

10 August 2022

Trading update triggers share price fall

ECO Animal Health issued a trading update earlier this week in somewhat unusual circumstances given it is in its closed period and expects to report FY22 results on or around 18 August. The statement also flagged up two financial issues that had recently emerged: that it will have to make a provision for a possible but unanticipated sales tax liability and treat certain previously capitalised development costs as an expense. The impact of these two items will be largely offset by exchange rate gains and ECO expects to report sales in excess of £82.5m and EBITDA of £6.5m, both broadly in line with consensus.

ECO also chose to comment on current trading, which has been clearly weak in the key Chinese market and will probably impact consensus results for FY23. This latter aspect of the trading statement has had a predictable effect on the shares, which have fallen by c. 20% in response, and are again at their lowest level since 2008.

The larger of the two accounting factors is the provision for the potential sales tax liability in an (undisclosed) country into which Aivlosin is imported and sold by an ECO subsidiary (hence it cannot be US or China). ECO stresses that the tax liability has not been confirmed but it will nevertheless have to make £2.5m provision, which will be apportioned over several financial years and charged to cost of sales. This will have a £1m negative impact on EBITDA in FY22. A secondary accounting item has also arisen in connection with development costs of £0.3m, which were expected to be capitalised but will now have to be expensed. However, the two items have been largely offset by a £1m exchange rate gain (presumably on the cash held by its Chinese subsidiary).

On current trading, ECO said that Chinese revenue in Q1 FY23 (April-June) was significantly below levels recorded in the prior year, although gross margins remain strong, while revenue in the Rest of the World grew strongly compared with the same period last year. While it is not clear yet the extent of the shortfall in China, it is not helped by comparison with a particularly strong prior year figure that reflected a favourable combination of industry structural changes and restocking of the pig herd after the ASF epidemic together with changes in regulations for use of antibiotics in feed. Nonetheless, it has been obvious for some months that profitability for large pork producers in China would be very poor to absent (which has an impact on demand for Aivlosin) as low pork prices (with pork demand suppressed by lockdowns as part of the Zero-Covid policy) combined with higher input costs (feed etc).

Ratings now low for sector

ECO should be able to give more colour on its assessment of overall trading in FY23 with its forthcoming results, which should at least remove the uncertainty that is presumably depressing its shares. With cash at the last balance sheet date of almost £23m, its EV currently stands at £45m. Thus, based on known FY22 figures, **EV/sales ratio is currently 0.54** and its **EV/EBITDA at 6.9**: both very low by any standards and certainly the norms of the animal health sector.

ECO resumed payment of a dividend in 2021 at 1p/share that, if repeated, would offer a yield of 1%.

Company Data

EPIC	EAH
Price	100p
52 weeks High/Low	380p/100p
Market cap	£68m
Net cash (LBSD)	£22.9m
Sector	Pharma & Biotech

Share Price, p



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.

Summary financials

y/e 30 Mar, £m	FY21	1H 22	H2 22e	FY22e
Sales	105.6	38.5	44.0	82.5
EBITDA	24.4	3.8	2.7	6.5
Net cash	19.5	22.3	n/a	n/a
EV/Sales	1.2			0.5

Source: Company historic data, ED estimates

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