the effects of other exchange rates are marginal. In the 1st half of 2024, the ruble strengthened by 7% against the euro but the average value of the ruble expressed in euros, as I mentioned before, was 15% lower in the 1st half of 2024 than in the same period of the previous year. Therefore, the impact of the ruble on the Krka’s group net financial result in the 1st half was positive, but it was unfavourable for the upper part of the income statement. Nevertheless, we had index above 100 also for EBIT and EBITDA.

Net financial income, including foreign exchange gains, interest, income and expenses. The impact of the financial instruments and other financial income and expense in total as I said, almost plus 30 million in the 1st half. Net foreign exchange gains account for more than 50% of this result, mostly from ruble and the rest is mostly result of hedging activities on US dollars and income from deposits and treasury bills that we have.

So once again, if we look at the profit and loss account, we can emphasize that at the top line you can see that the revenue growth has surpassed volume growth by 4 percentage points in the 1st half, which is a good sign and the consequence of various factors. For example, new launches and improved product mix. However, you most probably notice that there is a slight margin compression where expenses in general have grown faster by 2 percentage points and by 9% resulting in a bit lower gross margin. But in terms of expenses, we know that the labour costs are important item. This is followed by cost of materials and cost of services. All of these items are growing to certain extent but in recent quarters we have seen wage pressures as leading driver cost increase and I can say that wage pressure is still persistent in certain markets, but in general we can say that this pressure is reducing, and we expect it to normalize in the forthcoming quarters.

We have a strong financial position without debt. Inventories remained almost unchanged, although we would like them to be even higher, because they give us great flexibility on different markets to react to drug shortages. Trade receivables increased by 19% to above 600 million euros, which is due to growth in sales but also due to the fact that we are no longer using factoring in Russia to the same extent as we did last year. More than 90% of all trade receivables are insured by the credit insurance company.

All margins are very stable. They are high. Predominantly due to sales growth that we are generating from quarter to quarter from year to year. Also, due to volume, growth, and good product mix with many single pill combinations replacing some mono therapies. And also, thanks to recently launched many new products, including brand new products and products introduced to the new markets.. In addition, due to increased productivity and well controlled costs. So based on this our EBITDA margin is 28.8% and is on the level of 5-year average and we believe this is a good result for generic drug maker. We have strategic goal of maintaining the EBITDA margin above 25%.

The slide number fifteen shows continued and healthy growth of revenue and EBITDA for the last 5 years. The compound annual growth rate of revenue has been 6.4% over the last 5 years, and the growth rate of EBIT has been 11.4% annually over the last 5 years. We can summarize that the growth in sales and profitability over the last 5 years has also contributed to significant growth in earnings per share. The compound annual growth rate of EPS has been 13% over the last 5 years.

We remain committed to our long-term stable dividend policy, allocating every year at least 50% of profit for dividends, taking into account also all the financial needs for investments and potential acquisitions. This has resulted in a dividend CAGR of almost 14% over the past 10 years, and it was the same growth for the dividend pay-out for this year. Nearly 1.2 billion euro was allocated for dividends in the past 10 years. Over the past years, we realized a lot of share buybacks and currently, treasury shares represent 6.1% of share capital.

We are listed on 2 stock exchanges, on Ljubljana and Warsaw Stock Exchanges. Krka has over 47,000 shareholders. The shareholder structure is rather stable. The largest group of shareholders are Slovenian retail investors, holding 41% of shares, followed by the state, that owns 27% of our shares directly and indirectly. On the third place we have international investors holding around 20% of our shares. The current market cap is on the level of 4.9 billion euro.

Our strategy pursues sustainability aspects and objectives of operations. We strive to preserve economic, social, and environmental responsibility towards the environment in which we operate. The important thing is that at the end of November 2023 Krka received S&P Global CSA score. In the global corporate sustainability assessment, we got 50 out of 100 points, which ranks Krka among top 10% companies in the pharmaceutical industry. We are proud on that because there are more than 350 pharmaceutical companies included in rankings. This is something that is important to highlight. This excellent ESG rating is for us an encouragement and commitment to further develop sustainability in the operations of the Krka group. Currently we are working to implement all the requirements of the corporate sustainability reporting directive and of European sustainability reporting standards. We will further upgrade sustainability reporting and management approaches in the most material sustainability areas. As you all are well aware, sustainability reporting will be subject to external audit in 2024.

We are reaffirming our guidance for the whole of 2024. You should expect us to talk more about the results of the financial year in the mid November and also about the plans for 2025, when we will disclose 1-9 results. We still live in a world of full of challenges that we listed.

For example, the risk of geopolitical tensions remains at the top of this list, then we have also supply chain logistic disruptions. Then we have FX change risk and challenges, then we have some inflation pressure still.

We therefore believe that it is still too early to speculate on the results for the whole financial year. Nevertheless, we believe that with the help of our vertically integrated business model, our flexibility, that we are proving our good product portfolio, and our highly motivated and committed employees we will be able to achieve good results and margins well above our strategic targets also in the coming quarters.

Moving on to the last slide of todays' presentation. We can observe our long-term stable business operations. The green bars in this chart represent revenues, and the blue dots the volume of tablets sold annually. We can see that our revenues and volumes more than tripled from year 2005 to 2023. The compound annual growth rate of revenues for this period is about 7%, and for the volume as well, while the compound annual growth rate of net profit for this period is closer to 9%. This is a decent result. But the most important fact is that during this period we have outperformed the market growth, which is important to know. With this slide, I will end the first part of today's general presentation. I hope that you gained clear insights into our results for the first half of 2024 and the impact of the current situation and developments on our business operations. Thank you for your attention and now we can start a Q&A session. Thank you very much.

Q&A SESSION:

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

Uroš Ožbolt (Question from the chat)
It is your estimate for 2024 net income is currently at 310 million euros. What is the exchange rate of rubble expressed that you took into account and you plan to issue estimates for the full year 2024 in November? What are the current drivers that would most likely influence change in your 2024 guidance results?

David Bratož
As I said, we do not disclose our estimates for exchange rates. We have to take into account many factors that influence these, especially the volatility. We cannot simply multiply by 2 this excellent 1st half results, and say that this will be results in the terms of 2 billion of revenues and very high net profit, because we always have this 3rd quarter, which is quite a challenging for us. It means that the sales can be a bit down due to the seasonal effect. That's why we will be much more precise in the mid of November, when we disclose FY 2024 estimates for revenue and net profit.

Dawid Górzyński
Congratulations on good results. I have 2 questions today, and I will ask one by one. The 1st one is on the new oncology product. Do you think it has a potential to enter the list of top selling products over the time?

David Bratož
Oncology is one of our important therapeutic groups, we work on. We have many products. Regarding potential, it depends on the development of the markets, and the work of our medical representatives. But there are also some experiences from some other similar products from the past, where the prices went down very fast, very strongly. It's too soon to say more about development of this newly launched oncology product.

Dawid Górzyński
Second question is about your dividend policy in the last 5 years. The dividend pay-out ratio was very close to 55%. And your new dividend recommendation implies over 70% pay-out. So, I wonder if you change your dividend policy a little bit? You want to be more generous with dividend, or maybe you expect visibly higher net income in coming years.

Brane Kastelec
As you may have noticed, we have increased our dividend this year by the same percentage as the 10-year CAGR of the dividend. One of the criteria of our dividend policy is that we pay out more than 50% of our net profit from the previous year. This is correct, but at the same time we have always increased the absolute value of the dividend per share over the last 25 years. We adhere to both guidelines, on the one hand to the pay-out ratio and on the other hand to increasing the dividend in absolute terms every year. We can afford to do this in the coming years, even if the pay-out ratio is above 50%, because the company has a strong balance sheet and a stable business.

Uroš Ožbolt (Question from the chat by Bram Buring)
Question about the labour costs. What do you mean by saying the labour costs will normalize in the second half of the year? Will they remain close to 1st half levels, or something else?

David Bratož
Regarding the labour costs. I wanted to say that we do not expect such growth indexes that we saw last year, or in the 1st half of this year. We believe that we are able to keep them at the current level. That was my message.

Brane Kastelec
I would like to add that in the parent company, where we have the most employees, there is a salary increase at the beginning of the year. So later, during the year, there are no significant changes or increases in salaries.

Uroš Ožbolt (Question from the chat by Bram Buring)
Another question about the API and intermediates cost, what is the current trend and the outlook for the rest of the year?

David Bratož
At the moment, API costs are under control. We are not seeing any changes or special events. So we have an internal production first, then we have at least 2 or 3 external sources, so we can always compare. Because of this fact, we have always been very competitive. We believe that they will remain at a similar level in the second half of the year..

Brane Kastelec
The higher growth in COGS compared to sales was not the result of higher prices for active ingredients and intermediates, but a consequence of several factors, including intercompany profits tied up in our inventories in the Russian Federation due to the appreciation of the rouble. We discussed this topic in 2022. There is no need to present the adjusted figures, as some of our competitors do, because we are talking about small percentage points. Once again, the higher costs are not necessarily just due to higher material costs. In many cases, they are the result of inventory changes and interim profits included in these inventories not yet sold to end customers.

Uroš Ožbolt (Question from the chat by Bram Buring)
Question regarding the discussion on cost of goods sold. Should we assume that two factors mentioned will be weighing on gross margin somewhat in the second half of the year?

Brane Kastelec
It depends on the development of the rouble-euro exchange rate in the second half of the year.

Uroš Ožbolt
If there are no other questions, we will end today’s session. I believe we have answered the most important questions. With this I shall conclude this webinar today. So, thank you again for attending. In case you have further questions, you can easily reach out to our investor relations team. Thank you again for your participation. The transcript of today's webcast will be available on our website in the following days. Thank you for participation and have a nice rest of the day. Goodbye.

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