# CHIEF FINANCIAL OFFICER'S REVIEW

"We have delivered growth at a time of much change within our business. We continue to focus on delivering sustainable profit growth and improved cash generation"

**Chris Brewster**
Chief Financial Officer

## Introduction and presentation of results

On 13th July 2017, Animalcare Group plc completed the reverse acquisition of Ecuphar NV. 2018 therefore reflects the first full year of trading as a combined Group. On a statutory basis, and in accordance with IFRS3, the results for the comparative year ended 31st December 2017 represent twelve months of Ecuphar NV and approximately five and a half months of Animalcare Group plc as previously constituted.

In addition, following the divestment of our Wholesale business on 4th September 2018, both the 2018 and 2017 financial information have been presented to show the Pharmaceuticals segment as continuing operations separately from the Wholesale segment, which has been classified as discontinued.

Accordingly, to help Shareholders to assess the Group, an unaudited Proforma Consolidated Income Statement has been provided, which reflects twelve months of trading from the continuing Pharmaceuticals segment for both entities for 2018 and 2017. The Board believes that this statement provides the most appropriate basis for comparison of current and future operating performance. On this basis, the Group has delivered proforma revenue growth of 2.7% to £72.5m (2017: £70.6m) and proforma underlying EBITDA growth of 2.8% to £11.8m (2017: £11.5m). On a statutory basis, including non-underlying items, the Group delivered a loss after tax of £0.8m (2017: £0.2m profit).

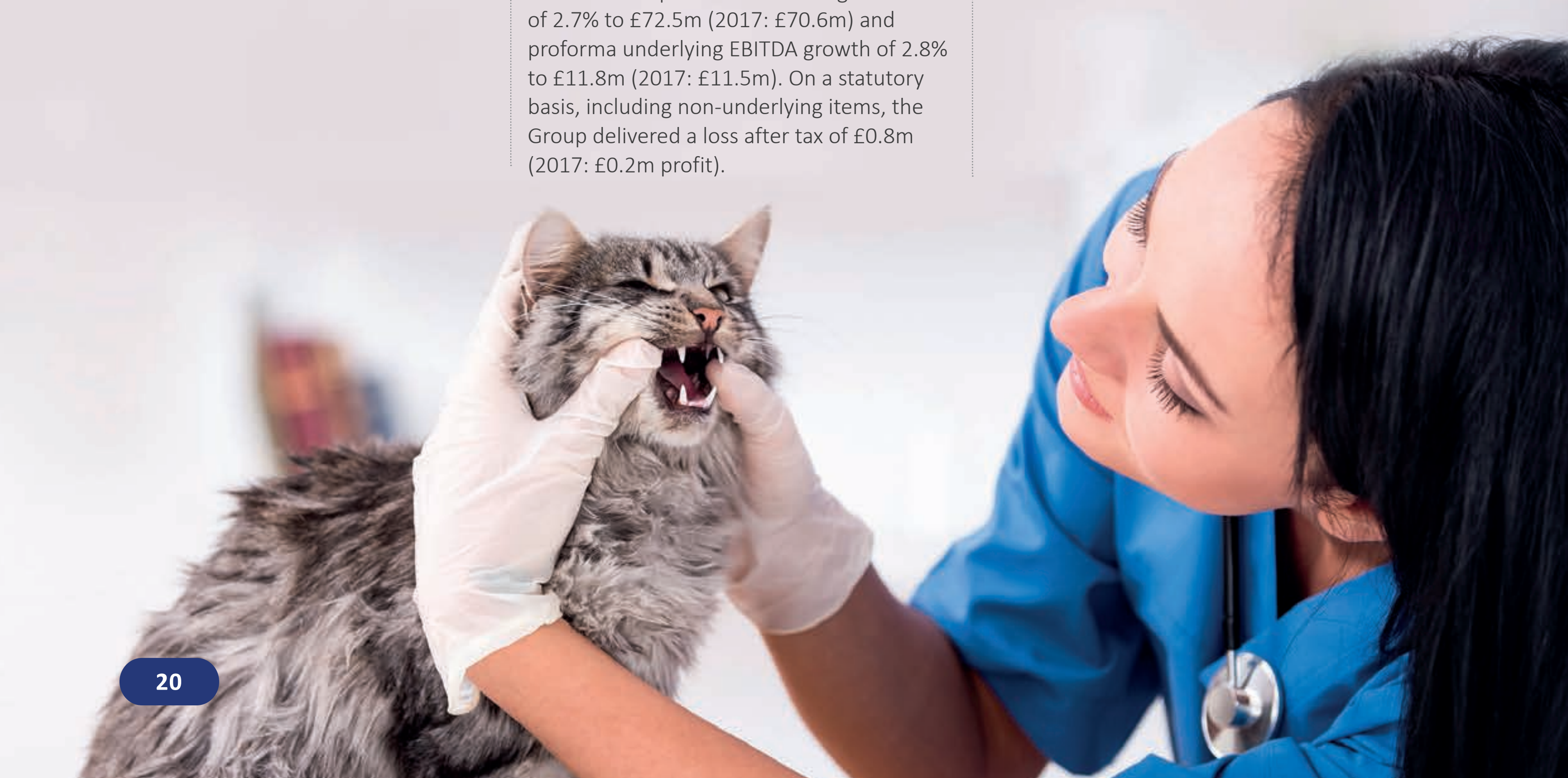
## Underlying and Statutory Results

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.

## Financial Review

### Pro forma Consolidated Income Statement (unaudited)

Compared to the statutory results for 2018, the unaudited Pro forma Consolidated Income Statement set out below represents the continuing pharmaceuticals segment for both 2018 and 2017, with the 2017 comparatives including an additional 28 weeks of Animalcare Group plc's results prior to the reverse acquisition. This has the impact of increasing 2017 revenue and underlying EBITDA by £8.3m and £1.8m respectively as set out in the table (right):



| | **Unaudited** | Unaudited | | |
|---|---|---|---|---|
| | **Continuing Operations 2018 £'000** | Continuing Operations – Post-acquisition 2017 £'000 | Animalcare pre-acquisition 2017 £'000 | Total proforma Continuing Operations 2017 £'000 |
| **Revenue** | **72,470** | 62,291 | 8,267 | 70,558 |
| Gross Profit | **37,339** | 32,325 | 4,464 | 36,789 |
| Operating expenses | **(37,122)** | (31,309) | (5,753) | (37,062) |
| **Operating profit/(loss)** | **217** | 1,016 | (1,289) | (273) |
| Depreciation, amortisation & impairment | **9,588** | 6,480 | 199 | 6,679 |
| Non-underlying items | **1,993** | 2,202 | 2,867 | 5,069 |
| **Underlying EBITDA** | **11,798** | 9,698 | 1,777 | 11,475 |
| Net financial expenses | **(574)** | (639) | (1) | (640) |
| **Profit/(loss) before tax** | **(357)** | 377 | (1,290) | (913) |
| Taxation | **135** | (292) | (82) | (374) |
| **Net (loss)/profit** | **(222)** | 85 | (1,372) | (1,287) |
| **Underlying net profit** | **7,016** | 5,175 | 1,309 | 6,484 |
| **Underlying basic EPS (p)** | **11.7p** | – | – | 10.8p |

## Revenue

On a proforma basis, the Group delivered revenue growth of 2.7% to £72.5m (2017: £70.6m), split by product category as shown in the table below:

| | **Unaudited** | Unaudited | |
|---|---|---|---|
| | **2018 £'000** | 2017 £'000 | % Change at AER % |
| Companion Animals | **44,465** | 41,937 | 6.0% |
| Production Animals | **22,824** | 23,680 | (3.6%) |
| Equine and other | **5,181** | 4,941 | 1.4% |
| **Total** | **72,470** | 70,558 | 2.7% |

Companion Animals revenue continues to be the largest proportion of the Group's business, representing 61.4% of total sales, up from 59.4%. As our existing portfolio continues to mature and be impacted by pricing pressure and changes in the competitor landscape, new products remain the main driver for the overall revenue growth of 6.0% to £44.5m (2017: £41.9m). We launched seven new products during the year including the nutritional supplement Cosequin in Spain, which contributed £2.4m sales in total. This was supplemented by £0.8m annualised growth of products launched in 2017 that were sourced from our partners, principally in Germany. Overall growth was impacted by supply challenges towards the year end relating to certain third-party manufacturers.

Production Animals revenue contracted by 3.6% versus prior year largely driven by lower demand for antibiotics offset in part by higher export sales of in particular Dinalgen (anti-inflammatory). Equine and other sales were broadly flat at £5.2m.

Underlying proforma continuing EBITDA increased by 2.8% to £11.8m with corresponding margin consistent with prior year at 16.3%. Gross margins at 51.5% modestly declined compared to prior year (2017: 52.1%) primarily reflecting lower margin sales mix in Companion Animals and the competitive environment. SG&A costs as a percentage of revenue reduced in the year from 35.9% to 35.2% as the business has continued to focus on costs efficiencies whilst investing in our people to support the integration and future growth.

Underlying proforma continuing basic EPS increased by 8.3% for the year to 11.7p, based on a weighted average number of shares of 60.0m applied to both 2018 and 2017. The effective tax rate was 22.3% (2017: 23.0%) primarily reflecting increased research and developments tax credits and partial utilisation of tax losses.

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## Underlying and Statutory Results

As a result of the reverse acquisition of Ecuphar NV, both the underlying and statutory basis for reporting results for the year ended 31st December 2017 include approximately five and a half months of Animalcare Group plc as previously constituted. The 2018 results are those noted in the unaudited Proforma Consolidated Income Statement on page 21.

## Overview of Underlying financial results – Continuing Operations

| | 2018 £'000 | 2017 £'000 | % Change at AER % |
|---|---|---|---|
| Revenue | **72,470** | 62,291 | 16.3% |
| Gross Profit | **37,339** | 32,325 | 15.5% |
| Gross Margin % | **51.5%** | 51.9% | (0.4%) |
| Underlying Operating Profit | **9,604** | 7,560 | 27.8% |
| Underlying EBITDA | **11,798** | 9,698 | 21.7% |
| Underlying EBITDA margin % | **16.3%** | 15.6% | 0.8% |
| Basic Underlying EPS (p) | **11.7p** | 12.3p | (4.9%) |

We delivered revenue of £72.5m and underlying EBITDA of £11.8m, representing growth of 16.3% and 21.7% respectively compared to the previous year. This was achieved through a combination of modest underlying growth as noted in the proforma results review together with a full year trading impact of the acquired Animalcare operations.

Underlying EBITDA margin improved to 16.3% largely reflecting the higher margin Animalcare business together with overall focus on costs to improve operating leverage. This focus includes a restructuring of our UK commercial team to put more emphasis on supporting larger corporate customers as well as continuing to provide strong service levels to independent practices. We expect this trend to continue and will closely monitor and adapt the Group's operations accordingly.

Basic underlying EPS decreased to 11.7 pence reflecting the 35.6% increase in underlying profit after tax to £7.0m offset by the significant increase in the weighted average number of shares resulting from the full year impact of the reverse acquisition (see note 8).

## Overview of reported financial results

Including the loss from the discontinued operations and non-underlying items, the Group reported a loss after tax of £1.0m (2017: £0.2m profit).

A reconciliation of underlying results to reported results for the year to 31st December 2018 is shown in the table (right):

| | **2018 Underlying results £'000** | Discontinued operations £'000 | Amortisation and impairment of intangibles £'000 | Acquisition, restructuring, integration and other costs £'000 | **2018 Reported results £'000** | 2017 Reported results (restated) £'000 |
|---|---|---|---|---|---|---|
| **Revenue** | **72,470** | – | – | – | **72,470** | 62,291 |
| Gross Profit | **37,339** | – | – | – | **37,339** | 31,924 |
| Selling, general & administrative expenses | **(24,312)** | – | (4,789) | – | **(29,101)** | (26,396) |
| Research & development expenses | **(3,466)** | – | (1,296) | – | **(4,762)** | (2,799) |
| Net other operating income (expenses) | **43** | – | (1,309) | (1,993) | **(3,259)** | (1,713) |
| **Operating Profit** | **9,604** | – | (7,394) | (1,993) | **217** | 1,016 |
| Net finance expenses | **(574)** | – | – | – | **(574)** | (639) |
| **Profit/(loss) before tax** | **9,032** | – | (7,394) | (1,993) | **(357)** | 377 |
| Taxation | **(2,016)** | – | 1,822 | 329 | **135** | (292) |
| Profit/(loss) after tax | **7,016** | – | (5,573) | (1,664) | **(222)** | 85 |
| Loss/(profit) from discontinued operations | **–** | (776) | – | – | **(776)** | 99 |
| **Profit/(loss) for the year** | **7,016** | (776) | (5,573) | (1,664) | **(998)** | 184 |
| Basic EPS (p) | **11.7p** | | | | **(1.7p)** | 0.2p |

The sale of our wholesale division was completed on 4th September 2018 with financial effect from 1st July 2018. The loss from discontinued operations was £0.8m which primarily represents the loss on disposal. Additional details are shown in note 4. Of the total £3.0m consideration, £2.4m has been received with a further £0.4m payable to the Group on 30th June 2019 in relation to the remaining intercompany balance owed. The balance of approximately £0.2m is subject to achieving specific revenue targets between 1st July 2019 and 30th June 2020 and payable in July 2020.

The amortisation and impairment of intangibles charge of £7.4m (pre-tax) principally comprises £4.6m charge arising on the acquired intangibles relating to the reverse acquisition and £2.5m charge in respect of previous acquisitions made by Ecuphar NV, namely Esteve SA which was acquired on 30th April 2015.

The remaining statutory items totalling £2.0m largely relate to restructuring and integration costs as detailed in note 5. Restructuring costs of £1.2m principally relate to executive changes, senior management restructuring and the UK commercial team reorganisation as noted earlier.

The reported basic loss per share, which incorporates non-underlying items, decreased to 1.7 pence (2017: 0.2 pence earnings per share).

## Dividends

The Board is proposing a final dividend of 2.4 pence per share, adding to the interim dividend of 2.0 pence per share paid in November 2018, giving a total dividend of 4.4 pence per share for the year ended 31st December 2018, the first full financial year as a combined Group. The Board continues to monitor the dividend policy, recognising the need for a balance between investment to support future growth and dividend flow to deliver overall value to our shareholders.

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## Cash flow, net debt and borrowing facilities

The Group is committed to improving cash generation, important to generate the funds we need to invest for growth and to maintain dividend payments. We will monitor progress using cash conversion as a percentage of underlying EBITDA as set out in the table below:

| | **2018 £'000** | 2017 £'000 |
|---|---|---|
| Underlying EBITDA | **11,798** | 9,698 |
| Net cash flow from operations | **7,430** | 2,425 |
| Non-underlying items | **1,993** | 3,968 |
| Underlying net cash flow from operations | **9,423** | 6,393 |
| **Cash conversion %** | **79.9%** | 65.9% |

The Group's underlying cash conversion significantly improved during the year to 79.9%, with net cash flow generated by our operations increasing to £7.4m (2017: £2.4m). Working capital increased by £0.9m, largely relating to further increased stocks. Our Group Head of Supply Chain has a clear target to reduce inventory levels over the next two years. Cash taxes of £2.2m were significantly higher than 2017 largely due to settlement of prior year taxes in Belgium and higher cash tax in Spain.

| | £'000 |
|---|---|
| **Net debt at 1st January 2018** | **(25,908)** |
| Net cash generated from operations | 7,430 |
| Net capital expenditure | (4,781) |
| Proceeds from divestment of wholesale operations | 2,403 |
| Net finance expenses | (626) |
| Dividends paid | (2,401) |
| Receipts from issue of share capital | 170 |
| Other cash movements | 474 |
| Foreign exchange on cash and borrowings | (349) |
| **Net debt at 31st December 2018** | **(23,588)** |

Net capital expenditure of £4.8m largely comprises investment in our product development pipeline of £4.2m from which six new products are expected to be launched during 2019 and into early 2020. The balance of expenditure largely relates to investment in our IT infrastructure which has made strong progress. This includes a new CRM system in Italy and SAP in the UK which went live on 1st January 2019. Both represent important steps in delivering our objective of common platforms across the Group which will help to drive integration and improve efficiencies.

The net borrowing position at the end of the year was £23.6m, representing net debt to underlying EBITDA leverage of 2.0 times (maximum bank covenant ratio is 3.5 times). At 31st December 2018, total facilities were £46.4m, of which £29.8m, net of cash balances, was utilised, leaving headroom of £16.6m. 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 investment.

## Brexit

Whilst the outcome of the Brexit negotiations remain unclear our contingency preparations are on track to maintain commercial supply. We expect to incur one-off costs of circa £0.3m in relation to transfer of product registrations during 2019.

## Summary and outlook

The Group delivered continued revenue growth in the year and translation through to both underlying profit and cash conversion is beginning to improve. We remain focused on our medium to long-term objective of delivering sustainable profit growth and improved cash generation, with cash flow expected to be supported by lower inventories.

Strategically and operationally it continues to be a time of change for the Group with the pace of integration of our businesses accelerating given the greater focus by our Leadership Team. During 2019, the drive for improved efficiency and integration across the business will continue including the integration of our Product Development and Regulatory teams. We will also focus on portfolio optimisation, improving service and driving efficiencies in our supply chain, all of which will require investment.

Whilst our performance was not as strong as originally expected, we have made steady progress across the business over the last 12 months and delivered growth at a time of much change within our business and the market. We will continue to seek opportunities to grow our business and I believe we are well placed to deliver medium to long-term shareholder value.

**Chris Brewster**
Chief Financial Officer