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Fagron Q1 2023 Trading Update

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Operator: Hello and welcome to the Fagron Q1 2023 trading update call. Please note, this call is being recorded. For the duration of the call, your lines will be on listen-only. However, you will have the opportunity to ask questions at the end. This can be done by pressing star one on your telephone keypad.

I will now hand you over to Karen Berg, Head of Investor Relations, to begin today's conference. Please go ahead.

Karen Berg: Good morning, everyone, and welcome to our Q1 trading update. I'm here together with our CEO, Rafael Padilla, and our CFO, Karin de Jong. Rafael will guide you through the results of the first quarter, and then there will be room for questions.

So with that, I would like to hand over to Rafael.

Rafael Padilla: Thanks, Karen. Good morning, and welcome all. Before Karin and I take your questions, we will go through the presentation, where we'll explain on a global and regional level the highlights of the first quarter of '23. We will then elaborate on the evolving environment where we operate, and we will discuss our full-year guidance. We will then conclude and open for Q&A.

In the first quarter, we operated in a high inflationary and evolving environment. Therefore, we are pleased to see a strong top line development, supported by organic growth in all three regions, disciplined M&A, whilst we have seen a forex tailwind.

Our solid Q1 performance has been accomplished in all businesses and segments, and is a result of the strategic actions taken, especially in our global operational excellence programs. Following our structured and disciplined M&A approach, we have completed the acquisition of Wildlife Pharmaceuticals in South Africa, which offers access to the attractive veterinary compounding market.

Lastly, we reiterate our full-year guidance.

Moving on to next slide. Despite the fact that we operate in an uncertain environment where inflationary pressure remains, we have seen strong organic revenue growth, particularly in EMEA and North America. We have continued driving operational improvements, mainly in our global sourcing departments where we are taking advantage of our global large scale. We have intensified our procurement and supply activities, resulting in stronger purchasing power and better logistic terms.

Regarding supply chain, again, given our global large scale, we have a broad supplier base, and we continue to further broaden our options. On an important note, syringe shortage continued to ease throughout the quarter.

Finally, we observed that pricing pass-through in EMEA is at the end of the cycle. Therefore, and as we mentioned during the previous call, operational excellence continues to be a key focus for us, as we expand our activities globally in a more competitive and efficient manner.

Now moving on to the regional update. EMEA's growing trajectory continues as the result of strategic actions taken: a centralized production, streamlined back office and brand rationalization and reinforcing registration and in-licensing capabilities, as we have seen today with the announced deal.

On a very relevant note, our compounding service activities in the Netherlands showed further growth. As we stated in the previous call, our cGMP repackaging facility in Poland is fully operational, and we have already seen the benefits out of it. For this region, continuous pricing pass-through exercises are important, and we have progressed well despite it being at the end of the cycle.

Also, as we explained, we continue diversifying across EMEA region by delivering outstanding performances in markets such as Italy, Czech, South Africa and Israel.

Moving into LatAm, the fact that we maintain our leading position in '22 paid off, as the market is showing signs of recovery, especially after the holiday and carnival season. Given the attractiveness of the Brazilian compounding market, the competitive landscape remains heightened. In order to continue maintaining our leadership and drive operational efficiencies, we are executing on back and front office projects, such as centralizing all our warehouse activities, this being finalized at the second semester of '23.

We are also improving our product availability on our A-items, and we are improving our innovation capabilities. During Q1, we also continued to further diversify into Mexico and Colombia, especially in the Compounding Services segment in this last country.

Looking ahead to '23, we remain cautious and committed to maintaining our market-leading position in Brazil, as it is the second biggest compounding market in the world and long-term fundamentals remain attractive.

Moving into North America. The market demand here is increasing as well as regulatory scrutiny, creating further opportunities for us. At FSS, we have reached the US$125 million run rate for Wichita and Boston combined. Again, we have seen further signs of the easing syringe shortage and we expect a progressive step-up through '23, as we ensure quality remains of the highest standards.

Regarding Boston, as you recall, strategically, the purchase of this high-quality asset is very important for us as it gives presence in the Northeast, more capacity and redundancy. During the first quarter, the FDA audited our Boston facility, concluding in only two observations, and we have already submitted our response.

As previously stated, the integrated – integration is on track, and we have now 16 licenses and expect to be breakeven during the second semester. We are also very pleased with the developments of our health and wellness division, Anazao, which is capitalizing on strong underlying demand for personalized treatments as well as short-term drug shortages.

On our B&E division, regarding the Minneapolis warning letter, we continue to take a more conservative approach and deliberately delay the sales from this facility to enable a seamless closure of the audit. We are also accelerating our original integration plan by increasing the transfer of sales and cGMP API repackaging to our Letco facility. All these actions will ensure the strength of our position, and we expect to see an acceleration of sales during the second semester of '23.

In line with our strategy of having the best-in-class facilities, we are assessing the investment requirements for a new cGMP repackaging facility, which will provide capacity expansion. And as communicated during the full-year results, we decided to invest additional Capex in the Tampa Anazao facility to support the underlying growth in the long run.

Moving on to next slide. We currently experience a fast-changing environment, where agility and guaranteeing the highest quality standards are key. Looking at the external risk, inflation remains high. We managed this by a dynamic pricing pass-through, though it is at the end of the cycle in EMEA.

Regarding the competitive landscape, we aim to maintain leadership in all of our markets by strengthening our commercial approach, balancing competitive pricing and being unique with our Brands. We offer the widest portfolio and aim to set the highest quality standards in the industry as regulatory environment evolves.

Being the global compounding leader, we have strengthened our quality management organization, and we continued implementing our global quality systems across all our regions. Also, we commit to invest in state-of-the-art infrastructure, especially in North America in order to remain well ahead of expectations.

Moving to supply chain risks. On sourcing, again, given our global large scale, we have a broad supplier base and are continuing to further broaden our options. We have intensified our procurement and supply activities, resulting in stronger purchasing power and better logistic terms.

Finally, on our internal business drivers, on operational excellence, while we always focus on it, it has now become necessary to be our key strength to support our activities across the globe to be more competitive and have better cost margin. We already see good developments through increased product availability.

And regarding our disciplined M&A activities, we continue to look actively for opportunities across all our markets and the announced acquisition of Wildlife in South Africa is an example of this.

Moving on to next slide. We reiterate our full-year guidance with revenues growing organically mid to high single-digit with an increased profitability compared to '22. Capex will remain at 3-3.5% of sales with one-off in North America.

To sum up, our Q1 '23 performance was slightly ahead of our expectations as we saw small gains across all regions. EMEA saw good operational efficiencies as well as pricing pass-through exercise. However, this last one has now reached the end of the cycle. LatAm's markets started seeing recovery, though competitive environment remains. North America saw an easing of the syringe supply shortage at FSS and Anazao capitalized on strong underlying demand.

Finally, to end, Fagron is a global vertical integrated niche, defensive, high cash generating company, who is consolidating a highly fragmented market. We benefit from a resilient business with diversified geographical presence and the broadest product portfolio in the industry with favorable underlying trends, such as demographics and personalization.

Our operational excellence plans will drive several efficiencies across the company, mainly on global procurement synergies. Since today, disciplined M&A remains a key part of our growth strategy.

To conclude, sustainability is a key strategic pillar as together we create the future of personalized medicine. Now time for Q&A. Karen?

Karen Berg: Thank you, Rafael. Yeah, it's time for Q&A.

Questions and Answers

Operator: Thank you. Ladies and gentlemen, as a reminder, if you would like to ask a question on today's call, please press star one on your telephone keypad. That is star one for questions. And our first question today comes from Frank Claassen of Degroof Petercam. Please go ahead.

Frank Claassen (Degroof Petercam): Yes. Good morning, all. Two questions, please. First on your outlook. With the full year results, you said that the organic growth would accelerate throughout the year to the mid to high single digits. Well, with 8% in Q1, that's clearly ahead of that. Why – yeah, what has changed? Why was it better than what you suggested, I would say, with the full year numbers? What are the main drivers?

And then secondly, on the acquisition, Wildlife. Could you indicate how big that roughly is? And will the veterinarian market be a new segment for you? Will you be looking for more M&A in that field? Thank you.

Karin de Jong: Yeah. Maybe first to start, Frank, with the question on the outlook. So, as you have seen, we had a good start of 2023, and we see positive signs across all the regions. We're slightly ahead of expectations and that had to do with improving demand, some supply chain easing and operational progress we have made. So, we reiterate our full-year guidance.

However, we also see that macroeconomically, there's still uncertainty. So, we see there is still inflation. We continued increasing prices. But for instance, in EMEA, we see that we're at the end of the cycle. We see

that – we see improving demand, but we also benefit from drug shortages. And therefore, we see that – we reiterate the guidance that we had a very good first quarter, but we expect to see mid to high single-digit growth for the year on top line.

So, maybe second on the Wildlife acquisition. So, Wildlife, we see that veterinary and human compounding are relatively similar and veterinary compounding is an attractive segment. With this acquisition, we have an entry point, mainly locally, to support existing efforts in selected markets globally. Wildlife has multiple registrations and is close to finalizing a handful of new ones. So that capability will strengthen Fagron's in-house knowledge on registration, first of all, of course, for the South African market, but potentially also outside this region, mainly in EMEA.

Veterinary is not completely new for Fagron. So, what we see is that in most of the markets, our Essentials and Brands are also sold to that segment and are used for vet compounding. So, it's not completely new. However, of course, our main focus remains on human compounding.

Frank Claassen: And how big is this acquisition? How much revenues were in that?

Karin de Jong: Low single digits, so it's a very small one, right? So, it's a very small one with the EBITDA-margin that is in line with Fagron's group average at this point.

Frank Claassen: Okay. Thank you.

Karin De Jong: Thank you, Frank.

Operator: And now we're moving on to our next questioner, which is Matthias Maenhaut of Kepler. Please go ahead.

Matthias Maenhaut (Kepler Cheuvreux): Yes. Good morning. Thanks for taking my questions. I have two, if I may. I will take them one by one. First one is actually a clarification. You have 8% organic growth in Q1. Could you split that out in the effect of pricing and the effect of volumes, please? And how does that stack up to Q4?

Karin de Jong: Yeah. So, thank you, Matthias, for the question. If we look overall for price and volume on Fagron, we see a balanced mix for total Fagron. However, if we go to the different regions, there's a slightly different picture in each region. So, for EMEA, we see a healthy mix of price and volume. So, we, of course, have the benefits of the price increases in EMEA. And if we correct for the COVID tests we sold last year, we also see nice volume increases, and that's driven by a strong demand in the European region. If we go to the LatAm region, we see an improvement, especially after the holiday season and the carnival. So, we see volumes increasing. However, that's fully offset by price decreases as the competitive pressure remains heightened. So there, we see an increase in volume, but a decrease in price. And for the US, growth is driven fully by volume increases, especially, of course, in the Compounding segment.

So overall, a balanced view for Fagron as a whole but different in the different regions.

Matthias Maenhaut: Okay. That's very clear. Thank you. Next question is actually on a remark that Rafael made during the introduction. He mentioned stronger purchasing power and logistic terms. Could you maybe elaborate a little bit on that process? Maybe quantify how much the benefit is, and when did you actually see this coming through? Was this already the fact in H2? Or is it an incremental step-up you're making now?

Rafael Padilla: Yes. Good morning, Matthias. On the procurement and supply elements, as we explained, mainly after the COVID period we reinforced that department globally. So of course, we were purchasing globally, but more on a spot base. Now we have that centralized, we are doing with categorization. So, we have better purchase power, if you will, right?

So having said that, on the logistics part, we see that the pricing of bringing the products from Asia decreased compared to the COVID period and also with the inflationary trends as well, that we saw afterwards. It's not yet at pre-COVID levels, but clearly improved.

And on the procurement side, what we see now is that prices start to be more rational. In some categories, it starts even decreasing. And as said before, taking the global volumes that we have is helping us to get better conditions.

Karin de Jong: Yeah. Maybe to add on that one, Matthias. So, we, of course, had the production location up and running last year and that was in H2 of 2022, and we continue to see benefit of that. So full-year benefit will be in 2023 and, of course, the EMEA gross margin will benefit from that.

Matthias Maenhaut: Yeah. Very clear. The last question is maybe on the registrations in Benelux that you mentioned. Could you maybe elaborate a little bit on what kind of registrations these are that you acquired, maybe the cost and the addressable market?

Karin de Jong: Yeah. So indeed, we acquired the rights for exclusive marketing and distribution of registered niche products in the Benelux. So, we consider this as an attractive add-on to our registration business. We start in the Benelux, where we already have other niche registrations as we consider this our home market, but we may consider extending this to other EMEA countries at a later stage.

So, we pay a low single-digit upfront fee in Q2, so in this quarter. And further payments of that same rate – range will follow later this year and in 2024, and that's mainly for R&D. We expect to see benefits and proceeds of this deal in H2 of 2024, and we expect a high single-digit revenue sales on an annual basis depending on different variables, such as the launch date, adoption, prescription behavior and marketing and action sales. So that's a short summary of the registration deal, Matthias.

Matthias Maenhaut: Yeah. Just a short follow-up if I may. These are products that you presently do not yet market or you do.

Karin de Jong: We don't.

Matthias Maenhaut: Okay. Thanks.

Operator: Thank you. And up next, we have Stijn Demeester of ING. Please go ahead.

Stijn Demeester (ING): Yes. Good morning. Thanks for taking my questions. Also, two from my end. The first one is also on the registration. Can you comment on the status of the organic initiatives in terms of registrations that you have announced in the past? Yeah, that's the first question.

Rafael Padilla: Sure. So good morning, Stijn. Here, as we also explained, we decided to invest in the – as you know, pharmaceutical compounding, mainly on the non-sterile side. Here the compounding starts with ad hoc, then it goes to bulk compounding when it becomes more or less sizable. You saw in the past that some pharmaceutical players entered the market and then compounding was not allowed, right?

So, what we decided also together with our partners and mainly with Tio in the Netherlands to start the registration process of some larger compounds, and we launched to the market at that time, some registrations together. Now you have seen the pipeline evolving. And if you recall, Stijn, at the Capital Markets Day, Hans Waals from Tiofarma announced that we had a registration coming, an interesting one. This has been launched, also during this – at the beginning of 2023. And we continue, of course, with the registration pipeline.

And this means not only the current compounding services, non-sterile compounding products, but also some items that we have lost in the past. So, it's a combination of both and the pipeline is full. Of course, not all the projects come to a good end, as you understand, right? But we are working diligently on that.

And next to this, we also work on distribution and in-licensing deals. We also saw last year with Curaphar, the Omeprazole suspension, and we have some of those that we bring into the Dutch and also now we're looking into the Belgium market.

Stijn Demeester: Okay. Understood. Second question is on Wichita. And yeah, the question is basically how do you see the growth trajectory from here on? Will you provide a new sort of mid-term target? Or will you leave it up to the market to sort that out?

Rafael Padilla: Sure. Right. So also, Stijn, when we had the Capital Markets Day last year in March, we guided the regional revenue growth. And in North America, it was mid-teens. So, the FSS activities are embedded in the mid-teens for US as a whole with the three divisions, right, that we have: FSS, prevention and lifestyle and the B&E, right?

And for 2023, being specific on your question, we will see a step up through the year and also, of course, depending on the supply and operational elements, but very important - and also that's something that we explained on the last call - having or maintaining the highest quality standards in the industry remains our main priority.

Stijn Demeester: Yes. Maybe a follow-up, if I may, on licenses for Boston. Any update here? I hear you're now at 16. So how should we look at sort of full coverage? And when that will arrive?

Rafael Padilla: Sure. This element is very important. It's a very important question, because we depend on the licenses, mainly on big states like Texas, New York, Florida, California, to make the jump on revenues there, right? And now that we did get the FDA on site, and we had those two observations - and we already submitted the response. This is very important for us because we need the report in order to get extra licenses, and we filed them almost in all the states, right, at least in the most relevant ones.

And we will – of course, we'll see throughout the next months, quarters, semesters. Also, next year, we will see them coming. And of course, this, together with the fact that we are – as we explained also during the last call - we have one commercial team selling both sites, right? So, the portfolio produced at both sites. This will increase the revenues. And at the end, this is very important in order to get to breakeven during the second semester of '23.

Stijn Demeester: Okay. And maybe one more follow-up, if you allow me, on Wichita in Q1. Has there been a case of sort of some pent-up demand after sort of the syringe shortages in the second half? Or is it purely a case of strong underlying demand that explains the Q1 performance?

Rafael Padilla: Sure. Yes, that's a good one because it's a combination of both, Stijn. The underlying demand is there, right? So, what we see is that hospitals outsource. We all know it very well. We have been talking about this for the last year, right? And next is the fact that this is being more outsourced. What we also see is that some of the players are having some challenges on the quality side, right? So, this means that the players that stay, that have the highest quality standards in the industry, do get more requests from the market. So, you have, in one side, new customers that come, and on the other side, existing customers that order more SKUs of your portfolio, right?

So having said that, the fact that also the syringe shortage is easing, right, that we also saw at the last call, the combination of the two factors make that we have been able to grow nicely because if you remember in Jan, we were at $100 million run rate. So, we made a nice step up in Feb and March. So, this is what we have seen during this first quarter.

Stijn Demeester: Okay. Thank you.

Rafael Padilla: Yeah. Welcome, Stijn.

Operator: Thank you. And as a reminder, that is star one for your question today. We're moving on now to Eric Wilmer of ABN AMRO. Please go ahead.

Eric Wilmer (ABN AMRO): Hi. Good morning, everyone, and thanks for taking my questions. I got a few remaining, also ask them one by one. My first is on Anazao. It has been a key contributor to strong North American growth. And you previously highlighted that you will invest a significant amount in your Tampa facility. So, to what extent will this negatively impact sales for Anazao in Q2, Q3, Q4 this year? That's my first question. Thanks.

Karin de Jong: Yeah. So, thank you, Eric, for the question. So, what we currently have is a facility in Tampa, which is running and we're building a new one. So, the sales will not be negatively impacted by the build out because it's a new facility. So, we'll run in the current one, we have still sufficient capacity there to cover the growth we are seeing, and we don't expect any negative elements causing a delay in net sales because of the new facility we are building.

Eric Wilmer: That's very clear. But it's also not the intention to integrate them, maybe at a later stage, and clearly just an expansion?

Karin de Jong: Yeah. Correct, Eric. Yeah, correct.

Eric Wilmer: Okay. Then my next question. It's tied to Stijn's question on your Wichita or on your 503B sales growth in Wichita and Boston combined. Could you also break that partly down to what came from Boston? Well, it's probably rather small still, but could you shed some light on that as well in that sequential growth?

Karin de Jong: Yes. So, if we look at the US$125 million, then approximately US$15 million is coming from Boston and the rest is coming from Wichita.

Eric Wilmer: Okay. And then my last question, you mentioned inflation this year. At the same time, we're also seeing some raw material costs coming down. Do you have any additional pricing rounds planned in EMEA this year?

Rafael Padilla: Yeah. Good morning, Eric, and as you know, the contract sales that we have are more than 50% of the sales that we have. In EMEA, it's mainly hospitals and wholesalers, and it's an ongoing process on 12 months, 18 months normally on average. And what we see now that we – that we come to the end of the cycle, right? So, when these are being renovated, we see some exhaustion of the customers and also on the customers of our customers. So, I would say that this arrived at the end of the cycle.

Eric Wilmer: Got it. Very clear. Thank you.

Rafael Padilla: Thanks a lot, Eric.

Karin De Jong: Thank you.

Operator: Thank you. And as a final reminder, that is star one for your question today. And we just received the question from Maarten Verbeek of The IDEA. Please go ahead.

Maarten Verbeek (The IDEA): Good morning. It's Maarten Verbeek, the IDEA. Couple of questions from my side. You just mentioned concerning those licenses for Boston, you are awaiting the FDA report. And once you have that FDA report, will you then automatically receive those licenses for those states and how many states does it involve? And do you also have a goal, how many licenses you would like to have for Boston?

Rafael Padilla: Sure. So good morning, Maarten. Regarding this one, it differs per state, the requirements that you need in order to get the license, right? So, in most of them, you need an FDA audit report that we already have, right? So, we already have this report. So, this helps because the audit went very well.

And what we do now is focus on the main states. So, we do that. If you remember, with Wichita, it took us approximately three years to get almost all the states. We have everything except North Dakota if I recall correctly, right? So here it will be the same. We do it state-by-state. Now our focus is to get New York, Texas, Florida, and California.

Maarten Verbeek: Okay. Thank you.

Rafael Padilla: Yeah.

Maarten Verbeek: And one brief follow-up on the acquisition of Wildlife. Could you inform us when it will be consolidated? And what kind of a multiple you paid for this business?

Karin de Jong: Yeah. So, we consolidated as of this month, so that will be the consolidation moment. And the multiple is within the range that we usually pay. So that's between 5 and 8 times.

Maarten Verbeek: Thank you very much.

Operator: Thank you. And we now have a follow-up question from Matthias Maenhaut of Kepler. Please go ahead.

Matthias Maenhaut: Yes. Thanks. Actually, two follow-ups, if I may. Just on the acquisition, can you maybe elaborate on the historical growth profile of this business, so the Wildlife acquisition?

And then secondly, on LatAm, I understood that demand is improving. Could you confirm also that you haven't done any additional, I would say, price investments that will trigger gross margin pressure in Brazil?

Karin de Jong: Yeah. So, on the first one, just to highlight, it's a very small acquisition, right? So, the sales are low-single digits. And they had a very – they had low single-digit organic growth historically. So, we believe we can accelerate that growth by the registrations and the ones that are in the pipeline. And so, the earn-out is based on sales picking up on – regarding those registrations. So – but just to highlight, it's a very small one.

And then secondly, on LatAm. So, we see volumes increasing. However, that has a price impact. So, what we said historically, H2 is better for LatAm than H1, if we look at profitability. So, we expect to see some impacts in H1 as prices are impacted in the first quarter.

Matthias Maenhaut: So, the prices will be up year-over-year in LatAm in H1?

Karin de Jong: Sorry, I missed you?

Matthias Maenhaut: Would the gross margin be up year-over-year in LatAm in H1?

Karin de Jong: Yeah. That's not something we're going to disclose. Overall, we see an increase in profitability. But for LatAm, it will be more towards the second half of the year than the first half of the year.

Matthias Maenhaut: All right. Very clear. Thank you.

Operator: Thank you. As we currently have no further telephone questions, I'd like to hand the call back over for any additional or closing remarks.

Karen Berg: Well, thank you very much, and thank you all for your questions. It was really nice to have you again. Looking forward to seeing you at our next results call and, of course, for those who are interested, at our AGM in May – early May. Thank you so much.

Karin de Jong: Thank you.

Rafael Padilla: Thank you.

Operator: Thank you for joining today's call. And you may now disconnect.