

Alternative performance measures 2019 of the Galenica Group

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Definitions of alternative performance measures

The annual report, the half year report and other communication to investors contain certain financial performance measures, which are not defined by IFRS. In addition to information based on IFRS, management uses these alternative performance measures to assess the financial and operational performance of the Group. Management believes that these non-IFRS financial performance measures provide useful information regarding Galenica's financial and operational performance. Alternative performance measures are used in Galenica's value-based management as the basis for management's incentive and remuneration schemes. Such measures may not be comparable to similar measures presented by other companies. The main alternative performance measures used by Galenica are explained and/or reconciled with the IFRS measures in this section.

The alternative performance measures are unaudited.

IAS 19 – Employee benefits

The pension plans of Galenica are organised in legally independent pension funds and are based purely on the defined contribution principle as stated in the Swiss "BVG" law. Nevertheless, Galenica's pension plans are classified as defined benefit pension plans under IAS 19.

Galenica's results are influenced by external parameters that cannot be managed by the Group and the management is of the opinion that such an impact should be excluded when it comes to assess the performance of the Galenica Group. For this reason, Galenica also evaluates its performance by adjusting personnel costs as if those plans were defined contribution plans (adjustments for the effects of IAS 19). For these adjustments, the costs of defined benefit plans and long-service awards determined in accordance with IAS 19 are replaced by an expense based on the employer's contribution and long-service awards for the period of service.

IFRS 16 – Leases

Since 1 January 2019 lessees have to account for most leases on balance sheet by recognising lease liabilities and corresponding right-of-use assets. The right-of-use assets are depreciated over the lease term and the lease liabilities generate interest expense in the statement of income. Variable lease payments, not dependent on an index or rate, such as sales-based rental expenses are accounted for as operating expenses when they are incurred. With its large network of retail pharmacies, the introduction of IFRS 16 has a significant impact on Galenica's balance sheet and the presentation of lease related expenses in the consolidated statement of income.

Galenica has lease agreements with fixed and variable lease payments and these payments affect various line items in the statement of income making comparisons across individual pharmacies and points-of-sale difficult. For this reason management also monitors results by adjusting the statement of income and balance sheet as if lease agreements were still accounted for as operating leases, e.g. all lease expense is presented in other operating costs on a straight-line basis and the depreciation of the right-of-use assets and the interest expense on the lease liabilities are removed. Income taxes are also adjusted accordingly.

These adjustments allow management to evaluate results with periods prior to the introduction of IFRS 16. In addition, IFRS 16 adjusted measures are important for Galenica's value-based management and therefore for management's incentive and remuneration schemes. As the type and duration of rental agreements under IFRS 16 have a significant influence on the invested capital and accordingly on the return on invested capital (ROIC) and on the Galenica economic profit (GEP), the invested capital is stated after removing lease liabilities. This minimises the risk that management makes decisions that are not in the interest of Galenica due to potential incentives when concluding leases.

Organic growth of net sales

Organic growth of net sales shows the development of net sales for the two most important business sectors Retail and Services excluding the effects of acquisitions, openings and closings (effect of net expansion). It provides a “like-for-like” comparison with previous periods. In the Retail business sector, organic growth of net sales is calculated only including points of sale with a full year period comparison. In order to show the impact of mandatory price reductions of medications reimbursed by health insurers on net sales transparently, organic growth of net sales is also disclosed without the effect of price reductions.

Organic growth of net sales 2019

in thousand CHF	Retail	Services
Net sales	1,515,726	2,441,048
Change to previous period	6.0%	2.9%
Effect of net expansion ¹⁾	79,836	—
In % of net sales of previous period	5.6%	—
Net sales excluding effect of net expansion	1,435,890	2,441,048
Organic growth of net sales	0.4%	2.9%
Mandatory price reductions ²⁾	26,329	54,466
In % of net sales of previous period	1.8%	2.3%
Net sales excluding effect of net expansion and mandatory price reductions	1,462,219	2,495,514
Organic growth of net sales excluding price reductions	2.2%	5.2%

¹⁾ Growth of net sales of pharmacies without full year comparative periods 2018 and 2019 (acquisitions, openings and closings)

²⁾ Mandatory price reductions of medications reimbursed by health insurers of the specialities list (SL/LS) released by the Federal Office of Public Health (FOPH), calculated based on volumes of previous period

Organic growth of net sales 2018

in thousand CHF	Retail	Services
Net sales	1,430,526	2,372,308
Change to previous period	3.1%	0.4%
Effect of net expansion ¹⁾	35,959	—
In % of net sales of previous period	2.6%	—
Net sales excluding effect of net expansion	1,394,567	2,372,308
Organic growth of net sales	0.5%	0.4%
Mandatory price reductions ²⁾	21,993	57,273
In % of net sales of previous period	1.6%	2.4%
Net sales excluding effect of net expansion and mandatory price reductions	1,416,560	2,429,581
Organic growth of net sales excluding price reductions	2.1%	2.8%

¹⁾ Growth of net sales of pharmacies without full year comparative periods 2017 and 2018 (acquisitions, openings and closings)

²⁾ Mandatory price reductions of medications reimbursed by health insurers of the specialities list (SL/LS) released by the Federal Office of Public Health (FOPH), calculated based on volumes of previous period

Adjusted consolidated statement of income

Galenica's consolidated statement of income adjusted by IAS 19 effects related to employee benefits (defined benefit plans and long-service awards) and IFRS 16 lease effects allowing financial results to be assessed on a comparable basis.

Adjusted consolidated statement of income 2019

in thousand CHF	As reported	Adjustments		Adjusted
		IAS 19	IFRS 16	
Net sales	3,301,002	–	–	3,301,002
Health & Beauty ¹⁾	1,620,785	–	–	1,620,785
Services ¹⁾	2,441,048	–	–	2,441,048
Other income	13,516	–	–	13,516
Operating income	3,314,518	–	–	3,314,518
Cost of goods	(2,453,528)	–	–	(2,453,528)
Personnel costs	(464,119)	91	–	(464,028)
Other operating costs	(142,191)	–	(50,031)	(192,222)
Share of profit from associates and joint ventures	5,656	(23)	53	5,686
Earnings before interest, taxes, depreciation and amortisation (EBITDA)	260,336	68	(49,978)	210,426
Health & Beauty ¹⁾	194,220	–	(47,749)	146,471
Services ¹⁾	68,003	–	(2,229)	65,774
Depreciation and amortisation	(90,845)	–	47,294	(43,551)
Earnings before interest and taxes (EBIT)	169,491	68	(2,684)	166,875
Return on sales (ROS) ²⁾	5.1%	–	(0.1%)	5.1%
Health & Beauty ¹⁾	126,270	–	(2,570)	123,700
Return on sales (ROS) ²⁾	7.8%	–	(0.2%)	7.6%
Services ¹⁾	44,793	–	(114)	44,679
Return on sales (ROS) ²⁾	1.8%	–	–	1.8%
Net financial expenses	(6,098)	459	2,471	(3,168)
Earnings before taxes (EBT)	163,393	527	(213)	163,707
Income taxes ³⁾	(38,093)	41	145	(37,907)
Net profit⁴⁾	125,300	568	(68)	125,800
Attributable to:				
– Shareholders of Galenica Ltd.	124,992	561	(69)	125,484
– Non-controlling interests	308	7	1	316

¹⁾ Reported for each Segment not taking into account Corporate and Eliminations

²⁾ Calculated as EBIT divided by net sales

³⁾ Including one-off expense of CHF 8.4 million related to the change of provisions for deferred taxes due to Swiss Tax Reform

⁴⁾ Net profit comparable of CHF 134.2 million is calculated as net profit adjusted without one-off tax expense of CHF 8.4 million. Earnings per share comparable would be CHF 2.72

in CHF	As reported	Adjustments		Adjusted
		IAS 19	IFRS 16	
Earnings per share	2.54	0.01	–	2.55
Diluted earnings per share	2.53	0.01	–	2.54

Alternative performance measures of the Galenica Group

Adjusted consolidated statement of income 2018

in thousand CHF	As reported	Adjustments IAS 19	Adjusted
Net sales	3,165,019	–	3,165,019
Health & Beauty ¹⁾	1,524,822	–	1,524,822
Services ¹⁾	2,372,308	–	2,372,308
Other income	15,936	–	15,936
Operating income	3,180,955	–	3,180,955
Cost of goods	(2,379,327)	–	(2,379,327)
Personnel costs	(474,453)	40,746	(433,707)
Other operating costs	(180,158)	–	(180,158)
Share of profit from associates and joint ventures	6,999	301	7,300
Earnings before interest, taxes, depreciation and amortisation (EBITDA)	154,016	41,047	195,063
Health & Beauty ¹⁾	130,439	–	130,439
Services ¹⁾	65,568	–	65,568
Depreciation and amortisation	(40,991)	–	(40,991)
Earnings before interest and taxes (EBIT)	113,025	41,047	154,072
Return on sales (ROS) ²⁾	3.6%	1.3%	4.9%
Health & Beauty ¹⁾	110,385	–	110,385
Return on sales (ROS) ²⁾	7.2%	–	7.2%
Services ¹⁾	44,206	–	44,206
Return on sales (ROS) ²⁾	1.9%	–	1.9%
Net financial expenses	(2,116)	225	(1,891)
Earnings before taxes (EBT)	110,909	41,272	152,181
Income taxes ³⁾	36,755	(8,042)	28,713
Net profit⁴⁾	147,664	33,230	180,894
Attributable to:			
– Shareholders of Galenica Ltd.	147,546	33,230	180,776
– Non-controlling interests	118	–	118

¹⁾ Reported for each Segment not taking into account Corporate and Eliminations

²⁾ Calculated as EBIT divided by net sales

³⁾ The final tax assessments for the fiscal year 2016 of group companies involved in an internal restructuring in 2016 were received in 2018. As a consequence of these final assessments, deferred tax liabilities on outside basis differences in an amount of CHF 56.2 million have been released. The deferred tax assets are released as the tax losses are utilised.

⁴⁾ Net profit comparable of CHF 124.7 million is calculated as net profit adjusted without one-off tax income of CHF 56.2 million. Earnings per share comparable would be CHF 2.54

in CHF	As reported	Adjustments IAS 19	Adjusted
Earnings per share	3.00	0.68	3.68
Diluted earnings per share	3.00	0.68	3.68

Free cash flow

The free cash flow shows Galenica's capacity to pay dividends and repay debt and repay equity. It provides information on the remaining cash and cash equivalents from the operating cash flow, reduced by all lease payments and after consideration of investment activities.

Free cash flow

in thousand CHF	2019	2018
Cash flow from operating activities before working capital changes	237,405	181,010
Payment of lease liabilities	(47,622)	–
Cash flow from operating activities before working capital changes adjusted	189,783	181,010
Working capital changes	13,033	(7,460)
Cash flow from operating activities adjusted	202,816	173,550
Cash flow from investing activities without M&A ¹⁾	(57,786)	(49,843)
Free cash flow before M&A	145,030	123,707
Cash flow from M&A ²⁾	(77,108)	(37,739)
Free cash flow	67,922	85,968

¹⁾ Cash flow from investing activities without purchase and sale of subsidiaries (net cash flow)

²⁾ Cash flow from purchase and sale of subsidiaries (net cash flow)

Cash conversion

	2019	2018
Cash conversion ¹⁾	74.8%	74.4%

¹⁾ Calculated as EBITDA adjusted less CAPEX (investments in property, plant and equipment and intangible assets) divided by EBITDA adjusted

Capital management

The capital of Galenica is managed and monitored at Group level. The objective of capital management at Galenica is to ensure the continuity of operations, increase enterprise value on a sustainable basis, provide an adequate return to investors, provide the financial resources to enable investments in areas that deliver future benefits for patients and customers and further returns to investors.

Galenica defines the capital that it manages as invested interest-bearing liabilities and equity. Galenica uses a system of financial control based on various key performance indicators. Capital is monitored based on the gearing, for example, which expresses net debt as a percentage of shareholders' equity including non-controlling interests and is communicated regularly to management as part of internal reporting. The debt coverage expresses net debt as a multiple of earnings before interest, taxes, depreciation and amortisation (EBITDA). Debt coverage ratio provide information about the creditworthiness of the Group. Galenica has no covenants requiring a minimum level of debt coverage.

Total assets and shareholders' equity are adjusted for the cumulative effects of the IAS 19 and IFRS 16 adjustments and net debt is adjusted for lease liabilities.

Total assets

in thousand CHF	2019	2018
Total assets	2,209,579	1,860,088
Cumulative effects of IAS 19 adjustments	(4,154)	(11,776)
Cumulative effects of IFRS 16 adjustments	(224,419)	–
Total assets adjusted	1,981,006	1,848,312

Net debt

in thousand CHF	2019	2018
Current financial liabilities ¹⁾	44,630	28,025
Current lease liabilities	47,796	–
Non-current financial liabilities ¹⁾	380,800	380,910
Non-current lease liabilities	182,772	–
Cash and cash equivalents	(90,532)	(104,970)
Interest-bearing receivables	(8,811)	(3,517)
Net debt	556,655	300,448
Lease liabilities (current and non-current)	(230,568)	–
Net debt adjusted	326,087	300,448

¹⁾ Excluding non-interest-bearing financial liabilities

Shareholders' equity

in thousand CHF	2019	2018
Shareholders' equity	999,540	933,599
Cumulative effects of IAS 19 adjustments	48,246	61,931
Cumulative effects of IFRS 16 adjustments	4,754	–
Shareholders' equity adjusted	1,052,540	995,530

Alternative performance measures of the Galenica Group

Equity ratio

	2019	2018
Equity ratio ¹⁾	45.2%	50.2%
Equity ratio adjusted ²⁾	53.1%	53.9%

¹⁾ Calculated as shareholders' equity divided by total assets

²⁾ Calculated as shareholders' equity adjusted divided by total assets adjusted

Gearing

	2019	2018
Gearing ¹⁾	55.7%	32.2%
Gearing adjusted ²⁾	31.0%	30.2%

¹⁾ Calculated as net debt divided by shareholders' equity

²⁾ Calculated as net debt adjusted divided by shareholders' equity adjusted

Debt coverage

	2019	2018
Debt coverage ¹⁾	2.1 ×	2.0 ×
Debt coverage adjusted ²⁾	1.5 ×	1.5 ×

¹⁾ Calculated as net debt divided by EBITDA

²⁾ Calculated as net debt adjusted divided by EBITDA adjusted

Value based management

Galenica has an integrated value-based management concept in place that derived from an economic value added (EVA) approach. It is based on the understanding that in the interest of shareholders and other important groups of stakeholders, Galenica will strive to achieve a long-term investment return which exceeds the weighted average cost of capital (WACC). Targets, plans, performance measurement and management compensation are aligned to increase the enterprise value.

Invested capital

Invested capital corresponds to current and fixed operating assets less cash and cash equivalents and non-interest-bearing current liabilities. In the following, invested capital is calculated indirectly via equity and net debt.

in thousand CHF	2019	2018
Shareholders' equity adjusted	1,052,540	995,530
Net debt adjusted	326,087	300,448
Deferred tax assets ¹⁾	–	(9,721)
Deferred tax liabilities ¹⁾	38,570	25,579
Invested capital	1,417,197	1,311,836
Average invested capital	1,364,517	1,279,829

¹⁾ Without deferred taxes due to IAS 19 and IFRS 16 as already taken into account in shareholders' equity adjusted

Net operating profit after tax (NOPAT) and return on invested capital (ROIC)

Net operating profit after tax (NOPAT) is the profit before interest and after depreciation, amortisation and taxes. It is calculated from the operating result (EBIT adjusted) less calculatory income taxes.

Return on invested capital (ROIC) is calculated as NOPAT divided by the average of invested capital. This measure of performance integrates both measures of profitability and measures of capital efficiency.

in thousand CHF	2019	2018
EBIT adjusted	166,875	154,072
Net financial income from financial assets	(253)	987
Net operating profit before taxes	166,622	155,059
Calculatory tax rate (20%)	(33,324)	(31,012)
Net operating profit after taxes (NOPAT)	133,298	124,047
Return on invested capital (ROIC)¹⁾	9.8%	9.7%

¹⁾ Calculated as NOPAT in % of average invested capital

Galenica economic profit (GEP)

The most important key figure in Galenica's value-based management concept is the Galenica economic profit (GEP). The GEP illustrates the result of the Galenica Group after consideration of the cost of capital. GEP is a measure designed to reflect the principles of value-based management derived from an economic value added (EVA) approach. GEP is calculated as the NOPAT less the WACC over the average invested capital.

in thousand CHF	2019	2018
Net operating profit after taxes (NOPAT)	133,298	124,047
Cost of capital ¹⁾	(85,282)	(79,989)
Galenica economic profit (GEP)	48,016	44,058

¹⁾ Calculated as average invested capital multiplied with WACC (weighted average cost of capital) of 6.25%