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Q1 2023 Krka Business Performance Results Webcast

CORPORATE PARTICIPANTS

PANELIST:

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HOST:

Uroš Ožbolt, *Head of Capital Markets, Krka d. d.*

BUSINESS PERFORMANCE PRESENTATION:

Uroš Ožbolt

Good afternoon ladies and gentlemen, and welcome to today's webcast on first quarter results of the Krka Group. My name is Uroš Ožbolt head of Capital markets at Krka 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 maintained the momentum and delivered strong top-line growth and operating profitability. Detailed interpretation of our performance and highlights for the first quarter 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, please go ahead.

David Bratož

Thank you and good afternoon, ladies and gentlemen. It is my great pleasure to welcome you at today’s webcast. I would like to share with you results for the first quarter of 2023. I can say that the Krka Group performed successfully in the first quarter. Thanks to our resilient business model and constant adjustments to the situation sales increased in five sales regions out of six, and in most of our key markets, and also in all product and service groups. We generated a revenue of 456 million euros. It's up 6% on the first quarter 2022. At the same time, we maintained high profitability of operations and achieved net profit of 89 million euros.

Rouble volatility affected operating and net financial results. We are on track to deliver planed sales and strategic profitability in terms of EBITDA margin in 2023 and first quarter shows that exactly. Krka is providing access to safe, high quality and affordable medicines to patients on 70 plus markets worldwide. This way we are implementing the highest level of social responsibility of providing access to medicines. We produce 17 billion finish dosage forms annually and more than 50 million patients use our medicines on daily basis. We operate in many low- to middle-income countries, enabling significant savings for patients and the healthcare system.

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 our sales in 5 out of 6 sales regions and the majority of markets in the first quarter. The increase was 6% or 25.6 million more than in Q1 2022. The Eastern Europe region recorded the highest sales, accounting for 31.5% of Krka Group sales. Sales in the largest single market for Krka, the Russian Federation, reached €88 million, an increase of 5% compared to the same period last year. We saw an increase in turnover in all other markets in Eastern Europe and Central Asia, with the exception of Ukraine, where our turnover was around €16 million lower compared to the first quarter of 2022. As far as our activities in the Russian Federation are concerned, business is running relatively smoothly and undisturbed. Market demand is also normal. Our local production facility has produced around 74% of the products sold in the Russian Federation. The collection of receivables is going smoothly. In addition, the majority of receivables are insured. Our subsidiary in the Russian Federation has the status of a domestic producer and we do not manufacture products in the Russian Federation for sale in any other country outside Russia. Krka has been present there for more than 50 years, and 10 million Russian patients use our medicines every day. In Ukraine, the emergency situation has caused many people to leave the country, and cautious stockholding by distributors has caused the pharmaceutical market to shrink. Nevertheless, Krka remains the second largest foreign supplier of generic pharmaceuticals in the pharmacy segment, according to the latest available data. We have to say that the first quarter of 2023 is not fully comparable to the first quarter of 2022, as last year the crisis broke out and everyone increased inventories, which had a positive impact on our sales last year. We expect the momentum of sales in Ukraine to strengthen by the end of the first half of the year.

The second biggest region in terms of sales is region Central Europe. Sales represent 24% share of total Krka sales and were up 11% year on year. Poland with 48 million euros of sales and 4% growth remained the leading regional market and the second largest individual key market for Krka. Sales increased in all other original markets of this region.

Our third largest region is region West Europe, which recorded sales of €92 million or 20% share of total Krka Group sales. Year on year, the sales presented an 8% rise. In Germany, which is Krka’s largest market in this region, we recorded decent sales. In the second half of the last year we successfully launched gliptins products for treating diabetes, and according to the latest IQVIA available data, Krka has managed to become the leading generic supplier on the market. We recorded sales growth in most other regional markets as well and the highest ones in the Portugal and Finland.

Sales in the region Southeast Europe, plus region Slovenia, represent together again one-fifth of the total Krka sales, which is actually the same or comparable to the share of the West Europe. Krka holds 7.6% share of the Slovenian market. We are the country's leading supplier of pharmaceuticals. The main sales drivers in Slovenia were promoted products from Krka’s key therapeutic groups of cardiovascular agents, central nervous system agents, agents for gastro and pain relief agents.

Region Overseas markets, which is the smallest one, generated the highest relative increase among all regions, a 20% increase. We recorded quite an impressive increase of sales in Far East and Africa.

In terms of the structure of sales, prescription medicines are still the most important for Krka, accounting for about 81% of Krka's total sales. This is our core business. In the first quarter of 2023, sales of prescription medicines increased by 5% and we generated an additional 17.2 million in sales. Sales of non-prescription medicines account for just over 10% of Krka's total sales and remained flat due to the strong increase in the first quarter of last year. Sales of veterinary medicines, which account for a good 6%, increased significantly by 30%. Especially in Eastern Europe, we were able to increase sales of products for pets.

We have diversified product portfolio. Treatments in cardiovascular group represent more than half of our Rx portfolio, followed by the second biggest therapeutic group CNS and on the third place, we have gastro and then pain relief medicines. In the last year, we added strong portfolio of antidiabetics. We are also focused on some other therapeutic groups, such as antibiotics, anti-coagulants and oncology products.

In terms of research and development, I would like to emphasise that we are focused on a strong pipeline. We are currently working on 170 new products in our pipeline. Our goal is to be among the first on the market when the patent expires. This is a very important goal for new launches, which allows us to increase market share. We regularly invest up to 10% of sales in research and development, and more than 800 experts, about 200 of whom hold PhDs, are involved in research and development. In the first quarter of 2023, we added three new products to our range. In addition, we received 74 MA's for our existing product range.

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, which is also important for the life cycle of our products. By adding different single-pill combinations, we are also tackling pricing pressures and other challenges. In this way, we give doctors and patients access to high-quality, innovative medicines, which firstly makes it easier to take the prescribed medication and secondly enables better adherence to treatment. Therefore, this solution is very much welcomed and accepted by patients.

This is also very favourable in terms of Krka's sustainable approach. The graph on slide no. 9 shows the sales and net price development of one of our best-selling medicines. In the first year we launched a regular mono tablet and then added different combinations of single tablets over the life cycle. This shows how we achieved sales growth and defied pricing pressures, even though sales of the original mono tablet stagnated from year 6 onwards.

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, so far we allocated just shy of 22 million euros, in the first quarter. I will mention the most important upcoming project. This is new facility for development and production of active pharmaceutical ingredients in Slovenia. The 163 million investment is in line with our strategy of vertical integration. The plant output will be bigger than all the existing API output to this day. We expect construction work to start soon, just waiting that the permission will become legally binding, at the end of second or beginning of third quarter of this year. I would like to emphasize that regular investments are crucial for sustainable long-term growth of Krka.

The Krka Group increased its turnover by 6% and maintained its profitability at a high level. Expenses increased by 4%, of which distribution costs rose by 10% and research and development costs by 5%. Operating profit was € 120 million, 12% higher than in the first quarter of 2022. The financial result was € -13.5 million and we achieved a net profit of € 89 million, slightly less than in the first quarter of 2022.

On slide number twelve we have shown the development of the Russian rouble since the end of 2021 and until the end of March this year. The rouble remains the biggest currency risk for the Krka Group, even though our rouble exposure is lower than in the past. The EURRUB exchange rate started 2023 at 78.4 and ended the first quarter at 84.7 roubles, a depreciation of 7.4% in the first quarter. This resulted in exchange rate losses totalling minus €11.7 million in the first quarter. The difference in exchange rate losses compared to the first quarter of 2022, when the rouble depreciated by 9.6% and Krka generated 8.9 million in exchange rate losses, is relatively small. The contribution of other currencies to total exchange rate gains and losses is generally small. However, we must point out that this could change in the following quarters due to the depreciation of the rouble. Krka generated extraordinary FX gains in Q2 2022. Given the current EURRUB development, we do not expect the rouble to appreciate as much as last year by the end of Q2 2023. This will lead to a significantly weaker net financial result and also net profit for the Krka Group for the first half of 2023 compared to the first half of 2022.

All margins are high, and this is primarily a result of sales growth. The main reasons behind are economy of scale and improved product mix. We are selling the products with better coverage, well-controlled costs and productivity. Average EURRUB was also favourable as you saw from the past slide. EBITDA margin for first quarter is at almost 32 %, which is higher than our 5-year average at 28.5%. This is high for generic industry. We have a strategic goal of maintaining EBITDA margin above 25%. All margins are expected to decrease gradually to a certain extent due to obvious reasons, including inflationary pressures, rise of salaries, energy costs, the rouble volatility, etc. Nevertheless, we believe and we work very hard to keep margins above our strategic objectives also in the next quarter.

On slide number 14, you can observe the persistent and healthy growth of sales on the left hand side, and EBITDA on the right-hand side of the slide. The compound average growth rate of sales for the last 5 years was a good 6%, while the average growth of EBITDA was around 10% annually for the past 5 years. We can summarize here that revenue and profitability growth resulted in significant earnings per share growth. The growth over the last 5 years, on average accounted to almost 20%. If we take all these elements into considerations, this means that we also generate strong cash flow from operations, which is stably growing year-on-year, as you can see from graphics. Compound average free cash flow growth rate is about 31%.

We remain committed to a long-term and stable dividend policy allocating every year at least 50% of distributable profit for dividends. This resulted in the average dividend increase of 15% over the last 10 years. We continue with the execution of our share buyback program, currently owning 5.6% stake. Pursuing the company's long-term dividend policy, the management and supervisory board proposed the dividend of € 6.6 gross per share, which is an increase of 17.2% over the previous year. Shareholders will vote on this proposal on 6 July.

We are listed on two stock exchanges, on Ljubljana and on Warsaw stock exchange. We have around 47,000 shareholders. Our shareholder structure is rather stable. The biggest group of shareholders are Slovenian retail investors, holding a good 40% of all shares, followed by the state, which directly and indirectly owns 27.1% of the shares and on the third place, there are international investors holding around 21% of our shares as visible from the pie chart. Market capitalisation is approximately € 3.7 billion.

Already in 2022, the management and supervisory board of Krka adopted the ESG Policy of the Krka Group along with strategic goals for most material ESG topics for Krka. We have conducted a new materiality assessment of key sustainability areas which include product quality & patient safety, talent attraction & retention, good leadership & governance practices, accessible healthcare, planet & climate change and compliance, integrity & transparency of course 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. In 2023, we plan to obtain an ESG rating, further upgrade ESG policy, and fully integrate the sustainability within the business strategy.

It is important to highlight that this is the first time we have calculated the carbon footprint for Scope 1 and Scope 2 for the period 2019 to 2022. We have also set the carbon emission reduction targets. The calculation for Scope 3 is still pending.

We believe that guidance for 2023 is realistic, especially due to our strong results for the first quarter and challenges we are all facing in the pharmaceutical industry, I mean inflation, supply chain challenges, looming recession, interest rates changes, etc. Our growth in recent quarters has been above the trend, with margins that expanded quite considerably already for many quarters now. We are well on track to achieve the strategic EBITDA margin of above 25%. Revenue should reach 1,755 million euros on the back of volume growth, good product mix, new launches and entries to new markets. We are a bit more cautious regarding the bottom line, where we expect net income of around 300 million euros. We can hardly expect so favourable year in terms of foreign exchange volatility. Nevertheless, 300 million euros in net income represent decent five-year compound average growth rate as well.

Planned investments for 2023 are higher than in 2022, in particular due to a significant investment in API facilities in Slovenia, which was originally already planned for 2022. The vertically integrated business model shown on the last slide is our key competitive advantage, as the entire product life cycle is in our hands. Thanks to this model, we remain flexible and can also adapt to special market conditions in the future. Looking at the sales development in the last quarters and especially in this quarter, we can observe solid and profitable business growth and our performance outlook and strategy for the future are also promising. We have a strong capital structure and generate stable cash flow from operations. We have no debt and our margins are stable. 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 quarter results. Let us now start the Q&A session, thank you for your attention.

Q&A SESSION:

Uroš Ožbolt
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.

Uroš Ožbolt (Question from the chat by Matthias Teig)
How is the progress in China?

Brane Kastelec
Turnover in the first quarter was modest and lower than in the first quarter of last year. Our sales in China is made up of two parts - the sale of the joint venture company and, to a lesser extent, the sale of a product that we manufacture in our subsidiary in Germany and distribute in China through a local partner. The partner is different from the one with whom we have the joint venture company. In the first quarter of last year, the delivery of this product to the partner was large and covered the entire annual sales. This year, there was no such shipment in the first quarter, which affects the index of our sales in China this year compared to the same period last year. In addition, at the end of last year, the joint venture company shipped large quantities of various products that we had registered in the Chinese market for the past 3 years because the Chinese New Year was quite early this year and we did not want to have a shortage of products in the market. In addition, the Covid 19 pandemic broke out in China at the beginning of the year, which also limited sales. However, and I would like to stress this, our plans for sales in China this year are in no way jeopardised. We expect higher sales this year than last year.

Uroš Ožbolt (Question from the chat by Matthias Teig)
Are you still looking for acquisitions and can we expect a deal this year?

David Bratož
We are working regularly on this field and are engaged very much but all the projects are still in confidential phase of development. We have a long-term focus.

Uroš Ožbolt (Question from the chat by Bram Buring)
You mentioned that the rouble liquidity will be an issue this year. Can you expand on this?

David Bratož

Perhaps I have not made myself clear. The volatility of the rouble, not liquidity, will be the issue this year. It was exceptionally favourable in the second quarter of 2022. I am referring to the huge foreign exchange gains thanks to the appreciation of the rouble. Given the current movements of the Russian rouble, we cannot expect a similar effect.

Brane Kastelec
As Mr. Bratož just said, no one expects such a strong appreciation of the rouble by the end of June this year as we experienced in the second quarter of last year. I would like to mention the factoring that we do in Russia. It helped us reduce our receivables from Russian clients at the end of last year and reduce credit and currency risk. We are using it also this year.

Uroš Ožbolt (Question from the chat by)
Strong sales in veterinary products. Is it mainly driven by new markets or new launches?

David Bratož
It is driven by new products and good promotional activities that we execute on markets. High contribution to the increase in Q1 2023 came from East Europe. People are paying for their pets a lot. Furthermore, we can see some correlations also for non-prescription drugs.

Uroš Ožbolt (Question from the chat)
When was the last tender you won in China and how many opportunities to expect in the second half of the year?

Brane Kastelec
The business environment in China, including the bidding conditions in China, is constantly changing. At the beginning, when we entered the market 3 years ago, there were so-called national tenders covering most of the market, i.e. many provinces. Now the tenders are generally smaller. This means that we participate in provincial tenders that cover one or a few provinces. We won the last tender in April this year, but it was not a big tender. As for the second half of this year, we cannot be very specific. We will report on the development of our business in China quarter by quarter.

Uroš Ožbolt
If there are no questions it seems that we clarified everything. We would like to thank you again for your participation in case of any other questions do not hesitate to reach towards us. The transcript of today's webcast will be available on our website in the following days. Thank you for listening, and have a nice day. Goodbye.

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