
EU Financial accounts reports

David Citron

Huntingdon Life Sciences Group plc: Results for the six months to 30th June, 2000

Huntingdon Life Sciences is one of Europe's largest contract research organisations. It provides non-clinical safety and efficacy evaluation services, with about two-thirds of its revenue generally coming from the pharmaceutical and biopharmaceutical sector. In 1999 over three-quarters of the world's top 50 pharmaceutical companies were customers of Huntingdon. The remaining one-third of the group's revenues are provided by the agrochemical, industrial chemical, veterinary and food industries.

Conflicts with animal rights activists in 1997 had triggered a financial crisis. This led in 1998 to a refinancing and new management who now refer to the 'new Huntingdon'. The company's share price, however, is still subject to considerable volatility. From a high of 121p in 1997, it languished at only 5¹/₂p by February 2000. While the company's improved 1999 results sparked a four-fold increase to 27p in March 2000, by the date of writing (late October 2000) the price had reverted to 5p.

The prolonged animal rights debacle led, in 2000, to a fund manager disposing of its 11 per cent holding in Huntingdon and to the resignation of the company's banker and broker. Dan Oakey, writing in the *Investor's Chronicle* (18th August, 2000), quotes Huntingdon's former chief executive as saying: 'What happened to Huntingdon could happen to any small company unless its directors are rigorous in their assessment of risk.' The article refers to the Institute of Chartered Accountants' guidelines for directors on risk management. This is defined in very broad terms to include the need to deal appropriately with those trends in a company's markets and wider environment that could exacerbate the risks

it faces. Indeed, in its corporate governance report as published in its 1999 annual report in March 2000, Huntingdon stated that it was preparing a risk management policy document setting out the Board's attitude to risk in the achievement of its business objectives.

While Huntingdon's results have improved in the last 18 months, there is still much progress to make. Although 1998's negative gross margin has now been eliminated, the company is still incurring losses at the post-tax level, albeit the £3.9m net loss for the six months to June 2000 was 23 per cent down on that for the corresponding period a year earlier.

However, the group's financial position is (at the time of writing) also precarious. At the end of June 2000 its £54m net debt was almost four times the size of shareholders' funds, and the auditors refer to the uncertainties surrounding the group's going concern status in their reports on both the 1999 annual results and the June 2000 interims. Specifically this referred to the refinancing of the company's £22.6m short-term loan from the Royal Bank of Scotland which had originally been due to be repaid in August 2000. By October 2000, however, Huntingdon had obtained the bank's agreement for an extension while it negotiated a new US\$15m asset-backed lending facility with another party. This deal was itself dependent on the successful sale and leaseback of the company's laboratory. As of October 2000 this entire deal was expected by Huntingdon to be successfully completed by 30th November.

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SmithKline Beecham plc: Results for six months to 30th June, 2000

1999 marked the tenth anniversary of the creation of the SmithKline Beecham group. No sooner was the year brought to a close than, on 17th January, 2000, SmithKline Beecham and Glaxo Wellcome announced their proposed merger. At the end of October 2000 these two companies together accounted for 12 per cent of the FTSE 100 capitalisation. Glaxo SmithKline, as it would be known, would account for 7.3 per cent of the world's pharmaceutical market and be a market leader in four key therapeutic areas: anti-infectives, central nervous system, respiratory and alimentary, and metabolic. The group would have the world's largest drugs salesforce and, remarkably, few overlaps in terms of treatments offered. Cost savings due to the merger were estimated at £1bn to £1.5bn, although the view of analysts was that the merger was being driven less by cost savings than by increased research productivity and leadership. Hence it was expected that much of these cost savings would be ploughed back into research and development and marketing.

Of interest from an accounting view was the information that Glaxo Wellcome's shareholders would hold approximately 58.75 per cent of the equity in the new group, with SmithKline Beecham's shareholders therefore having a 41.25 per cent holding. If this turns out to be the case, then one of the hurdles – the relative size test which requires that neither party should be substantially larger than the other – for the use of merger accounting for the newly created entity will have been passed. If the combination does qualify as a merger from an accounting viewpoint then the problem of accounting for goodwill will not arise.

A long memory is not required to recall that the merger of these two companies was last attempted in 1998. This failed, however, owing reportedly to management differences. This time round a successful outcome was looking more likely although in September 2000, just before completion was expected, the US Federal Trade

Commission caused the first delay. This arose from possible dominance of the new group in smoking-cessation products. This was unlikely to prove an unsurmountable barrier, however, and the expected completion date was revised to the end of the year.

SmithKline Beecham has itself undergone some relatively important changes in the build-up to the proposed merger. During 1999 it disposed of its various healthcare services businesses. These encompassed clinical laboratory testing and pharmacy benefit management which in 1998, their last full year, achieved sales in excess of £1bn, albeit with a trading profit of only £76m. These businesses were sold for £1bn, producing a substantial reduction in the company's debt/equity ratio from 52 per cent at the start of the year to 22 per cent by the end of 1999.

In October 2000 the acquisition of Block Drug, manufacturer of Sensodyne toothpaste, for US\$1.24bn (£855m) was announced, a purchase that would use up much of the cash generated from the healthcare services disposals. The purchase made SmithKline Beecham the world's second-largest toothpaste manufacturer and appears to confirm its interest in remaining in the consumer healthcare sector, a market in which Glaxo Wellcome does not operate.

This leaves SmithKline Beecham operating in two main sectors – pharmaceuticals and consumer healthcare. Total sales from these operations were £7.75bn in 1999, with pharmaceuticals sales roughly double those of consumer healthcare. Sales of these businesses increased by 10 per cent in 1999 and at the same rate again the first half of 2000. Earnings per share growth (excluding exceptionals) was strong, at 13 per cent in 1999 and 16 per cent in the six months to June 2000.

It remains to be seen whether the proposed merger with Glaxo Wellcome is affected by any further delays and whether these cause any damage, especially perhaps to staff morale.

October 2000

Scotia Holdings plc: Results for the six months to 30th June, 2000

Scotia's share price has been hit during the year 2000 by key events which, as is common in biotechnology companies, are in no way reflected in the currently reported financial results. The price lost 25 per cent when, in early May 2000, the *Financial Times* reported the findings of a *British Medical Journal* paper that the company's photodynamic therapy produced an unexpectedly high rate of burns among patients. The results related to the mode of delivery of the company's lead product, Foscan, a light-activated treatment for head and neck cancer. Scotia successfully challenged these findings, but even though the *BMJ* published an apology one month later the company's share price did not recover to its former level.

More worryingly for Scotia, in late September 2000 the US Food and Drug Administration (FDA) concluded that Foscan was 'not approvable at this time'. Immediately upon this announcement the share price collapsed 60 per cent to 47¹/₂p, and by the end of October had dropped further to 24¹/₂p. The *Financial Times* analysis (27th September, 2000) of the implications suggested that Scotia's cash reserves were sufficient to last only to March 2001. This seems about right given that the June 2000 balance sheet revealed just over £18m of cash and short-term deposits and that cash outflows in the first six months of 2000 came to about £14m.

While Scotia's chief executive Dr Robert Dow was confident that eventual FDA approval would be won, much depended on whether further tests would require only a relatively quick redesign of the previous study or whether new time-consuming clinical trials would be necessary. Timing here is of the essence, and it may turn out that the only feasible exit will be via takeover or piecemeal sale of the company's other products.

The company's pre-exceptional operating loss was £27.4m in 1999, up 23 per cent from the year before on a comparable basis excluding the results of operations sold in 1998. This increased loss was partly due to a 14 per cent increase in research and development expenditure arising from the Foscan project, and also due to the first full year's interest of £4.2m on the company's 8¹/₂ per cent £50m convertible bond which had been issued in 1998. Scotia raised a further £11.2m in January 2000 via an institutional share placing, but this was more than eaten up by the operating cash outflow in the subsequent six months.

The convertible bond may, however, prove to have been too risky a source of funds. While it is convertible into ordinary shares, the conversion price is 340p, a target that currently looks unattainable. In the absence of conversion the company must redeem the bonds in March 2002, a date close enough to concentrate the mind of any potential acquirer of the company.

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