Gedeon Richter
Announcement Conference Call
May 12, 2023

<u>Presenters</u>
Gabor Orban, CEO
Istvan Hamecz, CFO
Katalin Ordog, Head of IR Department
Laszlo Kovacs, Chief Controller

<u>Q&A Participants</u>
Alistair Campbell – RBC Capital Markets
Victoria Lambert – Berenberg
James Vane-Tempest – Jefferies

Operator
Greetings, and welcome to the Gedeon Richter Announcement Conference Call. At this time, all participants are in a listen-only mode. A question-and-answer session will follow the formal presentation. If anyone should require operator assistance during the conference, please press star, zero, on your telephone keypad. As a reminder, this conference is being recorded.

I would now like to turn the conference over to your host, Gabor Orban CEO. Please go ahead.

Gabor Orban
Thank you very much, and thank you, everyone, for joining the Gedeon Richter earnings call. Today, I have in the room with me, Istvan Hamecz, our CFO, Laszlo Kovacs, our Chief Controller and Katalin Ordog, the Head of Investor Relations. I apologize for the delay in starting this call today. We are working with a new system, which is actually working fine, but it still requires some getting used to, and that's what took seven minutes of your life. Again, I apologize.

The reason the system is new is, well, threefold. First of all, we'd like to provide you with slides in this earnings call, and a system was set up so that I can show you some graphs and diagrams while the discussion is ongoing. Secondly, we have changed the format of the earnings publication, and also the slide kit has been reformed so that we provide you with a better sense of underlying trends, and also more information on the performance of our business units.

When it comes to the underlying trends, we have made two important changes. One is we have expanded the range of figures that are provided in constant currencies for you to have a better understanding of what's going on, on net of FX influences. Secondly, we are introducing a new concept called Clean EBIT, in order to filter out the one-off effects that are unfortunately, recently have influenced our figures to a degree that it's very important to, in my view, to provide you with what's going on in the underlying business in the core operations. And that's what clean EBIT is supposed to indicate.

Secondly, information on our business units. I'd like to move away from the discussion on VRAYLAR versus everything else. We'd like to talk to you about business units that are in themselves, a healthy and strong contributors to profitability and we'd like to--this is a message that I've been giving you for years, but I'd like to make sure that that message is substantiated by a simplified P&L that we are about to give you.

With that, I'd like to turn to the first slide in which our financial highlights are provided. Top line grew by 25% year on year in the first quarter, to that HUF 210 billion. Pharma sales grew at a stronger pace, over 30%. The difference is the decline in the wholesale and retail business, which is quite natural given the stage of the transaction, the very final stage of the transaction. We are about to close this deal, given that this week we have received the green light from the competition authority in Romania, so next steps are closing. And then in the second quarter earnings report, you will probably be able to decipher, although we cannot tell you because it's confidential information, you'll be able to dig out the value of this deal.

Gross Margin ticked up quite remarkably. It stands at 60.7%, thanks to this decline in the weight of the wholesale business, also the contribution from VRAYLAR, also, the impact of currencies, which in this period, year-on-year was very positive still. And also, the underlying business posted very strong gains. The EBIT came in at 54, and the Clean EBIT at 59, the difference being mostly the special tax that was levied on us at the end of last year. Net profit came in at HUF 39 billion, the difference being attributable to the financial loss of HUF 17 billion, which was hardly a surprise to anybody, given how exchange rates have moved against us in the past three months, well, not in the past three months, but between the 31st of December and the 31st of March.

We also provide here two indicators that previously were not disclosed. One is free cash flow, which is negative as a consequence of the licensing agreement that was signed, and also upfront payment that was made in connection with that in the first quarter. The product is called the Donesta that's used in HRT, and you already know about it. And the return on equity, which is 14.4%, nothing to be ashamed of, but it did go down as a consequence of Q4. This is a rolling KPI and Q4, as you know, it was not our strongest quarter, at least in terms of the headline figures.

Here's a summary slide for you that basically outlines the ideas that are included also in the quote that I provided on the first page of the earnings report. There's nothing much to say about this, except that we have a renewed format. I am very pleased with the performance of all for business units. I have said already that currencies moved in our favor year-on-year. VRAYLAR was strong. We'll talk about that in a bit more detail later, and I also--maybe it's worth emphasizing, I'm also very pleased with the way that the portfolio expansion and the building of our pipeline progressed in the first quarter, both in terms of externally sourced projects and also our internal pipeline moved ahead at the required pace.

Okay. In early March, I disclosed our targets for this year, which was in very simple terms, a 10% growth in constant currencies with stable margins. We are well on track to achieve those targets in 2023. Clean EBIT went up by an even higher percentage, 24%, even after FX effects. This may not last into the rest of the year. We're very confident that we can keep a double digit increase in the rest of the year also. Quarterly EBIT without FX was 10%. In the base, there is no windfall tax, and in Q1 '23, the windfall tax was booked at HUF 3.4 billion. Now, the next slide I provide you with the reasons why this was the case.

Net financial income is of course a negative number. I said it already, HUF 17 billion in unrealized losses. The most important business drivers, I have already mentioned in the context of the gross profit, those four drivers that caused it to go up, both in absolute terms and also in relative terms as percentage of total revenues, sales and marketing and G&A, I'll give you a bit more detail in the following slides. Here are two important special items that bridge the gap between EBIT and clean EBIT. One is the windfall tax, which is estimated to be HUF 29 billion this year. There is some downside risk associated with this number, because currencies make the half denominated tax base rather lower than last year.

That said, the time proportional value would have been HUF 7.3 billion, and we only recognize 3.4. Why? Well, I did my best to convince the accountants and the experts to avoid this kind of, let's say, this way of presenting the numbers, but IFRS is very strict about this. It is explicitly prohibited in the case of this progressive tax, to estimate the tax base for the full-year and put in one quarter of that number. So it's 3.4, and please, I'd say, just adjust it in your heads to 7.3, because our best guess for this tax is still 29 for the full year.

The second thing that maybe clouds, or obscures the numbers, which we'd like to make more transparent was the reallocation of G&A, overheads from marketing into G&A. This is not unprecedented. We have already reclassified some of the spending items from one line to the other. This is what's causing the impression, giving you the impression that sales marketing costs are relatively well contained, whereas G&A went up by a very significant amount. I would love to be credited for effective strict cost control. In the case of marketing, that was not the case. We spent the budget in line with the plan on marketing while this reallocation, roughly HUF2.1 billion showed up among G&A costs.

Here's what happened to revenues, or here's a waterfall chart on a clean EBIT. We start from HUF 210 billion, healthy growth of HUF 32 billion, reduced to HUF 127.5 by cost of sales, cost of goods sold. As I said, here, we have a stronger dynamic in the growth profit than we have for revenues. It's reflected also in the margins. You see that the bottom of the diagram. 57.1 was lifted to 60.7, as a result.

Now, you might ask where inflation and energy and all those issues that I complained about in previous earnings calls, wages, what happened to all that? Well, energy costs are probably lower this year than last year. Istvan Hamecz will discuss this in greater detail if required. Also, wage costs have not fed through into these figures yet. So on the cost side, we had much more benign trends than in previous quarters, or than what we had in revenues, which is quite strong.

In sales and marketing, the growth is in line with the plan, but the reallocation made this ratio lower. The story is pretty much that simple. In G&A, the opposite occurred, and R&D is where I have to call your attention to a more modest R&D spend in the first quarter than planned. This has to do with some larger spending items, especially CRO invoices whose entry year profile cannot be very easily predicted. It's not that the projects are not moving forward at the pace required. We're actually well on track with all of our R&D projects this year, at least so far. So the lack of spending is not a reflection of any delay in those projects. It's simply the way in which the CRO invoices occur over time within the year.

We have started working on estimating and handling these costs in a different way so that such explanations don't have to be provided and there's no scope for any misunderstanding. Clawbacks and milestone income at zero lead to an EBIT of 59, a number you have already seen. And on the bottom half of this diagram is Clean EBIT going to EBIT at 54, given the other income taxes and others making it lower by HUF 4.7 billion, and then financial at 17, bringing 54 down to 39.2, which is our net profit for the quarter.

On the next page, that's a bit more--trying to give you a bit more clarity on EBIT versus Clean EBIT and constant currency. EBIT was higher by 44%, but constant currency, this increase was only 10. Clean EBIT was higher by 60%. Constant currency, the change is 24. I am very pleased with that number. And then here's another slide to provide you with a sense of how revenues were affected by the currency moves. It's quite clear that all major currencies, compared to Q1 last year, moved in our favor, especially the ruble.

We had HUF 8 billion revenue. Extra revenue came from USB with five and others three euros 2.6. Same is true by region. In this geographical breakdown, it's clear that all geographies benefited from currency moves in Q1 versus the previous year. I've already mentioned that G&A was boosted by reallocation. Sales and marketing on the other hand looks more contained than it actually is. And R&D was flat on the year because the inferior profile of R&D is not as it was expected.

Moving on, we have a slide on free cash flow in which we explain how the negative HUF 12 billion change in the cash position was created for you. To me, the important message is that cash is not building up like many have feared. We are able to mobilize our cash back into the business to recycle the cash into the business to improve the future earnings potential of the company. And here's the slide that is intended to show you that we have four healthy business units. Here's the simplified P&L of each.

We have a legacy business. The word some people like to describe our general medicine's effort in Central Eastern Europe and the former Soviet Union. Please be reminded that in the new geographical table, you'll find the post-Soviet region as Eastern Europe, which is maybe debatable as a label, given that a lot of Central Asian countries belong here. Central Europe is what many of you would think of as Eastern Europe, including Hungary, Poland, Slovakia, Czech Republic, etcetera, Romania, and this is the region that general medicine targets.

This quarter, the revenues were at HUF 60 billion. The gross margin here is below the company average, but still quite strong. And given that we rein in our spending on marketing and also R&D, it's not zero but clearly lower, both in absolute and relative terms than in any other business unit. We have an EBIT margin over 20%.

Our next business unit is women's health, of roughly equal size at HUF 60 billion. Gross margin as you know already, because we have had these discussions on and on, is higher than that in general medicines. This is a niche for us. It's something that we are particularly good at. Gross margins are better here, but we also spend more on marketing and also on R&D in order to feed the pipeline and and build a future portfolio, provide innovation to women all over the world. We ended up with a very similar EBIT margin of over 20%.

Biotechnology is a newer, younger business unit. It's a smaller one too, as a result. It consists of our rheumatology osteoporosis commercial performance, and also the CDMO contract manufacturing and development activities that we carry out on our technological platforms for external third party clients. The results in this quarter was HUF 8 billion in revenues. And here, we have a business unit where we continue to invest into a hefty R&D pipeline. We run three clinical trials at the same time, which is probably more than what we would normally do in the steady state. It just so happens that we have these three lined up on top of each other.

The performance is negative, but it's clear to you, I hope from this table, that all of that negative P&L is an investment into the future of the company and into the future business unit, building up Central Eastern Europe's one and only biosimilar capability in Hungary, and in our joint venture in Germany. CNS is well known to you. VRAYLAR dominates the picture here. HUF 43 billion, this is our most profitable business unit at the moment. Most of our costs are concentrated in research and development where we spend more and more, year after year as our pipeline moves forward.

Here's a geographical breakdown of these four business units and what the message to you should be that we have an evenly distributed commercial activity geographically. In CNS, North America dominates women's health as a more even picture. General medicine I told you already, Central Eastern Europe, which is equal to the Post Soviet region plus, essentially its European region. Biotech is concentrated in Western Europe, but also in North America and Asia, given the Terrosa sold in Japan, given the CDMO clients, many of whom are located in North America.

Some highlight for you on the women's health front. We have Evra performing nicely, improving the figures in a big way. We have oral contraceptives growing their weight in the mix in the first quarter. Drovelis is being ramped up nicely. We of course a bit delayed but it's still climbing. Endometriosis in the label is expected for the second half of the year and Bemfola turn the page to show you, is now back on track after last year's hiccup related to the Australian, let's say, shortfall or breakdown after commercial activity in the middle of the year, and here is Ryeco and Drovelis and

we are moving on to neuropsychiatry where we have the new indication and the new prescriptions giving us and AbbVie the opportunity to provide broader access to this drug for a growing patient population. Same is true for Reagila, new countries have--we ever obtained reimbursement in new countries like Romania and some other smaller countries, which is good news because our aim here is to expand the access to this star product into as many parts of the world as possible. It's on its way to becoming the most successful anti-psychotic ever.

R&D costs are growing here. You see a 17.5% increase over the same period last year. Why? Well, the AbbVie collaboration moves forward into later stages of the development process and also a standalone pipeline is progressing nicely. Here's just a few figures, also constant currencies on Reagila and VRAYLAR.
In biotech, we had a technical decline in revenues in the CDMO part of our business. Expect some volatility in these figures. Work in progress accounting is at least as complicated as windfall tax accounting, and that's why you see this number going from 8.9 to 7.9.

I would like to assure you, we have a growing number of clients. We have a growing number of business, and we expect--and growing capacity utilization, and biotechnology facilities. So we are well on track here, and there also is also making very good progress. It's still one of our fastest growing drugs, with 37% in constant currency. General medicine, and this will be my last slide for today. I think I need to mention Russia as a market which is extremely risky. We have been able to gain market share recently. We seem to be better at managing supply chain challenges or issues than our competitors.

That said, the risk is very high here, both for product flow and also for--capital flow doesn't exist, so money flow, in the sense that we have been--so far, we have been able to, to settle invoices in U.S dollars with our affiliate, but the days are counted for the practice, and we'll soon have to find other ways to settle invoices. Ukraine, another important contributor to this business unit, seems to have reached a low point and is now stable. Partners pay up front, and the volumes and the orders are significantly lower than they were a year ago.

FX was also favorable in this business unit year-on-year. And it's important for you to know that corporate level initiatives, efficiency projects, right sizing projects, have been initiated here, have been, may not be the right tense, because it wasn't very recently that we initiated these projects, but they are now becoming very, very important for the cost level of this business unit. And we hope for results and also reflection of those cost efficiency programs in the performance of the business units.

We have a couple more slides on which I will not go through. They just form a standard part of the slide kit. There's a discussion of the strategic goals, the R&D pipeline in two slides and our ESG initiatives, which I would like you to see how important they have become for us to focus also on the life beyond P&L. They will not be updated as frequently and in as much detail as the financial slides, but we'd still want this to be in the forefront for you to have all the info that you may need.

Okay. So, two slides on the SG here at the end, and this was it from me. Thank you very much. I'm asking my colleagues in the room to tell us if I have left out anything or if they'd like to contribute anything to the discussion at this stage. If not, then let's turn to questions and the floor is yours.

Operator
Thank you. At this time, we'll be conducting a question-and-answer session. If you would like to ask a question, please press star, one, on your telephone keypad. A confirmation tone will indicate your line is in the question queue. You may press star, two, if you would like to remove your question from the queue. For participants using speaker equipment, it may be necessary to pick up your handset before pressing the star keys. One moment please while we pull for questions.

Our first question today comes from James Vane-Tempest of Jefferies, please proceed with your question. …. Mr. Van Tempest, your line is open…… I believe you may be muted……

Moving on to the next question. We have a question from Alistair Campbell of RBC Capital Markets. Please proceed with your question.

Alistair Campbell
Thanks for actually taking the questions, and really strong quarter in growth, good start to the year. One question. I don't know whether you can answer this or not, but I'm intrigued to know if exchange rates stayed where they are today at current rates, what that would likely mean for an FX charge in the net financial income line for the full year?
And then, in terms of how I interpret the movement from Clean EBIT to reported EBIT, obviously, looks like the windfall tax goes in there. But are there any other elements I should consider in terms of one offs for the full year?
And then just finally, RJH706, in phase two, and I think just looking at clinical trials.gov, the data they're anticipating on April 24, so potentially a data readout to us maybe by midyear 2024 Is that kind of where you're on track, so you might see more then? And that'll do for me. Thank you.

Istvan Hamecz
Okay. So if exchange rate stays the same way, then we are not counting additional FX losses, only the unrealized losses will be realized. So out of the $17 billion overall negative financial results, $13 billion is unrealized yet, but if you look at the report, you can see that over time, against the OCI other comprehensive income, we have an $8 billion gain, which will filter through to the results and depending on the space of that, some definitely will impact positively this year, results as well. So net basis from here, we expect slight positive impact of the exchange rate through this other comprehensive income mechanisms.

Gabor Orban
Which is also the reflection of the hedging.

Istvan Hamecz
Yes, the hedging. If you look at the report on page 17, you can see that we have, at the moment, more than $400 million forwards outstanding, out of which $263 is is in under hedge accounting. So the gains we have are not in the income statement, but the other comprehensive income. So it does not show up here, and it will if the exchange rate will stay stay as it is today.

Gabor Orban
Thank you, Hami. And then on 706, we expect read-out in 2024 for what we think of or refer to internally as utility study. It's an interesting result, which shows whether larger spending on this project is worthwhile. We're looking forward to those results in 2024. You had a third question however, which I don't remember. Maybe Laszlo can--

Laszlo Kovacs
Yeah. There was a question around the difference between EBIT and Clean EBIT. So basically, Clean EBIT only contains from other income and other expense, the relevant Clawback part, which of course, major negative contributor to our profitability. So what could be missed out here, nothing really important in terms of the first quarter, but in the full-year some impairment expenses can be here, and some slight other tax charges like company cars and these kind of items. And of course, the great item, which is the windfall tax, which is part of the other income and expense, but we exclude it from the Clean EBIT.

Gabor Orban
I would like to--how to say this, build on what Laszlo has said. I have two more points. The first one is that impairment is an unlikely event, given what we have told you about intangible assets not being exposed to such write-downs as they were last year, because there's simply not--there isn't any intangible assets in early-stage or mid-stage development. Secondly, what you'll see here is also the sale income, the income from the sale of the whole selling business. That should also be recorded in other income, which is why I said earlier on that although we cannot disclose the sale price, you'll be able to decipher a number from the other income. And so that was it for me to Alistair's question.

Alistair Campbell
Thanks. Thanks so much. We appreciate it.

Operator
The next question is from Victoria Lambert of Berenberg. Please proceed with your question.

Victoria Lambert
Thanks. Hi. Thanks for taking my questions. The first is just on your Terrosa biosimilar. I see that you don't disclose specifically that product's EBIT margin or gross margin. So I was just wondering, is that product loss making, like the rest of the biopharma division? And then my other question is just how to think about Donesta, that your licensing deal with Mithra, when is that expected to launch in 2024? And yeah, just some more color on what we should be putting into our numbers for next year. Thank you.

Gabor Orban
Thanks for the questions, Victoria. I'm a bit puzzled by your observation that the biopharma division is loss making. The reason we presented the P&L to you was exactly to demonstrate that whatever negative figures show up there, it's really on the R&D side, which is compared to the size of the business unit is very large. And otherwise, the business unit in itself isn't loss making. It breaks even roughly, and Terrosa happens to be a very profitable product.

The reason we don't disclose the EBIT, or even the gross margin is that the business model is very complicated. As you know, this asset is owned with a German company called Helm. It's owned by a joint venture, whose 50% ownership is held by these two companies, Helm and us. Secondly, a significant share of the product sales are delivered by partners. Importantly, Mochida in Japan and Stada in Germany, contribute much of the sales in Terrosa, which is why that also does not have the kind of P&L that a simpler product or less complex business model would give you.

I would like to assure you, although I cannot substantiate this at the moment, Terrosa is highly profitable. It's one of our best contributors in terms of profits. And also, given how we are growing, the scale effects are becoming more and more pronounced. So costs are actually going down for Terrosa. On your second question, Donesta. HRT seems to be a market where opportunities are becoming quite important. This is an innovative drug, which we hope to be able to launch in 2025. The HRT market is growing in many parts of the world, including the UK, and we see a lot of potential, also in other countries. This drug has the potential of becoming one of our leading products, which means that an Everest size drug is very much in the cards.

Victoria Lambert
Thanks. Just a quick follow up. As you're licensing quite a few products from Mithra, and their market cap, I think it's gone below 100 million euros, would that not be a sort of full-time natural for Richter? And yeah, in that same topic, what other M&A targets are you seeing at the moment? Thanks.

Gabor Orban
It's quite--how to say this. It's all that being recorded now, so I have to be very careful here, unlike previously. I think your logic is sound and correct. Mithra would be a much better target if they didn't owe all that depth. That makes that EV still higher than what we'd like to pay for it.

Operator
As a reminder, if you would like to ask a question, please press star, one, on your telephone. Our next question comes from James Vane-Tempest of Jefferies. Please proceed with your question.

James Vane-Tempest
Hi, thanks for taking my questions and appreciate the additional disclosure of the accounts. Just can you remind us, the 10% EBIT growth guidance, is that Clean EBIT in constant currency just to avoid any potential confusion? That's my first question, then I've got a few more.

Gabor Orban
Yes, it is.

James Vane-Tempest
Okay. And I guess, reiterating that today--I mean, AbbVie also recently increased their VRAYLAR guidance. So I'm just kind of curious, you know you're seeing incremental headwinds, or is there scope to maybe revisit this later in the year, given the strong EBIT growth so far this year?

Gabor Orban
Yes, we have not incorporated this increase in AbbVie's guidance into ours.

Istvan Hamecz
Yes.

James Vane-Tempest
Okay. Thank you. And then on the biotech business, can you remind us how much of that is CDMO versus your own business and how important is the CDMO aspect for your capacity, you, important to the growth versus your own projects?

Gabor Orban
In the short-term, growth comes from additional CDMO contracts, and the ramping up further of Terrosa. In the medium-term, we expect the boost to come from our internal pipeline, which is denosumab tocilizum and also romiplostim. We have three in the clinical pipeline, in the clinical stage at the moment. So currently, outside of Terrosa, it's all CDMO.

James Vane-Tempest
Okay. That's helpful. And then last one is, you obviously announced the--thinking about shareholder returns. There's the buyback. I got dividend, and I'm just kind of curious with the wholesale proceeds, what the plans would be for those? Thank you.

Gabor Orban
Yes, I understand where you're coming from. I'm not mandated or authorized to give you any guidance about the future of those proceeds. My understanding is that returning cash to shareholders, has been decided on at the general meeting in the way that it was, and we'll leave it there. This can be overwritten by the Board, but for now, we don't really envisage any future steps.

James Vane-Tempest
Okay. So.. understood. So, it's not impossible that there could be a special dividend, or you just haven't decided what ultimately could happen with that. Is that right?

Gabor Orban
It is not impossible, but I would not rule it out, but that's not the sense I'm getting from the general meeting and its context and the board dynamics.

James Vane-Tempest
Understood. Thank you very much.

Operator
As a final reminder, if you would like to ask a question, please press star, one.
There appears to be no additional questions at this time. I'd like to turn the call back over to Gabor Orban for closing remarks.

Gabor Orban
Well, thank you very much, all of you for joining today's call. I appreciate your questions and insights. I hope the new format will give you much food for thought and they can help both of us focus on relevant questions and issues. So, thank you again and see you in three months' time.

Operator
This concludes today's conference. You may disconnect your lines at this time. Thank you for your participation.