



PALLA PHARMA

ASX ANNOUNCEMENT

Thursday 27 February 2020

Palla Pharma delivers double-digit growth in Revenue and Gross Profit

Palla Pharma Limited (ASX:PAL), a fully integrated opiate manufacturer and supplier to the global pain relief market, is pleased to announce its results for the financial year ended 31 December 2019 (FY19), which delivered record revenues of \$54.7 million and gross profit of \$17.3 million.

FY19 Highlights (vs FY18)

- Record FY19 Revenue up 18.4% to \$54.7 million (FY18 \$46.2 million)
- Gross Profit up 15.3% to \$17.3 million (FY18 \$15.0 million)
- Operating EBITDA up \$2.1 million to a loss of \$0.3 million (FY18 loss of \$2.4 million)
- Underlying NPAT loss of \$5.8 million (FY18 loss of \$6.5 million)

Commenting on the result, Managing Director and CEO, Jarrod Ritchie said, “We are pleased to have delivered a strong FY19 result with double-digit revenue and gross profit growth while maintaining a flat indirect cost base.

“We continue to focus on capturing additional margin as we move down the supply chain, this strategy diversifies our distribution channels, expands our customer base, reduces agricultural reliance and importantly; significantly multiplies our earnings growth for every kilogram of opiate sold as we continue to grow volumes across our business.

“We continued our efforts to diversify the supply of poppy straw, focussing on improving straw assay from Northern Hemisphere and developing additional growing areas. With the record straw harvested during FY19 and patent litigation behind us, we now have enough raw material for supply during the entire FY20.

“Following the December year end, we have entered into an option to acquire our largest UK customer as part of our strategy to increase the value we can extract across the whole production cycle. In conjunction with the acquisition option, PAL has acquired six Marketing Authorisation (MA`s) to supply Codeine based tablets in the UK at margins considerably higher than contract tablet manufacturing. This enables Palla Pharma to have a sales presence in the entire opiate supply chain, from the farm gate to opiate based tablet supply to wholesale distributors.

“During 2019 we also undertook a significant balance sheet de-risking by repaying borrowings with the capital raise proceeds to meet the Group’s near-term API growth capital expenditure needs. Reduced debt levels also allowed us to negotiate better terms for the working capital debt facility. Palla Pharma is now in the best position it has ever been to continue to execute on its strategy and gain market share in the global supply of opiate based pain relief products.”

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Result overview

A 77% increase in margin accretive API sales, early termination of a non-opiate contract manufacturing supply agreement, and increased opiate FDF sales have resulted in a record revenue of \$54.7 million, a 18.4% increase on FY18 revenue of \$46.2 million. Deferral of UK and French sales along with increased non-recurring legal and quality costs negatively impacted the results with both Revenue and EBITDA below expectation.

The ability of the Group to demonstrate a near breakeven Operating EBITDA for 2019 supports its strategy to capture further value from the supply chain by moving downstream from NRM supplier to an API and FDF producer.

Despite these short-term setbacks, the business continues to strengthen its foundation for the future with an increased focus on downstream, margin accretive supply in the form of FDF supply through both contract manufacturing and marketing authorisation-based supply agreements.

To support this strategy of downstream margin accretive production, the Group recently acquired six opiate based marketing authorisations, expanded its API capacity for less than \$0.2m to approximately 70 tonne per annum up from 40 tonne and continued to focus on increased poppy straw supply diversification.

Operational highlights:

- Record sales volumes of opiate equivalent product increasing 14.6% compared to FY18 due to growth in higher margin API sales and opiate based FDF
- Early exit from legacy low-margin CMO contract, which will see margin and working capital improve in 1H20
- In January 2020 Palla Pharma acquired six Marketing Authorisations from its largest UK customer, allowing to establish presence in a highly margin accretive segment of direct sales to wholesale distributors
- Palla Pharma also entered into an option agreement to acquire the UK manufacturing facilities, that would increase tableting capacity five-fold to 125 tonnes

Raw Material Straw Supply & Agriculture

A positive growing season in Australia throughout 2018/19 saw record poppy straw volumes harvested at the lowest growing cost achieved for domestic harvest. Utilisation of Codeine poppy varieties and enhanced Morphine poppy varieties continued to be a focus, ensuring greater quality straw to supply the NRM production facility.

Palla Pharma has continued to focus on standardising supply quality from Northern Hemisphere by improving local farmer expertise through seminars and consultations. On-site quality control was also implemented, whereby each bag of raw material is

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being tested for straw assay before arriving to Australia. It is expected that in 2020, a significant portion of agricultural supply will come from the Northern Hemisphere due to the reduction in area in NSW and Victoria as a result of the drought in 2019.

Dual-hemisphere raw material supply will assist in offsetting any impact of adverse growing conditions, for example, any bushfire or drought impacts, and increased water prices experienced in Australia in late 2019.

NRM Production

Narcotic Raw Material (NRM) production improved by 6.8% due to reliable raw material supply. Significant throughput improvement is expected in FY20 as more inventory is converted into NRM. Additional R&D investments were made to optimise the production process as we gear up for the increase in API capacity.

Palla Pharma's unique water-based extraction process is delivering a competitive cost advantage which, when combined with reliable straw supply, enables higher volumes and long-term API supply agreements to be secured further down the supply chain.

API Production

Palla Pharma experienced significant growth in API production and sales volumes during FY19, doubling prior year production to 39.5 tonnes of Codeine Phosphate. Target production rate has been achieved in Q3 and Q4, increasing from 500kg/week to over 1,500kg/week for an annualised production rate of 70t. This increase in production and efficiency was achieved with minor capital investment.

In January 2020, the Norway site received approval to manufacture 70 tonnes of codeine Phosphate and 5 tonnes Pholcodine. Additional expansion capex will be considered post FY20, to meet future demand.

Increasing interest in Palla Pharma's competitive pricing for Codeine Phosphate in the UK, Europe & developing markets drives the sales growth and production efficiencies. First Codeine Phosphate sales into developing markets in South-East Asia and North Africa also occurred during 2019.

FDF Production

Following the year-end, Palla Pharma acquired six Marketing Authorisations from a UK customer to supply opiate-based tablets into UK. These marketing authorisations provide access to a highly margin accretive segment of the opiate market, previously unavailable to the company.

Palla Pharma also entered into an option agreement to acquire this UK customer, a manufacturer of finished dosage Codeine Phosphate. The potential acquisition of the manufacturing site in UK would increase tableting capacity five-fold to 125 tonnes.

During the second half of FY19, Palla Pharma negotiated an early exit from a legacy contract manufacturing agreement of non-opiate based tablets effective from February 2020. This contract was not a part of Palla Pharma's core opiate based supply

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chain strategy and previously imposed significant pressure on working capital. This will release additional tableting capacity for higher margin opiate tablets and reduce annual indirect costs by \$1 million.

Trading Update and Outlook

FY19 was a period of transitioning to a more stable supply of raw material, de-risking the balance sheet and developing strong foundations for growth.

The FY20 result will be underpinned by:

- Revenue and earnings growth with a greater focus on API sales and the use of Norway capacity to increase production of opiate based finished dosage products;
- Significant revenue and earnings upside, should the UK acquisition proceed; and
- Improved straw supply in both quality and price from both hemispheres;
- Full utilisation of increased API capacity, demonstrated in late FY19;
- API expansion and new product development; and
- Improvement in working capital and reduction in net debt.

Continued revenue and EBITDA growth are expected with or without the UK acquisition.

Note: When “tonnes” are referred to when describing Poppy Straw, NRM, API or Tablets, this refers to tonnes of opiate equivalent in the product.



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Conference call details

Chief Executive Officer Jarrod Ritchie and Chief Financial Officer Brendan Middleton will host an analyst and investor conference call today at 10.30am AEDT to present the Company's results for the full year ended 31 December 2019.

To pre-register for this conference and avoid a queue when calling, please use the following link below:

<https://sl.c-conf.com/diamondpass/10003974-invite.html>

You will be given a unique pin number to enter when you call which will bypass the operator and give you immediate access to the event.

If you are unable to register, then at the time of the conference you can call one of the numbers below and provide the **conference ID 10003974** to an operator:

- Attendee Dial-in (Australia Toll Free): **1 800 558 698**
- Alternate Australia Toll Free: **1 800 809 971**

This announcement has been authorised for release by the Board of Directors.

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About Palla Pharma Limited:

Palla Pharma Limited (ASX:PAL) is a vertically integrated opiate manufacturer from poppy straw growing through to tableting production. Palla Pharma has developed an innovative, efficient and environmentally sustainable opiate manufacturing process based on a unique water-based extraction technology. The company is one of six licensed opiate producers globally, and one of three fully integrated suppliers from opiate extraction through to tableting production delivering on its strategy to secure access to regulated downstream narcotics markets by leveraging its production cost advantage.

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