# Letter from the Remuneration Committee Chairman

**Ishbel Macpherson** Remuneration Committee Chairman

## Dear Shareholder

I am pleased to present the Directors' Remuneration Report for the year ended 30 June 2017.

The report is divided into two sections: the Directors' Remuneration Policy, followed by the Annual Report on Remuneration. The Policy sets out our forward looking policy for Directors' remuneration and is a replacement for the Policy approved in 2014, which had 98.32% of votes cast in favour of it. The Annual Report on Remuneration provides details of the amounts earned in respect of the 2017 financial year and how the Policy will be implemented in the 2018 financial year.

Our existing Long Term Incentive Plan (LTIP) expires in 2018 and shareholders will be asked to approve a new Long Term Incentive Plan at the Annual General Meeting. Further information in relation to the new LTIP is included in the Notice of Annual General Meeting; there is no increase in quantum under the new LTIP and we have introduced a two year post vesting holding period.

## Our Directors' Remuneration Policy

The new Policy is proposed in the context of a significant change in the scale of the business, with Dechra's market capitalisation increasing from approximately £600.0 million in 2014 to approximately £1.7 billion. This increase has taken place over a period when Dechra has become increasingly international, and a more complex organisation as its scale and geographical spread has significantly increased.

The Committee considers that the current remuneration framework continues to support effectively the delivery of our business strategy and the creation of shareholder value, as shown in the table on page 83. Our new Policy is not a radical overhaul of the Policy approved in 2014. The changes refine that Policy and take account of developments in best practice. The changes are summarised in the introduction to the new Policy on page 84 and include the adoption of a post vesting holding period for LTIP awards and enhanced shareholding guidelines.

Our approach to the implementation of the Policy in the 2018 financial year, including our approach to performance measures for LTIP awards is described overleaf.

## Incentive Outturns in 2017

As a result of the progress in our strategy, we have delivered underlying profit before tax during the year of £77.0 million, an improvement of 38.4% at constant exchange rates (54.9% at actual exchange rates) on the prior year. Reflecting the performance of the Group in relation to profit targets and the performance of Executive Directors against personal objectives as described on page 94, bonuses for the year equal to 92% of salary have been earned by Ian Page and Richard Cotton, and 90% earned by Tony Griffin.

LTIP awards were granted to Ian Page and Tony Griffin in September 2014 and are due to vest on 15 September 2017, subject to the achievement of earnings per share (EPS) and total shareholder return (TSR) performance conditions (each applying to 50% of the awards) and an underpin based on return on capital employed (ROCE). The awards are scheduled to vest:

- as to 100% of the TSR element (50% of the total award) by reference to TSR performance (reflecting upper quartile performance); and
- as to 100% of the underlying diluted EPS element (50% of the total award) by reference to EPS performance (reflecting that the compound annual growth in the underlying diluted EPS at 21.0% was above the maximum threshold of 13.0%).

In aggregate, taking into account the ROCE underpin (reflecting that the ROCE at 17.7% had not fallen below 15.0%), the LTIP awards vested as to 100%.

# Letter from the Remuneration Committee Chairman
continued

## Executive Director Remuneration Decisions in 2017

In accordance with our Policy, our normal approach to Executive Director salary increases is that they will not exceed the range of increases awarded to the wider workforce. We explained last year that Ian Page's salary has not changed since January 2014 and that we would review it during the 2017 financial year in light of the exceptional change in the scale and complexity of the Group since that last review, taking into account the Group's significant acquisitions and international expansion in the period. In the last six years, revenue derived from the UK has fallen from 76% of total revenue in the 2012 financial year to 15.7% in the 2017 financial year, whilst the average number of employees has increased by 31.8% over the same period. Since 30 June 2014 our international sales operations (excluding our export business) have expanded from 14 countries (13 EU, 1 North America) to 24 (19 EU, 3 North America, 2 Australasia) as at 30 June 2017. Ian has been instrumental in guiding the Group through this period, having driven its growth and exceptional performance since it listed. Under Ian's leadership, shareholders have been provided with a stable investment that has delivered sustained and substantial returns. Taking into account the fundamental contribution that Ian has made to this transformation and recognising the increase in the scope and responsibilities of his role since his salary was last reviewed, we increased Ian's salary with effect from September 2016 by 13.6% (which is equivalent to the cumulative annual pay increases for a higher performer within the Group over the same period) to £500,000. This increase positions his salary slightly below the mid-point of the market competitive range compared to companies of a similar size and complexity. Ian has notified the Committee that he does not wish to be considered for a salary increase in respect of the 2018 financial year.

During the annual salary review cycle, Tony Griffin's salary was increased by 3% in respect of the 2017 financial year, broadly in line with the average range of increases awarded to employees throughout the Group.

We granted LTIP awards in September 2016 subject to TSR and EPS performance conditions (each applying to 50% of the awards) with the EPS target for maximum vesting increased for these awards to 20% CAGR, following shareholder consultation. A ROCE underpin continues to apply to each element. Details of the awards are set out on page 98.

## Directorate Changes

Richard Cotton joined Dechra on 3 January 2017 and his remuneration arrangements were implemented as set out in last year's Directors' Remuneration Report. As noted last year, Richard was granted two 'buyout' awards in respect of incentives forfeited as a result of joining Dechra; details of those awards are set out on page 98.

## Performance Conditions for LTIP Awards in 2018 Financial Year

Current performance conditions are based on relative TSR and EPS. The use of a relative TSR measure for Dechra presents challenges as it is difficult to determine an appropriate comparator group, and it can reward volatility which does not reflect Dechra's track record of consistent growth over the previous five years. We recognise, however, that some shareholders have a preference for a relative measure. Therefore, for the 2018 financial year LTIP awards we propose to retain relative TSR but to recalibrate the weightings so that relative TSR will account for one third of each award, and EPS growth will account for two thirds of each award. This recalibration provides a better line of sight for management and provides the best link to our strategy.

The use of a ROCE underpin ensures that the EPS measure will require the delivery of quality earnings, while the introduction of a two year holding period, along with our shareholding guidelines of 200% of salary, ensures that management are aligned with the long term interests of shareholders and the delivery of sustained performance.

The targets applying to the performance conditions are set to drive the right behaviours and, in appropriate circumstances such as following the acquisitions we undertook in the 2016 financial year, we adjust targets upwards to ensure that they remain stretching but achievable. As noted in the Directors' Remuneration Report for the 2016 financial year, the high level of growth for the three year performance period to June 2019 reflected the impact of earnings from acquisitions that were not included in the 2016 base year, we recognise that for future LTIP awards the EPS targets would need to be reduced to reflect a lower level of sustainable growth. Accordingly, we have decided to decrease the EPS performance requirement for maximum vesting from 20% to 15.5% to reflect the fact that the acquisitions are now included in the base year and the lower 2020 financial year broker forecasts. Full details of the performance measures and the targets for the 2018 financial year are set out on page 100. This level of growth is higher than the original 13% CAGR required for maximum vesting for the 2016 financial year LTIP awards. We consider that 15.5% EPS growth per annum is a stretching target which should act as an appropriate incentive for executives to deliver sustained business performance without encouraging excessive risk. Taking into account comments received from shareholders, the underpin continues to operate on the basis of a ROCE floor of 10%. However, to ensure that management are not disincentivised from making shareholder value enhancing acquisitions even if they have a short term impact on ROCE, the underpin will now operate solely by reference to this floor; the details of the underpin are set out on page 100.

## The Link between our Directors' Remuneration Policy and our Strategy

Dechra's Policy is designed to promote the long term success of the Group and to reward the creation of long term value for shareholders. The performance targets for all incentive elements are designed to reward high performance whilst not encouraging inappropriate business risks.

The table on the next page describes how certain remuneration elements are linked to our strategy.

| Remuneration Element | Strategic Growth Driver and Enabler | Link to our Key Performance Indicators |
|---|---|---|
| **Annual Bonus**<br>Our annual bonus incentivises the delivery of the long term strategy through the achievement of short term objectives.<br>90% of the opportunity is based on a stretching profit target which requires performance above budget and market expectations to trigger the payment of a maximum bonus.<br>The balance of the bonus is based on the achievement of personal objectives which reflect the priorities of the business, achievement of which is necessary to deliver the longer term strategy. | | • **Sales Growth** Strong sales performance is required to maximise profit<br>• **Cash Conversion** Strong cash conversion reduces liquidity risk |
| **Long Term Incentive Plan**<br>The LTIP is designed to reward the generation of long term value for shareholders. Performance measures reflect our long term objectives including sustainable profit growth and the enhancement of shareholder value. Awards are based two thirds on growth in EPS and one third on the delivery of shareholder returns.<br>The application of a ROCE underpin ensures executives are focused on using capital efficiently and appropriately to allow the business to capitalise on growth opportunities in new territories and markets whilst maintaining returns.<br>The introduction of a post vesting holding period aligns management with the long term interests of shareholders and the delivery of sustained performance. | | • **Underlying Diluted EPS Growth**<br>• **Return on Capital Employed**<br>• **New Product Sales** This measure encourages innovation, growth and sustainability |
| **Generation of Long Term Value for Shareholders/Alignment of Interests**<br>The Policy is designed to promote long term Group success and to reward the generation of shareholder value. A significant proportion of the remuneration opportunity is linked to the achievement of stretching performance targets.<br>The interests of shareholders and executives are aligned by formal shareholding guidelines. Executive Directors are required to retain half of any shares acquired under the LTIP and, if relevant, any recruitment award (after sales to cover tax) until such time as their holding has a value equal to 200% of their base salary. | | |

## Forward Looking

Subject to shareholder approval of the Policy at the Annual General Meeting, we will apply it in the 2018 financial year. More information is given on page 100, and we have summarised key aspects below.

- Salary: Executive Directors' salaries for the 2018 financial year will be considered in September at the same time as the salary review for the wider workforce. In line with our normal policy, any increase to Executive Directors' salaries will be in line with the increases awarded to the wider workforce, although as noted above Ian Page has already notified the Committee that he does not wish to receive any increase.
- Bonus: The Executive Directors' bonus opportunity for the 2018 financial year under the new Policy will remain at 100% of salary, consistent with the existing Policy. The bonus will be based on a mix of stretching profit before tax targets (90% of the opportunity) and personal objectives (10% of the opportunity).
- LTIP: Awards for the 2018 financial year will be granted under the new LTIP for which shareholder approval will be sought at the 2017 Annual General Meeting. In line with the new Policy, those awards will be subject to a two year post vesting holding period.

## Shareholder Views

We consulted with shareholders on the new Policy and LTIP and took account of feedback received before finalising our proposals. The Committee and I believe that ongoing dialogue with our major shareholders is of key importance. Should you have any queries in relation to this report, please contact me or the Company Secretary.

**Ishbel Macpherson**
Remuneration Committee Chairman
4 September 2017