Procaps Group
Conference Call Transcript
2Q23 & 1H23 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 statement 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 future 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, Investor Relations Director for Procaps. Please go ahead.

Melissa Angelini:

Thank you. Hello, everyone. Thank you for standing by and welcome to the Procaps business update call. We appreciate everyone joining us today.

This conference call is also being webcasted, and a link to the webcast is available on the Procaps IR website. The questions received through the webcast platform will be answered by email. Please note that we filed our earnings release today, which can also be found on the IR website. Please review the disclaimers included in the investor presentation.

During this 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.

Now, I would like to turn the call over to Procaps' CEO. Please, Ruben, go ahead.

Ruben Minski:

Thank you, Melissa, and thank you all for joining us today for our second quarter and six months of 2023 results conference call.

I wanted to give you an update on how we are doing and where we are headed. While we faced a tough 1H23, and it is true that we did not do as well as we hoped, the measures that we have started implementing late last year are already bearing the results of our full recovery.

We are continuing to work on our value creation and market growth initiatives and speeding up our plans to make the Company better in the medium and long term. The toughest issue we have had to deal with this year is the macroeconomic environment that challenges the entire industry in our region. We are affected by multiple factors such as rising costs and expenses from inflation, high interest rates, and cost of financing, reduced orders from pharma companies in our CDMO business due to working capital concerns.

We believe these impacts are temporary, and we are taking decisive steps to tackle them, adopting strategies to protect profitability, despite being unable to fulfill or fully pass all costs to customers on a timely manner. Relief should come later in the year.

The steps that we are taking are related to our already announced value creation initiatives and additional operational efficiency efforts, which will strengthen and streamline our operations by the end of this year, and absolutely fully in 2024. In our path to full recovery, we believe 3Q will have a better performance than 2Q23, very much in line with last year's 3Q, and we strongly believe that the 4Q23 would be a very strong quarter.

When we look at the growth per business lines, we have Rx growing approximately 15% in the 1H23, outgrowing the market by a quite a good percentage, especially in countries like Colombia, Ecuador, Honduras, Dominican Republic and Panama. Clinical Specialties grew approximately 6% in the same period on a constant-currency basis, and in CASAND region, we have found excellent growth of approximately 26% in the 1Q23 with the new important launches for the 2H23.

We believe our growth plan, including these new product launches and rollouts, combined with our value creation initiatives will result in strong demand of our aggressive plan to reduce expenses and generate efficiencies will position us for continued growth. We are focused on the medium to long term, committed to refining plans for a resilient organization beyond short term hurdles.

Moving on to slide 4, another important driver for our future growth is new products. Our new product launches have been a key driver for our growth. US$66 million in revenues for new products in the 1H23. Our renewal rate that is a percentage of our revenues coming from products launched in the last 36 months was a record of 34% in the 1H. We will continue to prioritize investments in our pipeline and business to realize the value of the near and long-term opportunities in front of us.

Ramp up for products launched in the last 36 months is performing quite well, highlighted several products, such as Aludel, which is an oncological prostate cancer product and Dolofen Xtra, which is the first ever Unigel triple combo for migraines. And this is just one example where we can see our own patented technologies playing an important role in and delivering a differentiated product to the marketplace.

Now I will pass it over to Melissa who will share a little about our ESG progress.

Melissa Angelini:

Thank you, Ruben. On this slide, we are going to share a little bit about our ESG initiatives and accomplishments. In 2023, we celebrated the 10-year anniversary of Procaps foundation that promotes quality of life improvement of several communities through education, nutritional, emotional health, skill developments, reproductive health and empowerment.

We are also increasing our product portfolio for prioritized conditions according to the sustainable development goals by United Nations and Access to Medicine Foundation for LATAM, such as cardiovascular and oncology.

Another important aspect is that we are also advancing on our packaging innovation initiatives. Unigel, for example, that Ruben just mentioned, besides plastic demands reduction, deploys different environment benefits across the whole supply chain. Reduces the demand for other packaging materials as well as contributes to the deliver treatments with less GHG emissions fuel and energy consumption. Lastly, we are working on our carbon neutrality strategy, and we will keep you posted on the progress.

I will now pass it over to Patricio who will comment on our operating results.

Patricio Vargas:

Thank you, Melissa. Moving to slide 6, you can see our top-line evolution. Although the Colombian peso has had an important appreciation since April, currency has still been a negative for us in the 2Q compared to last year. And because of that, it is important to look at constant currency to evaluate the health of business. So excluding this impact, on a constant currency basis, we ended with an increase of 4.3% in revenues for 2Q23 and 7% for 1H23, which was negatively impacted by CDMO order phasing, especially for US clients, decrease of sales related to Rymco ceased operations, and a decrease of sales in the OTC market in El Salvador.

In addition to this, I think it's worth mentioning that in 2Q22, there was a recognition of sales of brands in the amount of approximately US$3.5 million, leading to a higher comparison base.

The top-line growth was broad based across several therapeutic areas with increased demand for both our Rx and Clinical Specialties products which grew 15% and 16% respectively in 1H23 versus 1H22.

As just mentioned, the Nextgel business segment has been negatively impacted by challenges that also affected our partners, resulting in lower inventory levels on their side, delaying orders on our side. We anticipate a few more months of pressure before improving towards the end of the year where we already have important commitments for new orders.

Procaps Colombia was impacted by overall macro conditions in the country that have translated in customers reducing their purchase orders to improve their working capital. Exchange rates are now starting to help in the first part of the 3Q, bolstering our recovery for the rest of the year, and was positively impacted by the rollout of new products and portfolio expansion in several therapeutic areas such as gastrointestinal and feminine care, and strong performance in Nicaragua and Honduras, but this positive impact was offset by the OTC segment in El Salvador.

Negatively impacting the year-over-year comparison, we can see that the 2Q22 has a higher comparison base as we sold brands last year. [

CASAND was positively impacted by the higher demand and the rollout of new products in the region and the increased market share of existing brands.

Finally, our Diabetrics business segment is in a transition year. We are working on several synergies and focusing on portfolio renewal and internationalization.

Moving to slide 7, I would like to give a bit more color on our gross profit, which was down from last year. Both in the quarter and in the 1H23, we saw higher costs, a less favorable sales mix and lower sales of high margin product development services. In addition, we had the recognition of sales of brands in the 2Q22 which positively impacted gross profit for the prior period. Additionally, we weren't able to fully pass on higher cost to customers, but we are quickly adapting strategies protect profitability. Consolidated contribution margin is impacted by the same reasons above, partly offset by lower sales and marketing expenses.

On slide 8, we have the breakdown of our operating expenses and adjusted EBITDA. Looking only at SG&A expenses, there was a decrease of 15.4% in the quarter and 10.4% in the 1H23 versus the same periods of last year, reflecting already the measures we have taken to improve our financial results. We continue working on the execution of our value creation initiatives with price increases, contract adjustments, improvement of our product mix with new launches and containing costs.

Our adjusted EBITDA has negatively impacted by the effects we have seen in gross margin and higher comparison base in the 2Q22. Despite these hurdles, we are optimistic our ability to deliver growth in the medium to long term. For the time being, as we are not blind to the challenges, we will continue to work in a disciplined and creative way to improve our results quarter-over-quarter.

Turning to slide 9, we can take a look at the main items of our balance sheet. The cash balance for the 1H23 has decreased mainly due to the low results we had in the 4Q22, which traditionally is the strongest quarter in the year and the one that provides the cash to endure the lowest months of the year. In addition, working capital increase and debt service impacted on the overall cash generation.

Our leverage had only a slight increase, but the lower adjusted EBITDA combined with a decrease in cash impacted our net leverage targets. Despite this, we are in compliance with our debt agreements as we secure the necessary waivers to continue though these tough quarters. We forecast our cash flow for the next few months, we will continue to work on several initiatives while doing our business strategy and operations as well as our capital allocation priorities in order to increase the cash generation and maximize our long-term value.

When we look at the guidance for the year, we see some risks that we are working to mitigate. The political macro environment in Colombia could affect our business if the economic conditions deteriorate or if there are changes in the health care regulation. The continued cash pressures for some of our CDMO clients could pressure them into further the tightening of the working capital, therefore reducing their purchase order for the 2H. How this risks and our plans evolved during the year will be key to fulfilling our estimates. As the year evolves, we will keep you abreast of our estimates for the year.

With that, I will pass it back to Ruben.

Ruben Minski:

Thank you all for participating. If you want, please remember only four things from this call. I will ask you to keep in mind that number one, we are conscious, very conscious of the temporary hurdles, and we are working on them, all of them, or most importantly, the fundamentals and the demand for recreational products are as strong as ever.

We are executing at full speed our previously announced company-wide value creation initiatives extended to the right size of our business to current levels of market demand and deliver value to our shareholders and in 2023 in a much stronger operational and financial position. We are advancing in our CEO search process and I believe we will be able to be ready, at year end, as we anticipated.

And finally, we are always mindful of our low stock liquidity and continuing with our buyback program and other measures to enhance liquidity as well as shareholder value.

Thanks for listening, and we welcome any questions that you may have.

Kemp Doliver, Brookline Capital Markets:

Thank you, and good morning. I have a couple of questions. I can ask one or two and then go back into queue. The first question relates to the working capital accounts, most notably accounts receivable, but certainly inventories. Have you made any progress with either of those since the end of June, or is that still to come?

Patricio Vargas:

Kemp, thank you for your questions. We have made advancements, but there have been delays, as we mentioned in the press release and in now in the speech. The pressure that some of our customers have had to reduce their working capital, both abroad and the US and also due to the economic conditions in Colombia have made it harder to sell the full amount that we had anticipated. So that has put pressure on our efforts to improve our working capital.

But we are on track. I think I mentioned that we have several initiatives for cash improvement, and many of those are centered on accounts receivables and inventories, and we intend to improve it. I am not sure if that's what you were trying to say.

Kemp Doliver:

Thank you. That did get to the heart of the question. So my second question relates to Alejandro. I see he resigned again. Unfortunately, this kind of Board turnover does not cast things in a good light. Can you talk about the direction you are trying to take and how to have some stability with the Board?

Ruben Minski:

This is an excellent question. We were sorry to see Alejandro resign again. We feel that he was very impatient. Of course, he did not agree 100% with all the speeding which the Board wanted to implement a few ideas, and we were very much in line with many of his comments, but not in all of them, and he got very impatient. But nevertheless, he decided to leave.

He did leave, of course, a representative in the Board of his choice, and we will have everyday discussions with him. We feel very confident in the Board that the agility and the way we are facing the future of the Company, it is in very good terms. It's in very good shape, and we are getting great results along the way.

Kemp Doliver:

Great. So, what progress have you made since 1Q with regard to the US operation in Florida?

Patricio Vargas:

Thank you, Kemp. We have advanced significantly our operation in Miramar, the one that is the new facility for Funtrition, for the gummies. It has already started packing operations for third parties, and we are finalizing the setting up of all the machinery and we should be starting in a couple more months. At most, we should be starting the testing, the ramp up, and hopefully we can start producing and probably early next year. We think there's a possibility we can start by the end of this year, but we do not want to be overly optimistic. But, I think we are running on course for that.

And for the other one, for Softgel, if you remember, one of the main benefits that I was providing was to help us with R&D for the whole organization, and that has been happening and it has been helping us streamline that process.

And in addition, we are registering products and we are advancing to start sales during the year 2024. We already have some sales, but probably meaningfully, you are going to see an impact as we told from the beginning in the year 2024. So I think 2024 is the year in which you are going to see the two operations starting to bring the benefits that we anticipated.

Dimitri, private investor:

Congratulations on the completion of the quarter. Just wanted to maybe a little bit more sort of backup, or better understanding of the optimism you have of improvements in 4Q, you highlight it's going to be a strong quarter. Maybe just give us an indication, is that based on actual orders or contract? Maybe just kind of if you can help us understand the optimism that you guys expressed about the 4Q23?

Ruben Minski:

Thank you, Dimitri. As we mentioned, the CDMO business had some delays in orders because of the working capital policies of some of our large pharma customers, but these are already in place. We have a very strong portfolio of orders for the 4Q23. We also feel that we will be having all the tailwinds of the reevaluation of the Colombian Peso at that time. And definitely, there will be launches in September and October of this year that will be significant for reassuring the 2H23 as being excellent, at least in the 4Q.

As we mentioned, the 3Q will be good, but not significantly higher than last year's, but the 4Q is definitely going to make a very big difference with what we had last year.

Dimitri:

Okay. Also, in terms of the two Florida facilities, can you give us a sense of sort of what should we expect in terms of revenue or EBITDA once they are fully around time? Is this something that you can kind of give us a sense of how much they will add incrementally to your business?

Patricio Vargas:

Dimitri, unfortunately, we have not disclosed that information, so we cannot tell you at this point. I think that once both facilities are producing and selling, they are going to be part of the of the disclosure of business segments, and therefore, we will be able to talk more and set that aside. But right now, we have not given that information, so I cannot give you that estimate. I am sorry about that.

Participant:

If I can ask the last question, just any updates on M&A, sort of how you guys thinking about potentially some accretive deals to kind of help you grow inorganically? What's the landscape? What are you seeing? Are you active? What can you tell us?

Patricio Vargas:

That's also a very good question, Dimitri. I would say that the intent and our strategy has not changed from the moment we became public. So we do want to grow inorganically. It is a part of our strategy and we intend to do it.

I would say, given the setback that we had in the last part of last year, that we are recovering and that we have a tight cash, I think the focus for this year is definitely executing the efficiency plans, the value creation initiatives, getting back to our cash position, improving our EBITDA so that we can regain our leverage capacity.

So we are still looking at the market, but right now at this very, very moment, we could not be able to do it, only marginal. So I think it's more reasonable to wait until the year 2024 when we are back in full steam.

Dimitri:

And my last question, you had a comment about increasing liquidity of the shares. Are you thinking about that? That was kind of your last comment in the presentation. Maybe if you can expand on that a little bit.

Patricio Vargas:

We have been executing since, I think it was end of June, I might be missing by a couple of days, but I think from the end of June, the program of the buyback. It's been a slow-moving program given that we have low liquidity but I think it's been helpful in the sense that without that program, probably the liquidity would be even worse, or even lower. We think we need to continue doing it. Despite the fact that it's not so good or despite the fact that it takes some of our cash, we think we need to still be doing there in order to help that liquidity albeit small.

Other measures that we want to take is that, we have been discussing with others more boutique or smaller investment bank so that they can help us bolster our presence in the market, try to get more coverage, trying to attend more conferences and, more importantly, trying to get the story to a broader base of investors.

We have an investor base that has not changed that much since we did the IPO, the de-SPACing. So therefore, I think we do need to take the story and convince more potential investors, and that in its turn, it will be able to enhance the trading and the liquidity of the Company.

So we are optimistic that we will get there, it's just taking us longer than we that we anticipated. And probably the last thing as we recover results and we fulfill our promise to the market, I think that will also help in a virtuous circle to try to also to get more liquidity and more investors.

Kemp Doliver, Brookline Capital Markets:

Thank you. You recently signed a new debt agreement. Could you highlight the significant changes in the agreement over your prior agreements?

Patricio Vargas:

Yes, Kemp. We were running close to ending the syndicated facility we had before, which was roughly US$40 million. We only have about a year left, a year and a few more months left with amortizations. We work, as you know, constrained in cash. So we renegotiated that syndicated loan into a club deal for roughly US$60 million. The amount we are negotiating in Colombian Pesos, but roughly US$60 million. So we also tied other higher cost debt and put it all together into this club deal.

But I would say the most important benefit for us is that we were able to extend it. The new maturity was pushed forward to six years with amortizations after a grace period, but first, it put some order into our debt, extend the terms, and I think the strategy at this moment is, we need to make sure we get back to our numbers, get back to our profitability, reduce our net leverage, and then with improved numbers, then we can start to think about the next phase of our financing. Right now, it was something that we needed to do in order to continue with our plans.

Kemp Doliver:

Okay. And just to be clear, is the short-term debt, shown on the balance sheet at the end of June going to decrease?

Patricio Vargas:

Yes. There will still be short term debt, but the long-term debt will increase. Correct.

Kemp Doliver:

And what's a good estimate for the short-term debt near term?

Patricio Vargas:

Near term, probably, I would say, US$100 million of short-term debt with roughly US$180 million of long-term debt. Rough.

Operator:

This concludes our question-and-answer session and concludes our conference call today. Thank you for attending today's presentation. You may now disconnect.