ASX Release

Apiam Animal Health Limited

(ASX: **AHX**)

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2019 Annual General Meeting, Managing Director's Address

Thank-you Andrew and welcome everyone.

It has been another busy year for Apiam, and while we have remained focused on executing our strategic plan, we have also faced external industry challenges.

I will start this morning by reviewing FY2019, before focussing on our growth strategy and our recent business initiatives and acquisitions. I will finish by providing a summary of our performance in this FY2020 financial year to date, and the outlook.

FY2019 in review

Let's start with a review of Apiam's 2019 financial year.

We reported our full year financial results in late August and provided detailed analysis at this time, so I will keep my summary brief today.

The main highlights from these results were that we reported revenue growth year-on-year, a result that is indicative of the diversification benefits of our business model – even in the face of the challenging & dry industry conditions affecting many of our customers.

We were pleased to report growing gross margins across all of our operating segments, mainly as a result of focusing on high value services, however these gains and growth in bottom line earnings were dampened by the difficult industry conditions we faced in some regions, and our commitment to investing for future growth in the form of starting new clinics.

Both these factors have had a negative impact in the short-term on our earnings performance.

From a business development perspective, we executed on a number of initiatives in FY2019 that were very much focussed on adding complementary and high growth revenue streams to our business. We made significant progress in this area and I will talk to this in detail during the growth strategy section of my presentation.

We have also continued to grow our business via strategic acquisitions. We target acquisitions that provide synergy opportunities, diversification benefits, specialised skills and financial benefits to our shareholders. In FY2019 we assessed several rural veterinary clinics as potential acquisitions, and we have made three important acquisition announcements in the months since our results, I will also talk to these further this morning.

FY2019 financial summary

I will now run through a few key financial metrics from our FY2019 financial results.

- Revenue in the year to 30 June was $111.7 million, 4.8% higher than the prior year - a result that is robust given the industry challenges we have faced. There were three acquisitions that made part year contributions to this result or to the prior year being Gympie, Passionate Vetcare and Terang &

Mortlake Veterinary Centre. When we adjust for these acquisitions, Apiam's underlying revenue fell 1.5% versus PCP, a defensive result in the current environment.

- I have just mentioned we delivered strong gross margins in all operating segments and this led to improvement in gross profit of 9.0% versus PCP.
- While our reported operating expenses did increase 10.6% year-on-year, our underlying expense base was a key management focus in FY2019. The growth in reported expenses was directly related to the impact of acquisitions and the opening of new clinics during the period. These clinics have delivered strong revenue growth and earnings are now coming in line with desired performance.
- When we exclude the impact of acquisitions and new clinics, underlying operating expenses declined and this is reflective of the synergy benefits flowing through from our enlarged but more efficient corporate infrastructure base.
- As you can also see, our earnings at the EBIT and NPAT level have been negatively affected by the growth in depreciation & amortisation expense over the FY2019 year. This is a direct result of the significant capital investments made in our clinics and systems over the last three years. Depreciation & amortisation expense growth slowed significantly in the second half of the financial year as our systems investment was largely completed and we don't expect growth at this rate in the coming year.
- Net debt as at 30 June 2019 reduced $1.0 million compared to the prior year. This reduction was despite our re-investment in the business and this is reflective of the operating cash flows that our business generates. Our leverage ratios are comfortable and well within covenants. You may have also seen that in July we renegotiated with NAB to increase our acquisition facility from $25 million to $39 million and this has provided significant headroom for acquisitions and helped to fund our recently announced acquisitions which I will talk to shortly.

A resilient vet services portfolio with high growth opportunities

I would now like to talk to a slide that many of you probably have seen before but which I think provides a good snapshot of our business and is key to understanding how we think about our business model. The left-hand side of this slide shows the core veterinary business being veterinary services and product solutions. Our veterinary services and solutions are what accounts for the majority of our revenue and earnings and is the "engine room" of the business.

The right-hand side highlights what we think of as the high growth complementary business initiatives that help to diversify our revenue base and add high revenue and margin growth opportunities.

A lot of work has been done on this side of the business and some of our recent acquisitions – such as ACE Laboratories and Grampians Animal Health – which offer highly specialised services in the areas of diagnostics, bespoke vaccines and sheep consulting which will be very complementary to our existing business.

Resilient revenue base

This next slide shows how this diversified approach benefits Apiam, and how it supports revenue stability in the face of industry challenges that can be a feature of the Australian agricultural sector.

This chart graphs Apiam's revenue for the last three financial years – on a half by half basis against Australia wide average rainfall. This is obviously a key driver of farmers inputs such as water prices, grain availability and pasture growth, which our clients rely upon to maintain and expand their business profitability.

The reason I have included this chart is to show how in the face of significant change in this key agricultural metric, which has had its highest impact on water prices in the dairy industry and grain prices in both pigs and dairy, we have maintained our revenue base and delivered resilient revenue over these periods. I do want to also point out that we have not had significant revenue contributions from new acquisitions over these latter periods either.

I think what is interesting and what it highlights to me is the defensive nature of our business and the benefits of our diversified model. This is what drives our business strategy and provides a solid base for when conditions improve, particularly in the pigs and dairy segments. With that, let's turn to the growth strategy section of the presentation.

Strategic focus

You will have seen this slide before and I like to start with it as it summaries the key building blocks of our strategic roadmap.

Leveraging performance through a focus on three key business drivers being operations, process & capacity, animal numbers and services & product range - remains the basis of our growth strategy. Andrew has also just discussed this.

Service & product range expansion

Service and product range expansion has been a key focus for us in FY2019 and FY2020 YTD and this slide summarises many of the initiatives we have executed on in this area.

At the time of last year's AGM I talked about the initiatives summarised on the top line of the slide being the Plumbline distribution agreement, the US JV and the Chinese consultancy & export agreement.

These initiatives all continue to progress well and are at various stages of progress. Clinical trials are commencing for Plumbline, the US JV has commenced generating revenue and the Chinese sheep genetics centre commenced operating in September. These remain important projects that will generate complementary and diverse revenue streams in the medium term.

We have also introduced new programs based on recurring revenue models in both the dairy and companion animal segments. In July we launched Best Mates, a wellness program for companion animals and in August we launched the ProDairy consultancy program.

We have also announced important acquisitions in the last few months and on Tuesday we announced a new distribution agreement with ASX listed Zoono for their innovative disinfectant and surface protectant nanotechnology in the Australian and US markets.

These are all initiatives that diversify our revenue streams and expand our product and service offering.

I'll talk to some of these initiatives now in further detail.

New programs & initiatives

We launched Best Mates in July as a wellness program to improve outcomes for animals and to reward customer loyalty and retention. Customers sign up to this program for 12-month periods.

As the chart on the right shows since the initial launch, the growth in this program has been excellent, with average member growth of 116% per month since July. This program is being expanded across our entire companion animal footprint through the remainder of FY2020.

We have also this month executed a distribution agreement with Zoono for the exclusive distribution of their proprietary disinfectant nanotechnology for use in livestock facilities in Australia and for swine customers in the US.

Zoono produce an alternative to chemicals which both sanitises and provides ongoing mechanical activity for up to 30 days. Successful trials have been conducted in Australian and NZ poultry and pigs over the last 18 months and we see great potential for this across our livestock customer base as we continue to seek alternatives to antibiotics to manage disease. We also see this product as a new tool to improve biosecurity programs, a service of high importance in a world challenged by the impact of African Swine Fever. It has been exciting for our company to be part of the process of bringing this effective medical technology across to the animal industries and to objectively measure the impact it's had on reducing and maintaining low microbe loads over time.

Strategic acquisition – ACE Laboratory Services

Now let's turn to some of our recent acquisitions. We completed the acquisition of ACE Laboratory Services (ACE) in October and this was the largest acquisition with an initial purchase price of $12.4 million and potential earn-out consideration of $3.6 million. I do want to note that ACE generated revenue of $6.5 million last financial year so on an acquisition multiple basis this is an attractive valuation compared to other acquisitions of similar business types.

ACE is very specialised business, operating in highly technical and regulated markets. It offers autogenous – otherwise known as custom or bespoke – vaccines, as well as diagnostic services for large production animal producers. It is the market leader in both these segments and for this reason is a very compelling acquisition for us.

Where this acquisition is really compelling however, is that it offers us an attractive product & service extension that can then be leveraged across our large production animal footprint. We have the largest production animal numbers under veterinary management in Australia so this gives us a very extensive opportunity to increase the scale of ACE's business.

These types of markets also have strong future demand drivers. The autogenous vaccine market is very fast growing as it provides an alternative when commercial vaccines are not available or are not effective. Autogenous vaccines are also increasingly being used as a preventative herd health tool to reduce the usage of antimicrobials and potential antimicrobial resistance.

Similar factors are also supporting rapid growth in production animal diagnostics where the trend to precision farming practices continues to be a driver for sustainable production practices.

Both markets also offer attractive earnings margin profiles given their highly specialised nature.

Strategic acquisition – Grampians Animal Health

We also announced this week the acquisition of Grampians Animal Health which has important regional expansion and consolidation benefits. This business is located in Hamilton, in the Western District region of Victoria and one of Australia's largest & most productive sheep farming regions.

The business is comprised of two key operating units being a small animal and equine vet clinic and hospital known as Cox Street Vets and a specialised consulting business called Livestock Logic.

Livestock Logic are a group of veterinary and agricultural consultants that provide expertise in sheep consultancy services, pasture and grain analysis and offer parasitology laboratory services. Similar to the rationale I've just discussed with ACE, these are attractive services which we can leverage over a much larger footprint to add value.

We also have existing infrastructure in this region and this is a fundamental pillar of our regional expansion strategy. This acquisition will take our South West Victorian operating region to 7 clinics.

Let's turn to the final section on Year to date performance and Outlook.

Industry conditions & outlook

Before we get to our company performance and outlook, I will start by giving an update of broader industry conditions.

The feedlot sector conditions remain strong and dry conditions continue to drive growth in animal numbers on feed.

The outlook for dairy is expected to remain challenging in the short term and according to Dairy Australia is expected to remain challenging for the remainder of the year due to high input costs and a dry weather outlook. Despite this, on a global level the market is well-balanced and supports a positive outlook for commodity pricing.

The outlook for the companion animal market in regional areas shows no sign of changing and is growing strongly as animal health and wellbeing attitudes in regional areas continue to align with metropolitan attitudes.

Lastly, the outlook for the pig industry remains challenging but pork prices are beginning to recover on the back of supply shortfall. The impact of African Swine Fever is also becoming more significant for the Australian sector. I have covered this more on the next slide.

African Swine Fever update

To give you some brief background, African Swine Fever has long been present in Africa and eastern Europe and as you would be aware from the media has recently spread through China as a result of poor biosecurity practices, illegal movement of pigs and feeding contaminated pork back to pigs.

Australia's commercial pig industry has extensive biosecurity practices in place, including laws that make feeding pork and bacon back to pigs illegal.

Since the outbreak in Asia, Apiam has been working with its customers and the industry as a whole to be at the forefront of farmer education, and ensuring they have the best knowledge available to prevent incursion of African Swine Fever on their farms.

Apiam's swine vets are actively involved in the auditing of biosecurity systems across the commercial pig industry.

From a market perspective, the shortfall in global pork protein has already resulted in strong exports of Australian beef and lamb. It has been forecast that African Swine Fever could result in a 25% loss of global pork supply and we are working with our pig producing customers to identify new export markets and leverage this as an opportunity to increase the export of high quality Australian pork products.

YTD performance & Apiam outlook

I will now give a brief operating update based on the first four months of the FY2020 financial year, being July to October.

The dairy & pig segments continue to recover from animal reductions as a result of the challenging industry conditions we have just discussed. These challenges are being offset by strong fundamentals in feedlot, companion animals and the complementary business initiatives we have executed.

Our revenue for the first 4-months is down 1.3% versus the same time last year. In addition to industry challenges our revenue continues to be affected by our decision to reduce our low margin wholesale product sales. We expect this will be a feature of our revenue results until 2019 calendar year end but is beneficial for our earnings margins and effective use of capital.

Our gross margins continue to improve and our gross profit is up 2.9% YTD compared to PCP.

In terms of the company outlook for the remainder of FY2020, we expect the industry challenges we have discussed today to continue in the pigs and dairy segments in the short-term.

As I have highlighted this morning, we continue to work on adding new business lines and initiatives to deliver complementary revenue streams and increase our earnings margins. These also support diversification and resilience of revenues.

We expect growth in earnings as industry conditions continue to improve and many of these service and product lines come to market.

To wrap up, there is much to do this coming year to leverage our performance and drive improved earnings for our shareholders. Despite the industry challenges we face, this continues to be our overarching goal and our commitment to delivering material improvement to our EBITDA and NPAT remains our priority.

I would like to finish by thanking our shareholders for your continuing support. I also thank my Board colleagues & employees for your ongoing commitment and hard work to move our company into its next stage of growth.

I will now hand back to Andrew for the balance of the meeting formalities and resolutions.

-Ends-

For further information, please contact:

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About Apiam Animal Health Limited

Apiam Animal Health is positioned in the Australian market as a vertically integrated animal health business providing a range of products and services to Production and Mixed animals. Apiam Animal Health's strategy is to service Production and Mixed animals throughout their lifecycle, including the provision of veterinary services, ancillary services, genetics, wholesale and retail of related products, together with technical services related to food-chain security.