Euroapi Conference Call

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Operator: Hello, and welcome to the Euroapi conference call. My name is Melissa, and I will be your coordinator for today's event. Please note this conference is being recorded and for the duration of the call, your lines will be in a listen only mode. However, you will have the opportunity to ask questions. This can be done by pressing star one on your telephone keypad to register your question. If you require assistance at any point, please press star zero and you'll be connected to an operator. I'll now turn you over to your host, Sophie Palliez, Head of Investor Relations. Please go ahead.

Sophie Palliez: Thank you. And thank you, all of you, for joining us. Today with me Karl Rotthier, Euroapi Chief Executive Officer, and Antoine Delcour, Euroapi Chief Financial Officer. As just mentioned, this conference call will be recorded and the replay will be available on the website. We will start by a very short introduction from Karl and then open for a Q&A session. I would like to hand it over to Karl. Thank you.

Karl Rotthier: Thank you very much, Sophie. So good evening, everybody, and thank you for joining us on this call on such a short notice. Our goal today is first and foremost to answer your questions following the press release we just issued. However, I would like to introduce this call with a short summary.

As mentioned, the board of directors met today to review the full year 2023 results forecast. The forecasts show a lower than anticipated top line growth for the balance of the year, impacting our objectives for the full year. So hence leading us to revise downward guidance.

Net sales are now expected to grow between 3% and 5% compared to the 7% to 8% previously. The core EBITDA margin is now expected to stand between 9% and 11% compared to 12.5% to 13.5% previously. The CapEx guidance remains unchanged between 120 and 130 million Euro. Why is that? The slowdown of the full year 2023 net sales growth is driven by both API solutions and CDMO activities. For API solutions, our price optimization strategy has recently been impaired by a change in the market environment. In fact, we see now more pricing pressure resulting from lower overall inflation, as well as inventory reduction programs implemented by some of our customers also called destocking.

For the CDMO activities, net sales are expected to grow at a slower pace than anticipated due to weaker sales recognition than expected in Q4. As mentioned already in earlier calls, we are impacted by the biotech funding crisis, which accelerated during the last couple of months. In 2023, the revenue of more than 20 projects has been delayed, which means a delay of start of activities, a reduced scope of activity, or a stop of programs.

This slower than expected topline growth impacts also our core EBITDA margin with less favorable fixed cost absorption than initially anticipated and an unfavorable margin mix for the balance of the year resulting from the slowdown of the CDMO business.

It is yet too early to comment on the full P&L and free cash flow. But however, let me emphasize that this guidance revision does not at all impact the company's financing capabilities in the short term. Based on these new and revised targets, we have decided to conduct a thorough strategic review of our operating model and to suspend our midterm objectives and guidance. We intend to provide information on the outcome of the review on the 29th of February at the latest. So this was my short introduction, and Antoine and myself are now happy to take whatever questions that you might have. Please feel free, operator, to ask for the questions.

Questions and Answers

Operator: Thank you. As a reminder, if you'd like to ask a question on today's call, please press star one on your telephone keypad. And we do have a few questions coming through. Our first question is from Zain Ebrahim of JP Morgan. Please go ahead.

Zain Ebrahim (JP Morgan): Hi there. Zain Ebrahim, JP Morgan. Thank you for taking my questions. I've just got a few questions if I may. My first question would just be on revenues and the guidance cut there for 2023. How should we think about how much of that guidance cut is sort of due to the weakness you've seen at API solutions versus the changing environment you've seen in CDMO? And maybe if you could elaborate on the CDMO weakness that you've seen with the biotech customers in particular, how much visibility do you have on these customers and based on the contract wins you've had previously and visibility now, how much visibility do you have over 2024 revenue for biotech customers? Would be my first question.

And then my second question would just be on the Core EBITDA margin guidance you've now gone to 200 BPs wide, 9% to 11%. So just wanted to understand what the differences between the top end and the bottom end. And I think the exit rate implied is maybe high single digit margin for the second half. So is that the sort of margin we can think about as a starting point for 2024? And what other moving parts we must think about for 2024?

Karl Rotthier: Okay. Thank you. Thank you very much for your questions. I will let Antoine in a second come back to the core EBITDA question and the range of 9% to 11%. Your question first on the API solutions, the revenue for 2023. So what we see indeed and don't forget that we come out of an entire situation where almost one and a half years ago we were confronted with an energy and raw material price increase, which we were able to pass through to third parties and partially passed through to Sanofi. We made that very clear in earlier calls.

Now we see also, and that is very recent, that the market is changing in this environment leading to a lot of customers who are now destocking and off taking lesser volume, which leads then indeed to price decreases. As well that we see indeed with some customers coming on in the API solutions, which of course has a higher turnover than the CDMO projects that we were referring to because these were primarily projects coming from preclinical phase one or phase two, which are traditionally at a slower pace than the API solutions business that we have.

For 2024, that is too early to tell because that's why actually we are initiating this strategic review. We really want to make crystal clear whether the changing market trends that we currently see is there to stay, is there going to continue? How long will it continue? And then in the end, based on these different scenarios that we are going to have developed, what is then the right adaptation for the company and its organization. So that's why it is now a little bit too early to talk about 2024 revenues of biotech companies and the funding issues. We really want to have an in-depth analysis and a strategic review. Then on how long will it last and what do we need to do to adapt core EBITDA range from 9% to 11%, Antoine.

Antoine Delcour: So explained earlier by Karl, what drove this change in core EBITDA guidance for the end of this year was price pressure coming from the market on API solution plus a negative mix with lower contribution of CDMO activity and also the timing of the year give enough time for us to adjust I would say our cost baseline accordingly and which impacted also cost absorption. So it doesn't mean that this will be a flaw for the upcoming years, it's still working progress. It'll depend also on the mix of the sales we'll have in H1 and for next year. And so, we'll communicate to you what will be our guidance as early as possible.

Zain Ebrahim (JP Morgan): Great. Thank you. That's clear.

Karl Rotthier: Thanks, Zain.

Operator: Thank you. Our next question comes from Gary Steventon of BNP Paribas. Please go ahead.

Karl Rotthier: Hi, Gary.

Gary Steventon (BNP Paribas): Hi there. Thanks for taking the questions. So firstly, just on the revised top line outlook, just conscious that most of what you manufacture probably has lead times are in excess of a few weeks. So now we're in October. I guess you should have good visibility on the sales you expect to book for 2023. So given you've still got that two percentage point range on the sales outlook, can you just help us understand kind of where you still see risks, which could impact where you end up within that range?

And then secondly, you suspended the midterm outlook and there'll be the strategic review to adapt the operating model. So what does that mean for the ongoing capacity expansion projects you have particularly the peptide oligo capacity in Frankfurt that's due to come online in 2025. So is that something you still remain committed to and have confidence there'll be demand for when that comes online? Thank you.

Karl Rotthier: Let's start with the second question. Yes, we are indeed fully committed to that, that of course did not change at all. The lead time, 3% to 5% or the growth of 3% to 5%. What we also currently saw, and we have already some initial vision on that is that the market growth in the API business, where we are active in our portfolio is indeed only growing at a 3% to 4% range right now, which we, in the beginning, did not see, but now it's coming clearer because of these market circumstances that changed coming out of a period where the focus was fully on the price increase. Hence, we are indeed here more conservative on also our prediction of growth for the portfolio of 3% to 5% going forward as well.

Antoine Delcour: And what I would say to answer, to complete speaking about your question, I guess for the products you're producing, we have good visibility on pure and delivery time, but as we mentioned on the CDMO part of the business, because of the financing of the biotech, we see some delay of startup activities and so on, which could impair our capacity to deliver pipeline growth. And this is the reason why we kept the range 3% to 5% as one other reason in order to be also cautious on this aspect.

Gary Steventon (BNP Paribas): Thanks, that's clear. And could I just follow up as well, the strategic review, is that includes perhaps any kind of potential for sale or new ownership?

Karl Rotthier: That is at this point in time, certainly not the scope of the strategic review that we initiated now with the board. As I mentioned, we want to have a clear and in-depth analysis of what we estimate of being the current market and market growth, is that correct? And then adapt the organization according to these new insights, but no new ownership or something Gary, that has never, ever been discussed. Let me be very clear on that.

Gary Steventon (BNP Paribas): Clear, thank you.

Operator: Thank you. Our next question comes from James Quigley of Morgan Stanley. Please go ahead.

James Quigley (Morgan Stanley): Hi there. Thanks for taking my questions. Just a couple from me. So within the API solutions business, are there any particular products or product families or areas that are seeing more destocking than others? And again, is this purely due to the biotech funding? You mentioned the price focus and the inflation focus in the last couple of years, but from a volume perspective, how is that moving? And can you give us a bit of an idea of how the destocking will progress?

And secondly on visibility, so we've seen a number of profit warnings across the CDMO sector this year, but how would you sort of classify your visibility in terms of months currently? And how has that changed with respect to some of the factors that have led to your guidance cut?

And then finally, thinking about the midterm, and obviously you've withdrawn the guidance, but to what extent are the short-term pressures impacting some of your long-term features? So the increasing penetration in the CDMO market moving to more complex molecules in terms of your favorable mix. So obviously, you've withdrawn that, but to what extent of the near-term impact in that long term? Thank you very much.

Karl Rotthier: Okay. Thank you very much, James. So, on your first question. What we see in the API solutions business eventually more of the pressure coming that is indeed in those molecules, and we identified that also clearly when we mentioned 55% of our portfolio is highly differentiated and 45% is lesser differentiated, but still differentiated. We see that in the portfolio where you have higher volumes and you have a little bit more competition coming from both European companies and also from Indian companies. We do not see that really in our, let's say, prostaglandin business or in our highly differentiated hypo API business. So it is more the genericized higher volume business where you see this coming up.

On the visibility for the CDMO part. Did that change? Well, no, it did not change. What we saw currently in the market is indeed some projects, which we mentioned stopped or delayed because of these issues. And that's why we also initiated primarily the strategic review to also in-depth review. Okay, what is this? Do we need to now really have another path of going into the CDMO because we still are more focused there on the highly complex to make molecules both in the preclinical phase one and phase two. So that also did not did not change. The midterm guidance, yeah, it is now suspended, and I can only repeat myself, James. We need to have this in-depth strategic review in order to come with a new guidance for 2024, 2025 and 2026. Okay.

James Quigley (Morgan Stanley): Got it. Thank you. Thank you very much.

Operator: Thank you. As a reminder, if you'd like to ask a question on today's call, please press star one on your telephone keypad. And our next question comes from Vasia Kotlida of Berenberg. Please go ahead.

Vasia Kotlida (Berenberg): Hi there. The first question is why did this profit warning happen so late in the year? Like you didn't have visibility early on? Why did you wait until October? And the second one is, why should you do another strategic review since when you had the first profit warning you disclosed that you have reviewed your base, your cost base, and in general your profitability and your targets, and why should you suspend your midterm targets?

Karl Rotthier: Thank you. Thank you very much. So why now? I think a very obvious question, a very important one. We saw this indeed now coming up since last week. Since last week, we had actually our, like every other company start of the budget reviews, but also the predictions of volumes coming for the rest of this year primarily, and then also the indications of the other years to come. In that aspect, we indeed saw only last week for, okay, the business of this year in API solutions and CDMO might be lower than what we expected. And that's actually also the first time that we saw that the market circumstances are switching, are changing, because up till now, the price increase strategy and the push in API solutions will also, the project that the RFP that we have gained in in the CDMO part were, as we always explained to you, we pushed it on the price to third parties, partially to Sanofi because of the partial raw material pass through and half of the energy.

And here for the first time, we saw actually the destocking effect coming of our customers who are indeed now not accepting the higher price anymore in the market as well. So that is actually the reason why we only come now with this news because as at a certain point in time you need to of course prepare for the later months. And like all the other companies, we have three rolling annual forecast exercises per year. And this one was the rolling forecast three that we did.

The strategic review that we announced is then fitting in this plan because what we announced in March was still all based on a higher prices and also the increased volumes coming from the market together with the increased CDMO activity as well. So that is why, again, we are investigating in depth is the market trend that we currently see. Is that here to stay, yes or no? But in the meantime, we are fully transparent and it'll have an effect on what we expect from top line and bottom line this year.

Vasia Kotlida (Berenberg): Thank you.

Operator: Thank you. As we have no further questions, I'd like to turn it back over to your host for any closing comments.

Karl Rotthier: Well, I think unless you have other questions, many thanks for being available, having been available on such short notice. And I look forward to speak with you very soon. Again, thank you very much.

[END OF TRANSCRIPT]