Y 2020 Earnings Call

Company Participants

- Ben Jacklin, Chief Operating Officer
- Richard Fairman, Chief Executive Officer
- Robin Alfonso, Finance Director
- Unidentified Speaker

Presentation

Richard Fairman {BIO 20456596 <GO>}

So good morning everyone. This is Richard Fairman. Can I just check if we've got N+1 on the call?

Unidentified Speaker

Okay. Brilliant. So, just a quick reading [ph] from just to explain that on this call today, Bloomberg will be recording the transcript and there will be questions afterwards. So we'll run through with the management who will obviously do their presentation, and then the Bloomberg transcript recording will finish, and then we'll be free for shareholders to ask, or non-shareholders who are on the call to ask questions as they see fit at the end.

So with that, if I pass over to Richard. Thank you very much.

Richard Fairman {BIO 20456596 <GO>}

Good morning and welcome to the presentation of CVS Group plc's results for the year to June. I'm Richard Fairman, Chief Executive, and presenting with me are Robin Alfonso, Chief Financial Officer and Ben Jacklin, Chief Operating Officer.

I will begin with an overview of CVS, the fundamental strengths we have as a business, and will also provide a summary of the highlights of the past financial year, notwithstanding the severe impact we faced at the height of the COVID-19 pandemic and lockdown restrictions. Robin will then provide an overview of the financial results for the year. And Ben will then add more color in providing an update on each of our four key divisions. I will then wrap up with an overview and an update on current trading.

So if we turn to Page 4, we operate an integrated veterinary model with first opinion practices and specialist referral hospitals with complementary laboratories and crematoria. Alongside these, we have our buying groups and our online retailer, Animed Direct.

We operate in an attractive sector, which has proven resilient in the face of past economic downturns and which showed strong recovery post the severe initial impact of COVID-19 lockdown restrictions introduced in the U.K. in March. We have robust revenue streams and around 40% of our active small animal clients are members of our Healthy Pet Club, ensuring compliance with preventative medicine and also bonding customers to our practices. In previous economic downturns, the sector proved very resilient, but preventative medicine is one area which saw a decline. We believe our HPC membership should provide increased protection in this regard.

Our scale particularly in the U.K. leads to buying synergies. This is most important for pharmaceutical purchasing given that drugs cost represent over 20% of the turnover. We continue to pride ourselves on the provision of the highest levels of clinical care, and this was a key factor in the like-for-like growth that we delivered in the first eight months of the year prior to lockdown. We are also cash generative with high levels of operating cash conversion. This has resulted in increased financial covenant headroom under our bank facilities and reduced leverage.

On Page 5, we have set out some of the favorable market trends. The U.K. pet care market is both valuable and showing continued strong growth, and there are recent encouraging signs of an increased demand for pets. The trend of increasing humanization of pets continues with more pets sleeping in bedrooms and increased consumer willingness to spend.

Coupled with this, medical advances mean that there are more procedures now available, and as we've seen in human health, the underlying average life expectancy of pets is expected to increase as a result. The U.K. pet insurance market remains strong, and this is important for our referrals business where the average treatment cost is higher. Our Animed Direct business continues to enjoy strong growth with the COVID-19 pandemic leading to an increase in online pet food purchases.

If we now turn to Page 6. As we reported in our trading update issued on the 24th of July, the financial year was significantly impacted by the COVID-19 pandemic, the lockdown restrictions imposed and the resulting guidance issued by the RCVS and BVA. We took a number of appropriate actions in response to the pandemic, and we were humbled by the support, dedication and sacrifices of our outstanding team of colleagues.

Prior to lockdown, we saw a strong performance in the first eight months of the financial year to February with 7.9% like-for-like growth reflecting, amongst other things, increased clinical care of cases, particularly in diagnostics in first opinion small animal practices and increased referrals revenues. We renewed and extended our bank facilities in January with non-amortizing facilities of GBP170 million in place to January 2024. The financial covenants remain unchanged and will continue to be measured throughout the life of the facilities on pre-IFRS 16 GAAP.

We made four acquisitions in the financial year, all small animal practices at sensible multiples and these were all performing at or above business plan prior to lockdown. We also strengthened our Board with the appointment of an additional non-exec director, and we've further improved our controls with enhancements to our reporting and a daily suite of KPIs, which proved invaluable in managing the business through the height of COVID-19 lockdown in the final quarter of our financial year.

Importantly, we saw our clinical vacancy rates fall and employment costs were reduced, albeit with significant government support through the furlough scheme. As a result, we closed the financial year with reduced leverage, revenues recovered to pre-COVID-19 level and we have a strong platform for growth, which we hope will also help protect against future COVID-19 disruption.

So I'll now hand over to Robin who will provide more color on our financial performance.

Robin Alfonso {BIO 21334646 <GO>}

Thank you, Richard. As set out on Page 8, despite the impact of COVID-19 and lockdown, I'm pleased to report full year revenue GBP427.8 million, GBP21.3 million or 5.2% higher than prior year. This represents full year like-for-like growth of 0.7%. Like-for-like growth excludes current year acquisitions, pro rates to prior year acquisitions to include revenue in the current year from the date of acquisition in the prior year and adjusts for working days.

This revenue performance has been delivered despite the impact of COVID-19 and lockdown due to the strong performance in the first eight months of the year, and faster than anticipated recovery of revenue to pre-COVID-19 levels by the end of June. In the first half of the financial year, like-for-like revenue growth was 8.4%, reflecting growth experienced across all our divisions and business units. In the second half of the financial year, like-for-like revenue reduced by 6.9%, impacted significantly by COVID-19 and lockdown in the final quarter.

All our divisions and business units were impacted with Farm and Animed Direct impacted the least due to the ambulatory nature, of farm veterinary work, and the requirements to protect the food chain, and Animed Direct benefiting from consumers shifting to purchasing pet food online.

Our full-year gross margin of 75.5% was 0.7 percentage points down on the prior year, primarily due to the second half seeing a change in mix with lower margin Farm and Animed Direct revenues increasing as a proportion of overall revenue, and the deferral of circa GBP6 million of Healthy Pet Club revenue into the new financial year.

Turning to Page 9. Full year adjusted EBITDA was GBP55.3 million, GBP0.8 million or 1.5% higher than the previous year. It is important for me to note that in order to ease comparisons, this is pre-IFRS 16, and I'll explain the impact of IFRS 16 later. Despite the significant reduction in revenue in the second half, the impact was softened by access to Coronavirus Job Retention Scheme. With circa 3,500 employees on furlough, we applied for and received grant income from the government of GBP8.2 million in total over April, May, and June. The full financial benefit to CVS, including the benefits of not topping up salaries from 80% was circa GBP11 million.

Full year employment costs as a percentage of revenue were 49.9%, an improvement of 1 percentage point on prior year. The employment cost percentage benefited significantly from access to the Coronavirus Job Retention Scheme, a reduction in our use of locums and reduced bonus accruals. The employment cost percentage also benefited from reduction in travel and associated costs.

On Page 10, we have repeated the chart which we included in our July update showing the impact to revenues in our first opinion small animal practices in Great Britain. This chart shows our rolling seven-day average of small animal fees and drugs revenue. We saw a significant reduction in revenue following the joint RCVS and BVA announcement issued on the 23rd of March, limiting us to performing urgent and emergency care only in our practices.

From the significant reduction in revenue in the early part of April, the gradual easing of lockdown, the amended RCVS and BVA guidance, and our resulting ability to perform more procedures resulted in a steady recovery in revenue, such that we closed the financial year with revenues recovering to pre-COVID-19 levels. This improvement has continued through the first two months of our new financial year.

As set out on Page 11, in response to COVID-19 pandemic and the lockdown restrictions, we took a number of actions to protect the company and our people. We temporarily closed half of our practice sites, one third by capacity, and we furloughed a significant number of our staff. We introduced a new teleconsultation service for non-urgent and non-emergency cases. We developed new daily reporting and the executive team and the Board held regular meetings to facilitate timely decision making. We took a number of actions to preserve cash, including accessing the Coronavirus Job Retention Scheme and deferring VAT payments, circa GBP15 million.

We also took a number of steps to protect our colleagues, including promoting the use of personal protective equipment and increasing awareness of the importance of wellbeing and positive mental health. All colleagues have now returned from furlough and we are trialing clients being allowed back into our practices whilst continuing to promote social distancing and the use of PPE.

Turning to Page 12. As previously mentioned, we've deferred circa GBP6 million of HPC revenue from the past financial year. Throughout COVID-19 and lockdown, we continued to collect cash in respect of HPC monthly and annual subscription fees. However, in accordance with International Financial Reporting Standards, we've deferred GBP6 million revenue into the new financial year. The graph illustrates the impact of this deferral on revenue over three periods. In the first period, we see a reduction in revenue recognized versus the normal run rate as we were unable to meet the full service obligations under our HPC contracts.

In the second period, we see an improvement in revenue recognized versus the normal run rate as we catch up on our service obligations, after which in the third period, revenue recognized normalizes. For the avoidance of doubt, this impacts revenue recognition, not cash, which continue to be collected.

Moving on to cash on Slide 13. Free cash flow of GBP55.4 million was generated in the year, an increase of GBP22.9 million on the prior year. The increase year-on-year is largely due to working capital improvements from deferral of taxes, amounting to circa GBP17 million, and the deferred recognition of HPC revenue within adjusted EBITDA. Free cash flow also clearly benefited from the GBP8.2 million furlough claim.

The increase in tax paid is due to changes to HMRC payments on account reforms, bringing quarterly payments, which were previously paid two quarters in arrears forwards to match the quarter the payment relates to. This results in a one-off catch-up such that we made six quarterly payments on account in the year as opposed to the normal four.

As you will see from Page 14, the faster than anticipated revenue recovery, the actions we have taken, the access to government support and the focus on organic growth as opposed to acquisition investments resulted in a reduction in net debt. Our balance sheet has therefore strengthened at the year end with leverage at 1.14x as at the end of June 2020 versus 2.08x as at the previous year end.

Turning to Page 15. Adjusted earnings per share reduced to 44.1 pence, a reduction of 5.6%. Whilst we've delivered a slight increase in EBITDA, this reduction reflects increased depreciation charges as a result of investment in our facilities, and one-off finance cost write-offs following the renewal of our bank facilities in January 2020. As signaled in our July update, in light of the fact we have accessed significant government support, the Board is not proposing the payment of a final dividend.

On Page 16, we've set out some color on capital expenditure incurred in the financial year to the 30th of June 2020. We continue to invest in our sites to underpin current business performance and to deliver future growth. We believe that the investment we have made and will continue to make makes it easier to attract and retain employees, supports our objective to provide the best clinical care and broaden services we are able to offer, and improves our customer experience, encouraging clients to continue to use our services.

During the year, we invested GBP12.4 million of capital expenditure, a reduction of GBP0.5 million from the prior year. The reduction was largely as a result of the restrictions we've put in place and expenditure during the height of COVID-19 and lockdown in order to preserve cash and liquidity. Circa GBP5.2 million of CapEx was spent on replacements and new equipment, circa GBP3.5 million on IT, hardware and software, including our new warehouse management system, vehicles and routine building maintenance and circa GBP3.7 million on relocations and new sites. We plan to continue to make investments throughout the 2021 financial year.

I will close my financial update on Page 17. In the financial year, we adopted IFRS 16 leases, which impacts our financial numbers in the current and future years. We chose the prospective adjustment method for implementation, and this means our comparative financial statements for the year to 30th of June 2019 and earlier are not impacted. Under IFRS 16, we recognize right-of-use assets and lease liabilities on our balance sheet, and we replace operating lease rental charges in our income statement with depreciation and interest charges. Profit before tax is adversely impacted in earlier years due to the interest costs being higher in those early years, and further details are set out in appendix 3.

I will now hand over to Ben who will provide an update on each of our four divisions.

Ben Jacklin {BIO 21334654 <GO>}

Thank you, Robin. Turning to Page 19, those of you who know us well will know that our veterinary practices are the core of our business, primarily small animal first opinion practices, but that we do have a number of other businesses that are ancillary to veterinary practice including our laboratories, crematoria and our online pharmacy.

In terms of our practice, we have 480 surgeries operating currently, and 8 of those are specialist referral hospitals. The majority of those surgeries are in the UK with 25 in the Netherlands and 6 in the Republic of Ireland. We employ just under 2,000 veterinary surgeons and just over 2,000 veterinary nurses. Centralto our ethos is clinical governance, and ensuring we give our patients the best possible clinical care.

Additionally, CVS have, we believe, led the profession in the areas of quality improvement and clinical governance over the last few years. We employ a team of experienced clinical leaders to help us deliver this, and fulfill our purpose of giving the best possible care to our patients.

As set out on Page 20, over the financial year, the practice division recorded revenue of just over GBP384 million, representing a 3.6% increase over prior year. Like-for-like, that represents a deterioration of 1.2%, due to the closure of a significant number of our practices during the very height of the pandemic, after The Royal College of Veterinary Surgeons and the British Veterinary Association issued guidance limiting the number of procedures we could do to just those that were urgent and/or emergency in nature.

As we reported in our trading update, we did recover strongly as restrictions eased and we've opened -- re-opened our practices and unfurloughed those colleagues that were furloughed. We did, however, take the opportunity to close 33 of our sites permanently, the majority of which were small branches of larger groups and were marginal or loss making. This both represents an ongoing desire to have the very best clinical facilities as well as to rationalize our operations where it makes sense.

We have also expanded into a range of innovative areas, including Equicall, the first out- of-hours on-call service for equine practices globally; Vet Oracle, an online telemedicine and image interpretation service; and the introduction of ophthalmology services into our referral hospitals. We've also launched an exciting partnership to deliver equine clinical rotations on behalf of Bristol University, further cementing our relationships with the vets of the future.

Despite the impact of COVID-19, which, as we said, was significant for our practices, our EBITDA did increase in the practice division by GBP0.7 million, which is an increase of 1.2% year-on-year with an EBITDA margin of 14.8%.

Turning to Page 21, our Healthy Pet Club. As those of you are familiar with the business will know, it's core to our offering in our first opinion small animal practices, providing all routine preventative healthcare to our clients and patients. Pleasingly, membership grew by 3.5% during the year despite the challenges of COVID-19. As you'll see in the data on the bottom left-hand graph, we suffered a deterioration in the number of signups during COVID-19 as our reception and nursing teams were furloughed, but have recovered well from that and the scheme returned to growth by the end of the financial year.

At the end of the financial year, I'm pleased to say, we remain the leading scheme in the industry with around 40% of our small animal active patients as members.

As set out on Page 22, our MiNightVet clinic network offers out of hours emergency services to our own and third-party first opinion small animal practices, and we grew our network during the year to 29 clinics, which includes 7 new sites since June 2019. This network enables us not only to capture revenue that would otherwise be lost out of hours, but more importantly, ensures that our veterinary teams have the very best environment in which to work without being burdened by the duty of out-of-hours care, which is central to our vision of being the veterinary company that people most want to work for.

Many of you will also be aware that we have our own brand range of white label pharmaceutical products branded MiPet, which during the year, represented 28% of our small animal practice drug sales. The majority of the product range is small animal, including two further products added during the year, but we have also launched our first equine and farm animal product lines.

We also provide consumables and equipment to our practices and to third party practices through our Vet Direct business. And during the year, we enhanced our website functionality to allow this business to grow and supply an increasing volume of particularly consumables to veterinary practices both within and outside CVS. Our referrals division is central to our ability to offer the very best in clinical care, providing a network of specialists for our first opinion vets to refer to.

During the year, we launched the first specialist-led referral hospital in Northern Ireland, the Northern Ireland Veterinary Specialists. And we also announced plans to relocate and expand significantly our Bristol referrals business to a new state-of-the-art multidisciplinary hospital.

We have continued to grow our advanced clinical services network team. This team are highly experienced veterinary surgeons in specific areas of expertise who work with our practices to deliver a middle tier of veterinary care for those cases which don't merit referrals to a full specialist referral hospital. This has the dual benefit of improving clinical care at practice levels whilst ensuring that these cases don't get lost to third party peripatetic clinicians, over whom we have no clinical governance oversight.

If you now turn to Page 23, we also operate a laboratory division which comprised of two parts. First diagnostic referral laboratory where practices can send samples for interpretation and analysis, and additionally, our MiLab business which operates desktop analyzers in the practices and supplies these practices with the reagents that they need. This division grew well in terms of revenue to just over GBP21 million over the course of the year, which was delivered alongside closing on Greendale site and consolidating this work into our existing network to maximize operational efficiencies.

I'm pleased to say that we've also introduced human COVID-19 antigen testing at our Axiom laboratory during the course of the year, and we're offering it to private clients and potentially extending it further over the months to come. The Laboratories division saw extremely strong EBITDA growth of 31.4% despite the impact of COVID-19 taking annual EBITDA to GBP5.7 million through improved revenue, margin improvement and increasing the number of analyzers in practices.

As set out on Page 24 in our Crematoria division, our revenue declined by GBP0.1 million during the year, though that was in the reduction of clinical waste services that we previously offered to a key account that was lost during the prior financial year. Aside from that continued growth in our online shops and our drive towards offering clients individual cremation and more bespoke services have been positive, and we've also increased our capacity and invested and expanded in both the small animal and equine elements of the division. The division maintained the EBITDA at GBP2.5 million despite that reduction in revenue.

If we now turn to Page 25, Animed Direct, our online e-commerce pharmaceutical business, performed extremely well during the course of the year, growing revenue by 37.8% and EBITDA by 47.1%. This was delivered through increased visits to our website driven in part by improvements that we made to our website during the year as well as a new customer service management system that we introduced to maintain our five star Trustpilot rating.

And I shall now hand over back to Richard Fairman who'll summarize.

Richard Fairman {BIO 20456596 <GO>}

Thanks, Ben. So if we can now turn to Page 27, there are some key takeaways. We have a stable business with competitive advantage from our integrated model. We've strengthened the management team and further improved controls and KPIs. We operate in an attractive sector that's resilient with a sizable and growing market. We continue to see favorable consumer trends with humanization of pets and increased customer willingness to spend. We continue to focus on high clinical standards and attracting and retaining the very best talent in the profession.

We successfully renewed and extended our bank facilities in the year. We continue to generate cash and we've seen a reduction in our leverage. Now, these all help to improve our balance sheet strength at year-end. Most importantly, we have a great team of colleagues whose efforts and support over the past few months has been outstanding.

On Page 28, we've set out our key strategic pillars that will help us achieve our vision to be the veterinary company people most want to work for. These four strategic pillars are recommending and providing the best clinical care, providing a great place to work for our colleagues and offering them great career prospects, providing excellent facilities and equipment, and taking our wider responsibilities seriously.

If you turn to Page 29, we've set out some key focus areas. We have consciously focused on organic growth in the past 18 months, and that has been crucial in improving underlying business performance. Providing the best clinical care has been important in delivering like-for-like growth and our vets and clinical teams are fully engaged with providing the best clinical care and in working cases fully. We continue to develop our Vet Oracle telemedicine capability, and we now offer specialist neurology, radiology, dermatology and exotics.

Furthermore, we launched new first opinion teleconsultations at the start of the COVID-19 lockdown. We're committed to further investment in clinical standards and we are the first large veterinary groups to publish an annual quality improvement report, which is aimed at continuous outcome improvements for our patients.

Our people are at the heart of our business, and I'm pleased to report that we've seen our vet and nurse vacancy rates reduced significantly. Many of you will recall that our vet vacancy rate peaked to 12.5% in April 2018. We continue to invest in leading learning education and development support to our colleagues, and we've expanded our Hub Clinical Lead role to drive further improvement in clinical case management. We recognize the need to invest in our facilities and our practices. We opened a new customer contact facility in Wetherby recently and approved investment in a new state- of-the-art multidisciplinary special referral hospital in Bristol. We're also well placed to make further acquisitions at sensible multiples.

Importantly, we continue to provide support to our colleagues to promote their well-being and positive mental health. We have established closer relationships with the RCVS and BVA. We've invested in increased health and safety monitoring and compliance, and we will continue to do what we can to reduce waste.

Now, if you turn to Page 30, I'd like to close with a brief update on performance in the first two months of the new financial year. I'm pleased to report that the recovery we saw in revenues in June has continued into the new financial year, with revenue for the first two months 3.5% above prior year. This is driven by like-for-like sales and volume and from increased levels of clinical work. We've consciously delayed our annual price increase, and hence, there is potential for further pricing uplift to come. We've seen our gross margins improve and our vet vacancy rate has remained below the prior year level.

Adjusted EBITDA (pre-IFRS 16) is 6.4% above prior year with adjusted EBITDA margin increasing to 15.4%. As Robin said earlier, we deferred GBP6 million of HPC revenue from the previous financial year, and this is yet to be recognized, hence the growth year-to-date reflects true underlying growth in the business. Furthermore, we've continued to generate cash, which together we have improved adjusted EBITDA, has resulted in our leverage falling to 0.8x at 31st of August.

Now, we've recognized this performance only reflects a two-month period, but nonetheless, this is an encouraging start to the new financial year. As a result, we believe we are well placed to withstand the impact of further COVID-19 disruption, and the experience of the previous lockdown should stand us in good stead.

We also have an increased pipeline of acquisition opportunities, and whilst we will continue to apply caution, our disciplined approach to acquisitions and subsequent integration should help us deliver further growth through acquisitions in due course.

Key to our full year results and our future performance are our dedicated colleagues and I would like to take this opportunity to recognize their outstanding contribution in recent months. Thank you for listening and for your ongoing support.

Unidentified Speaker

That's great. So thank you, Richard. And that closes the management presentation. A recording of this presentation will be added to the CVS website very shortly. And now, I can open up for questions. Has anyone got any questions?