

VALUE FOCUS

# Animal Health Industry



SEGMENT FOCUS

**Pharmaceutical & Biotechnology**

**2016**

**Pharmaceutical &  
Biotechnology Overview**

Segment Overview	1
Pharmaceuticals	2
Biotechnology	3
Laboratory Testing	4
Other M&A Activity	5
Sector Outlook	6

**Animal Health Industry**

Publicly Traded	
Animal Health Companies	7
LTM Stock Prices	
by Industry Segment	7
<b>About Mercer Capital</b>	<b>8</b>

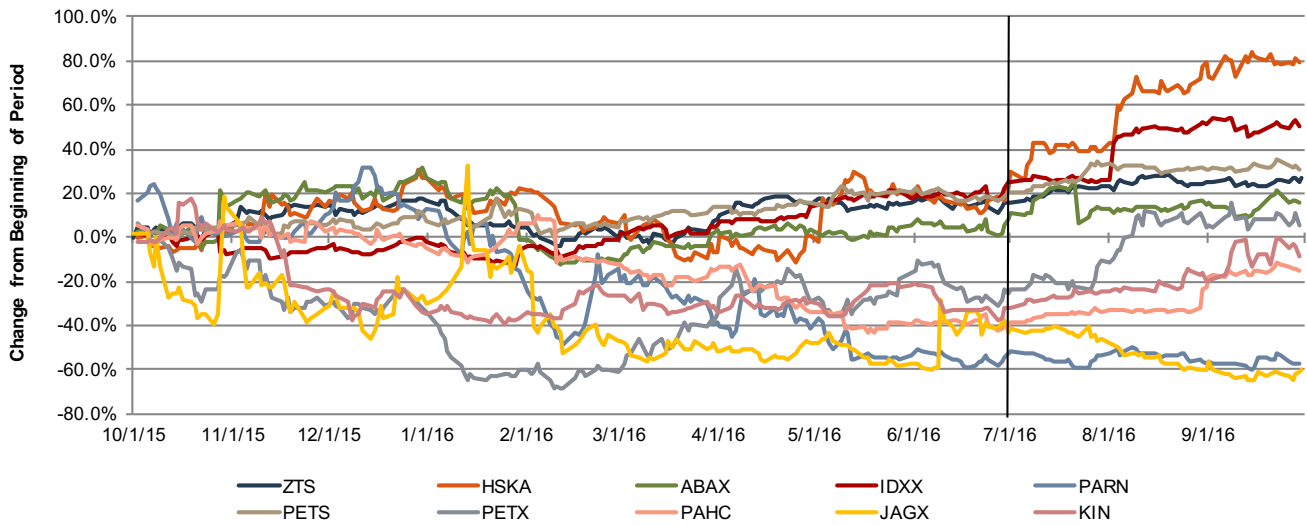
Q1: Veterinary Care
Q2: Retail & Pet Services
Q3: Veterinary Care
Q4: Pharmaceutical & Biotechnology

## Segment Overview

The development of animal pharmaceuticals and biotechnology continues to grow. Laboratory testing is becoming increasingly routine at veterinary clinics, increasing demand for lab services and equipment. Many veterinary clinics offer in-office laboratory tests, but in-office tests are often

costly and require the purchase or lease of equipment, maintenance of equipment, and trained technicians. The number of companion pets and food animals also impacts the demand for animal pharmacology and biotechnology.

### Pharmaceutical & Biotechnology LTM Stock Performance



Source: Bloomberg

## Pharmaceuticals

Animal pharmaceutical companies develop and distribute medications, ranging from flea medicine to heart worm preventative drugs to antibiotics. Pharmaceutical companies often rely on third-party suppliers to manufacture some of their products, placing them in a position of elevated risk. Pharmaceutical companies also typically sell their products to distributors who then market the products to veterinary service providers. Heska, Corp. (HSKA) and Zoetis, Inc. (ZTS) dominate the production and distribution of animal pharmaceuticals. Parnell Pharmaceuticals (PARN); Phibro Animal Health Corp. (PAHC); Aratana Therapeutics (PETX); Jaguar Animal Health, Inc. (JAGX); and Kindred Biosciences (KIN) operate in smaller niches in the animal health industry and focus on new developments. PetMed Express, Inc. (PETS) distributes pharmaceuticals to pet owners throughout the country. Increasingly tighter federal regulations have been restricting the use of "medically important" (to humans) antibiotics, requiring veterinary approval and reducing the situations in which they may be used.

**Zoetis, Inc.** was spun off from Pfizer in 2013 and William Ackman, a hedge fund manager known for his activist policies, acquired an 8.5% stake in November 2014. In May 2016, Ackman offered 16.9 million shares (approximately 40% of his stake) for sale. *Forbes* estimated that Ackman gained 17% on his holding over the year and half that he held the stock. The price of Zoetis stock increased 9.1% during the third quarter and 33% over the last twelve months.

**PetMed Express, Inc.** experienced stock price growth of 31% during the past year. In the nine month period that ended September 30, 2016, the company's revenue increased 3.8% and operating margin increased to 13.6% from 12.6%.

**Phibro Animal Health Corp. (PAHC)**, which produces and markets various animal health and nutrition products, executed its IPO on April 10, 2014. Although it raised \$176.5 million, Phibro's shares initially priced at \$15, below the expected range of \$16-\$18. Phibro closed on September 30, 2016 at \$27.18, which represents a year-over-year loss of 13%. Despite the year-long slide in prices, Phibro's stock price jumped in September as the Company surpassed analysts' revenue expectations.

**Aratana Therapeutics, Inc. (PETX)** has not reported positive net income following its IPO in June 2013. Aratana currently has several dog and cat medications in development, including new treatments for lymphoma, although these medications are still pending regulatory approval. One medication is expected to receive a conditional license in late 2016 or early 2017, and another is expected to receive approval in Europe in early 2017. At the end of June 2015, Aratana filed for FDA approval of a post-operative analgesic for ligament surgery in dogs. Additional drugs are in late-stage field tests. Aratana's stock price increased 48% and 11% over the past quarter and year, respectively.

**Parnell Pharmaceuticals Holdings, Limited (PARN)** experienced a year-over-year stock price decline of nearly 60%. Although the company's stock price reacted positively during the first quarter of 2016 to news of significant U.S. revenue growth during 2015, the company's share price declined in later months, including after the announcement of a second stock offering in May 2016. The shares were offered at a price of \$1.65, compared to a price of \$1.95 on May 11, on day prior to the announcement. Parnell develops pharmaceuticals for both companion animals and livestock, and is known for its research and development of osteoarthritis treatments.

**Jaguar Animal Health, Inc. (JAGX)** is an animal pharmaceutical company which specializes in developing gastrointestinal medications for companion and livestock animals. It launched its first product in September 2014 and has several other products seeking approval from the FDA. Jaguar was priced for its IPO on May 13, 2015 at an expected price of \$7.00 (valuing the company at \$35 million). This reflects the lower end of the range from its initial IPO announcement in August 2014. On a year-over-year basis, the company's stock price declined 60%. Jaguar's stock performance has been volatile throughout the year, with the largest drop in price occurring in the first quarter of 2016. In March 2016, Napo Pharmaceuticals, a company that focuses on the commercialization of pharmaceuticals, announced that it had acquired over 30% of Jaguar's shares on the open market.

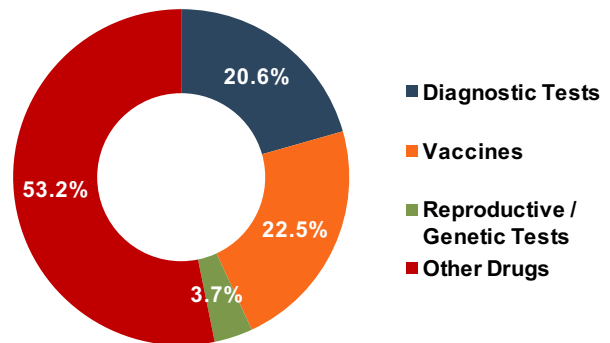
## Biotechnology

Animal health biotechnology companies research, develop, and test health-related equipment, tests, and products for companion animals and livestock. Biotechnology helps diagnose, treat, and prevent costly diseases. There is currently uncertainty surrounding future of animal biotechnology, which will be largely affected by government regulation and public opinion. After years of review, the FDA approved Aquabounty's genetically engineered salmon for human consumption in December 2012 and permitted its sale in November 2015. Genetically modified mosquitos incapable of reproducing were approved by regulatory agencies and local voters to help combat the Zika virus in Florida.

**Heska, Corp.** has experienced stock price growth in excess of 79% during the last twelve months. Heska achieved significant growth in both revenue and net income during the second quarter of 2016, resulting in increasing stock prices. According to management of Heska, the vaccines and pharmaceuticals segment experienced a 74% increase in year-over-year revenue which was greater than expected.

**Abaxis, Inc.** has experienced a stock price increase of 18.5% during the last four quarters. Abaxis, which manufactures medical equipment for both human and animal health purposes, conducts business on an international level. Abaxis is heavily dependent on MWI Veterinary, Inc., which distributes approximately 20% of its equipment worldwide. During the third quarter of 2016, Abaxis's veterinary income increased 4% relative to the prior year's third quarter.

Biotech Products Revenue

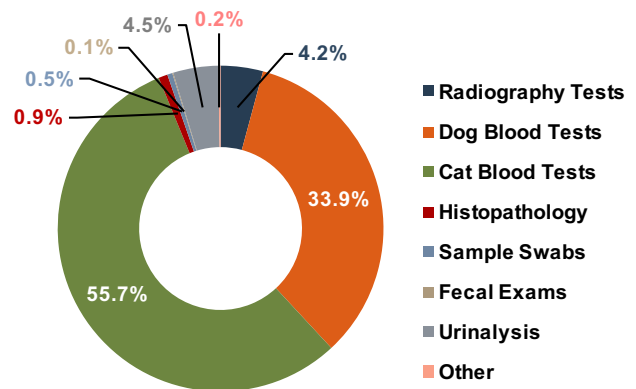


## Laboratory Testing

The routine use of diagnostic testing at veterinary clinics and increasing pet ownership has increased demand for veterinary laboratories. Additionally, increasingly stringent agricultural regulations has increased demands for laboratory testing on livestock animals. **IDEXX Laboratories**, the veterinary testing laboratory with the largest share of industry revenue, estimates that half of all diagnostic veterinary lab testing is outsourced to third party labs. There has been a push for veterinary practices to integrate laboratory testing services within their practices; however, doing so is capital intensive. Such integration is most commonly observed when a large company (such as VCA Antech) acquires smaller practices.

Based on strong earnings throughout the past year, IDEXX's share price has risen 52% during the last twelve months. IDEXX's organic revenue growth for the second quarter of 2016 was 13%, which management attributes in part to strong performance from its **Companion Animal Group ("CAG")**. Based on its performance in the second quarter of 2016, IDEXX increased its revenue guidance by \$25 million, which would represent organic growth of 10% to 11.5% for the full year. During the third quarter of 2016, CAG laboratory diagnostics grew 13% relative to the prior year and VetLab consumables revenue grew 15%. IDEXX has continued investing in veterinary laboratory testing services and has begun locating laboratories inside of veterinary practices. IDEXX leases space from the practice and provides in-house testing services to the veterinary practice, enabling the practice to get faster results and IDEXX to earn a higher margin.

Laboratory Testing Revenue



## Other M&A Activity

Mergers and acquisitions in the pharmaceutical and biotechnology industry generally reflect consolidations of larger firms with access to a vast R&D network and smaller firms with specific patents or drugs. This consolidation

trend is expected to continue through at least the next five years, resulting in potential cost efficiencies that may increase profits at the surviving companies.

### Trends in EBITDA Pricing Multiples

	4Q 2015	1Q 2016	2Q 2016	3Q 2016
VCA, Inc. (WOOF)	12.85	13.12	15.03	14.79
PetMed Express (PETS)	9.20	9.75	9.70	10.17
Heska, Inc. (HSKA)	19.45	13.63	16.22	21.40
Zoetis, Inc. (ZTS)	18.97	17.72	17.91	18.71
IDEXX Laboratories (IDXX)	20.35	21.31	23.37	26.82
Abaxis, Inc. (ABAX)	24.90	17.72	18.28	20.28
Phibro Animal Health (PAHC)	13.54	12.73	9.49	12.15

Source: Capital IQ

Presented pricing multiples represent enterprise value relative to EBITDA from the prior twelve months

EBITDA: Earnings before interest, taxes, depreciation, and amortization

## Sector Outlook

The economic growth outlook for the animal health biotech industry is positive. Established players in the industry have generally strong growth through the year, and new entrants continue to develop pipelines of new products and innovations. Increasing demand for products and technology to treat companion animals, which are increasingly being considered full members of the family, will prompt continued investment in the industry.

Biotech companies rely heavily on research and development. Research and development expenditures at biotech companies have increased at an annualized rate of 4.5% during the last five years. Evidence indicates that future growth of the industry will primarily be driven by increased testing of companion animals. Demand for improved quality of life for livestock animals will also impact the animal biotech industry. Increasing consumer demand is expected to lead

to improved profit margins and continuing revenue growth. New labs are expected to open in animal hospitals and the industry will see a trend to outsourcing of specialty lab tests. The increased use of human-based medical equipment and pharmaceuticals in animal health research should spur innovations in the animal health industry.

Innovations in commercial animal health continue as well. The application of GMO practices to animals will result in new areas of application for animal pharmaceuticals and biotechnology. Increasing use of human equipment and medicine for pet treatment will also expand the reaches of the animal pharmaceutical and biotechnology industry. The impact of governmental actions (including regulations, funding grants, and local tax laws) can have significant impacts on the industry.

**Publicly Traded Animal Health Companies**

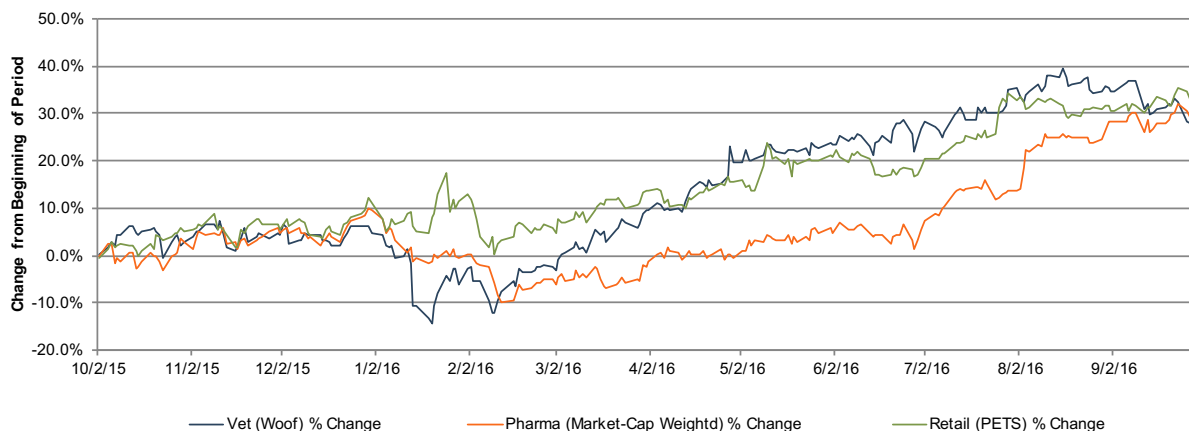
Company Name	Ticker	9/30/16 Price (\$)	52 Wk Perform (%)	Sales (\$)	Enterprise Value (\$M)	Debt/ Mart. Cap	EBITDA Margin	EV/ EBITDA (x)	EV / Next Yr EBITDA (x)	P/E (x)
<b>Veterinary Services</b>										
VCA Inc.	WOOF	69.98	32.9%	80.86	6,964.23	18.7%	19.7%	15.34	12.82	28.11
<b>Pet Retail</b>										
PetMed Express Inc	PETS	20.28	31.2%	235.54	414.68	0.0%	14.63%	12.03	11.66	19.29
<b>Animal Pharmaceuticals and Biotech</b>										
Heska Corp	HSKA	54.43	78.6%	114.90	374.76	0.2%	13.54%	24.09	16.61	58.46
Zoetis Inc	ZTS	52.01	27.3%	4,858.00	30,234.22	14.8%	29.39%	21.17	15.39	30.33
IDEXX Laboratories Inc	IDXX	112.73	51.8%	1,690.19	11,252.06	10.3%	23.13%	28.78	24.88	49.32
Abaxis Inc	ABAX	51.62	18.5%	223.51	1,161.80	0.0%	24.38%	21.32	22.72	38.13
Aratana Therapeutics Inc	PETX	\$9.36	10.6%	38.51	365.66	10.9%	nm	nm	-9.83	nm
PetMed Express Inc	PETS	20.28	31.2%	235.54	414.68	0.0%	14.63%	12.03	11.66	19.29
Parnell Pharmaceuticals Holdings Ltd	PARN	1.42	-58.7%	na	38.68	38.9%	nm	nm	nm	nm
Phibro Animal Health Corp	PAHC	27.18	-12.7%	751.53	1,423.81	24.8%	14.53%	13.04	12.04	12.71
Jaguar Animal Health Inc	JAGX	1.28	nm	0.20	18.15	23.7%	nm	nm	nm	nm
Kindred Biosciences Inc	KIN	4.99	-4.0%	0.00	99.26	0.0%	nm	nm	-3.82	nm
<b>Median-Animal Pharm &amp; Biotech</b>		<b>23.73</b>	<b>18.5%</b>	<b>223.51</b>	<b>394.72</b>	<b>10.6%</b>	<b>18.9%</b>	<b>21.25</b>	<b>13.72</b>	<b>34.23</b>

Source: Bloomberg

Note: Aratana, Parnell, Jaguar, and Kindred current income results in nonmeaningful multiples.

Note: PetSmart and MWI Veterinary no longer included due to acquisitions in the first quarter of 2015.

**Median Percent Change in LTM Stock Prices by Industry Segment**



Source: Bloomberg



# Mercer Capital

## Animal Health Industry Services

Mercer Capital has expertise providing business valuation and financial advisory services to companies in the animal health industry.

### Industry Segments

Mercer Capital serves the following industry segments:

- General, Specialty, and Emergency Care
- Pharmaceutical & Biotechnology
- Retail and Pet Services

### Services Provided

- Valuation of animal health companies and veterinary practices
- Transaction advisory for mergers and acquisitions
- Valuations for purchase accounting and impairment testing
- Fairness and solvency opinions
- Litigation support for economic damages and valuation and shareholder disputes

Contact a Mercer Capital professional to discuss your needs in confidence.

## Contact Us

**Nicholas J. Heinz, ASA**  
901.322.9788  
heinzjn@mercercapital.com

**Samantha L. Albert**  
901.322.9702  
alberts@mercercapital.com

### MERCER CAPITAL

**Memphis**  
5100 Poplar Avenue, Suite 2600  
Memphis, Tennessee 38137  
901.685.2120

**Nashville**  
102 Woodmont Blvd., Suite 231  
Nashville, Tennessee 37205  
615.345.0350

**Dallas**  
12201 Merit Drive, Suite 480  
Dallas, Texas 75251  
214.468.8400

[www.mercercapital.com](http://www.mercercapital.com)