# Chairman's and Chief Executive Officer's Statement

**Michael Redmond**
Non-Executive Chairman

**Ian Page**
Chief Executive Officer

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We are pleased to report that the Group has delivered a solid performance with revenue and operating margins increasing in the majority of countries in which we trade. Following a difficult start to the year, predominantly due to a disappointing performance in the Netherlands and continuing supply issues in the US, we experienced positive momentum in the second half with improved revenue growth of 4.0% compared to a decline of 0.7% in the first half (at CER). This creates a strong platform for the start of our new financial year.

Following the divestment of the Services Segment in August 2013, which created a pure veterinary pharmaceuticals and related products business, we have focused on our four key growth drivers, namely portfolio focus, pipeline delivery, geographical expansion and acquisition:

- we have optimised returns from our existing portfolio by achieving a higher gross margin;
- our pipeline has delivered a major new equine product, *Osphos*, and we have received regulatory approval to relaunch our ophthalmic range in the US;
- geographical expansion has continued with the establishment of a new subsidiary in Italy, whilst planning is at an advanced stage to commence trading in Canada; and
- we have completed a strategic acquisition in the US, which has both increased our critical mass and bolstered our product portfolio.

## Portfolio Focus

Our aim is to maximise revenue and profits from our existing portfolio through a clear focus and a strong market position in eight therapeutic sectors: dermatology, ophthalmology, equine medicine, anaesthesia and analgesia, endocrinology, cardiovascular disease, food producing animal antimicrobials and pet diets.

### Maximising revenues and profit

*(i) Driving revenue growth*

Our focus on defined therapeutic categories and extensive marketing and sales capabilities have enabled us to deliver growth in almost all our target therapeutic sectors:

- within our major sector, endocrinology, *Forthyron*® and *Felimazole*® have seen growth in the EU, whilst in the US, *Vetoryl*® and *Felimazole* have increased by 24% and 19% respectively;
- our unique market leading brands in dermatology, *Canaural*® and Malaseb™, continue to expand. The current strong performance of our range of medicated shampoos will be further enhanced by the recent launch of a new formulation in the US, MiconaHex+Triz™;
- *Cardisure*®, our cardiovascular product, the only branded, differentiated pimobendan generic within the EU, has delivered exceptional growth of 32% across all our key European markets;
- our unique anaesthetic and analgesic product, *Comfortan*®, is highly rated by veterinarians and has grown by 40%. By offering a comprehensive range of critical care products, we are successfully retaining market share despite strong competition; and


- within ophthalmology, *Fucithalmic*® Vet remains the leading first line treatment for eye infections. We are also pleased to report that we have successfully re-launched *Vetropolycin*® and *Vetropolycin* HC within the US market following the resolution of long term supply issues.

Our success is driven by our ability to offer unique and specialised products that address veterinarians' requirements. This, in turn, is supported by clear branding and marketing messages, examples of which can be found on page 29.

*(ii) Increasing profits through our own distribution*

We have brought in-house a number of products that were acquired through *Eurovet*, which were historically marketed through distribution partners, thereby enabling the Group to retain the full margin and enhance sales focus. Contracts with the previous partners ended in December 2013, allowing us to market *Forthyron* in France and Sweden, and *Atipam*® and *Sedator*® in the Nordics from January 2014.

*(iii) Positioning Dechra as a trusted partner to veterinarians*

We provide solutions that add value to veterinarians by supporting them in their daily clinical work and keeping them abreast of developments in our key therapeutic sectors.

We have updated the Dechra Academy online tool, a well respected platform that can be accessed by all veterinarians and provides certified Continuous Professional Development in a number of our therapeutic focus areas. We have also conducted over 165 evening meetings in the US, presenting endocrinology seminars with an average of 35 veterinarians attending each session. This demonstrates our ability to support veterinarians in improving their understanding of our areas of therapeutic expertise.

### Food Producing Animal Antimicrobials

Our strategic intent is to build critical mass over the medium to long term; however, within the financial year, sales in this sector declined by 7.3% at CER.

This anticipated decline was due to a very competitive environment and a global focus on antimicrobial reduction. The Netherlands has seen the largest decline and overall is our only European market not to have shown total growth within the year. As previously reported, Dutch veterinarians have reduced antibiotic usage by over 50% in the last three years due to government pressure.

Despite the recognised benefits of some of our water soluble products, we believe that the Group has further exposure to the decline in antimicrobials, predominantly in Germany where we have a strong market position. In the majority of other markets in which we trade, we have low market shares and we anticipate that we should be able to compensate for any decline in the market by increasing our volumes.

### Pipeline Delivery

Our aim is to deliver the ongoing development projects and ensure we continuously refill the pipeline in order to sustain the flow of new products.

To learn more about *Osphos* read the case study on page 58.

# Chairman's and Chief Executive Officer's Statement continued

## Delivering the existing pipeline

We achieved a significant milestone in April 2014 with the approval in the US and UK of a major new equine product, branded *Osphos*. We also submitted our EU dossier in July 2014 having completed the studies to establish a maximum residue limit for the product. *Osphos* (clodronate injection) is used for the control of the clinical signs associated with navicular syndrome in horses. Navicular syndrome occurs in approximately 6% of horses and causes pain and lameness in the forelimbs. *Osphos* is applied as an intramuscular injection by the veterinarian and demonstrates measurable clinical improvement.

Following the successful registrations reported last year, we have introduced the following products:

- *Buprenodale*® Multidose Injection launched in 16 European countries in October 2013. *Buprenodale* is a generic Buprenorphine injection which complements our analgesics portfolio; and
- *Felimazole* Tablets 1.25mg launched in 12 European countries in September 2013. *Felimazole* is our leading endocrinology treatment for hyperthyroidism in cats. The 1.25mg dosage strength provides flexibility on dosing options and was introduced to differentiate our product from recent generic competition.

Progress in our US pipeline is important to continue to deliver organic growth:

- MiconaHex+Triz™ was formulated and launched as a shampoo, topical spray and wet wipes to complement our dermatological range and to compete with the market leading brand whose patents have recently expired; and
- *Vetropolycin* and *Vetropolycin* HC have been successfully transferred into a new manufacturing site with the necessary variations to the licenses completed and approved by the FDA. These ophthalmic products are unique in being the only veterinary approved products within their sector and were relaunched at the end of our financial year in June 2014. They were historically sold by the Group up until January 2010 and achieved historic peak sales of US$2.2 million per annum. However, manufacturing supply issues with a third party contractor resulted in the product coming off the market in 2010.

Finally, to support our global expansion strategy, registrations into new subsidiary territories were also achieved, for example:

- *Felimazole* Tablets in South Korea in October 2013;
- *Felimazole* Tablets 1.25mg in Canada in September 2013; and
- *Sedator* and *Atipam* in Israel in February 2014.

## Pipeline Progress Update

The following progress has been made on our pipeline products:

- dossiers have been submitted for both the US and EU for a new novel canine endocrinology product following the completion of a successful clinical trial;
- a pivotal clinical trial is under way for a canine endocrine opportunity;
- characterisation studies are ongoing for canine dermatological and canine ophthalmology products;
- clinical trials for a feline endocrinology drug were suspended during the third quarter of our financial year due to concerns over the formulation. A revised formulation is now being assessed for suitability to recommence the trial;
- a number of generic and range extension dossiers have been submitted within the EU and are currently under review; and
- *Osphos* has been submitted in Australia and Canada.

## Refilling the pipeline

We are focused on continuously identifying and evaluating new ideas and we have screened several new opportunities within the period. As a result we have started new development projects as shown on page 25.

We are of course in the early phases of these programmes but these new projects increase the depth of our pipeline.

Additional potential candidates are still being assessed and we expect further progress next year.

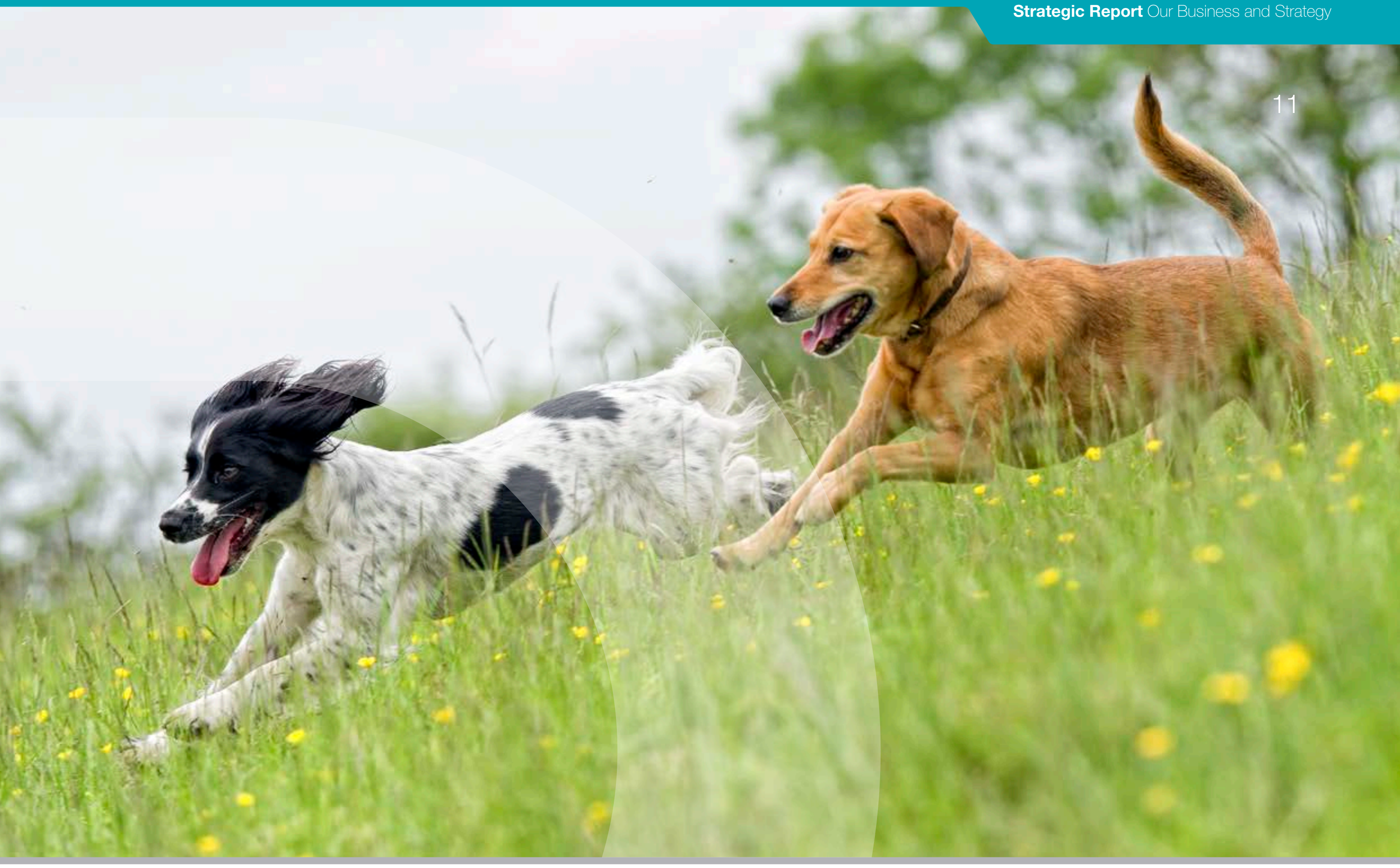
## Geographical Expansion

We aim to expand geographically through a strategy addressing short, medium and long term opportunities. In the short term we are opening subsidiaries where we have existing critical mass. For the medium to long term we are developing our plans to build a presence in new geographies where there is a recognised market opportunity.

The start of trading in Italy on 1 March 2014 represented a major milestone for Dechra as it is the first major territory we have entered as a greenfield start-up since the US in 2004. The financial justification for setting up our own subsidiary is clear: the value of the margins retained by selling our own products exceeds the incremental infrastructure costs, therefore delivering additional profit to the bottom line. We appointed an experienced country manager who led the process to establish the office and recruited a skilled team based in Turin. Distribution agreements with our main Italian distributors were terminated, with our contractual obligations ending in February 2014. Since the start of trading under our own Dechra brand, sales have been in line with our expectations.

We are following a similar process in Canada with the appointment of a country manager who has set up an office facility in Montreal. We have two major distributors in Canada; our contractual obligations with one of them will terminate in December 2014, therefore, trading will commence in January 2015.

We have identified other countries and conducted thorough market reviews to ascertain the feasibility of future greenfield start-ups. We are currently preparing detailed financial plans with the intention of trading in another new territory during the 2016 calendar year.



Our Export department has focused their commercial efforts on a number of key territories. The Regulatory team has provided product registration support. Our objective is to obtain enough product registrations to build a critical mass to support our subsidiary expansion strategy in future years. To accelerate this process additional regulatory support is being recruited.

### Acquisition

We aim to identify and complete acquisitions that will increase Dechra's value and improve returns to shareholders.

In May 2014 we announced the acquisition of the trade and assets of PSPC Inc., for a consideration of US$8.5 million. In addition to the initial consideration Dechra will pay royalties on total net sales of 10.0%, which will increase by 2.5% once annualised sales exceed US$7.5 million with a further increase should sales exceed US$12.5 million. Subsequent to the acquisition of the trade and assets, in June 2014 we acquired PSPC's facility for a further US$3.0 million. PSPC's principal product, *Phycox*®, is a nutraceutical with historic sales of approximately US$4.5 million per annum. *Phycox*, a novel and patented product, competes in the US veterinary joint healthcare supplement market, a sector estimated at US$55.0 million. The business has also developed a new Levothyroxine product which is in the final phase of development. We paid a milestone of US$1.5 million for this product which will be launched in the first half of our new financial year (ending June 2015). This product will strengthen Dechra's endocrinology therapeutic sector and contains the same active principal ingredient as one of our leading European market brands. You can read more details on PSPC in the case study on page 61.

We are evaluating selective acquisition opportunities. The principal selection criteria are businesses that:

- have their own intellectual property;
- can introduce new technologies, or complementary product ranges; or
- would provide entry into new geographies.

We continue to have a dialogue with a number of businesses; however, recent transactions by big pharma in the animal health sector have created unreasonably high expectations. Where acquisition is not possible, we are pursuing strategic partnerships.

## Strategic Enablers

### Manufacturing

There have been notable developments in our manufacturing capabilities throughout the year. With a focus on continuous improvement and efficiency gains, significant investments have been made in the liquids, creams and ointments suite, tablet compression machines and the encapsulation production line. This investment is important as we work towards one of our strategic objectives for manufacturing: the extension of our FDA compliance into new dosage forms.

The application to the FDA for the approval of a new canine endocrinology product has triggered the FDA inspection of our sterile injectables facility at Skipton where the product will be manufactured. A significant amount of resource and effort has been put into ensuring that our facility and procedures will meet the standards required.

We have also completed the transfer of *Cardisure* and *Forthyron* to our Skipton facility. These key Companion Animal Products, which came into the Group through the *Eurovet* acquisition, were previously outsourced. Bringing these products in-house will improve margins and provide us with greater flexibility and control of production.

# Chairman's and Chief Executive Officer's Statement continued

### Logistics

Following a €2 million investment, our new enlarged central European distribution centre in Uldum, Denmark was opened on 26 November 2013. The new facility has more than doubled our scale to 7,400 $m^2$ and has tripled our pallet handling capacity to 10,500. This facility:

- creates a logistics hub that provides for all our current and medium term distribution requirements;
- almost entirely eliminates third party storage and handling costs; and
- improves logistics efficiency.

In the second half of the financial year we started an exercise to transfer our *Specific* pet diets to a new external third party manufacturing partner to improve overall delivery efficiency and product quality. Following an extensive search and due diligence, we identified a new supplier and started to transfer products into the new manufacturer. To date we have transferred over 50% of our volume requirements and are already seeing an improvement in quality, palatability and on time delivery. We anticipate the transfer will be completed by the end of December 2014, at which time we intend to re-position and re-market this important range of products.

### Information Technology

Further progress has been made with the Oracle ERP implementation. Our manufacturing facility in Bladel successfully went live on the platform in November 2013. After a full review of the project plan to ensure that the Oracle implementation would support our strategic objectives, we are now focusing on the next phase which includes the Group financial consolidation and the set-up of our European subsidiaries.

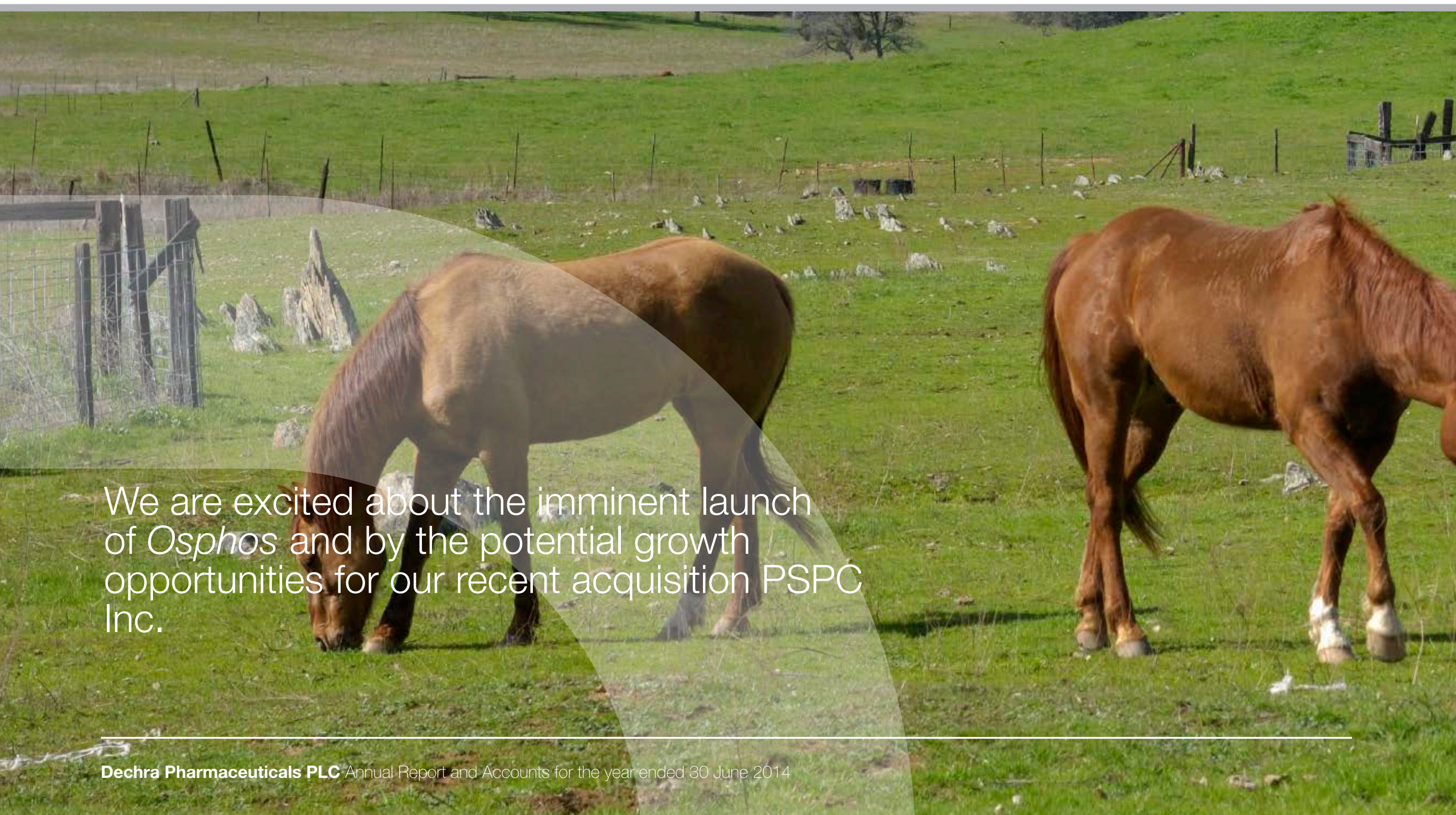
Within the year we have successfully standardised all critical non ERP software and hardware use across the Group, thereby reducing costs and improving internal systems. We have also improved communication capabilities by completing the roll out of a new secure private network across the majority of the business units.

Given the increasing importance of digital technologies, we have worked to update our customer-facing interfaces such as the Dechra Veterinary Products website and the Dechra Academy. The Dechra Veterinary Products website has been completely rewritten utilising the latest software capabilities with an optimised user interface pulling data from a newly established single database of all the Group's products' technical and marketing information. Furthermore, the Dechra Academy, with online learning courses for our veterinary customers, has been redeveloped to enhance its content and functionality. The site, www.dechra.co.uk, was launched in the UK in July 2014 and will be translated and rolled out across all our other trading subsidiaries throughout the remainder of the 2014 calendar year.

### People

#### *Senior Executive Team*

Following the disposal of the Services Segment a new Senior Executive Team (SET) was established. The principal objective of the SET is to develop and implement the Group's strategy. The team comprises the Executive Directors along with the Company Secretary, US and Manufacturing Managing Directors and the heads of Product Development and Regulatory Affairs, HR and IT.



We are excited about the imminent launch of *Osphos* and by the potential growth opportunities for our recent acquisition PSPC Inc.

*Management and Staff*

A new Group HR Director, Katy Clough, joined us at the end of April 2014. Working closely with senior managers and the HR team, she has developed a people plan that supports our strategic aims and continues to build on the strong Values embedded across the Group. Dechra now employs 775 people in over 14 countries and we expect the headcount to increase during the next financial year. Our diverse and talented workforce has been key to our success and we will continue to leverage this advantage through succession planning and ongoing development programmes throughout the 2015 financial year.

*Board Changes*

At the Company's Annual General Meeting in October 2013 Neil Warner stepped down as Senior Independent Non-Executive Director and Chairman of the Audit Committee. Upon his retirement, Ishbel Macpherson was appointed as Senior Independent Non-Executive Director and Julian Heslop stepped into Neil's role as Chairman of the Audit Committee. In January 2014 Ed Torr stepped down as an Executive Director from the main Board following 17 years with the business. Ed has entered into a Consultancy Agreement with the Company to work on specific projects as and when required. We would like to express our thanks to both Neil and Ed for the huge contributions they have made to Dechra.

**Dividend**

The Board is proposing a final dividend of 10.65 pence per share (2013: 9.66 pence). Added to the interim dividend of 4.75 pence per share, this brings the total dividend per share for the financial year ended June 2014 to 15.40 pence, representing 10% growth over the previous year.

Subject to shareholder approval at the Annual General Meeting to be held on 24 October 2014, the final dividend will be paid on 21 November 2014 to shareholders on the Register at 7 November 2014. The shares will become ex-dividend on 6 November 2014.

**Prospects**

Current trading is in line with management expectations and is consistent, at constant exchange rates, with the growth seen in the second half of our prior financial year.

Looking ahead, we are confident that the execution of our strategy will continue to deliver growth. We have a strong balance sheet which allows us to make strategic investments and deliver new products from our pipeline.

We are excited about the imminent launch of *Osphos* and by the potential growth opportunities for our recent acquisition PSPC Inc. These factors, together with revenue and margin growth from geographical expansion in Italy and Canada, and the delivery of further new products, give the Board confidence in the Group's future prospects.

The Strategic Report has been approved by the Board and signed on its behalf by:

**Michael Redmond**
Non-Executive Chairman
8 September 2014

**Ian Page**
Chief Executive Officer
8 September 2014