Financial Review

Anne-Francoise Nesmes
Chief Financial Officer

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Find out more about Our Financials on pages 121 to 169.

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After several years of progressive organic growth and successful acquisitions, our 2014 financial year was predominantly a year of consolidation during which we implemented several improvement projects to support the execution of our four strategic growth drivers. During the year we achieved a balance between revenue growth and investments to support our strategic ambitions whilst delivering profit growth and improved operating leverage.

When presenting our financial results, we use a number of adjusted measures which are used by management in reporting and planning discussions. These measures are reconciled to the financial results reported under IFRS on page 41.

- Underlying results reflect the Group's trading performance excluding amortisation of acquired intangibles, non-underlying charges and other one-off events such as restructuring and acquisition costs.
- All growth rates for both underlying and non-underlying results included in this review are at constant exchange rates (CER) unless otherwise stated. This shows the year-on-year growth as if exchange rates had remained the same as in the previous year.
- All numbers are presented on a continuing operations basis. The divested Services Segment is shown as discontinued operations in accordance with IFRS.

Overview of Underlying Financial Results

We delivered underlying operating profit of £42.2 million, representing a growth of 7.2% compared to the previous year. This was achieved through a combination of modest revenue growth, improvement in margins and investments in strategic areas.

	2014 £m	2013 £m	Reported currency	Constant currency
Revenue	**193.6**	189.2	2.3%	1.6%
Gross profit	**107.7**	100.7	7.0%	6.5%
Gross profit %	**55.6%**	53.2%		
Underlying operating profit	**42.2**	39.1	7.9%	7.2%
EBIT %	**21.8%**	20.7%		
Underlying EBITDA	**46.2**	42.8	7.9%	7.2%
Underlying diluted EPS (p)	**36.32**	29.07	24.9%	23.9%
Dividend per share (p)	**15.40**	14.00	10.0%	10.0%

A reconciliation to reported results is shown on page 41.

Revenue

Total revenue grew by 1.6% to £193.6 million. Our growth accelerated to 4.0% in the second half from a decline in the first half of 0.7% (compared to the same period last year).

Revenue by Segment

European Pharmaceuticals Segment revenue grew by 1.0% to £172.4 million as a good performance in all markets was offset by very disappointing sales in the Netherlands. The decline in this market was due to competitive pressure and reduced use of antibiotics. We have taken actions to address the situation.

Revenue in our US Pharmaceuticals Segment grew by 6.8% to £21.2 million. Our key products performed strongly with an increase of 24.3% for *Vetoryl,* 18.7% for *Felimazole* and 10.5% for *DermaPet*. There were no sales of *Animax* in 2014 (2013: £1.5 million) due to previously reported supply issues. This reduced overall US growth by 9 percentage points.

Revenue by Categories

Overall the performance across our major product categories has been adversely affected by a decline in FAP sales.

CAP grew by 3.7%. As stated in the Chairman's and Chief Executive Officer's Statement on pages 8 to 9, all our key products performed well. However *Vetoryl* sales momentum in Europe slowed down compared to the prior year due to phasing of sales in Italy and the unavailability of a third party drug necessary to diagnose Cushing's disease. It is also worth noting that our generics defence strategy for *Felimazole* proved successful, except in the Netherlands.

Given the increasing importance of and our focus on our Equine product portfolio, we are pleased to report growth of 13.6% driven by the uptake in *HY-50*, a drug for lameness caused by joint dysfunction.

FAP declined by 7.3%, mostly due to the impact of the reduction in the prescription of antibiotics and increased competition in the Netherlands.

The Pet Diets franchise remained stable compared to the prior year, a satisfying performance as we transfer manufacturing to a new third party supplier (see Chairman's and Chief Executive Officer's Statement on page 12). Finally, third party manufacturing sales increased by 4.0%. The incremental value obtained by securing several new third party contracts was reduced due to a delay in production in Bladel. We expect to recover fully in the 2015 financial year.

Gross Profit

Our gross margins have improved from 53.2% to 55.6% reflecting the continued realisation of the Eurovet synergies and changes in our product mix based on our sales performance.

We benefited in this financial year from a full year of margin synergies realised by bringing in-house third party distribution contracts in France and Germany part way through the prior financial year. Additionally the impact of higher margin CAP growth and lower margin FAP decline resulted in a more favourable product mix.

Selling, General and Administrative Expenses (SG&A)

SG&A expenses grew by 6.4% to £57.3 million as we invested in people and targeted projects to support our strategic ambition.

Staff costs increased faster than inflation in a few departments as we invested strategically to support our growth. For instance we have continued to invest in the US sales infrastructure which has delivered clear benefits to the top line.

We have also incurred additional one-off costs in relation to several significant finance projects that will deliver future benefits, an example of which is outlined in the Taxation section of this report.

	2014 £m	2013 £m	Reported currency	Constant currency
CAP	**98.7**	94.8	4.1%	3.7%
Equine	**12.6**	11.0	14.5%	13.6%
FAP	**35.8**	38.1	(6.0%)	(7.3%)
Subtotal Pharma	**147.1**	143.9	2.2%	1.5%
Diets	**28.4**	27.9	1.8%	0.7%
Third Party Manufacturing	**18.1**	17.4	4.0%	4.0%
Total	**193.6**	189.2	2.3%	1.6%

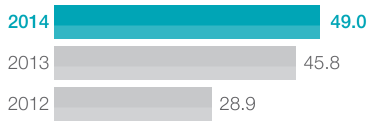
"Our gross margins have improved from 53.2% to 55.6% reflecting the continued realisation of the Eurovet synergies and changes in our product mix based on our sales performance."

Financial Review continued

EU Profit

£49.0m

2013: £45.8m



US Profit

£6.0m

2013: £5.6m

Research and Development Expenses (R&D)

Our R&D spend totalled £8.2 million as we continued to progress the pipeline.

Our spend is broadly in line with last year. However, it is slightly lower than expected as we suspended the clinical trial of a feline endocrinology drug following concerns over the formulation. All other projects progressed as planned.

Segmental Profit

Operating leverage is improving in our EU and US Pharmaceuticals Segments with underlying profit as a percentage of sales at 28.4% and 28.3% respectively.

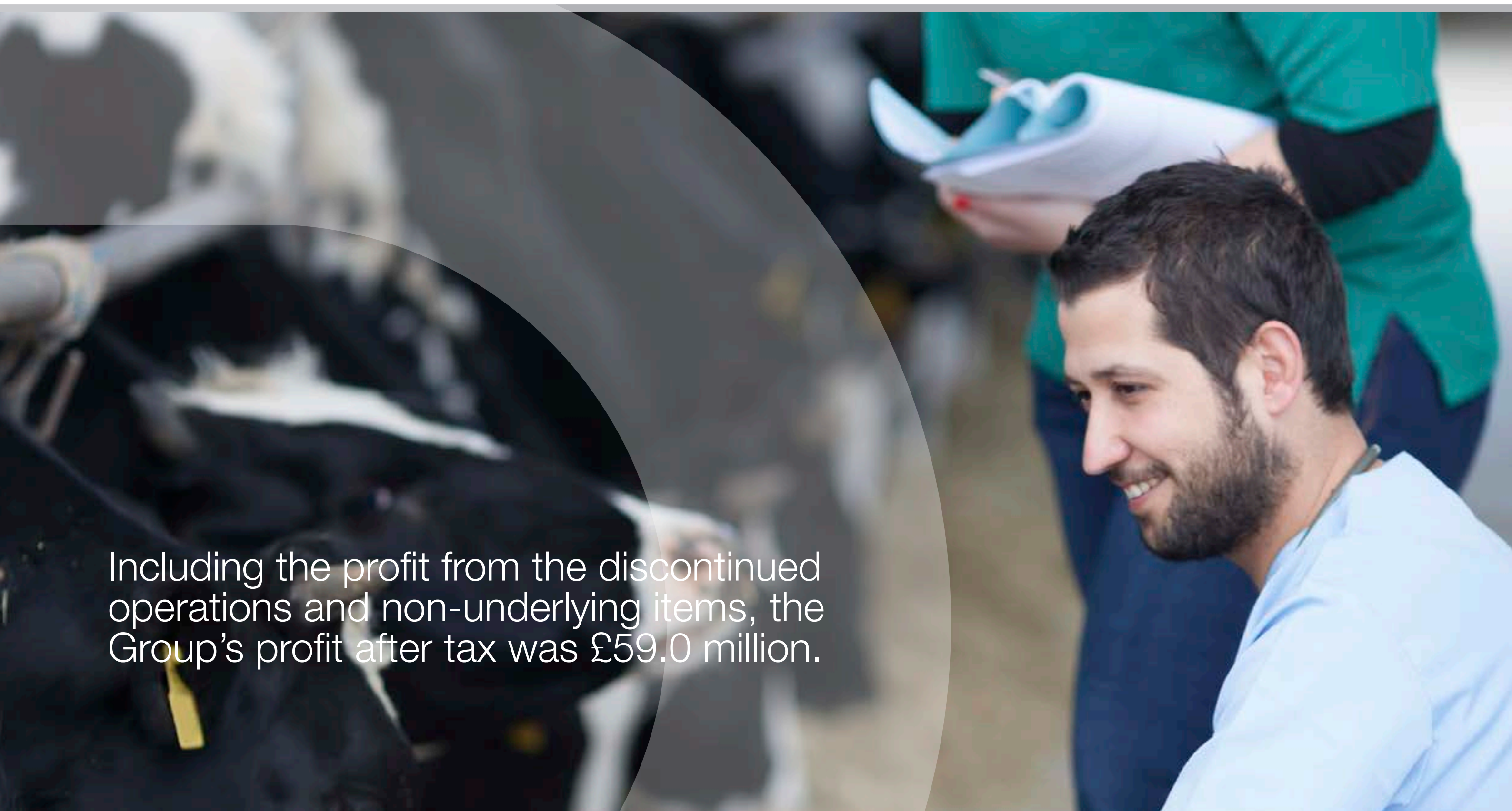
Following the divestment of the Services Segment, the Board reviewed our reporting Segments and concluded that retaining the EU Pharmaceuticals and US Pharmaceuticals Segments reflected the way we currently manage the Group and they meet the criteria defined under IFRS 8.

The operating leverage of our US Pharmaceuticals Segment is improving as past investment in infrastructure drives revenue growth. Investment will continue to support the forthcoming launch of *Osphos*.

Overview of Reported Financial Results

Including the profit from the discontinued operations and non-underlying items, Group's profit after tax of £59.0 million increased by 227.9% at CER (229.6% at reported).

	2014 £m	2013 £m	Reported currency	Constant currency
Revenue	**193.6**	189.2	2.3%	1.6%
Gross profit	**107.7**	100.7	7.0%	6.5%
Gross profit %	**55.6%**	53.2%		
Operating profit	**25.0**	18.3	36.6%	34.4%
EBIT %	**12.9%**	9.7%		
Profit after tax	**19.4**	10.9	78.0%	75.2%
Profit after tax including discontinued operations	**59.0**	17.9	229.6%	227.9%
Diluted EPS (p)	**67.33**	20.45	229.2%	227.5%



A reconciliation of underlying results to reported results as at 30 June 2014 is shown in the table below:

	2014 Underlying results £m	Non-underlying items: Discontinued operations £m	Amortisation of intangibles £m	Acquisition costs £m	Finance expenses £m	Rationalisation costs £m	2014 Total reported results £m
Revenue	193.6						193.6
Gross profit	107.7						107.7
Selling, General and Administrative Expenses	(57.3)		(16.5)	(0.2)		(0.5)	(74.5)
Research and Development expenses	(8.2)						(8.2)
Operating profit	**42.2**		**(16.5)**	**(0.2)**		**(0.5)**	**25.0**
Net finance costs	(2.3)				(1.3)		(3.6)
Profit before tax	**39.9**		**(16.5)**	**(0.2)**	**(1.3)**	**(0.5)**	**21.4**
Taxation	(8.0)		5.7		0.2	0.1	(2.0)
Profit after tax	**31.9**		**(10.8)**	**(0.2)**	**(1.1)**	**(0.4)**	**19.4**
Profit from discontinued operations		39.6					39.6
Profit for the period	**31.9**	**39.6**	**(10.8)**	**(0.2)**	**(1.1)**	**(0.4)**	**59.0**
Diluted Earnings per share (pence)	36.32						67.33

The sale of the Services Segment was completed on 16 August 2013. The profit from the discontinued operations was £39.6 million, of which £38.7 million was the pre-tax profit on the disposal. Additional details are shown in note 30 of the accounts.

Non-underlying items of £18.4 million, excluding the discontinued operations, are £2.7 million lower than the previous year due to *Eurovet* rationalisation costs in the prior year and favourable foreign exchange movements on the amortisation of acquired intangibles held in foreign currencies. Full details are shown in notes 4 and 5 on page 138.

Earnings per Share and Dividends

Underlying diluted EPS from continuing operations for the year was 36.32 pence, 23.9% growth versus last year as we benefited from interest and tax savings. The total dividend per share is 15.40 pence.

The reduction in interest payments following the repayment of our debt, together with expected tax savings and prior year tax adjustments (see note 8 on page 141), contributed to our Earnings per Share increase. Our tax strategy is covered in more detail later in this report.

The reported diluted EPS for the year was 67.33 pence (2013: 20.45 pence). The growth over the previous year reflected the profit on the sale of the Services Segment partly offset by the lost operating profit contribution from that business.

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, it brings the total dividend per share for the year to 15.40 pence, representing 10% growth over the previous year. Dividend cover based on underlying earnings was 2.4 times.

Net Debt

Our net debt position has improved considerably, from £80.8 million in the prior year to £5.0 million as at 30 June 2014.

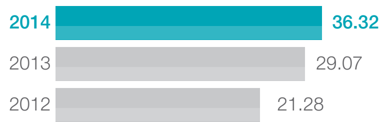
The proceeds from the divestment of the Services Segment were used to pay down the term loan in full and partly pay down the revolving credit facility, which significantly improved our net debt position.

Covenants on the loan facilities were met during the year.

Underlying Diluted Earnings per Share

36.32p

2013: 29.07p



Dividend per Share

15.40p

2013: 14.00p

Find out more about EPS in note 10 of the Consolidated Financial Statements on page 142.

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Financial Review continued

£75.8m

Reduction in net debt

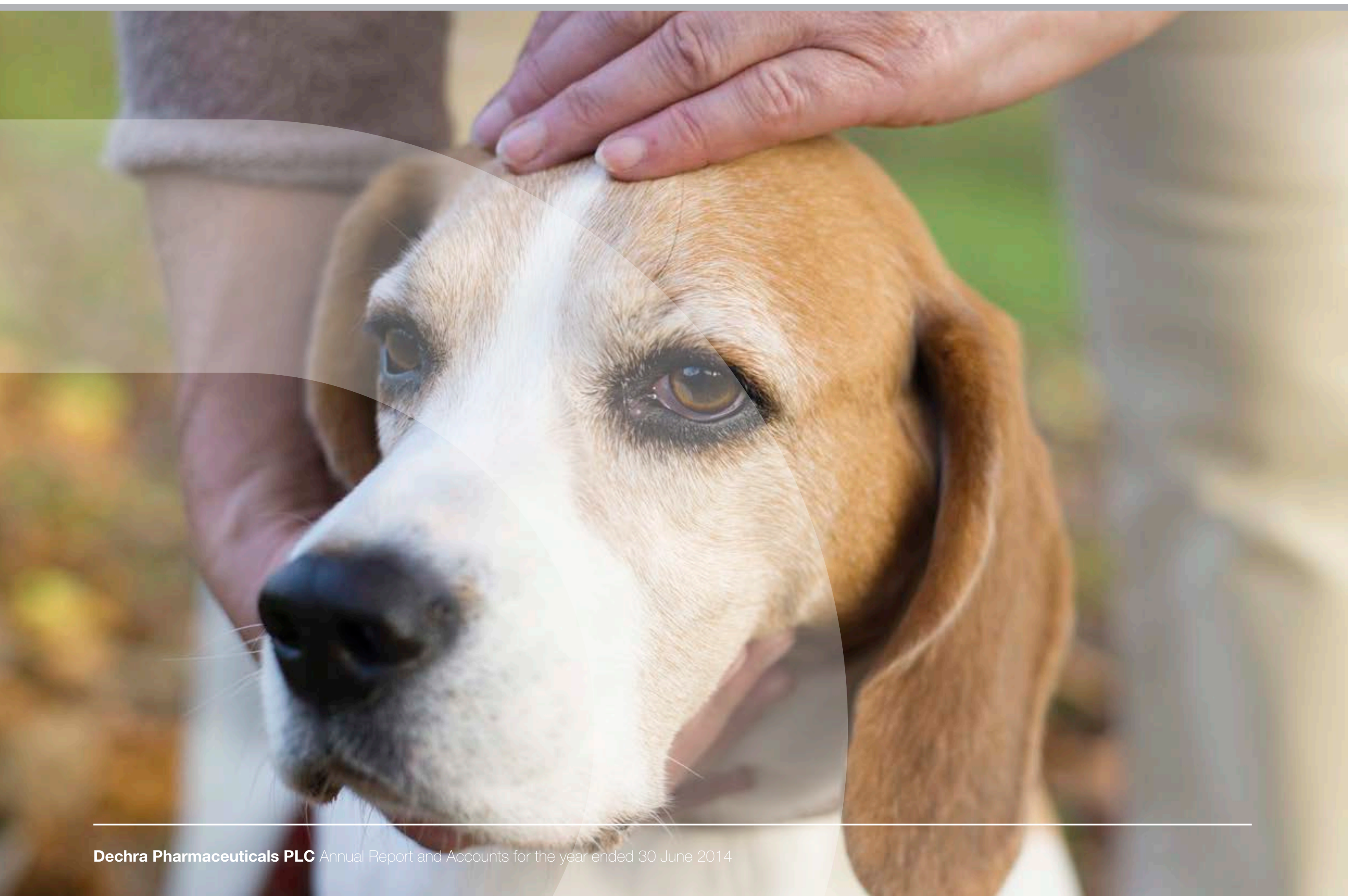
Balance Sheet

Net assets at 30 June 2013 totalled £204.8 million, a £30.2 million increase compared to the prior year.

	2014 £m	2013 £m
Assets		
Total non-current assets	**214.4**	235.7
Total current assets	**86.3**	89.6
Assets of disposal group held for sales	**–**	89.8
Total assets	**300.7**	415.1
Liabilities		
Total current liabilities	**(35.7)**	(49.5)
Total non-current liabilities	**(60.2)**	(137.0)
Liabilities of disposal group held for sales	**–**	(54.0)
Total liabilities	**(95.9)**	(240.5)
Total net assets	**204.8**	174.6

Total non-current assets include intangibles which amounted to £196.2 million (2013: £219.6m) as at 30 June 2014. The only significant addition relates to the product rights to *Phycox* and Levothyroxine from the PSPC Inc. acquisition which was more than offset by amortisation charges and currency translation differences.

Lower non-current liabilities reflect the repayment of borrowings following the Services Segment divestment.



Additionally it is worth noting that total working capital increased during the year from £28.4 million (on a continuing basis) to £32.2 million. £2.5 million of this rise is due to an increase in our trade working capital balance. The key drivers for this were the inclusion of the Services Segment as debtors in working capital combined with bringing business in-house from our distributors, offset by favourable exchange rates. The remainder is an increase in the non-trade balance principally due to exchange rates and divestment costs accruals. This has impacted our cash conversion.

Finance Strategy

During the year we have reviewed our tax and treasury strategies, resulting in improvements that will make our operations more efficient, robust and scalable. They will deliver financial benefits that will contribute to earnings growth.

Taxation

We have implemented a tax strategy that reflects the current and future Group business model, in line with the tax policy approved by the Audit Committee (see page 81).

We have performed a strategic review of our international tax affairs to ensure we take advantage of international government-backed incentive schemes, such as the patent box in the UK, innovation box in the Netherlands and global research and development regimes in the countries in which we operate. We are also aiming to simplify our operating model in order to improve control and ensure that we are structured in the most tax efficient manner.

Treasury

In September 2014, the Group refinanced its existing bank facility.

Our existing bank facility was committed until October 2016. Given the current economic context and our strategic ambitions, we felt it was appropriate to refinance.

The Group's revised borrowing facilities comprise a committed £90 million Revolving Credit Facility with an 'Accordion' facility of £30 million. The terms apply until September 2019.

The interest rate that is charged on the Revolving Credit Facility is dependent upon the Group's Leverage ratio (defined as the ratio of Total Net Debt to Total Adjusted EBITDA). The minimum interest rate payable by the Group is 1.30% over LIBOR and the maximum interest rate payable by the Group is 2.00% over LIBOR.

The facilities are provided by a syndicate of three banks: HSBC, RBS and Barclays. We will also consolidate our day-to-day banking operations with these banks, thereby improving the effectiveness of, and the controls over, our cash management.

This will give rise to a loss on extinguishment of debt of £386,000 in the year ending 30 June 2015.

Summary

We have consolidated our position in 2014 and are in a strong financial position to execute our strategy going forward:

- our gross margin improvements increase our operating leverage. Profits can be reinvested in the business where needed to drive returns;
- the progress we have made defining our tax and treasury strategies ensure that we are building a scalable finance structure; and
- we have maintained a strong balance sheet which gives us the flexibility to pursue strategic investment opportunities as and when they arise.

Anne-Francoise Nesmes
Chief Financial Officer
8 September 2014

"We are in a strong financial position to execute our strategy going forward."