**Embecta Corp.**
**Q2 FY 23 Earnings Call Script**
**May 12th, 2023**

Please standby. Welcome, ladies and gentlemen, to the fiscal second quarter 2023 embecta Earnings Conference Call.

At this time, all participants have been placed in a listen-only mode.

Please note that this conference call is being recorded and that the recording will be available on the Company's website for replay following the completion of this call.

I would now like to hand the conference call over to your host today, Mr. Pravesh Khandelwal, Vice President of Investor Relations. Please go ahead.

Thank you, operator.

Good morning, everyone and welcome to embecta's fiscal second quarter 2023 earnings conference call.

The press release and slides to accompany today's call, and webcast replay details, are available on the Investor Relations section of the Company's website at www.embecta.com.

With me today are Dev Kurdikar, embecta's Chief Executive Officer; and Jake Elguicze, our Chief Financial Officer.

Before we begin, I'd like to remind you that some of the matters discussed in the conference call will contain forward-looking statements regarding future events as outlined in our slides. We wish to caution you that such statements are, in fact, forward-looking in nature and are subject to risks and uncertainties and actual events or results may differ materially. The factors that could cause actual results or events to differ materially include but are not limited to, factors referenced in our press release today as well as our filings with the SEC, which can be accessed on our website. In addition, we will discuss certain non-GAAP financial measures on this call, which should be considered a supplement to, and not a substitute for, financial measures prepared in accordance with GAAP. A reconciliation of these non-GAAP measures to the comparable GAAP measures is included in our press release and conference call presentation.

Our agenda for today's call is as follows:

- Dev will begin by providing an overview of embecta; our strategic priorities for 2023; and some remarks on the overall performance of our business during the second quarter;
- Jake will then provide a more in-depth review of Q2 financial results, as well as our updated financial guidance for the year;
- We will then open the call for questions.

With that said, I would now like to turn the call over to our CEO, Dev Kurdikar.

Dev….

Good morning everyone and thank you for joining us today.

The end of the last quarter marked one year since we officially launched embecta and kicked off a bold new chapter for a company that has been integral to the evolution of diabetes care over the past century.

It has been a remarkable year, from ringing the bell at Nasdaq twice, to transitioning our global employees from BD's HR systems to our own embecta systems, moving into approximately 30 offices around the world, attending more than 30 conferences and symposiums, and serving an estimated 30 million people in 100-plus countries.

For all of those milestones, it's that last number—the 30 million people with diabetes who use our products—that motivates our global embecta team. As you know, our mission is to develop and provide solutions that make life better for people living with diabetes, and we are proud to have a role in helping them live their lives with fewer limitations. We remain driven by a sense of urgency to accelerate the journey to better diabetes care - something we've been doing for nearly 100 years now. Our accomplishments in the first year since our spinoff from BD have made me even more excited for what the future holds for us - and for people living with diabetes.

Our strategic priorities for Fiscal Year 2023 are shown on slide 5.

First, we are focused on strengthening our base business, while maintaining our global leadership position in the category of insulin injection devices.

Second, we want to finish the work to operationally stand-up and separate embecta as an independent company.

And finally, we intend to continue investing in R&D, most notably around our patch pump that is being developed for the type 2 market, as well as seek M&A and additional partnership opportunities.

Moving to slide 6.

During the first six months of our fiscal year, we have made progress in each one of those strategic priorities, yielding results that have exceeded our internal expectations.

In terms of solidifying our base business, we have continued to deepen our partnerships with key customers resulting in winning preferred brand status, implementing growth initiatives, and signing multi-year agreements with major retailers and payers. These strengthened partnerships are in addition to us being awarded exclusive preferred status on the Express Scripts National Preferred Formulary as well as pen needle and insulin syringe contract wins from the US Department of Veterans Affairs, as noted last quarter.

Additionally, we are helping patients shift behavior to clinically recommended best practices through a dedicated media campaign, educational materials, and retail pharmacy programs, thereby helping raise awareness of the importance of using a new needle with each insulin injection and maintaining an adequate supply of needles.

And recently we held our first industry-sponsored educational symposium at the Advanced Technologies and Treatments for Diabetes Conference.

Second, we continue to make progress in our separation efforts, as demonstrated by the exit of several transition service agreements, as we continue to build up our internal organization, systems, and processes.

We also published our inaugural ESG strategy report, providing a summary of how we are managing environmental, social and governance issues. This initial report sets the stage for how we operate our business, engage with our stakeholders and drive results that we believe will support the sustainability and strength of embecta well into the future.

And we signed a co-promotion collaboration agreement with PolyPhotonix, under which our commercial teams in the UK and Ireland will promote PolyPhotonix' sleep mask used for the management of two common sight threatening complications associated with diabetes; as well as entered into an agreement with Tidepool to help develop automated insulin delivery solutions for people with type 2 diabetes, using our proprietary patch pump.

Our global team has continued to execute our key commercial programs which is allowing us, once again, to raise our guidance for key financial metrics.

Before I discuss our revenue performance, I'd like to share some additional details regarding our recently announced partnership with Tidepool.

Our collaboration agreement with Tidepool is focused on the development of an automated insulin delivery system for people living with type 2 diabetes, a population that we believe could be better served by an AID system tailored to meet their unique needs.

Under terms of the agreement, embecta will leverage Tidepool's expertise in diabetes management software to develop an AID algorithm for our closed-loop patch pump system that is being designed with the specific needs of people living with type 2 diabetes.

The recent FDA clearance of the Tidepool Loop for type 1 diabetes, an algorithm technology that started as a patient-led initiative, affirms that Tidepool's approach to AID system development combines patient insights with a robust diabetes management solution.

We are very excited to be able to work with the team at Tidepool, and to collaborate on the development of a patient-centric type 2 automated insulin delivery system.

Next, let's review our second quarter, and first half of the year, revenue performance in a bit more detail.

During Q2, we generated revenues of $277.1 million, which represented an increase of 0.9% on an as-reported basis, and 4.0% on a constant currency basis.

These results exceeded our internal expectations and included U.S. revenues which totaled $146.4 million and grew 3.6%; as well as International revenues which totaled $130.7 million and grew 4.4% on a constant currency basis.

The year-over-year growth in the U.S. was primarily driven by the contract manufacturing and sale of certain non-diabetes products to BD which did not occur in the prior year period and accounted for approximately 2.5% of the year-over-year growth; an adjustment to our rebate reserves which contributed approximately 1% of year-over-year growth; and favorable pricing dynamics. This was partially offset by the unwinding of the previously communicated timing benefit of certain distributor orders in Q1.

Turning to our performance outside of the U.S.

During Q2, the year-over-year growth within our International business was primarily due to an increase in product volumes, which were aided by a competitor product supply shortage in certain regions, and a timing benefit of certain orders which we expect to unwind during the remainder of the year. As we have communicated before, it is not uncommon for us to get timing benefits from distributor orders in any particular quarter that get unwound in succeeding quarters.

Turning to our revenue performance for the first six months of the year, we generated revenues of $552.8 million, which represented a decrease of 2.0% on an as-reported basis, but an increase of 2.3% on a constant currency basis.

The year-over-year constant currency growth was due to a combination of contract manufacturing revenue, which contributed approximately 1.3%; and our base business performance, which contributed approximately 1.0%.

That completes my prepared remarks, and with that, let me turn the call over to Jake to discuss our Q2 financial results in a bit more detail, as well as provide our updated fiscal 2023 financial guidance and underlying assumptions.

Jake…

Thank you, Dev, and good morning, everyone.

Before I discuss the financial results for the three-month period ending March 31st, I would like to remind the investment community that embecta was spun-off from BD on April 1st, 2022, and that the financial results during the pre-spin periods were based on carve-out accounting principles, and **do not reflect** what embecta's financial results would have been had embecta operated as a standalone public company. Therefore, the financial results for the three and six-month periods ending March 31, 2023, and March 31, 2022, are not meaningfully comparable.

Given the discussion that has already occurred regarding revenue, I will start my review of embecta's financial performance for the second quarter at the gross profit line.

GAAP gross profit and margin for the second quarter of fiscal 2023 totaled $189.8 million and 68.5%, respectively. This compares to $191.2 million and 69.7% in the prior year period.

The year over year decline in GAAP gross profit and margin was driven by the negative impact of inflation; the impact of low-margin contract manufacturing revenue that was not in the prior year period; and incremental stand-up and separation costs, including the markup on the purchase of cannula from BD.

While on an adjusted basis, gross profit and margin for the second quarter of 2023 was $190.1 million and 68.6%, respectively.

The adjusted gross margin performance during the second quarter was better than we previously expected due to a greater than anticipated benefit from pricing, as well as favorable product mix.

Additionally, adjusted gross margin during the quarter was also aided by two items that are not expected to reoccur during the second half of the year. These two items relate to the adjustment to our rebate reserves which Dev mentioned, and a year-to-date true-up of certain charges from our former-parent, that when taken together, positively impacted adjusted gross margin by approximately 200 basis points as compared to our previous expectations.

Turning to GAAP operating income and margin, during the second quarter they were $55.6 million and 20.1%, respectively. This compared to operating income and margin of $98.9 million and 36.0%, respectively, in the prior year period.

The decline in year-over-year GAAP operating income and margin is primarily due to an increase in Selling and Administrative expenses associated with separating and standing up embecta to operate as a stand-alone publicly traded company; as well as an increase in Research and Development expenses, including amounts paid in connection with the collaboration arrangement signed with Tidepool to develop and commercialize an interoperable automated glycemic controller to complement our insulin patch pump currently in development.

While on an adjusted basis, during the second quarter of 2023, operating income and margin totaled $84.9 million and 30.6%, respectively.

The adjusted operating income and margin performance was better than we previously expected, due to the overachievement at the gross profit and margin line that I referenced earlier.

Turning to the bottom line.

GAAP net income and earnings per diluted share was $14.0 million and $0.24 per share during the second quarter of fiscal 2023. This compares to $79.6 million and $1.38 in the prior year period.

As I mentioned at the outset, because the financials for pre-spin periods were prepared on a carve-out accounting basis, the comparisons of pre-spin to post-spin periods are not meaningfully comparable. One example of this is the additional operating expenses necessary for us to operate as a stand-alone entity, while another is interest expense, which burdened our P&L in the current year by $26.8 million, but was only $4.9 million in the prior year period.

While on an adjusted basis, net income and earnings per share were $43.3 million and $0.75 per share during the second quarter of fiscal 2023.

Lastly from a P&L perspective, for the second quarter of 2023 our adjusted EBITDA and margin totaled approximately $96.7 million and 34.9%.

Like our adjusted operating profit, due to the revenue and gross profit overachievement in the quarter, our adjusted EBITDA during the second quarter also exceeded our previous expectations.

Finally, with respect to our balance sheet and financial condition at quarter-end.

As of March 31st, 2023, we held approximately $346 million in cash and cash equivalents, and approximately $1.64 billion in debt, which taken together with our last-twelve months adjusted EBITDA, resulted in a net leverage ratio of approximately 3.1x.

That completes my prepared remarks as it relates to embecta's financial results for the second quarter of fiscal 2023.

Next, I would like to discuss embecta's updated 2023 financial guidance and certain underlying assumptions.

Beginning with revenue.

Given our performance during the first half of the year, we are once again increasing our constant currency revenue guidance range, as we are now calling for full year 2023 constant currency revenue growth of between zero and 1%. This is an increase as compared to our previous range which had called for a decline of 1.5% on the low-end, to 0.5% of growth on the upper end.

This new range translates into a second half of the year constant currency revenue range of between flat to down approximately 2%.

The low-end of our new constant currency revenue range assumes no additional contract manufacturing revenue during quarters three and four, which would result in a headwind of approximately 3% during the second half of fiscal 2023. As you may recall, we generated approximately $15 million of contract manufacturing revenue during the second half of fiscal 2022. The headwind from the lack of additional contract manufacturing revenue is expected to be somewhat offset by our base business growing at approximately 1%, or consistent with the performance achieved during the first half of the year.

While the high-end of our new constant currency revenue range assumes a modestly smaller headwind associated with contract manufacturing revenue, and a slight improvement during the second half of the year in terms our base business performance as compared to the first half of the year, largely attributed to our anticipated performance in both the U.S. and China.

And while we continue to make progress in this area, our updated constant currency revenue guidance range continues to assume an immaterial amount of revenue associated with any recently announced partnership agreements.

Turning to our thoughts on F/X, they remain unchanged from our previous expectations, and as such, our updated guidance continues to call for a foreign currency headwind of approximately 2.5% during 2023.

Our updated F/X assumptions were based on foreign exchange rates that were in existence in the early-May timeframe.

On a combined basis, we are raising our full-year as-reported revenue guidance from a range which called for a decline of between two and four percent, to a new range which calls for a decline of between one and a half and two and a half percent. In dollar terms this equates to a revenue range of between one billion one hundred one million and one billion one hundred thirteen million.

Lastly concerning revenue, we currently anticipate a sequential decline from Q2 to Q3 in terms of our as-reported revenue dollars, due to the timing benefits and rebate reserve adjustments that positively impacted Q2 that are not expected to reoccur during the third quarter, coupled with lower contract manufacturing revenue.

Moving to margins.

Based on the performance that was achieved during the first half of the year, we are raising our expectations for adjusted gross, adjusted operating, and adjusted EBITDA margins, as we now anticipate that our adjusted gross margin will be approximately 64.5%, up from our prior guidance of approximately 63.5%; our adjusted operating margin is expected to be approximately 28.0%, up from our prior guidance of approximately 26.5%; while our adjusted EBITDA margin is now projected to be approximately 32.5% for full year 2023, up from our previous guidance of approximately 31.5%.

Consistent with the comments we made on our first quarter earnings conference call, this implies a step down in our margin profile from the first half of the year to the second half of the year, and is due to a combination of factors, including the revaluation of our inventory that occurred at the beginning of our current fiscal year which we will sell at a higher standard cost during the second half of the year; positive absorption that was achieved during the first half of the year, as we manufactured additional product in advance of our planned temporary suspension of our manufacturing operations in our facility in Suzhou, China later this year that are associated with the corresponding regulatory approvals and transitions there; as well as total operating expenses as a percentage of revenue that during the second half of the year are expected to be similar to that which occurred during the second quarter.

Continuing down the P&L, we currently expect that our net interest expense will be approximately $113 million, or slightly favorable as compared to our previous expectation which called for interest expense of approximately $115 million during 2023.

Our assumptions regarding our non-GAAP tax rate and weighted average shares remain unchanged at approximately 25% and 57.7 million shares, respectively.

At the bottom line this translates into our new full year 2023 adjusted earnings per diluted share range of between $2.50 and $2.60, which is an increase from our previous range of between $2.20 and $2.35; or a raise of approximately $0.27 at the mid-point.

In closing, during the first half of the year, embecta made good progress in each of our three major strategic priorities, including strengthening our base business; separating and standing ourselves up as an independent entity; and investing in growth.

We generated solid financial performance during the first half of the year, and we are pleased to be able to raise several of our financial metrics yet again.

That said, we are mindful that we are only halfway through our first full fiscal year as an independent entity, and as we look ahead, we still have some important separation activities in front of us, including the implementation of our ERP system, managing through the anticipated temporary suspension of manufacturing operations at our facility in Suzhou, China, and, setting up our own distribution network.

That completes my prepared remarks, and at this time, I would like to turn the call over to the Operator for questions.