# ECO Animal Health Group

## Poised to recover in 2022

30 November 2021

**ECO Animal Health's shares currently stand at a 52-week low, likely on concerns over its exposure to the unpredictable Chinese pork market. Sales of the company's main product, Aivlosin, are highly exposed to the economics of the pig farming sector in China, which has moved from an unusual situation of shortage in 2020 to one of over-supply this year. Thus, the investment proposition is currently geared to a recovery in Chinese pork prices and rebalancing of supply and demand, something that should occur - not least because of State intervention in the market designed to bring this about.**

**In the longer term, ECO offers investors exposure to a niche within animal health characterised by favourable economic drivers (demographics, good practices in farming) in which it enjoys a strong market position.**

- **Interim results:** Weaker demand from Chinese pork producers saw revenues fall 9% to £38.5m in the six months to end September albeit from exceptional levels, with China/Japan now representing 41% of sales. Excluding China/Japan, other markets globally saw revenues grow by 5% with a generally stable market in North America and significantly higher demand in South/Southeast Asia. Adjusted EBITDA was £3.8m (vs £6.7m), with the decrease in profitability directly attributable to lower revenue from China. The gross margin dipped 2% points (46% vs 48%), reflecting the revenue fall in China, which is a higher margin territory. Net cash at period end stood at £22.9m, of which £22.7m is held within the 51%-owned Chinese subsidiary.

- **Chinese pork market:** Pig prices in China have fallen this year from an exceptional CNY30-35/kg to a low of CNY15/kg in October, as the market become oversupplied after producers rebuilt herds last year (in turn after a Swine fever outbreak in 2019). At the low price level many producers would have been selling pigs this year at a loss. Management regards the situation in China as cyclical and expects a recovery in H2 (six months to March 2022). There is already some evidence for this, with a rise in pig prices from CNY15/kg to CNY20/kg in the last month.

- **Financial forecasts:** Equity Development is in the early stages of formal coverage, so is not publishing forecasts at this point; a comprehensive initiation should be published in due course. Consensus FY22 forecasts suggest sales of c. £81.5m and adjusted EBITDA of £9.4m.

- **Valuation:** ECO's shares have been under pressure this year and stand at their lowest point since 2009. The enterprise value is c£113m, which based on consensus FY22 figures, suggests an EV/sales of 1.5 and EV/EBITDA of ~12, both well below the average in the animal health sector. ECO also paid a maiden dividend of 1p/share in 2021 that, if repeated, would offer a prospective yield of ~0.7%.

### Summary results

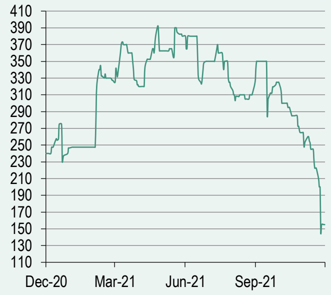
| y/e 30 Mar, £m | FY21 | H121 | H122 |
|---|---|---|---|
| Sales | 105.6 | 42.5 | 38.5 |
| EBITDA* | 24.4 | 6.7 | 3.8 |
| Net cash | 19.5 | 12.9 | 22.3 |
| EV/Sales** | 1.1 | 2.9 | 3.0 |

*Source: Company historic data * Adjusted earnings before interest, tax, depreciation, amortisation, exceptional items. Note EV calculated based on current market capitalised less year end cash.*

### Company Data

| | |
|---|---|
| EPIC | EAH |
| Price (last close) | 150p |
| 52 weeks High/Low | 405p/140p |
| Market cap | £136m |
| Net cash (LBSD) | £22.9m |
| Sector | Pharma & Biotech |

### Share Price, p




Source: ADVFN

### Description

ECO Animal Health's (ECO) main product is the macrolide antibiotic Aivlosin for the treatment of enteric and respiratory diseases in pigs and poultry. It also sells a suite of products to treat and prevent parasites in sheep, horses, cattle, dogs, and pigs.

ECO operates through a combination of joint ventures and wholly owned subsidiaries in high volume animal production markets in North and South America, along with key producing pork-producing regions in Asia.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## H1 results update

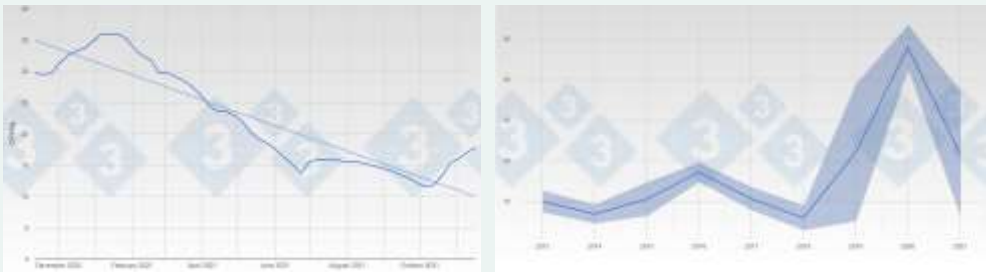
Sales revenue in the six months to end September fell by 9% to £38.5m, as a result of the fall in demand for Aivlosin in China from exceptional levels that were seen in 2020. Sales revenue for China/Japan (which are grouped for reporting purposes) represented 41% of sales. Excluding China/Japan, other markets saw revenues grow by 5% with a generally stable market in North America and significantly higher demand in South and Southeast Asia.

Reported EBITDA in the period was £2m (versus £5.8m), which if adjusted for foreign exchange movements and an impairment charge, gives an adjusted EBITDA of £3.8m (vs £6.7m). The decrease in profitability was again directly attributable to the lower revenue from China. This also affected the gross margin, which dipped 2% points (46% vs 48%). ECO took a £2m impairment relating to a specific R&D project that has been discontinued, which after finance charges and associates, meant profit before tax was £0.9m (vs a restated £4.8m). EPS in the period was -0.21p (vs 3.63p).

Cash generated by operations of £6.1m and net cash at the period end was £22.9m, of which £22.7m is held within the 51%-owned Chinese subsidiary (this is important as it would be subject to a withholding tax if this were to be repaid to the parent as a dividend).

As noted, ECO is heavily geared to the Chinese pork market for sales of Aivlosin. Pig prices in China have fallen this year from CNY30-35/kg in 2020 to a low of CNY15/kg in October, as a result of the market becoming over-supplied after producers built (overly) large herds last year in response to the African Swine fever outbreak in 2019. The Chinese government announced an emergency programme to buy pork in June and the price appears to have now stabilised, indeed prices have risen from CNY15/kg to CNY20/kg in the last month. Pricing data obtained from an industry news website, www.pig333.com, is shown below.

**Pig prices in China (CNY/kg) in 2021 and period 2013-2021**



*Source: Pig333.com.* LHS chart shows a real time price and trendline; RHS shows average and deviation of price.

China has the world's largest commercial pig herd, hence is the most important market for Aivlosin. Demand is very sensitive to the economics of production in this market, which has in turn been affected the knock-on effects of an outbreak of African swine fever in 2019. The recovery and the effect of Chinese government subsidies and price controls shifted production to the larger and better capitalised producers, which in turn has led to the situation of oversupply.

### Aivlosin

Aivlosin is the mainstay product contributing over 80% of overall sales in FY2021. It is a macrolide antibiotic indicated for the treatment of swine enzootic pneumonia, caused by susceptible strains of Mycoplasma hyopneumoniae, in pigs and for porcine proliferative enteropathy (ileitis) or swine dysentery, caused by Brachyspira hyodysenteriae. The medicine is noted for its relatively simple administration – a key differentiator when dealing with large herds - and is used as an additive to animal feed for a period of seven days until the initial infection has cleared. In poultry farming, Aivlosin is used for the treatment of respiratory disease associated with Mycoplasma gallisepticum.

## Large addressable market

Aivlosin is a small but important contributor to the global animal antimicrobials/antibiotics market, which is projected to reach $5.6bn by 2026, up from $4.7bn in 2021, a CAGR of 3.6%. Market growth is largely based on rising demand for animal-derived food products, as well as the increasing incidence of zoonotic diseases, and the implementation of regulations to prevent their spread.

On a domestic level, overall rising animal healthcare spending, and the growing demand for pet insurance to pay for it, are further expected to drive the growth of this market segment. Emerging markets such as China, India, and Brazil, along with growth in the overall companion animal population, are also expected to offer significant growth opportunities in the coming years. The projected growth in the market is a key element in ECO's investment case.

## Key issues

For many years there has been mounting concern the role that animal antibiotics as a by-product of intensive farming practices might play in anti-microbial resistance for human use. International animal health guidance is clear that microlide antibiotics should only be administered on the advice of a veterinary professional after a verifiable diagnosis. Eco should in fact benefit from a more restricted and appropriate use of antibiotics in animal health, as Aivlosin is only used for a short duration, and should in effect displace the practice of more liberal (and potentially irresponsible) use of generic antibiotics in animal feed.

## Valuation thoughts

ECO's shares have been under pressure this year and currently are at a 52 weeks' low, indeed they stand at their lowest point since 2009. We attribute this to concerns about the economics and moreover unpredictability of the Chinese pork market. The enterprise value is c £113m, which based on consensus FY22 figures, suggests an EV/EBITDA of 12. This is well below the average for listed companies in the animal health sector. ECO paid a maiden dividend of 1p/share in 2021 that, if repeated, would offer a prospective yield of ~0.7%.

We see the investment proposition in the short term as being geared to a recovery in Chinese pork prices and rebalancing of supply and demand. In the longer term, Eco offers exposure to a niche segment within animal health characterised by some favourable economic drivers (demographics, good practices in farming) in which it enjoys a strong market position.

The company has also been investing for some time in a number of R&D projects that are now starting to come to fruition. These are expected to be presented (for the first time) at a Capital Markets Day in early 2022, which may help bolster investor confidence.

## Contacts

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