MEDIA RELEASE Dottikon, November 27, 2018

DOTTIKON ES – Lower Sales and Net Income

Dottikon, Switzerland, November 27, 2018 – DOTTIKON ES Group, positioned as strategic development and manufacturing partner and specialized in the area of hazardous reactions and the exclusive synthesis of active pharmaceutical ingredients (API) and fine chemicals, closed its first business half-year 2018/19 on September 30, 2018.

As previously announced on October 22, 2018, net sales and net income in the first business half-year were clearly lower than in the previous-year period. Net sales stood at CHF 56.6 million, around 19 percent below the previous-year period's result. The production output – net sales plus inventory changes in semi-finished and finished goods – declined by 11 percent. This decline is the result of current market challenges: (i) geopolitical and economic uncertainties; (ii) intermittent scale-up of processes with limited experience due to accelerated market approval processes; and (iii) supply bottlenecks due to rigorous enforcement of environmental regulations and, subsequently, the temporary or permanent closure of Asian chemical producers. In the period under review, this resulted in increased sourcing complexity, the interruption of campaigns, and therefore production and delivery acceptance delays related to existing customer contracts.

The increase in inventory in semi-finished and finished goods, which was twice as high in the reporting period compared to the previous-year period, as well as the partially related more material-intense product mix led to an increase in material expenses by approximately 9 percent in the first half of the business year 2018/19. The number of staff rose by 6 percent compared to the previous-year period, while personnel expenses only increased by 3 percent or CHF 0.9 million. This resulted in an operating result before depreciation and amortization (EBITDA) of CHF 9.8 million, down approximately 51 percent from the previous year, with an EBITDA margin of 17.4 percent (previous year: 28.5 percent). The previously announced major investments will be put into operation at the end of the second business half-year 2018/19 and therefore did not yet have an impact on depreciation in the current reporting period. In addition, depreciation on some plant components from previous years expired, which reduced depreciation and amortization by around CHF 1.1 million to CHF 7.4 million. The operating result (EBIT) stood at CHF 2.4 million, around 79 percent below the previous-year period. Together with the financial result and income taxes, net income was CHF 2.0 million (previous year: CHF 9.6 million) and the net income margin stood at 3.5 percent, clearly below the previous year's 13.6 percent. Cash flow from operating activities was CHF 24.8 million in the reporting period (previous year: CHF 39.0 million). In line with the quality management, development, and production capacity increase, cash outflows for investments in property, plant and equipment rose by around 45 percent compared to the previous-year period to CHF 22.2 million. At the end of the reporting period, cash and cash equivalents stood at CHF 56.9 million (end of business year 2017/18: CHF 54.6 million). The equity ratio was a solid 80.2 percent.

Global economic growth continued to improve in the period under review. Given the brighter economic situation in industrialized nations, inflation rates move closer to their target ranges. Central banks mainly maintain their expansive policies. With additional interest rate hikes, the Federal Reserve has taken further steps toward normalization. While growth rates are generally expected to ease, the expansive monetary policies and the improved labor market situation continue to provide the economy with further impetus. Despite this, the economic risk continues to rise. High debt levels, low interest rates, and the rising, but still low raw material and energy prices clash with increasing geopolitical tension, which creates a dangerous combination. The demonstration and expansion of power in the new tripolar world order with a confrontational United States, subversive Russia, and ambivalent China give rise to regionalization and nationalization. As a result, unpredictability and uncertainty intensify. Values such as trust, reliability, and long-term consistency as well as cultural and regional proximity become increasingly important.

The demographic trend and the accelerated market approval for novel drugs, combined with inexpensive capital, are key innovation drivers. They ensure long-term pharma volume growth. Despite state-imposed efforts to curb health care costs, boost generics and biosimilars, and contain excessive drug price hikes, global pharma drug sales volumes are expected to grow by 6 to 7 percent annually over the next 5 years. For generics, which represent more than 90 percent of the pharma market volume, annual volume growth is expected at 3 percent, in proportion with the increase in the population of over 65-year-olds. In contrast, the pharma market share of innovative patent-protected drugs, which represent around 80 percent of pharma sales, is expected to grow at a more rapid pace of around 10 percent, primarily driven by the US, European, and Japanese markets.

Innovation is undiminished. In the first 9 months of this calendar year alone, the FDA has approved as many as 42 new drugs. Extrapolated for the entire year, this would amount to 56 new approvals and represent a new high since 1996. At more than 70 percent, small molecules continue to represent the lion's share of market approvals. The significant capital inflow in the biotech sector has increased the number of market approvals of drugs subject to accelerated market approval processes, which has further intensified competitive and pricing pressure and increasingly reduced the times to harvest profits to shorter periods than the patent lifetime. This reduces the return on invested capital.

The chemical industry that emerged along the main rivers in Asia has resulted in grave environmental pollution and health problems in densely populated downstream regions. Targeted government measures to enforce environmental constraints and further requirements as well as the elimination of local corruption will result in presumably non-compliant Asian producers being closed temporarily and reviewed, shut down or forced to relocate to compliant industrial parks. This results in temporary interruptions of the supply chain, with the respective impact on the supply security for chemical intermediates and end products.

Raw material and API production costs have risen and are set to increase even further on the back of tighter regulatory requirements and the repatriation of manufacturing steps to the West. As a result, available high-quality development and manufacturing capacities become increasingly scarce.

The main risks to the generally positive outlook for the pharma market are: (i) larger geopolitical escalation with acts of war; (ii) global financial crisis with fast interest rate hikes; (iii) disruptions in the API production supply chain due to the closure of Asian producers based on the enforcement of environmental regulation; (iv) intense competition and pricing pressure on the back of a vast number of market approvals in similar indication areas as well as state-imposed drug price regulation in the United States; and (v) the occurrence of adverse events with drugs subject to accelerated market approval due to insufficient drug safety tests. These risks would have an immediate adverse effect on short to medium-term demand for API development and production.
Yet regardless of the mentioned risks, the increased molecular complexity, higher regulatory requirements, changed mechanics in the supply chain, and the cutback in high-quality development and manufacturing capacities create promising opportunities for high-quality, technologically advanced exclusive synthesis providers that are specialized in the process development and manufacturing of active pharmaceutical ingredients.
In this environment, reliable, trustworthy, and established strategic development and manufacturing partners that are able to deliver the required quality and to provide the full range of services from chemical synthesis routefinding, the development of chemical processes and analytical methods to multi-step API production, including validation and stability studies, remain in demand. On the one hand, the partners should possess cutting-edge development and production infrastructure, an impeccable quality track record, and a broad technology platform with the possibility for backward integration, while on the other hand having profound experience in the development and design of chemical processes and the production of APIs.

DOTTIKON ES' corporate strategy – strategic development and manufacturing 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 collaborates closely with its customers and cultivates an integrated partnership. 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. DOTTIKON ES continues to focus on safety, reliability, high flexibility, and speed and is thus strengthening its position as strategic development and manufacturing partner and performance leader.
The pharmaceutical market is and remains the main market with ongoing growth potential. In order to realize the expected product-related sales growth in the medium term, significant additional chemical development and API drying capacities are built and existing ones expanded. In addition, the planning for a new raw material, intermediates, and API warehouse and the engineering for new chemical multipurpose production capacities for APIs have been continued. The main objective is to create the option for capturing the longer-term growth potential. Against this background, investments will continue to rise and remain high in the current and the following years. Financing options remain in evaluation and will be considered if required.

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Due to the delayed net sales realization in the past first business half-year and despite the forecasted significantly stronger second business half-year, DOTTIKON ES expects lower net sales and net income for the full business year 2018/19 compared to the previous year. The focus remains on stabilizing past successes, additional buildup and expansion efforts in infrastructure as well as development and manufacturing plants, and advance performances for the expected product-related medium-term growth.

Key Figures DOTTIKON ES Group

CHF million	**FY 2017/18**[1]	**HY 2017/18**[1]	**HY 2018/19**
Net sales	**158.2**	**70.1**	**56.6**
EBITDA[2]	**47.1**	**19.9**	**9.8**
EBITDA margin (in % of net sales)	*29.7%*	*28.5%*	*17.4%*
EBIT[3]	**30.8**	**11.4**	**2.4**
EBIT margin (in % of net sales)	*19.5%*	*16.3%*	*4.3%*
Net income	**25.8**	**9.6**	**2.0**
Net income margin (in % of net sales)	*16.3%*	*13.6%*	*3.5%*
Cash flow from operating activities	**39.2**	**39.0**	**24.8**
Capital expenditure	–35.7	–15.4	–22.4
Free cash flow[4]	**3.5**	**23.6**	**2.4**

[1] Restated, change of accounting standard from IFRS to Swiss GAAP FER
[2] Operating result before depreciation of property, plant and equipment and amortization of intangible assets
[3] Operating result
[4] Cash flow from operating activities and cash flow from investing activities in property, plant and equipment and intangible assets

FY: business year from April 1, 2017, to March 31, 2018
HY: business half-year from April 1 to September 30

The Annual Report 2018/19, covering the period from April 1, 2018, to March 31, 2019, will be presented on May 28, 2019.

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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.
DOTTIKON ES' one-site strategy allows reduced decision and communication pathways. This ensures rapid and efficient project development as well as clear and transparent communication with customers.

DOTTIKON ES HOLDING AG is listed at the SIX Swiss Exchange.
Symbol: DESN
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