EU Financial accounts reports

David Citron

Celltech Group plc: Results for the year to 31st December, 2000

Following its August 1999 merger with Chiroscience to create one of Europe's largest research and development groups, Celltech acquired Medeva in January 2000 to provide a product portfolio with annual sales in excess of £200m. The new enlarged group thus comprises two principal businesses – Celltech R&D and Celltech Pharmaceuticals.

A key development in the R&D operation was the February 2001 agreement with Pharmacia Corporation, the world leader in arthritis treatment, under which Pharmacia acquired the rights to worldwide development and marketing of Celltech's product for treatment of rheumatoid arthritis and Crohn's disease. Celltech received an initial payment of US$50m plus expected milestone payments of up to US$230m, dependent on attainment of certain events.

Medeva was acquired via a share exchange. When the acquisition was announced in November 1999 the 118.2 million new shares issued by Celltech to Medeva's shareholders valued the business at about £580m. By the time the deal was completed less than three months later in January 2000, however, Celltech's shares had risen in value by 60 per cent. As a result the purchase of Medeva was recorded at £937m in Celltech's accounts. Since this apparent change in value was brought about by the increase in Celltech's share price and not by any improvement in Medeva's business itself, the value of the Medeva acquisition was then written back down in the accounts. This resulted in an exceptional charge of £354m in Celltech's 2000 income statement for the somewhat inappropriately named 'goodwill impairment'. All the same, this left £600m of goodwill remaining on Celltech's balance sheet, which the company is amortising over a seven year period based on the best estimate of its useful life.

Celltech identified three of Medeva's operations for more or less immediate disposal. In line with this, the vaccine business was sold to PowderJect Pharmaceuticals in October 2000 for £55m, of which £30m was in cash; and the Armstrong business was sold in February 2001 for US$18m (£12m).

Celltech has been so active in the acquisitions and disposals market that its year-on-year results are difficult to make sense of on a comparable basis. The problem is compounded by the prior period having been 15 months. Celltech's annual report comes to our aid here by supplementing its statutory accounts with a set of pro-forma statements, which provide a more comparable set of figures. These pro-formas present the results for 2000 and 1999 *as if* Medeva had been part of the group for two full years while excluding divested businesses altogether, even those sold *after* the December 2000 year end.

On this basis, sales in 2000 were £250m, of which product sales contributed 85 per cent, and representing an overall increase of almost 3 per cent. Operating profit at £23.5m compared with £19.7m the year before, shows what the company describes as 'a significant underlying increase in profitability'. It is worth pointing out, however, that this operating profit is struck before goodwill amortisation. Some would argue that if Celltech's directors have assessed the £600m of goodwill to have a seven year useful life, then there is no reason why the associated £85m annual amortisation charge should not be deducted. This would result in a £60m pre-exceptional operating loss.

Celltech had net cash of £43m at

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December 2000. By May 2001, however, cash reserves had approximately doubled thanks to the Pharmacia agreement and business disposals. Given also its three-year £80m revolving credit facility, the cash position looks quite strong enough to support the ongoing development of the newly enlarged group.

August 2001

ML Laboratories plc: Results for the six months to 31st March, 2001

While ML Laboratories has had a successful product development history, this has arguably been at the expense of overstretched resources.

The company has taken five products from research idea through to marketing authorisation, and subsequently launched four of these. A drug for the treatment of renal failure is licensed to Baxter Healthcare, two products for the treatment of asthma are licensed to Celltech Medeva, while a product for reducing post-surgical adhesion generates its own direct sales revenue. Furthermore the annual report for 2000 states that a further eight products were at that time (January 2001) in late stage development.

In March 2000 ML Laboratories further extended its activities via the acquisition of Cobra Therapeutics, a leading gene therapeutics company. The £10.4m consideration was paid by a share exchange and included £5.9m of goodwill. However, ML Laboratories may have to pay additional amounts up to a maximum of £12m as determined by earn out conditions. These depend on the future performance of Cobra or on any amounts received on the disposal of its operations. Any such additional consideration will be payable in cash or shares, the choice between these importantly being at the option of ML Laboratories.

Given its successful product development the company has a relatively reliable revenue flow. Turnover for the six months to 31st March, 2001, was £4.6m. While this was 13 per cent down on the year before, the drop was due entirely to a fall in the less predictable milestone receipts from licensing evaluation and development fees. Royalty income and direct product sales registered a 29 per cent increase. Nevertheless the company continues to incur losses. The pre-tax loss for the half-year to March 2001 was £7.7m, and even ignoring research and development expenditure this loss was £2.7m.

The company's financial position is of concern however. Its last major share issue had been for £11.5m in July 2000. The Cobra acquisition brought in additional cash of £4.1m. By March 2001, however, the company's cash balance amounted to only £7.1m. Moreover, on the other side of its March 2001 Balance Sheet, there was a £7.5m loan outstanding from N M Rothschild & Sons, a facility that was due to expire in the second half of 2002. Chairman Kevin Leech stated that the March 2001 £7.1m cash balance was roughly equivalent to half a year's cash burn.

This position was somewhat alleviated by the July 2001 announcement that the company had successfully raised £17.5m from Paul Capital Royalty Acquisition Fund. This was to be used to repay the £7.5m Rothschild loan, with the balance available for financing US clinical trials of the anti-adhesion product. In return Paul Capital will receive a proportion of the royalty and revenue streams from this and two other products until 2010. Interestingly the *Financial Times* (10th July, 2001) reported that this £17.5m injection would be included in ML Laboratories' 2001 full year accounts as revenue.

A straightforward calculation indicates that the Paul Capital cash receipt still leaves the company with little over one year's cash burn. Little surprise then that in 2001 the company announced that it was embarking on a major strategic review. This would entail increased focus in its operations by a reduction in the number of therapeutic areas in which it was active. The stated objective was to maximise shareholder value. At the time of the announcement in January 2001 the company's share price stood at about

120p. By August 2001, however, it had fallen almost 50 per cent to 62p. Clearly the outcome of the strategic review and its impact on the company's financial position will be crucial.

August 2001

Pharmagene plc: Results for the year to 31st December, 2000

Pharmagene, founded in 1996, was floated on the London Stock Exchange in July 2000. The company, which is active in all major areas of pharmaceutical research, uses its library of human tissue to improve the efficiency of the drug discovery and development process of its pharmaceutical and biotechnology partners. It aims to achieve this by helping customers both identify potentially toxic compounds at an earlier stage and decide which drug targets to commit resources to over the medium term. In addition the company wishes to use its technologies internally to find new therapeutics, an activity that will require partners to supplement the group's own limited resources.

By early 2001 Pharmagene had a customer base of 18, 7 of which were numbered among the world's top 20 pharmaceutical companies.

Not surprisingly owing to the highly sensitive nature of its library of human tissue, the company devotes a fair amount of attention in its annual report to the ethical guidelines it follows in this area. Thus it tells us, for example, that it obtains the informed consent of the donor or donor's next of kin; it does not act as a tissue bank in the sense of selling or distributing it to third parties; and it rigorously adheres to various legal and ethical guidelines such as those of the Medical Research Council and the Royal College of Pathologists. This aspect of Pharmagene's activity undoubtedly involves an element of risk. A 14th March, 2001, article in the *Guardian*, for example, pointed to the effect of the Alder Hey hospital scandal in which surgeons removed organs of dead children without permission, the immediate short-term result of which was reportedly to deter nurses from asking relatives' permission for donations to Pharmagene.

A second source of risk, and one not at all untypical in the sector, is the company's reliance on revenues from a small number of large partners. This was illustrated graphically in November 2000 when it announced that about one-third of expected revenues for the year 2000, a sum of about £700,000, would in fact be postponed to 2001. This was due to two major pharmaceutical partners postponing drug trials for a variety of internal reasons quite unconnected with Pharmagene itself (see the *Financial Times*, 30th November, 2000). Nevertheless Pharmagene's share price, which had been 285p on flotation four months earlier and had subsequently risen to 370p, fell 46 per cent to 115½p on this announcement, and has since languished at around the 100p mark. While both the company and the *Financial Times* felt this was harsh treatment from the markets, the fact is that nine months later the share price has not yet recovered.

Thanks to raising £37m on flotation Pharmagene had a healthy net cash position of £35m as at 31st December, 2000. The operating cash outflow in 2000 was only £3.8m. While this was expected to increase in 2001 owing to increased research and development and sales and marketing spending, cash resources at the end of 2000 looked more than adequate. The company's market rating appears to be more a reflection of a start-up operation highly dependent on fortunes and activities of a small number of large pharmaceutical partners.

August 2001