# CHIEF FINANCIAL OFFICER'S REVIEW

***"The reverse acquisition will provide a number of opportunities for growth and long-term value creation for our shareholders"***

**CHRIS BREWSTER**
CHIEF FINANCIAL OFFICER

## Presentation of Results

On 13th July 2017, Animalcare Group plc completed the acquisition of Ecuphar NV, a European Animal Health Company headquartered in Belgium. The acquisition constituted a reverse takeover for the purposes of Rule 14 of the AIM Rules for Companies.

This business combination has been treated as a reverse acquisition in accordance with IFRS 3. Under the provisions of IFRS 3 the results for the year ended 31st December 2017 are reported as a continuation of Ecuphar NV with the results of Animalcare Group plc consolidated from the date of acquisition.

Accordingly, the statutory results for the year end 31st December 2017 reflect 12 months of Ecuphar NV and approximately five and a half months of Animalcare Group plc as previously constituted.

To help shareholders to assess the Group, an unaudited Pro forma Consolidated Income Statement has been provided, which reflects 12 months of trading from both entities. The Board believes that these statements provide the most appropriate basis for future comparison of operating performance.

## Underlying and Statutory Results

To provide comparability across reporting periods, the Group presents its results on both an underlying and statutory (IFRS) basis.

The Directors believe that presenting our financial results on an underlying basis, which exclude non – underlying items, provides a clearer understanding of business performance. IFRS results include these items to provide the statutory results.

All figures are reported at actual exchange rates (AER) unless otherwise stated. Commentary will include references to constant exchange rates (CER) to identify the impact of foreign exchange movements

A reconciliation between underlying and statutory results is provided at the end of this financial review prior to the pro- forma information as described above.

# CHIEF FINANCIAL OFFICER'S REVIEW

## Overview of Underlying Results

To assist with the understanding of our underlying financial results, the Group results presented below are split between continuing operations (Ecuphar NV) and acquisition, being Animalcare Group plc from 13th July 2017.

| | 2017 Continuing £'000 | 2017 Acquisition £'000 | 2017 Total £'000 | 2016 Total £'000 | % Change at AER Continuing % | Total % |
|---|---|---|---|---|---|---|
| Revenue | 76,118 | 7,558 | 83,676 | 68,361 | 11.3% | 22.4% |
| Underlying Gross Profit | 30,408 | 4,256 | 34,664 | 28,275 | 7.5% | 22.6% |
| Gross Margin % | 39.9% | 56.3% | 41.4% | 41.4% | (1.2%) | – |
| Underlying Operating Profit | 6,229 | 1,530 | 7,759 | 6,720 | (7.3%) | 15.5% |
| Underlying EBITDA | 8,415 | 1,572 | 9,987 | 8,914 | (4.2%) | 11.9% |
| Underlying EBITDA margin % | 11.1% | 20.8% | 11.9% | 13.0% | (1.9%) | (1.3%) |
| Underlying Profit after tax | 3,824 | 1,460 | 5,284 | 3,964 | (3.5%) | 33.3% |
| Basic Underlying EPS (p) | – | – | 12.6p | 16.7p | – | (24.6%) |

The Group delivered total revenue of £83.7m, an increase of 22.4% versus the prior year. This included £76.1m from the continuing Ecuphar business, an increase of 11.3% (3.8% at CER) and £7.6m contribution from the acquired Animalcare operations.

Underlying EBITDA increased by 11.9% to £10.0m (2016: £8.9m) including a £1.6m contribution from acquisition business. Ecuphar's continuing business underlying EBITDA decreased by 5.6% to £8.4m primarily reflecting the lower gross margins, investments in our infrastructure and people to support future growth and the disposal of NutriScience which Ecuphar sold in October 2016 which contributed profits of approximately £0.2m. More details regarding operational performance are provided within the Trading Performance section.

Basic underlying EPS decreased by 24.6% to 12.6 pence (2016: 16.7 pence). The 33.3% increase in profit after tax was offset by the significant increase in the weighted average number of shares from 23.8 million (which has been adjusted for the merger ratio of 63:37 as described in note 9) to 42.0 million.

## Trading Performance

The following table sets out Group underlying trading performance by operating segment (see note 5 for more detail) analysed between continuing and acquisition businesses. This analysis will evolve over time as we integrate the two businesses.

| | 2017 Continuing £'000 | 2017 Acquisition £'000 | 2017 Total £'000 | 2016 Total £'000 | % Change at AER Continuing % | Total % |
|---|---|---|---|---|---|---|
| Revenue by Segment | | | | | | |
| Pharma | 52,180 | 7,558 | 59,738 | 46,530 | 12.1% | 28.4% |
| Wholesale | 23,938 | – | 23,938 | 21,831 | 9.7% | 9.7% |
| **Total** | 76,118 | 7,558 | 83,676 | 68,361 | 11.3% | 22.4% |
| Underlying Gross Profit by Segment | | | | | | |
| Pharma | 27.993 | 4,256 | 32,249 | 26,003 | 7.7% | 24.0% |
| Wholesale | 2,415 | – | 2,415 | 2,272 | 6.3% | 5.8% |
| **Total** | 30,408 | 4,256 | 34,664 | 28,275 | 7.5% | 22.6% |
| Underlying EBITDA | | | | | | |
| Pharma | 8,126 | 1,572 | 9,698 | 8,429 | (3.6%) | 15.1% |
| Wholesale | 289 | – | 289 | 485 | (40.4%) | (40.4%) |
| **Total** | 8,415 | 1,572 | 9,987 | 8,914 | (5.6%) | 11.9% |

## Pharma segment

Revenue in our pharma segment grew by 28.4%, 12.1% of which was delivered by the continuing Ecuphar business. This growth was primarily driven by very strong growth in Production Animals revenue which as an overall category increased by 25.2% versus prior year to £28.4m together with a strong contribution from the Companion Animals category. Further detail on revenue by product category is given below.

Underlying EBITDA improved by 15.1% to £9.7m however declined by 3.6% from continuing business to £8.1m (2016: £8.4m), representing an EBITDA margin of 15.6% (2016: 18.1%). This decline was driven by a combination of lower gross margins which fell by 2.3% to 53.6% and a £2.3m increase in operating costs.

Gross margins in our continuing business have fallen for three main reasons:

- Lower margin sales mix primarily reflecting higher growth in our Production Animal product category and export markets.
- Maintaining market share in a competitive environment, at some expense to margins.
- Disposal of NutriScience in October 2016 which generated £1.3m sales at margins in excess of 50%.

Operating costs have increased by £2.3m to £19.9m (2016: £17.6m) representing 38.2% (2016: 37.8%) of sales. Approximately £1.5m of this increase relates to investment in our infrastructure (in particular IT and R&D), people and marketing to position the business for future growth. The balance of £0.8m reflects higher distribution costs as a result of significantly increased vaccine sales together with higher inventory write offs.

Reported EBITDA, which includes £2.2m non-underlying items as analysed in note 5, reduced to £7.5m (2016: £10.2m).

## Wholesale segment

Our wholesale segment, which comprises the purchase and re-sale of veterinary pharmaceuticals, supplies and instruments in Belgium, delivered revenue of £23.9m, representing an increase of 9.7% on the prior year. Whilst gross margins at 10.1% remained broadly comparable with prior year (2016: 10.4%), underlying and reported EBITDA reduced from £0.5m to £0.3m mainly due to increased employee costs to drive product sales and services growth.

## Revenue by Product Category

| | 2017 £'000 | 2016 £'000 | % Change at AER % |
|---|---|---|---|
| Companion Animals | **42,791** | 30,799 | 38.9% |
| Production Animals | **28,390** | 22,668 | 25.2% |
| Equine | **4,718** | 5,567 | (15.3%) |
| Other products and services | **7,777** | 9,327 | (16.6%) |
| **Total** | **83,676** | 68,361 | 11.3% |

Companion Animals revenue increased by 38.9% to £42.8m and, following the reverse acquisition of Animalcare Group plc, now represents 51.1% of total business, up from 45.1% in the prior year. Animalcare revenues generated 24.5% of the growth with the balance of 14.4% delivered by existing business, primarily driven by increased export sales, increased wholesale sales and market penetration of core pharmaceuticals.

Production Animals revenue grew by 25.2% on prior year despite ongoing pressure on antibiotic usage. This growth largely came from full year sales of new products launched in 2016, in particular rabbit vaccines, and continued growth of core products in both our established markets as well as newer geographies such as Italy.

Equine revenues reduced to £4.7m due to the prior year one-off benefit of horse vaccine sales in Germany as a result of competitor supply issues.

## Reported Financial Results

Given the significant changes to the Group following the reverse acquisition, the financial results contain a number of non-underlying items comprising the fair value uplift of inventory acquired, amortisation and impairment of acquired intangibles and acquisition and integration costs.

Animalcare Group plc

# CHIEF FINANCIAL OFFICER'S REVIEW

A reconciliation of underlying results to reported results is provided below:

| | 2017 Underlying results £'000 | Fair value adjustment on acquired inventory £'000 | Amortisation and impairment of acquired intangibles £'000 | Acquisition and integration costs £'000 | 2017 Reported results £'000 | 2016 Reported results £'000 |
|---|---|---|---|---|---|---|
| **Revenue** | **83,676** | – | – | – | **83,676** | 68,361 |
| Gross Profit | **34,664** | (401) | – | – | **34,263** | 28,275 |
| Selling, general & administrative expenses | **(24,912)** | – | (3,590) | – | **(28,502)** | (22,347) |
| Research & development expenses | **(2,048)** | – | (751) | – | **(2,799)** | (1,776) |
| Net other operating income (expenses) | **55** | – | – | (1,817) | **(1,762)** | 1,887 |
| **Operating Profit** | **7,759** | (401) | (4,341) | (1,817) | **1,200** | 6,039 |
| Net finance expenses | **(656)** | – | – | – | **(656)** | (891) |
| **Profit before tax** | **7,103** | (401) | (4,341) | (1,817) | **544** | 5,148 |
| Taxation | **(1,819)** | 76 | 972 | 411 | **(360)** | (1,632) |
| **Profit after tax** | **5,284** | (325) | (3,369) | (1,406) | **184** | 3,516 |
| Basic EPS (p) | **12.6p** | – | – | – | **0.4p** | 14.8p |

Including non-underlying items, the Group's profit after tax fell to £0.2m (2016: £3.5m). Non-underlying items incurred in the year are summarised below (all figures are pre-tax):

- Fair value adjustment of acquired inventory of £0.4m – this is a non-cash uplift to the value of acquisition inventory as a result of the fair value exercise carried out in accordance with IFRS 3 'Business Combinations'.
- Amortisation and impairment of acquired intangibles totalling £4.3m – this comprises £1.7m charge arising on the acquired intangibles relating to the Animalcare reverse acquisition and £2.6m in relation to previous acquisitions made by Ecuphar NV, principally Esteve SA which was acquired on 30th April 2015.
- Acquisition and integration costs of £1.8m – this principally includes the transaction costs borne by Ecuphar NV in relation to the reverse acquisition of Animalcare Group plc and post-acquisition integration costs including the internal transfer of Animalcare Ltd to Ecuphar NV and the set-up of a new long-term incentive plan which the Board is seeking to implement during 2018.

## Earnings per Share and Dividend

Basic underlying EPS decreased by 24.6% to 12.6pence (2016: 16.7 pence). The 33.3% increase in profit after tax was offset by the significant increase in the weighted average number of shares from 23.8 million (which has been adjusted for the merger ratio of 63:37 as described in note 8) to 42.0 million.

The reported basic EPS, which incorporates non-underlying items, decreased to 0.4 pence (2016: 14.8 pence)

The Board is proposing a final dividend of 2.0 pence per share, added to the second interim dividend of 4.7 pence per share paid in November 2017, giving a total dividend of 6.7 pence per share since the reverse acquisition. This final dividend is subject to shareholder approval at the Annual General Meeting on 27th June 2017. The Board will continue to maintain the current dividend policy and timing of payments whilst continuing to invest for future growth.

## Cash Flow, Net Debt and Borrowing Facilities

| | £'000 |
|---|---|
| **Net debt at 1st January 2017** | **(23,782)** |
| Net cash generated from operations | 2,425 |
| Net capital expenditure | (2,532) |
| Acquisition of subsidiaries net of cash acquired | (26,852) |
| Receipts from issue of share capital | 29,402 |
| Net finance expenses | (657) |
| Dividends paid | (2,816) |
| Other cash movements | (45) |
| Foreign exchange on cash and borrowings | (1,051) |
| **Net debt at 31st December 2017** | **(25,908)** |

The Group generated £2.4m net cash from operations (2016: £9.3m) which includes a cash outflow from non-underlying items totalling £3.8m. Working capital increased by £5.6m principally reflecting the payment of £2.5m non-underlying items which were recognised (accrued) at the time of the reverse acquisition, £2.0m increase in trade receivables due to strong growth in the final quarter and £1.4m investment in stock. This stock increase was mainly within our wholesale operation due to anticipated further antibiotic restrictions with the balance largely in our high-growth territories.

Net capital expenditure of £2.5m largely comprises investment in our product development pipeline from which a significant number of new products launches are expected in 2019 and 2020.

The £33.1m cash consideration for the acquisition of Ecuphar NV was funded using £4.0m of cash held by Animalcare Group plc and £29.1m of equity raised through a placing net of £0.9m expenses.

As part of the reverse acquisition, the Group agreed to maintain the existing Ecuphar NV borrowing facilities (the Facilities) through four banks which comprised (i) €41.5m revolving credit facility (RCF), (ii) €10m term facility to finance permitted acquisitions (Term Loan A) and (iii) €4.08m quarterly amortising term facility (Term Loan B).

There are three covenants governing the facilities:

(i) a minimum adjusted solvency ratio of 30% measured as consolidated adjusted equity to consolidated adjusted total assets;

(ii) a maximum leverage ratio of 3.5 times measured as consolidated net debt to consolidated EBITDA;

(iii) a minimum interest coverage ratio of 4 times measured as consolidated EBITDA to consolidated interest expenses.

Based on the 12 months unaudited pro-forma underlying EBITDA of £11.8m (see below), the Group's net debt: underlying EBITDA leverage ratio was 2.2 times. At 31st December 2017, total facilities were £48.4m, of which £33.5m, net of cash balances, was being utilised leaving headroom of £14.9m. These bank facilities, together with the Group's operational cash flow, indicate that the Group has sufficient facilities available to fund its operations and allow for future expansion.

## Summary

The transformational reverse acquisition of Ecuphar has created critical scale for the Group within the European animal health market, providing a strengthened position to capitalise on growth in the market to deliver long-term shareholder value.

To support this value creation, and to maximise the commercial, operational and financial synergies, the Group must deliver a wide-ranging and comprehensive integration. The historical growth of Ecuphar was complemented by a series of acquisitions including the largest and most significant acquisition of Esteve in 2015. Prior to the reverse, limited integration of these operations was undertaken. This has presented additional challenges resulting in the current process to integrate the businesses taking longer than expected.

From a financial performance perspective, we have delivered strong revenue growth; however, this has not translated through to our operating profit as we have experienced competitive market pressures and changing sales mix, leading to margin decline in the second half of 2017.

Against this backdrop, our priorities for the current year are:

- Increasing sales of new products from our distribution network and expanding our geographic footprint
- Focusing on gross margin and EBITDA development in order to deliver anticipated profit growth
- Improving operating cash generation, important in providing the business with the funds to continue the momentum in our product development pipeline together with dividend flow
- Delivering integration to unlock scale benefits and support EBITDA

We remain firm in our belief that the reverse acquisition will provide a number of opportunities for growth. Delivering the comprehensive integration to realise the synergies and benefits available is key. Ultimately, to create value the combination of our businesses must become more than the sum of the parts.

We expect to see some benefits of the integration in the current year but a more meaningful impact on profit in 2019.

Once fully integrated, we believe this will provide a strong platform for long-term value creation for our shareholders.

# CHIEF FINANCIAL OFFICER'S REVIEW

## Proforma Consolidated Financial Information (unaudited)

As noted previously, to help shareholders to assess the Group, an unaudited Proforma Consolidated Income Statement has been produced, which reflects 12 months of trading from both entities as below. Pro forma information has been prepared in a manner consistent with the accounting policies adopted by the Group in preparing the audited financial statements for the year ended 31st December 2017.

## Proforma Consolidated Income Statement (unaudited)

| | **Animalcare 2017 £'000** | **Ecuphar 2017 £'000** | **Total 2017 £'000** | Animalcare 2016 £'000 | Ecuphar 2016 £'000 | Total 2016 £'000 |
|---|---|---|---|---|---|---|
| **Revenue** | **15,825** | **76,118** | **91,943** | 15,556 | 68,361 | 83,917 |
| Gross Profit | **8,720** | **30,408** | **39,128** | 8,722 | 28,275 | 36,997 |
| Operating expenses | **(8,696)** | **(28,475)** | **(37,171)** | (5,353) | (22,236) | (27,589) |
| **Operating Profit** | **24** | **1,933** | **1,957** | 3,369 | 6,039 | 9,408 |
| Depreciation, amortisation & impairment | **280** | **4,843** | **5,123** | 403 | 4,689 | 5,092 |
| Non-underlying items | **3,045** | **1,639** | **4,684** | 172 | (1,814) | (1,642) |
| **Underlying EBITDA** | **3,349** | **8,415** | **11,764** | 3,944 | 8,914 | 12,858 |
| Net financial (expenses)/income | **(40)** | **(617)** | **(657)** | 36 | (891) | (855) |
| **(Loss)/profit before tax** | **(16)** | **1,316** | **1,300** | 3,405 | 5,148 | 8,553 |
| Taxation | **(104)** | **(724)** | **(828)** | (466) | (1,632) | (2,098) |
| **Net (loss)/profit** | **(120)** | **592** | **472** | 2,939 | 3,516 | 6,455 |
| **Underlying net profit** | **2,769** | **3,824** | **6,593** | 3,139 | 3,964 | 7,103 |
| **Underlying basic EPS (p)** | **–** | **–** | **11.0p** | – | – | 11.8p |

Compared to the statutory results, the unaudited proforma consolidated income statement includes an additional 28 weeks of Animalcare Group plc's results prior to the reverse acquisition which has the impact of increasing revenue and underlying EBITDA by £8.3m and £1.8m respectively. This is shown in further detail in the reconciliation section below.

On the proforma basis, revenue increased by 9.6% (3.4% at CER) to £91.9m however underlying EBITDA decreased by 8.5% (12.9% decrease at CER) to £11.8m.

The principal drivers for the financial performance of the existing Ecuphar business are described earlier in the Trading Performance section.

For the acquired Animalcare business, revenues increased 1.7% to £15.8m, driven by £0.6m growth within export offset by a £0.4m reduction in sales from our microchipping business, the latter primarily as a result of the £0.3m incremental sales benefit observed in 2016 following the introduction of compulsory microchipping in the UK. Gross profit was flat at £8.7m largely reflecting the changing sales mix towards lower margin export business. Operating expenses excluding non-underlying items increased by £0.4m of which approximately half relates to higher central costs, including the enlarged Board. The balance primarily relates to investment in our UK trading business staff base. As a result, underlying EBITDA fell by £0.6m to £3.3m.

The proforma results are yet to reflect the benefits from leveraging the Group's enlarged platform which include commercial synergies, operating efficiencies and optimisation of the R&D function. We will continue to deliver the integration throughout 2018 to deliver more significant value creation from 2019.

## Reconciliation of Pro forma Consolidated Income Statement

A reconciliation of the statutory results to the Pro forma results is shown below:

| | Reported results 2017 £'000 | Fair value adjustment on acquired inventory(1) 2017 £'000 | Acquisition and integration costs(2) 2017 £'000 | Amortisation of Animalcare acquired intangibles(3) 2017 £'000 | Animalcare pre-acquisition(4) 2017 £'000 | Pro forma results 2017 £'000 |
|---|---|---|---|---|---|---|
| **Revenue** | **83,676** | **–** | **–** | **–** | **8,267** | **91,943** |
| Gross profit | 34,263 | 401 | – | – | 4,464 | 39,128 |
| Operating expenses | (33,063) | – | – | 1,645 | (5,753) | (37,171) |
| **Operating profit/(loss)** | **1,200** | **401** | **–** | **1,645** | **(1,289)** | **1,957** |
| Depreciation, amortisation & impairment | 6,569 | – | – | (1,645) | 199 | 5,123 |
| Non-underlying items | – | – | 1,817 | – | 2,867 | 4,684 |
| **EBITDA** | **7,769** | **401** | **1,817** | **–** | **1,777** | **11,764** |
| Net financial (expenses)/income | (656) | – | – | – | (1) | (657) |
| **Profit/(loss) before tax** | **544** | **401** | **–** | **1,645** | **(1,290)** | **1,300** |
| Taxation | (360) | (76) | – | (310) | (82) | (828) |
| **Net profit/(loss)** | **184** | **325** | **–** | **1,335** | **(1,372)** | **472** |

Notes

1. See description within the reconciliation of underlying to statutory results.
2. See description within the reconciliation of underlying to statutory results.
3. See description within the reconciliation of underlying to statutory results – this is net of £40k amortisation of acquired intangibles relating to the previous reverse acquisition of Animalcare Ltd in January 2008.
4. Pre-acquisition results of Animalcare Group plc from 1st January 2017 to 12th July 2017.

**CHRIS BREWSTER**
CHIEF FINANCIAL OFFICER