**Procaps Group**
**Conference Call Transcript**
**3Q22 Results**

**Operator:**

Good day, and welcome to the Procaps Group Business Update Call and Webcast.

Today's conference is being recorded. Please note that some statements made during this call may contain forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995, and are subject to risks and uncertainties. Any statements that refers to expectations, projections and/or future events, including financial projections or future market conditions, is a forward-looking statement. The Company's actual results could differ materially from those expressed in such forward-looking statements due to a variety of risks, uncertainties and other factors including, but not limited to those set forth in Procaps Group's SEC filings. Procaps assumes no obligation to update any such forward-looking statements. Please also note that past performance or market information is not a guarantee of future results.

At this time, I would like to turn the conference over to Melissa Angelini is the Investor Relations Director of Procaps. Please go ahead Melissa.

**Melissa Angelini:**

Thank you and hello everyone. Thank you for standing by and welcome to the Procaps' business update call. This conference call is also being webcast and a link to the webcast is available on the Procaps' IR website at investor.procapsgroup.com. We appreciate everyone joining us today.

Please note that our press release was issued on Monday and can also be found on the Procaps' IR website. Please review the disclaimers included in the investor presentation. During the call, non-GAAP financial measures will be discussed and presented. We believe non-GAAP disclosures enable investors to better understand Procaps' core operating performance. Please refer to the Investor presentation for a reconciliation of each of these non-GAAP measures to the most directly comparable GAAP financial measures to.

Hosting today's call, we have Ruben Minski, our CEO and Patricio Vargas, our CFO. I will now turn the call over the Procaps' CEO. Please Ruben, go ahead?

**Ruben Minski:**

Thank you, Melissa and thank you all for joining us today for our 3Q and 9M22 results conference call. As an agenda, I wanted to provide everyone with an overview of our performance for the period, as well as give an update perspective of our strategy going forward. From there, I will turn it over to Patricio to take you through the more detailed specifics of our financial statements. At the end of our call, Patricio and I are both very happy to answer any questions you may have and additionally, please feel free to follow up as well with my podcast with or us or with Melissa.

Moving to slide 5, I wanted to share some highlights of the quarter and the 9M with you. Our top line sales and market share positions are right on track. I am very pleased with our results for the quarter and the year to date. We delivered solid numbers on the backdrop of significant foreign exchange and other macro headwinds.

Overall, our constant currency results show the resilience of our business segments and our portfolio diversification that continues to evolve with new products and new geographies. You will also hear from Patricio that we are very committed to structuring the Company for future organic and inorganic growth, investing in people, in systems and in processes.

We posted an 11% increase in net revenues in constant currency for the quarter and 15% for the 9M with our CDMO business growing 17% year-over-year.

On our B2C business, we posted a 40% growth in constant currency in the 9M22, supported by the very positive performance of our Rx and OTC products.

All our divisions, except for diabetrics, are growing in terms of revenue in constant currency for the quarter and for the 9M. Our new product launches have been key drivers of our overall growth, our renewal rate that is the percentage of our revenues from product launch in the last 36 months is at 24% year-to-date. The construction of our gummy facilities in the U.S. is on track and we expect to begin operations in the 1Q of next year.

As we continue to navigate through the dynamic operating environment, we remain very committed to our investments to fortify our businesses, portfolio, organizational structure and value chain by increasing our production capacity, continued investment in research and development and new product and diversifying our geographic footprint. We also expect to close Grupo Somar acquisition before the year's end.

Moving to slide 6, another important driver for our future growth is research and developments in new products. As I always have said, innovation around our properties or delivery systems is a very much of a key to our success. As of September, we launched over one 140 products in the region, continue to execute our geo expansion diversification strategy. The ramp-up of these products is going well.

We continue to invest approximately 5% of net revenues in research and development in pipeline and the business to realize that the value of the near and long term opportunities are very much in front of us.

Moving to slide 7, I want to take a deeper dive into explaining business segments performance. Our top line performance was broad based across several therapeutic areas. In general, main drivers for growth were increased demand for both of our Rx and OTC products, the rollout of our existing portfolio with new product launches, the higher market penetration in the Andean Region and the south of the Central America region and the higher demand for products and services for third parties. Our top line growth is indicative of our diversified portfolio, brand and market share execution.

The Nextgel business segment is growing consistently and the demand from regional and global businesses partners remained quite strong. Procaps Colombia, was the business unit most impacted by the currency devaluation, as Columbia is our biggest market today. In addition to the currency devaluation, it experienced a decrease in sales for the most relevant products of the ICU units in our clinical specialty lines.

Looking at our OTC on Rx lines in Colombia, growth was substantial almost 20% supported by the performance of products launched last year and increased demand for existing products. However, Procaps Colombia as a whole, grew 3% in the quarter and 9% for the first 9M on a constant currency basis.

CAN, that is Central American North, was positively impacted by the rollout of new products and portfolio expansion in several therapeutic areas such as gastrointestinal and feminine care. The low growth for this quarter is almost related to high comparison base in the 3Q21. CAN started to increase its sales after an 18-month period of inventory normalization in the trade, which caused lower than normal sales in the previous quarters.

CASAND, or Central America, South and Andean Region, grew 25% in 9M22 in constant bases. The increase was a result of higher demand and the rollout of new products in the region and the increased market share over existing brands.

Finally, our diabetrics SBU increased 16% in the 9M22 and 22% in the 3Q on a constant current basis. Impacted by the delay in the launch of one of our insulin products, which was due to a product with a device supplier. The issue has been already resolved and we are very happy that acceptance of the product, looks quite promising.

We were also affected by the delay in Invima, which is the Colombian Registration Office, to register products. Invima suffered some cyber security issues during this year and several registration processes got very much delayed. For diabetrics, we were specifically waiting for a new follow-on products that was going to replace all the versions in the market and those products were not yet launched.

With that, I will ask Patricio to review our financial statements before we take on Q&A.

**Patricio Vargas:**

Thank you, Ruben. In the next slide, I would like to give you a little more color on the 3Q and 9M22 results.

Moving to slide 9, you can see our top line evolution. In the consolidated view, we ended the quarter with a net sales growth of 11% in constant currency and an equivalent of 15% for 9M. The increase was mainly driven by positive performances in Nextgel and CASAND business segments, and Rx and OTC products, as Ruben already showed you.

Currency devaluation, especially in the last few months, negatively impacted our revenues by US$8 million in the quarter and by US$16 million in the first 9M. Although in the long term, we have ways to transfer most of these impacts to the market, we must continue to monitor the evolution of the currencies where we operate, but in particular, that of the Columbian peso, given its weight in our results. Our 4Q revenues may be negatively affected if the Colombian peso does not correct soon.

Moving to slide 10, on the gross profit line, we reached US$68 million in 3Q22 and US$187 million for the 9M22 with a 64% gross margin in both periods. This result is due to a positive exchange rate impact on costs and a better sales mix.

We are also showing our consolidated contribution margin, which includes the impact of sales and marketing expenses. Here you can see that we have been able to defend the margin in these challenging markets, but we are improving and that the business performance is solid, even with the higher expenses we have in the period.

Moving on to the next slide, we have the breakdown of our SG&A. In addition to the impact we had in the top line by the exchange rate, in this slide, you can see that SG&A is also impacting our EBITDA as we continue to invest in our product brands to increase market share, reinforcing the organizational structure and preparing the Company for future organic and inorganic growth.

SG&A expenses increased by 15% in the quarter and 19% in the 9M22. This was mainly due to the return of in-person promotional events and stronger commercial and marketing efforts, the increase in costs associated with higher personal headcount and the cost of being a publicly listed company and the fact that we have restructured the Company for future growth with new hires, systems and processes improvements.

All of these expenses, which were not part of most of the year 2021, negatively impacted our adjusted EBITDA, which totaled US$23 million in the quarter and US$60 million in the 9M22. As a measure to compensate this, we are working on price increases, contract adjustments whenever possible, improvement of our product mix with new launches and containing cost, so we can continue to protect our margins going forward. As we continue to grow as planned, we will be diluting most of these expenses as well as reducing some of them as we become a more efficient organization in our new context.

Looking into the 4Q and beyond, we see that the challenges we are facing will linger for a while. We think it is reasonable to adjust our guidance now as we believe with current market conditions, adjusted EBITDA for the full year could well move closer to the low 90s area, negatively affecting 4Q22 and even early 2023.

Despite these hurdles, we remain happy with the results so far and optimistic about our ability to deliver growth in the long term. For the time being, as we are not blind to these challenges, we will continue to work in a disciplined and creative way to improve our results quarter-over-quarter.

Finally, on slide 12, as of September 20, 2022, we have a view of our balance sheet. You can see that cash balance has decreased as a result of increased working capital needs to increase inventory to provide support to the supply chain challenges we have been facing, increase our CAPEX to support the future growth and increased expenses associated with being a public agency and financing M&A projects.

Due to this, our net debt levels have slightly increased with the resulting 2.2 times net debt to adjusted EBITDA ratio, but we remain in a healthy financial position to take on the increased leverage that will come on the back of the Grupo Somar acquisition.

In summary, although we are facing some challenges external to our operations such as strong currency devaluation, global supply chain restrictions and inflationary pressures and economic uncertainties, we are confident in the fundamentals of our market, and we believe we will see operating leverage as we continue to grow our revenues and after executing and integrating our M&A deal.

With that, I will pass it back to Ruben.

**Ruben Minski:**

As I said before, we are very proud of our performance. Our results support our belief that we have the competitive advantage capabilities, the right team and effective strategies to continue growing even in challenging scenarios. We are demonstrating impressive resilience across all aspects of our business in a very challenging global environment, with variables that are always within our control.

We are growing in constant currency and we are making the necessary investments in our businesses. We also expect to see operating leverage as we integrate more M&A and drive their synergies. The demand has remained consistent and the key growth drivers remain quite unchanged.

We will continue to benefit from population growth and aging trends under related higher expenditure. This will continue to lead to double-digit growth with our innovative product portfolio.

Thanks very much for listening and we welcome up any questions that you may have.

**Yan Cesquim, BTG Pactual:**

Good evening. I have one question here on my side about Procaps Colombia. We see here that there are too main effect pressuring net revenues growth in the business unit. The first one is the effect of local currency depreciation and the other one is the sales of clinical specialties products and, the distributor stocks after the pandemic.

My question here is regarding the timing for the normalization of this demand, right. So ex currency, when do you expect this organic growth of Procaps Colombia to resume back to normal levels. Thank you.

**Ruben Minski:**

Thank you for your question. It is an estimate we need to make. We do not know the exact amount of inventories at the time, what happened is that some of the distributors at the end of last year were a bit nervous and therefore they did stop themselves with our product and they have been pushing that into the market.

I think it is too early to say, or to have an effect in the 4Q. I think it is more likely that we should see more normalized levels by the 1Q; for sure by the 2Q, maybe by the 1Q23.

**Kemp Dolliver, Brookline Capital Markets:**

Good day. I have a couple of questions. A couple of questions related to working capital. Your days receivable have extended a little bit since yearend. How much of that is seasonality and how much of that is a reflection of the macro environment, whether it be your translation of receivables or extension of terms to help customers?

**Ruben Minski:**

Kemp, thanks for your question. I would say that most of the expansion we have had in receivables is related to the current environment. You can see in the air, whenever you look, that there is tightness, or people preparing themselves for more complicated times. So you can see an extension of those receivables.

**Kemp Dolliver:**

Thank you for that. And then, somewhat related, you had built up inventory over the last few months to address supply chain issues. How would you rate the success of that effort so far?

**Ruben Minski:**

Kemp, I think we have reached the point where we feel comfortable. When you compare us with the end of year, end of 2021 inventories, we have increased by a bit more than US$20 million in terms of value. So of course, that is not spread evenly across every business line, so there may be some adjustment that we still need to make, but on average, I would say we have reached the level that we want. So we will not see much more pressure on this side, and hopefully, we can start beginning next year, to go back to more normal levels.

**Kemp Dolliver:**

Great. Thank you. And my last question relates to reimbursement in the pharmaceutical business across the region. How have the government payment formulas adjusted with the higher inflationary environment? Is it a lag effect that is causing some pressure on you, or have the adjustments been closer to current cost increases?

**Patricio Vargas:**

We have been able to pass most of them to the system. I am very happy that whatever we have not been able to do, we have been able to discontinue the product for them, or just stop selling the product. So we have been able to move in a very solid way in this ecosystem of high devaluation, high inflation rates, and the logistics difficulties.

But at the end, just to answer your question, yes, we have been able to pass most of these difficulties to market in almost all the cases. In some of them, you will find that we will not see them until probably 1Q23, the actual raises in prices, but I would say more than 70% or 80% of them we are already seeing in the 4Q.

**Operator:**

Showing no further questions, this concludes our question-and-answer session, as well as today's conference. Thank you for attending today's presentation. You may now disconnect.