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DOTTIKON ES – Higher Investments, Net Sales, and Net Income

Dottikon, Switzerland, May 31, 2018 – SIX-listed DOTTIKON ES HOLDING AG closed its business year 2017/18 on March 31, 2018.

- Net sales of CHF 158.2 million – 4.3 percent increase
  - Services related to API manufacturing climbed to 9 percent of net sales
- EBITDA of CHF 47.3 million, EBITDA margin of 29.9 percent
- EBIT of 31.1 million, EBIT margin of 19.6 percent
- Net income of CHF 25.9 million, net income margin of 16.4 percent
- Expenses for research and development were increased by 10.6 percent to around 10 percent of net sales
- Investments of CHF 40.5 million in additional development and manufacturing capacities – increase of 14 percent
- Stabilizing, additional buildup and expansion efforts, as well as advance performances and more investments in additional development and manufacturing capacities for medium-term growth
- The Board of Directors proposes to the Annual General Meeting
  - No dividend payment
  - Reelection of all members of the Board of Directors and the Remuneration Committee
  - Reelection of the current auditors

Assessment of situation

The existing geopolitical risks of the new tripolar world order centered on the United States, Russia, and China continue to intensify. Despite the favorable economic environment, the global economic risk factors remain high or have intensified against the background of record global debt. Technology and innovation pressure is on the rise. Amid growing uncertainty and ongoing regionalization, values such as trust, reliability, and long-term consistency – along with cultural and regional proximity – continue to gain importance.

The demographic trend and the accelerated market approval for generics, biosimilars, and novel drugs, combined with inexpensive capital, are key volume growth and innovation drivers in the pharmaceutical market. The demographic developments continue to ensure further long-term volume growth. Due to state-imposed efforts to boost generics and cut health care costs, generics now make up around 80 percent of the prescription drug market volume-wise, but given the lower prices, they only account for 28 percent of global sales.

Contrary to the tactics adopted by the rest of the world, the United States – the largest pharma market in terms of global drug sales with a market share in excess of 40 percent – are trying to curb the rising health care costs mainly by stepping up the economic competition. Among generics and biosimilars manufacturers, this intensified competition is already at play, while generics manufacturers face significantly more price and consolidation pressure. A similar development is expected for biosimilars, the generic versions of biologics affected by patent expiries. The FDA has its mind set on simplifying and accelerating the approval process for biosimilars. The discounts granted by the pharmaceutical companies on their list prices in the United States still

remain stuck within the strongly consolidated drug distribution channels and rarely reach the patients. The three largest intermediary buyers and distributors represent a combined generics market share of more than three quarters. They stand opposite a growing number of competing generics manufacturers. Time will tell whether the announced market entry of online distributors will disrupt the oligopolistic drug distribution structure and whether this will result in increased competition in the distribution channels and, subsequently, in lower drug prices for the end consumer. Furthermore, some US states have taken measures against the annual price hikes for approved drugs with little competition by introducing new transparency rules and ceilings for annual price increases. On the federal level, competition is still the measure of choice. The main method is an additional acceleration of the market approval for drugs targeting rare diseases or orphan drugs (specialty drugs). 61 percent of the 46 approved drugs in 2017 were subject to expedited development and review methods for accelerated market approval. In 2019, the FDA intends to allocate 13 percent more funds to make the processes for innovative drugs even more transparent and effective, which should further intensify competitive pressure. Small and medium-sized biotech companies account for a significant percentage of innovation, and they increasingly introduce their products into the market by themselves. The growing number of market approvals and the faster pace of the approval process, along with the intensified competition and price pressure over the last 10 years, have shortened the times available to generate profits despite patent protection. Accordingly, the average return on invested capital for pharma has fallen step-by-step over the past few years. Due to low interest rates and a lack of investment alternatives, financing in the biotech sector remains favorable. Expected annual growth rates for the global pharmaceutical market stand at 2 to 5 percent. With more than 50 percent of this growth coming from the United States and Europe, these markets are the main growth drivers. Looking ahead, around 80 percent of high-margin specialty drug sales will continue to be generated in the United States, the EU5 and Japan.

The trend to repatriate drug substance and drug product manufacturing from Asia to the West has gained more momentum amid supply, quality, and intellectual property concerns, intensified regulatory pressure from US and European authorities, and rising costs. At the same time, considering the intensifying price and innovation pressure, many large pharma and biotech companies no longer regard API production as one of their core business areas. Accordingly, they are not interested in owning and tying up capital in expensive cGMP production facilities. This is particularly true for small molecule APIs. Yet given the more stringent regulatory requirements, additional services and documentation are necessary with regard to the development and manufacturing of APIs. This explains the growing demand for process development, process and API analytical methods, API manufacturing and documentation, as well as further-reaching services at Custom Development and Manufacturing Organizations (CDMO). CDMO also play an important role in the diversification of approval risks and quantity requirement volatility related to intensifying competitive pressure. In addition, they can support biotechs thanks to their long-standing experience in the compilation of Chemical Manufacturing Control (CMC) documents required for the application for approval. If the required quality is delivered at the first attempt, painful opportunity costs and intense delays can be avoided in the market approval process. Reliability, an impeccable quality track record, and profound experience are the key criteria in selecting a CDMO, as switching costs are high and a change in CDMO is time-consuming. The pharma CDMO indus-

try is strongly fragmented. In recent times, the sector's growth potential has attracted a number of strategic and tactical investors. The number and volumes of M&A transactions have been on the rise over the last 5 years. Currently, three basic CDMO strategy models can be observed: (i) specialization with a strong focus on a few value chain segments and niche technologies; (ii) horizontal consolidation, external growth based on capacity acquisition in the same value chain segment; and (iii) vertical integration, backward or forward integration in adjacent value chain segments, usually by acquisition. Many large CDMO with a global footprint currently execute a hybrid strategy between horizontal consolidation and vertical integration, while smaller and medium-sized CDMO tend to focus on technology and performance leadership. The real art lies in offering the entire range of development, manufacturing, and respective services for one or several value chain segments – with competent, high-quality execution and without dissipating energy. Time will tell whether (i) process and analytical development and drug substance manufacturing; (ii) drug product formulation and finishing; and (iii) the respective filling, packaging and distribution create sufficient synergistic value if they are offered, in total or partially combined, by the same company.
The global pharma pipeline today is promising and full of innovation. Market approval processes are accelerating and competitive pressure is on the rise. Quality requirements and regulations continue to increase, resulting in longer cGMP sequences in chemical API synthesis and foster higher cGMP manufacturing volume requirements. The increasing repatriation and outsourcing of small molecule APIs, along with the shortage of process development and manufacturing experience and capacities among biotech and pharmaceutical companies, have already created first bottlenecks in high-quality, technologically proficient chemical process development and API manufacturing capacities. This trend is set to become even more apparent over the coming few years, as many CDMO have been rattled by several changes of ownership and the subsequent restructuring or are, based on the crucial experiences over the last two decades, still unwilling to make capital-intensive investments in high-quality development and manufacturing capacities.

Review
In the period under review, net sales were increased by 4.3 percent to CHF 158.2 million. Meanwhile, the production output – net sales plus inventory changes in semi-finished and finished goods – rose by 7.7 percent to CHF 162.4 million. The growth was purely organic, i.e. without any acquisitions of business units, and was entirely self-financed and broad based thanks to a further development of the existing project and customer relation base.
Expenses for research and development were increased by 10.6 percent and accounted for around 10 percent of net sales in the period under review. For the first time, services related to API manufacturing climbed to 9 percent of net sales.

Key Figures DOTTIKON ES Group

CHF million	FY 2016/17	FY 2017/18	Changes
Net sales	**151.7**	**158.2**	+4.3%
Changes in semi-finished and finished goods	–0.9	4.2	
Other operating income	4.2	3.9	
Material expenses	–28.6	–35.9	
Personnel expenses	–53.3	–63.9	
Other operating expenses	–24.5	–19.2	
EBITDA	**48.6**	**47.3**	–2.6%
EBITDA margin (in % of net sales)	*32.0%*	*29.9%*	
Depreciation and amortization	–21.9	–16.2	
EBIT	**26.7**	**31.1**	+16.4%
EBIT margin (in % of net sales)	*17.6%*	*19.6%*	
Financial result[1]	0.1	0.3	
Income taxes	–4.6	–5.5	
Net income	**22.2**	**25.9**	+16.8%
Net income margin (in % of net sales)	*14.6%*	*16.4%*	
Earnings per share (in CHF)	**17.74**	**20.70**	+16.7%
Proposed dividend per share (in CHF)	–	–	
Cash flow from operating activities	**57.0**	**39.2**	–31.3%
Capital expenditure	–27.9	–35.7	
Free cash flow	**29.1**	**3.5**	

[1] Including result from associated companies

FY 2016/17: business year from April 1, 2016, to March 31, 2017
FY 2017/18: business year from April 1, 2017, to March 31, 2018

The net sales increase, the increase in inventory in semi-finished and finished goods, as well as the more material-intensive product mix resulted in approximately a 26 percent increase in material expenses in the reporting period. Mutually compensating extraordinary effects in personnel and other operating expenses of CHF 6 million each in the previous year, together with a 5.3 percent increase in the average number of staff in the reporting period, led to a 20 percent increase in personnel expenses compared to the previous year (excluding the previous year's extraordinary effect: around 8 percent) and a 22 percent decrease in other operating expenses. This results in an EBITDA of CHF 47.3 million, down 2.6 percent from the previous year, and

an EBITDA margin of 29.9 percent (previous year: 32.0 percent). Together with lower depreciation and amortization compared to the previous year due to the previous year's value adjustments on rectification plants and infrastructure, EBIT was up around 16 percent at CHF 31.1 million (previous year: CHF 26.7 million). The EBIT margin rose to 19.6 percent (previous year: 17.6 percent). Net income rose by around 17 percent to CHF 25.9 million (previous year: CHF 22.2 million), resulting in a net income margin of 16.4 percent (previous year: 14.6 percent). Despite an increase in investments in additional development and manufacturing capacities of around 14 percent to CHF 40.5 million, cash and cash equivalents and current financial assets rose around 8 percent to CHF 54.6 million.
In the period under review, the increase of chemical development and API drying capacities with the creation of new facilities and the expansion of existing ones, which will mainly be put into operation in early 2019, was driven ahead. In addition, the planning for a new raw material, intermediates, and API warehouse and the extended basic engineering for a further expansion of chemical multipurpose production capacities have been continued. Shareholders' equity rose by around 10 percent, while the equity ratio remained at a solid 80 percent.

Outlook
In the current pharmaceutical environment, DOTTIKON ES remains well positioned to capture the expected medium-term growth potential amid the ongoing expansion of process development and analytical resources as well as its API manufacturing and drying capacities. The corporate strategy – strategic partner and specialist for hazardous reactions – is reaffirmed: By using enabling technology, DOTTIKON ES develops and manufactures high-quality, demanding chemical products safely and efficiently. DOTTIKON ES cultivates an integrated partnership with its customers. By applying its full development and manufacturing capabilities, DOTTIKON ES supports its customers in the successful execution of their strategy. In doing so, DOTTIKON ES creates more value for its customers than its competitors.
The pharmaceutical market is and remains the main market in which profitable growth is achieved. For this purpose, capacity utilization of the existing infrastructure will be increased. In order to achieve the expected net sales growth in the medium term, new laboratory facilities for additional process development and analytical capacities as well as further API drying capacities will be created and put into operation in the business year 2018/19. The activities for the construction of a new raw material, intermediates, and API warehouse will be tackled. In addition, the extended basic design for a new multipurpose API production plant is driven ahead. Against this background, investments will rise substantially in the current business year. For financing the new chemical multipurpose production plant in planning, external options for issuing a corporate bond are in evaluation.
DOTTIKON ES continues to focus on safety, reliability, high flexibility, and speed and is thus strengthening its position as strategic development and manufacturing partner. In order to ensure long-term growth, the independent Performance Chemicals project team develops new proprietary innovative products to satisfy currently unmet market needs and bring them closer to market readiness.

DOTTIKON ES' one-site strategy allows short decision and communication pathways. This ensures rapid and efficient project development as well as clear and transparent communication with its customers. The safety culture created over 105 years guides innovative use of hazardous reactions, low-temperature and high-pressure chemistry, as well as continuous processing. This shortens conventional chemical synthesis routes, increases yields, selectivities, and purities, and reduces waste. The versatile technology and equipment portfolio is used, maintained, and continuously expanded to design, develop, and optimize chemical processes, and rapidly scale up from kilograms to multi-tons and to produce and deliver the respective market quantities. Following the rapid growth seen over the last few years, 2018/19 will be a year of stabilizing past successes, additional buildup and expansion efforts, as well as advance performances for the expected product-related medium-term growth. For the full business year 2018/19, DOTTIKON ES anticipates net sales in the order of magnitude of the previous year, with a weaker first half year than in the first half of the previous business year.

DOTTIKON ES HOLDING AG is listed at the SIX Swiss Exchange.
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DOTTIKON ES manufactures high-quality performance chemicals, intermediates and exclusive active pharmaceutical ingredients (APIs) for the world's leading chemical and pharmaceutical industry. The company with its production site in Dottikon (Aargau, Switzerland) is specialized in hazardous reactions and is positioning itself as strategic development and manufacturing partner. Its safety culture created over 105 years guides innovative use of hazardous reactions, low-temperature and high-pressure chemistry, as well as continuous processing. This shortens conventional chemical synthesis routes, increases yields, selectivities and purities, and reduces waste. The versatile technology and equipment portfolio is used to design, develop and optimize chemical processes, and scale up from kilograms to multi-tons.
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