Chief Executive's Review

"The Group continues to progress its strategic objective of building a high margin, cash generative veterinary products business"

Ian Page
Chief Executive

Introduction

The Group has delivered strong growth throughout the financial year and continues to progress its strategic objective of building a high margin, cash generative veterinary products business. Both revenue and profit growth have been driven by the performance of our Pharmaceutical segments; predominantly from the solid organic growth of our licensed pharmaceuticals. *Specific* branded specialist pet diets achieved modest growth at constant currency. Third party manufacturing revenues and profitability increased in the year; *Dales*, our main manufacturing site, achieved its first FDA approval to manufacture product for the US market. Good revenue growth was seen in our Services segment although gross margin remained under pressure due to product mix and increased discounting in a highly competitive market. However, as previously reported, there was an improvement in margin in the second half of the financial year compared to that achieved in the first half. There have been two acquisitions during the year (for, in aggregate £117.3 million): an equine product, HY-50®; and a Dutch based business, *Eurovet*. Both are detailed later in this report. These acquisitions will be earnings enhancing in the first full year of ownership, *Eurovet* is expected to be materially enhancing in the financial year ending 30 June 2014.

Our Strategy for Delivering and Maintaining Value

Historically the majority of the Group's turnover and profitability were derived from our Services segment. However, due to our clear strategic objective to develop a high growth, cash generative veterinary products business, Group profits are now predominantly derived from our Pharmaceutical segments.

Products

In the Group's Pharmaceutical segments growth will be delivered by:

- maintaining and, where possible, increasing market share of existing products;
- development of innovative, high margin, intellectually protected, international novel pharmaceutical products;
- approval of pharmaceutical differentiated and standard generic products;
- the continued development of *Specific* pet diets;
- in-licensing of high end products which can be marketed through existing sales and customer channels;
- increased geographical coverage through the creation of our own sales and marketing businesses;
- improving and developing sales growth via our export partners in non-subsidiary territories; and
- the selective acquisition of assets which either bring new products to the Group, or accelerate global expansion.

Services

With respect to the Services segment, specifically *NVS*, the strategic objective remains:

- to continue improving logistics excellence;
- to reduce operating costs as a percentage of sales;
- to, at a minimum, maintain operating margins; and
- to deliver new innovative customer services.

Manufacturing

The key strategic objective of manufacturing is to effectively and economically produce our own veterinary pharmaceutical product range. However, we have been successful in developing a contract manufacturing business by strategic implementation of:

- therapeutic sector specialisation;
- provision of a full service, from formulation and development through to manufacturing and packaging; and
- the ability to offer our customers a wide range of scale, dosage forms and packaging formats.

Acquisitions

HY-50

The worldwide rights (excluding Canada) to *HY-50* were acquired in January 2012 from Bexinc Limited for a cash consideration of 8.0 million Canadian Dollars (approximately £5.1 million), funded from the Group's existing cash resources.

HY-50 is used for intra-articular ("IA") or intravenous ("IV") treatment of lameness in horses caused by joint dysfunction. It is unique in Europe as being the only single injection to deliver 50mg of Sodium Hyaluronate and having both IA and IV indications. This product acquisition strengthens our specialist equine portfolio and will be earnings enhancing in the first full year of ownership.

It is currently approved and marketed by various companies in the UK, Belgium, the Netherlands, Sweden, Finland, Denmark, Norway, Italy, Germany and Spain. Furthermore, registrations are being considered for France and Ireland. Dechra already markets the product in the UK as the marketing rights were acquired as part of the Genitrix® acquisition. Marketing rights for all other territories return to Dechra by July 2013.

Eurovet Animal Health B.V.

On 23 May 2012, *Eurovet* was acquired from A.U.V. Holdings B.V. for €135 million in cash, on a debt free cash free basis. The acquisition was funded by a £60 million Rights Issue and a new £120 million debt facility, details of which are provided in the financial section of this report. *Eurovet* is a profitable European business, very similar in structure to DVP EU. It has targeted niche differentiated products in both companion animals and farm animals and has highly complementary products, geographies, manufacturing competencies and markets to Dechra.

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There are a number of benefits to the acquisition:

Complementary Geographies

- It creates a strong presence in Germany where Dechra historically sold its products through a distributor;
- It considerably strengthens our sales and marketing infrastructure in Denmark, the Netherlands, Belgium and the UK, where synergies have already been realised through cost savings as duplicated sales offices have been rationalised; and
- There will also be some margin benefit from *Eurovet* products that can be distributed through Dechra's other European subsidiaries once *Eurovet*'s third party contracts are terminated.

Product Range

- *Eurovet* has a successful line of specialised generics that deliver technical or economic added value to end users;
- There is no significant overlap with Dechra's companion animal product portfolio with the range being complementary and enhancing to Dechra's own portfolio; and
- It provides an entry to the farm animal market which has been one of Dechra's strategic objectives.

Manufacturing Capabilities

- *Eurovet* brings a sterile facility providing a new manufacturing competency for Dechra. The facility is modern, having been built in 2007.
- The site, at Bladel in the Netherlands, also manufactures oral liquids, pre-mixes and water soluble powders which are almost entirely complementary to our existing manufacturing competencies.

Product Development

- *Eurovet* has a proven track record of delivering first entrant generics and added value generics with a new dosage form or delivery method. They have several products at an advanced stage of development with four already in registration.

Synergies

Annualised synergies of €6.0 million are targeted to be delivered within three years, of which €2.0 million is already being realised. These synergies will be achieved through:

- The rationalisation of the four duplicated sales and marketing functions with significant cost savings;
- Revenue synergies from Dechra products being sold through *Eurovet*'s German distributor;
- Revenue synergies from *Eurovet* products being sold through Dechra subsidiaries;
- Cost synergies from rationalisation of administrative expenses; and
- Margin improvement from in-house manufacturing of some previously outsourced products.