

VALUE FOCUS

Animal Health Industry

SEGMENT FOCUS

Pharmaceutical & Biotechnology

2015

Pharmaceutical & Biotechnology Overview

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Animal Health Industry

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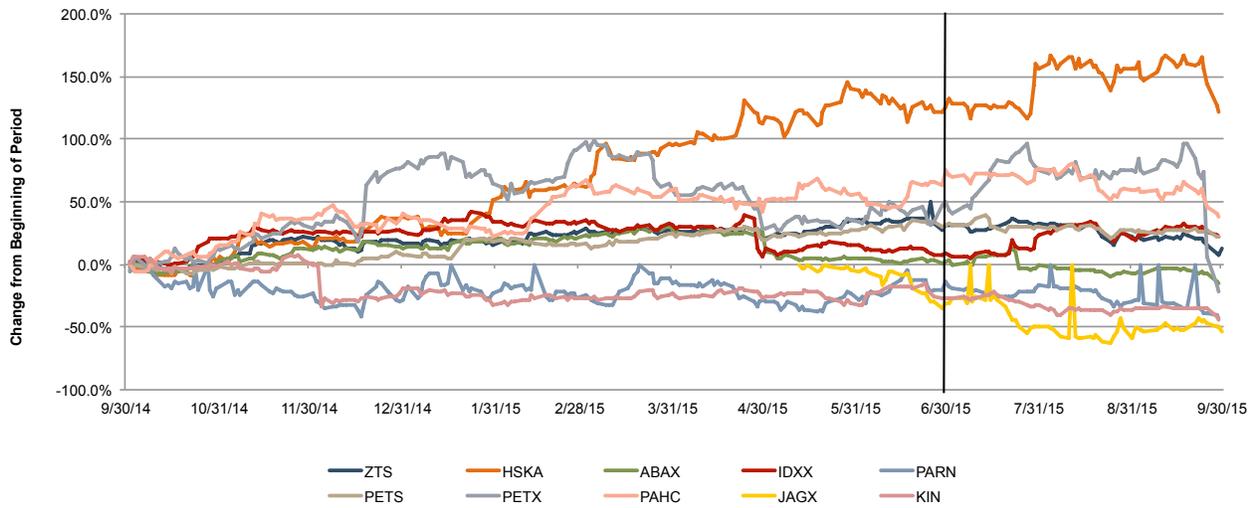
Q1: Veterinary Care
Q2: Retail & Pet Services
Q3: Veterinary Care
Q4: Pharmaceutical & Biotechnology

Industry 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. Advances in pharma technology can have mixed effects on the industry. While new treatments are continuously being developed, the approval and subsequent adoption by many practices of a two-dose parvovirus vaccine (as opposed to the earlier three-dose vaccine) can ultimately impair revenue growth.

Zoetis, Inc. (ZTS), which spun off from Pfizer in 2013, currently ranks as one of the largest animal health companies in the world. Zoetis has experienced 12.3% growth in its share price year-over-year. In November 2014, William Ackman, a hedge fund manager known for his activist policies, acquired an 8.5% stake in Zoetis. Ackman took an active interest in Zoetis throughout 2015, and is believed to be behind Zoetis's plans to cut \$300 million in costs by 2017. The plan includes terminating 2,500 workers.

PetMed Express, Inc. (PETS) experienced stock price growth of 24% during the past year. Most of the company's growth occurred in the first quarter of 2015 when PetMed announced income growth of 5.6% quarter-over-quarter. Although revenue growth has remained slow, margins have improved relative to past performance. Consumers continue to prefer lower-margin and more-easily-obtainable generic medications to the brand name products primarily offered by PetMed Express. PetMed continued to report net income growth through 2015.

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, 2015, at \$31.63, which represents year-over-year growth of 43%. Despite this significant growth, Phibro's stock was fairly volatile throughout the year

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; however, these medications are still pending regulatory approval and are not expected to be launched until 2016. In the third quarter of 2015, Aratana announced that trials of some of its in-development drugs were not as effective as believed. Consequently, Aratana impaired the goodwill related to the treatments in question. Investors reacted negatively to the news, causing Aratana's stock price to decline from \$19.73 on September 27 to \$8.46 at the end of the quarter (a loss of 57%). Over the past year, Aratana's stock price declined 16%.

Parnell Pharmaceuticals Holdings, Limited (PARN) experienced a stock price decline of 40%. Volatile earnings combined with management changes likely affected the pharmaceutical developer's stock price. Parnell develops pharmaceuticals for both companion animals and livestock, and it is known for its research and development of osteoarthritis treatments.

Jaguar Animal Health, Inc. (JAGX) 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. The IPO occurred on May 27, 2015, and the company raised approximately \$20 million. However, the stock price fell 3% on its first day of trading. Jaguar's stock price continued to decline, ending the quarter at \$3.24, a decline of 53% from its 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.

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.

Heska, Corp. (HSKA) has experienced stock price growth in excess of 130% during the last twelve months. Continuing revenue growth and improving margins helped Heska's stock price grow consistently throughout the year. Heska also acquired the remaining shares of Cuattro Veterinary USA, LLC, an animal health imaging and radiography distributor and a key supplier for the company. Heska paid \$6.0 million for a 45.5% interest in Cuattro and

\$2.1 million in liabilities, implying a total enterprise value of \$8.1 million for the equipment sales company. The transaction also resulted in an Enterprise to Revenue ratio of 1.3x.

Abaxis, Inc. (ABAX) has experienced a stock price decline of 12.6% 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. In April 2015, despite reporting quarterly income growth of 33% relative to the prior year, income per share fell. Additionally the management team restructured. Abaxis share price fell 22% in five days and continued to decline throughout the quarter. After the end of the third quarter, reports of higher-than-expected growth led to modest gains that were insufficient to reverse the losses sustained earlier in the quarter.

Laboratory Testing

The routine use of diagnostic testing at veterinary clinics has increased demand for veterinary laboratories. **IDEXX Laboratories** (IDXX), 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 26% during the last twelve months. IDEXX is expected to generate \$710 million in revenue during 2015, 83.5%

of which is expected to be generated by veterinary-related testing. IDEXX continued investing in veterinary laboratory testing services and 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.

Abaxis Inc. (ABAX), which previously operated in the laboratory testing field, sold most of the assets of its laboratory testing service reporting unit to Antech Diagnostics, Inc. in March 2015. The agreed upon purchase price was \$21 million. An estimate of Abaxis revenue generated by laboratory services was not available.

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 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.

Trends in EBITDA Pricing Multiples

	4Q 2014	1Q 2015	2Q 2015	3Q 2015
VCA, Inc. (WOOF)	13.75x	14.66x	13.96x	13.08x
PetMed Express (PETS)	8.66x	9.96x	9.82x	8.81x
Heska, Inc. (HSKA)	18.88x	22.38x	22.43x	17.58x
Zoetis, Inc. (ZTS)	18.16x	19.51x	19.60x	16.49x
IDEXX Laboratories (IDXX)	23.96x	24.96x	20.90x	23.19x
Abaxis, Inc. (ABAX)	27.53x	32.03x	24.86x	19.80x
Phibro Animal Health (PAHC)	15.04x	15.75x	16.61x	14.48x

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

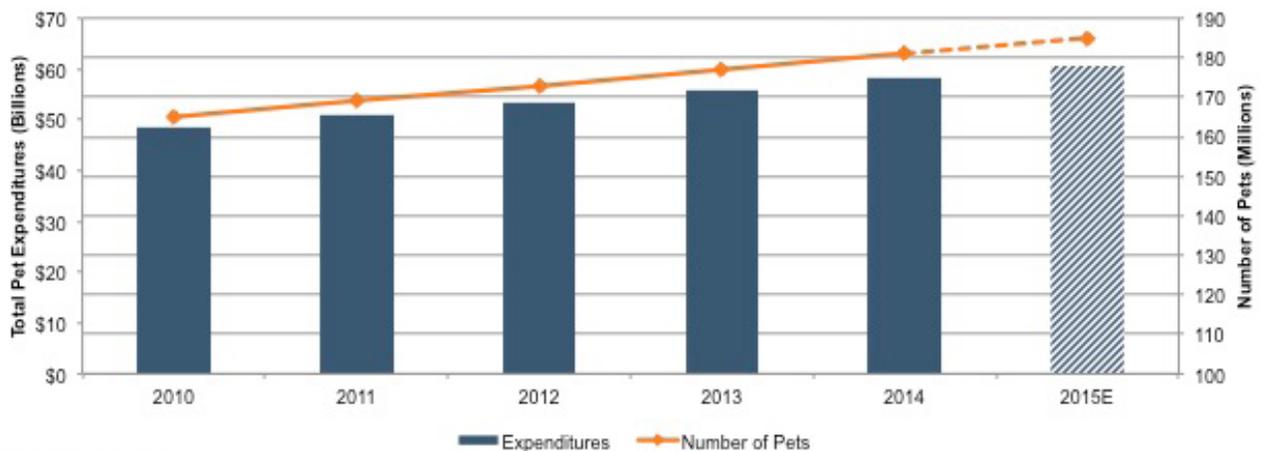
The economic growth outlook for the animal health biotech industry is positive. Increasing demand for products and technology to treat companion animals, which are increasingly being considered full members of the family, will prompt continued investment in the industry.

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. Increasing use of human equipment and medicine for pet treatment will also expand the reaches of the animal pharmaceutical and biotechnology industry.

Number of Pet Expenditures



Source: APPA and IBIS

Publicly Traded Animal Health Companies

Company Name	Ticker	9/30/15 Price (\$)	52 Wk Perform (%)	Sales (\$)	Enterprise Value (\$M)	Debt/ Mart. Cap	EBITDA Margin	EV/ EBITDA (x)	EV/ Next Yr EBITDA (x)	P/E (x)
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Veterinary Services

VCA Inc.	WOOF	52.65	33.9%	2,027.74	8,763.64	16.6%	17.4%	14.60x	14.60x	33.79x
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Pet Retail

PetMed Express Inc	PETS	16.10	23.9%	228.49	326.18	0.0%	12.93%	11.04x	10.10x	17.50x
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Animal Pharmaceuticals and Biotech

Heska Corp	HSKA	30.48	131.1%	92.93	200.62	0.8%	9.81%	22.01x	14.56x	66.26x
Zoetis Inc	ZTS	41.18	12.3%	4,807.00	24,209.80	15.1%	18.99%	26.52x	15.00x	49.02x
IDEXX Laboratories Inc	IDXX	74.25	26.0%	1,531.30	7,975.15	13.8%	21.67%	24.03x	20.08x	39.60x
Abaxis Inc	ABAX	43.99	-12.6%	218.55	997.80	0.0%	20.37%	22.42x	19.00x	44.89x
Aratana Therapeutics Inc	PETX	\$8.46	-15.7%	0.68	305.54	4.9%	nm	nm	nm	nm
PetMed Express Inc	PETS	16.10	23.9%	228.49	326.18	0.0%	12.93%	11.04x	10.10x	17.50x
Parnell Pharmaceuticals Holdings Ltd	PARN	3.44	-40.2%	9.50	31.82	94.6%	3.16%	106.07x	nm	nm
Phibro Animal Health Corp	PAHC	31.63	42.8%	748.59	1,525.24	19.0%	14.60%	13.96x	13.18x	19.05x
Jaguar Animal Health Inc	JAGX	3.24	nm	0.00	26.43	0.5%	nm	nm	nm	nm
Kindred Biosciences Inc	KIN	5.20	-43.8%	0.00	102.92	0.0%	nm	nm	nm	nm
Median- Animal Pharm & Biotech		23.29	12.3%	155.74	315.86	2.9%	14.6%	22.42x	14.78x	42.24x

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

— Vet (Woof) % Change — Pharma (Market-Cap Weighted) % Change — Retail (PETS) % Change

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.

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