CHIEF EXECUTIVE OFFICER'S REVIEW

"The key aim for our business is to create a cash-generative, growing pan-European animal health company"

CHRIS CARDON
CHIEF EXECUTIVE OFFICER

Introduction and Summary of the Group

The key aim for our business is to create a cash-generative, growing pan-European animal health company and in July 2017 Animalcare Group plc completed the acquisition of Ecuphar NV ("Ecuphar"), an acquisition that constituted a reverse takeover. This brought together two businesses to create an enlarged group focused on the development and marketing of innovative products providing significant benefits to animal health.

The business now has a considerably enlarged footprint and sales network with direct sales teams in 7 European countries and an export network that covers over 38 countries across Europe, Asia, Australasia, Africa and South America through 86 different distribution partners. Within our product portfolio we have 50 licensed drugs, eight vaccines and over 100 care and nutraceutical products employing around 100 sales representatives and 28 agents marketing these products to our global customer base.

Shareholders in Animalcare are now invested in a substantially increased pan-European animal health platform with the following characteristics and strategic objectives:

- **Delivering double digit profit growth**: We expect to deliver further incremental organic growth across revenues, EBITDA and underlying net earnings with the potential to achieve double-digit profit growth.
- **Cash generative**: Continuing focus on cash generation allows us to maintain dividend payments as well as invest in our business to drive future growth.
- **Strong organic growth potential**: We now have an increased geographic footprint for cross-selling; we expect to extract further synergies taking effect in 2018 but with a more meaningful impact in 2019, and we expect to deliver further growth through our new product development pipeline.
- **Acquisitive growth potential**: Our strong balance sheet and scale also opens opportunities for value-accretive acquisitions which would allow us to target direct sales in other geographical territories.

Business Review

The Group is focused on the development and sale of veterinary products in the companion animal, production animal and equine markets and is divided into two segments: Pharmaceuticals and Wholesale.

Pharmaceuticals

The Pharmaceuticals segment develops and markets veterinary pharmaceutical products which are supplied to animal health professionals both directly and through our international distribution network. Our products fall into two categories: regulated pharmaceuticals and over the counter products. Products are either owned by the Group or licensed on long-term distribution agreements with third parties. We have a very broad portfolio of over 300 products including pharmaceuticals, vaccines, biocides and nutraceuticals and the Group focuses on certain niche therapy areas including odontology, dermatology, otology and surgery/anaesthesia. As a Group we invest significantly in our in-house development pipeline which I discuss later on in my report.

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Following the acquisition this segment now includes the products that were previously categorised as Licensed Veterinary Medicines, Animal Welfare and Companion Animal Identification.

Based on the statutory results for the year ended 31st December 2017, sales in this division (net of intercompany sales) increased by 28.4% to £59.7m (2016: £46.5m), which now accounts for 71.4% of total revenues. The £13.2m year-on-year increase is attributable to an additional £7.6m of sales derived from acquisition growth, with the balance generated through organic growth within the Ecuphar business.

Organic growth was driven by a number of factors including a very strong performance from sales into the Production Animals market, as well as strong growth from Companion Animals.

In the division our top 20 pharmaceutical products, which account for 51% of this division's total sales, grew by 15.1% in 2017. Looking at our direct sales markets, Orozyme, the first product of the Company that was developed, continues to hold a strong position in the Oro-dental area. Direct sales for this product grew by 11% and we expect to see further growth in this area through the launch of new innovative products in 2018.

Leisguard, our treatment against leishmaniosis in dogs, showed strong sales across our Mediterranean footprint and we expect to see future growth for this product in 2018 in Scandinavia. Prazitel and Caniquantel, which both play an important role in the area of anti-parasitic treatment, also grew well in 2017.

We were pleased with the performance across our export network. Our key core export markets of France, the Nordics and UK and Ireland showed significant growth and we expect to benefit from ongoing direct sales in the UK now following the acquisition. During the period we signed new distribution agreements to cover New Zealand and Taiwan and both regions granted regulatory approval to sell Aqupharm (intravenous fluid range) and Isocare (anaesthesia), our recently launched products for use in surgery.

This contributed to the growth of Aqupharm and Isocare sales, which were ahead of management expectations, and sales of core established brands such as Danilon (anti-inflammatory), Otoclean (dermatology) and Caniquantel (anti-parasitics) all showed double digit growth. Dinalgen (anti-inflammatory) sales were behind prior year but this was largely down to phasing of purchasing patterns in major markets.

The positive impact of the cross-selling opportunity was minimal during the year. We expect to see this contribute to our organic growth during Q4 2018, later than originally anticipated, with a more meaningful contribution in 2019.

The underlying EBITDA performance of our Pharmaceuticals division increased by 15.1% to £9.7m (97.1% of the Group's underlying EBITDA) with reported EBITDA reducing to £7.5m (2016: £10.2m). Whilst this underlying growth was driven by the contribution of the acquisition, the organic performance in this division was impacted by lower gross margins, mainly due to a changing sales mix following higher growth from lower margin Production Animal products and export sales, as well as pricing pressures in a competitive market and the disposal of Nutriscience in 2016 which generated £1.3m of sales at margins in excess of 50%.

Whilst the impact of a changing sales mix and competitive pricing pressures are likely to persist over the rest of 2018 we expect to deliver at least double digit growth in underlying EBITDA in this division and to see further strong sales growth driven by a growing portfolio of products and a wider geographical sales reach for these products.

Wholesale

Our Wholesale division focuses on the sale of third-party veterinary pharmaceuticals, supplies and instruments in Belgium. Based close to Bruges, in the North West of Belgium, this business supplies veterinary professionals across the country and has been trading for 25 years and is well established in a stable market.

The extensive range of over 5,000 products includes own label and branded items ranging from small disposable items to larger capital equipment and diagnostic instruments. The division also specialises in the supply of surgical instruments.

Revenues increased by 9.7%, entirely through organic growth, to £23.9m (2016: £21.8m) with this division representing 28.6% of total Group sales. This division delivered underlying and reported EBITDA of £0.3m (2016: £0.5m) reflecting the investment made in sales staff to drive future growth. Growth was driven by the addition of new customers, as well as expanding the range of products sold to existing customers.

Product Development Pipeline

The focus on building value within our product development pipeline continues. As an enlarged business our development team is located across a number of sites providing extensive skills and capabilities across Belgium, Germany, Spain and UK. Karolyn Tapper, previously Director of Business Development for Animalcare Ltd, has been appointed to the new role of Group Head of Technical and Commercial Development to structure and integrate the teams to ensure that we continue to grow through investing in and attracting new product opportunities.

A project rationalisation and prioritisation process for all projects across the Group has been undertaken. Within the context of the enlarged Group, technical feasibility, development costs and commercial forecasts have been reviewed thoroughly to determine which projects would be continued. The Company is currently focused on 17 active new product development pipeline projects within Spain and UK.

In 2017 we launched Acecare, a sedative, from the original UK pipeline. Sales have been in line with the original project forecast. One centralised registration was submitted in 2017 and launch of this product is planned in late 2018. Progress of the pipeline continues and in 2018 three new products have already been registered across Europe with additional submissions planned throughout the year.

Alongside the new product development pipeline, a number of product improvement and product maintenance projects are ongoing. Several registrations to expand the global presence of our products were made in 2017 and launch within new territories is planned at the end of 2018 and during 2019.

New Products through Strategic Alliances and Partnerships

In addition to broadening our product portfolio through our own development pipeline, we are aware that our wide geographical footprint is attractive to similar companies in the US and Asia who are seeking routes to market for their products across Europe. During the period we have seen the first result of this strategy with an agreement with US-based Nutramax, to provide Europe-wide distribution of their nutritional supplement Cosequin, which promotes canine joint health.

People

We currently have 100 sales representatives and 28 agents across Europe, having invested in an additional 6 sales representatives and support roles during the year.

As a result of changes in senior and executive management in the Company it was necessary to find and appoint new Country Managers in Spain and the UK, the two key territories in the Group. This has been completed with the new recruits now in post in the weeks following the year end.

Internal appointments have also been made in the important areas of Technical and Product Development and Export. These new roles will progress the integration of the Group and help us to realise commercial opportunities more quickly.

It is clear that an appointment in supply chain management will be required in the near future to ensure the operational efficiencies of the Group within this area are achieved.

In addition, we announced at the end of April that Iain Menneer has stood down from his role as Chief Operating Officer. We are very grateful for all of Iain's work on the integration of Animalcare and Ecuphar and we wish him well for the future. Iain's role as COO will not be replaced and has been redistributed within the senior management team that he was accountable for, who will take on further responsibilities and report directly to myself.

The key component to ensuring we continue to deliver on our long-term growth strategy is to continue to attract and retain the highest calibre people to drive forward our development. I would like to extend my thanks to all of our staff for their hard work.

Brexit

The details of how the UK pharmaceutical regulations will be extracted from the current harmonised European structure are not yet clear. The Veterinary Medicines Directorate (UK Government agency) is looking for close cooperation to enable a smooth transition to ensure animal welfare and food safety. The recent acquisition has enabled the new Group to start restructuring its pharmaceutical licence ownership with legal entities in the UK and Europe post-Brexit to allow uninterrupted commercial supply of product. We will continue to monitor the situation and take the necessary action to ensure business continuity.

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Post-period end – Le Vet purchase by Dechra

On 13th February, Dechra plc acquired Le Vet Beheer B.V. ("Le Vet"), a business which has developed a portfolio of products, and established a network of marketing partners across Europe. Le Vet has been a long-term partner of Animalcare and Ecuphar with distribution agreements in four territories. Whilst certain distribution arrangements will not change, it is clear that this will not be the case across all of them. We are taking action now to mitigate against any material change which could adversely impact trading part way through 2019.

Strategy and Outlook

The strategy of the business remains focused on building long-term shareholder value by creating a growing, profitable and highly cash generative pan-European animal health platform, capable of investing in a steady flow of new products and rewarding shareholders with dividend payments.

Further growth is expected through the execution of a clear strategy for growth via both organic sales growth and through targeted acquisitions. Our strategy for growth includes:

- Cross-selling opportunities across customers and distribution channels
- More synergies delivered through further integration of the businesses
- Enhancing geographic footprint and sales, marketing and distribution network
- Developing network of partnerships / strategic alliances to increase exposure to new opportunities
- Identifying selective value-accretive acquisitions
- Diversifying the portfolio of products into additional therapeutic areas within companion animal as well as production animal and equine markets
- Broadening the product development pipeline to include novel therapies

We expect growth in revenues to be driven by the launch of new products from our development pipeline, additional regulatory approvals for our existing products in new territories and the distribution of new products for US or Asia based third parties across our European footprint. We also expect margin improvement to be seen as the opportunity to cross-sell products fully impacts as existing distribution agreements held by our UK business for Germany, Spain, Portugal, Italy and Belgium are exited and replaced by our own direct sales network.

We believe we are on track to deliver double digit profit growth during 2018 and enhancement to profit margins will be driven by further synergies and cross-selling opportunities, which will start to take effect late in 2018 as integration progresses, but will deliver a more meaningful impact on profit margins during 2019 as the full effect of these changes are felt.

We believe the business is well positioned for future growth and the Directors remain confident of delivering long-term shareholder value.

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