

VALUE FOCUS

Animal Health Industry



SEGMENT FOCUS
Pharmaceutical & Biotechnology

2014

Pharmaceutical & Biotechnology Overview	1	Animal Health Industry	6
Pharmaceuticals	2	LTM Stock Prices by Industry Segment	6
Biotechnology	3	Publicly Traded	6
Laboratory Testing	3	Animal Health Companies	6
Other M&A Activity	4	About Mercer Capital	7
Sector Outlook	5		

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

SEGMENT FOCUS

Pharmaceutical & Biotechnology

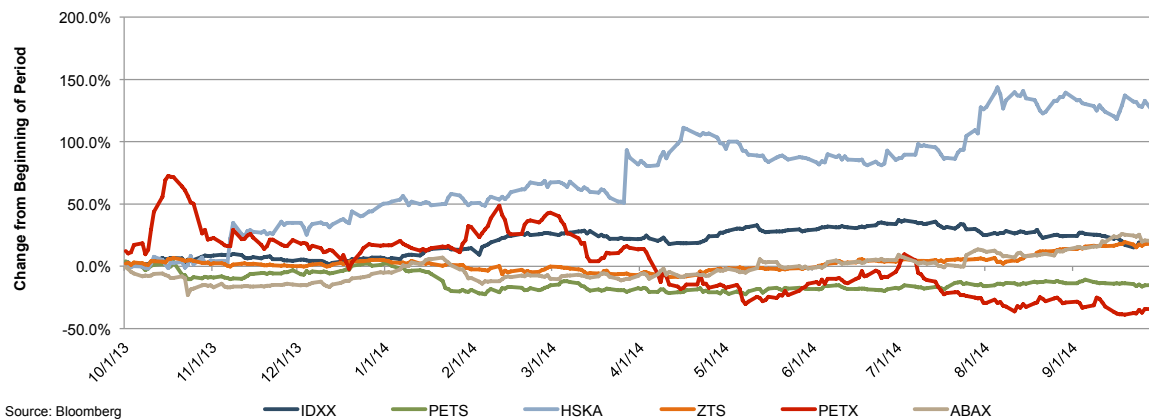
2014 Fourth Quarter

Pharmaceutical & Biotechnology Overview

As demand for improved care for companion animals and livestock increases, the development of animal pharmaceuticals and biotechnology will continue 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. There are currently an estimated 85 million households with at least one pet and the increasing meat consumption has prompted the recovery of livestock herd sizes.

Pharma / Biotech LTM Historic Stock Prices



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); Zoetis, Inc. (ZTS); Phibro Animal Health Corp. (PAHC); and Aratana Therapeutics, Inc. (PETX); are publicly traded companies that dominate the production and distribution of animal pharmaceuticals. PetMed Express, Inc. (PETS) distributes pharmaceuticals to pet owners throughout the country. Most of the companies operating in the pharmaceuticals segment of the animal health industry have experienced positive growth trends throughout the past year.

Zoetis, Inc., which spun off from Pfizer in 2013, currently ranks as one of the largest animal health companies in the world. Zoetis has experienced modest growth in its share price. On November 12, 2014, William Ackman, a hedge fund manager known for his activist policies, announced his acquisition of an 8.5% stake in Zoetis. Experts believe that Zoetis might become a prominent part of Ackman's portfolios.

PetMed Express, Inc. announced in January 2013 that revenue for the nine months ending December 31, 2012 had declined 3.0% relative to the same period in the prior year. Despite net income

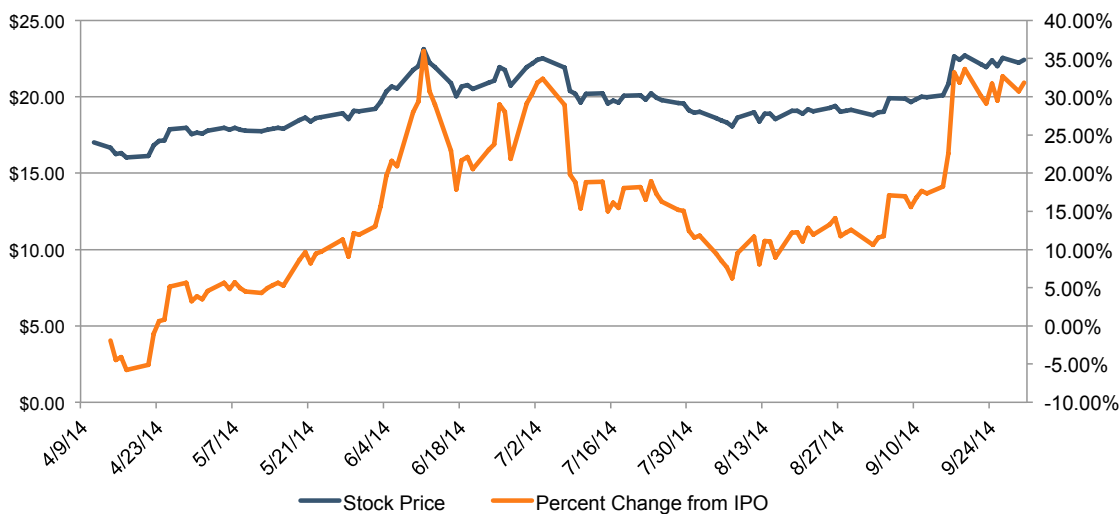
remaining relatively flat, PetMed shares fell 20% by the end of January. Lackluster performance has resulted in the stock price being unable to fully recover, and the shares remain depressed, over 16% below their trading value a year ago. Consumers continue to prefer lower-margin and more-easily-obtainable generic medications to the brand name products primarily offered by PetMed Express.

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. Between the offering and the end of the quarter, however, Phibro's shares rose almost 50%, closing the third quarter at \$22.41.

At the time of the IPO, Phibro reported LTM revenue of \$672 million and EBITDA of \$84.38 million. At the \$15 IPO per share price, Phibro had an implied market capitalization of \$581.9 million, implying revenue and EBITDA multiples of .86 and 6.89, respectively.

Following its IPO in June 2013, **Aratana Therapeutics** is yet to report positive net income. As a result, its share price has fallen almost 40% during the last twelve months. Aratana currently has several dog and cat medications in development, including new treatments for lymphoma, although these medications are still pending regulatory approval and are not expected to be launched until 2016.

PAHC Post – IPO Performance



Source: Bloomberg

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 the future of animal biotechnology, which will be largely affected by government regulation and public opinion. Although the FDA said that Aquabounty's genetically engineered salmon was safe for human consumption in December 2012, Aquabounty is still waiting for approval as the FDA decides whether it will allow genetically engineered salmon to be a food product.

Heska Corp., in particular, has experienced stock price growth in excess of 100% during the last twelve months. In March 2014, Heska's stock price jumped over 25% in a single day based on its fourth quarter earnings release. Although the company experienced a modest net loss for the year, revenue jumped almost 8.0%, largely due to exceptional fourth quarter improvements.

Heska has continued its ongoing acquisition activities by acquiring an equity stake in one of its suppliers. Heska also acquired a con-

trolling interest in Cuattro Veterinary USA, LLC, an animal health imaging and radiography distributor. Cuattro was and remains a key supplier for the company. Heska paid \$7.57 million for a 54.6% interest in Cuattro, implying a total enterprise value of \$13.8 million for the equipment sales company. Following the transaction, Heska rebranded Cuattro as Heska Imaging. Heska funded the transaction using currently available cash and equity, without resorting to using debt or a initiating a capital raise.

Abaxis, Inc. has experienced modest growth after share prices dipped in the fourth quarter of 2013. 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 six months that ended September 30, 2014, revenue from veterinary instruments declined 23%, while revenue from veterinary consumables increased 23% relative to the same period in 2013. Other veterinary products and services increased 72%.

Laboratory Testing

The routine use of diagnostic testing at veterinary clinics has increased demand for veterinary laboratories. **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. In general, laboratory testing service providers require significant investment in equipment and machinery.

Based on strong earnings throughout the past year, IDEXX's share price has risen 18% during the last twelve months, performing slightly better than the S&P 500 during the same period. Rev-

enue and net income had increased 11% and 8%, respectively, during the nine month period ending September 30, 2014, relative to same period in the prior year. IDEXX has narrowed the focus of its operations recently, investing in a veterinary testing laboratory and divesting itself of a veterinary hospital operator, both within the last seven months.

Abaxis, Inc. which also operates in the laboratory testing field, has also reported increased demand for laboratory testing services, resulting in greater revenues. Abaxis has experienced declining costs in laboratory services, enabling it to expand its gross margin.

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 trend has been evident in the last twelve months. This consolidation is expected to continue through at least the next five years, resulting in potential cost efficiencies that may increase profits at the surviving companies.

Elanco Animal Health, Inc., a wholly-owned subsidiary of **Eli Lilly and Company** (LLY), announced its planned acquisition of **Novartis AG's** animal health segment in April 2014. The transaction would boost Elanco and make it one of the largest animal health companies in the world, second only to Zoetis in terms of revenue. This transaction is part of Lilly's expansion beyond human pharmaceuticals. As a result, animal pharmaceuticals are expected to generate 9% of Lilly's total revenue. Additionally, Lilly expects to reduce the newly acquired business's expenses by approximately 10%. Lilly

paid \$5.35 billion for the operating unit, around \$2 billion of which was funded by debt. Novartis's Animal Health segment reported revenue of \$1.1 billion in 2013, implying a transaction multiple of 4.9x revenue. The transaction is subject to anti-trust review, but has already been approved by European and Indian regulators.

In August 2014, **Jaguar Animal Health, Inc.** (JAGX) announced a planned IPO. The animal pharmaceutical company, which specializes in developing gastrointestinal medications for companion and livestock animals, launched its first product in September 2014 and has several other products seeking approval from the FDA. With an expected price range of \$7.00 to \$9.00, the company is valued between \$35 million and \$45 million. The company expects to use the proceeds of its IPO to commercialize its products in order to distribute them broadly across the United States. Although no date has been announced for the IPO, Jaguar Animal Health hopes to complete the offering as soon as possible.

Trends in EBITDA Pricing Multiples

	4Q 2013	1Q 2014	2Q 2014	3Q 2014
VCA, Inc. (WOOF)	10.12	10.24	10.67	11.36
MWI Vet Supply (MWIV)	19.64	18.11	16.03	15.46
PetMed Express (PETS)	9.49	7.70	8.19	7.82
Heska, Inc. (HSKA)	nm	71.84	40.12	14.17
Zoetis, Inc. (ZTS)	16.78	13.90	14.97	16.55
Pet Smart (PETM)	8.17	7.42	6.55	7.53
IDEXX Laboratories (IDXX)	17.46	19.93	21.31	18.34
Phibro Animal Health (PAHC)	nm	nm	14.40	13.08
Abaxis, Inc. (ABAX)	23.69	24.36	31.60	33.08
Aratana Therapeutics (PETX)	nm	nm	nm	nm

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

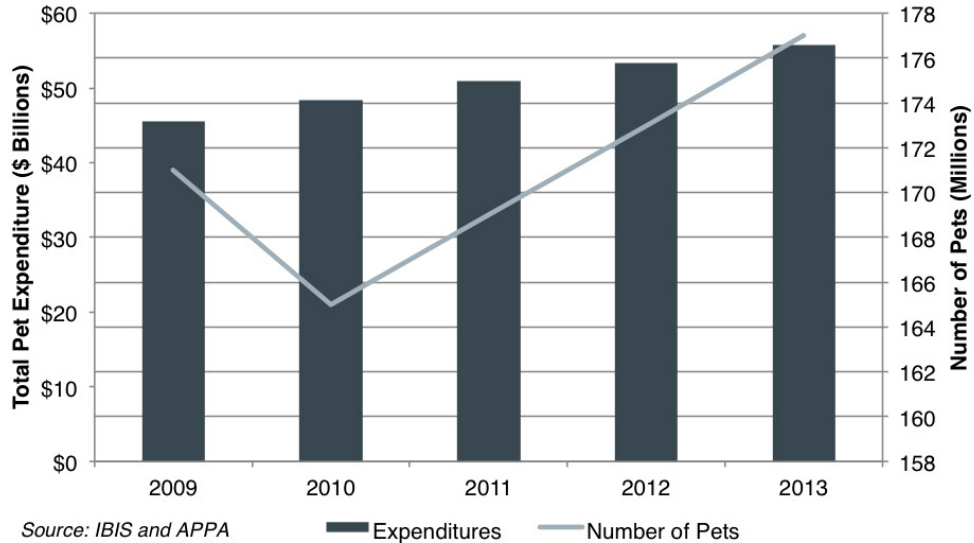
The economic growth outlook for the animal health biotech industry is positive. Increasing demand for products and technology to treat companion animals, which are increasingly being considered full members of the family, will prompt continued investment in the industry.

Biotech companies rely heavily on research and development. Evidence indicates that future growth of the industry will primarily be driven by increased testing of companion animals. 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. The impact of governmental actions (including regulations, funding grants, and local tax laws) can have significant impacts on the 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. In particular, aquaculture is expected to grow rapidly in the next decade, due to recent productivity innovations. Aquaculture produced 66.5 million tons of fish in 2012, and farmed fish consumption surpassed captured fish consumption for the first time in 2014. According to the UN's Food and Agriculture Organization, aquaculture production has the potential to grow as much as 4% annually.

Number of Pets and Pet Expenditures



Publicly Traded Animal Health Companies

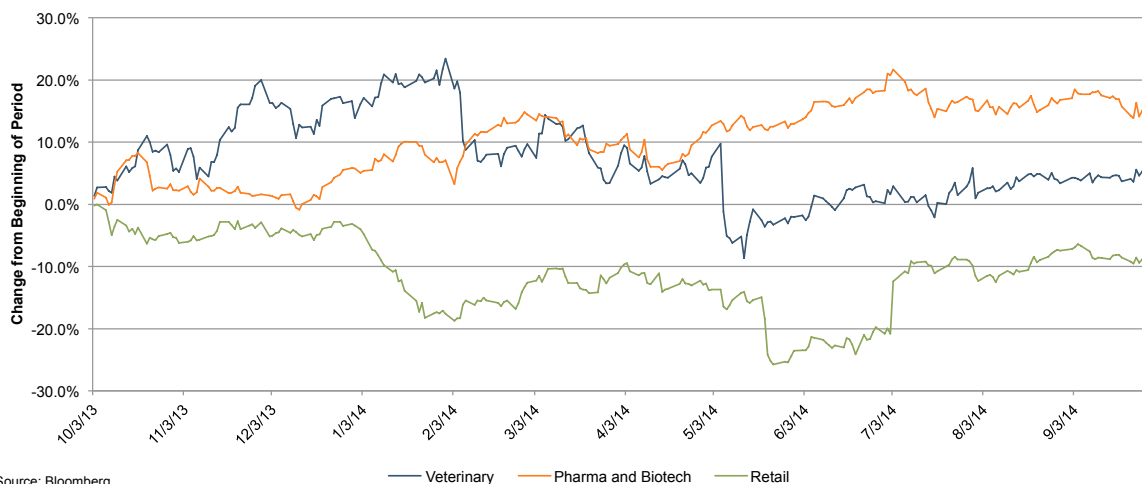
Company Name	Ticker	30-Sept Price (\$)	52 Wk Perform (%)	Sales (\$)	Enterprise Value (\$M)	Debt/Equity	EBITDA Margin	EV/EBITDA (x)	EV / Next Yr EBITDA (x)	P/E (x)
Veterinary Services										
VCA Inc.	WOOF	39.33	43.2%	85.29	7,462.40	16.4%	18.5%	11.56	10.52	26.57
MWI Veterinary Supply, inc.	MWIV	148.40	-0.6%	12.86	4,014.94	3.9%	4.3%	15.33	14.01	26.27
Median-Veterinary Services		93.87	21.3%	49.08	5,738.67	10.2%	11.4%	13.44	12.26	26.42
Pet Retail										
PetSmart Inc	PETM	69.89	-7.0%	6,959.11	7,462.40	7.0%	13.50%	7.95	7.86	16.72
PetMed Express Inc	PETS	13.42	-12.2%	228.84	272.03	0.0%	12.56%	9.46	9.66	15.79
Median-Pet Retail		41.66	-9.6%	3,593.97	3,867.21	3.5%	13.0%	8.71	8.76	16.26
Animal Pharmaceuticals and Biotech										
Heska Corp	HSKA	13.19	127.4%	89.02	79.35	2.8%	8.19%	10.89	8.04	27.48
Zoetis Inc	ZTS	36.88	nm	4,719.00	22,135.30	16.5%	23.99%	19.55	14.91	32.93
IDEXX Laboratories Inc	IDXX	117.83	18.2%	1,487.92	6,412.42	11.3%	23.11%	18.65	16.02	30.68
Abaxis Inc	ABAX	50.62	21.0%	184.27	1,140.56	0.0%	19.18%	32.27	27.80	66.60
Aratana Therapeutics Inc	PETX	10.04	-38.6%	0.64	356.87	4.2%	nm	nm	nm	nm
PetMed Express Inc	PETS	13.42	-12.2%	228.84	272.03	0.0%	12.56%	9.46	9.66	15.79
Median- Pharma/Biotech		25.15	18.2%	206.55	748.72	3.5%	19.2%	18.65	14.91	30.68

Source: Bloomberg

Note: Aratana's recent IPO has resulted in nonmeaningful multiples and ratios in the short term.

Median Percent Change in LTM Stock Prices by Industry Segment

(Price-Weighted Indices)



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
5100 Poplar Avenue, Suite 2600
Memphis, Tennessee 38137
901.685.2120 (P)

www.mercercapital.com