EU Financial accounts reports

David Citron

Professor David Citron
Faculty of Finance,
Cass Business School,
106 Bunhill Row,
London EC1Y 8TZ, UK

Tel: +44 (0) 20 7040 8665
Fax: +44 (0) 20 7040 8881
E-mail: d.b.citron@city.ac.uk

Profile Therapeutics plc: results for year to 30th June, 2002

Profile Therapeutics, which was floated on the London Stock Exchange in March 2000, develops inhaled drug delivery systems and drugs to treat chronic respiratory conditions. Sales revenues have grown by about £1m each year over the last three years, totalling £12.7m in the year to June 2002. The associated operating loss of £5.8m, however, masks the fact that the cost of the company's ongoing investment in drug and drug delivery development is partially offset by a section of the group which operates in the black.

The profitable operation, Profile Respiratory Systems, is a market leader in the UK in developing and supplying respiratory therapy equipment and related services for home and hospital use. This business, which accounts for virtually all the company's sales and which earned an operating profit of £1.2m in 2001/2, provides Profile Therapeutics with an in-house source of cash flow, not found in many other biotechs, to help fund its earlier stage projects.

These projects can be viewed under two heads. The first is the Profile Drug Delivery (PDD) business, which is developing the company's Intelligent Inhaler Technology. This aims to ensure that, taking account of the patient's breathing pattern, the prescribed amount of drug reaches the right part of the lungs in every treatment. PDD has established collaborations with Schering, Pfizer and Alpha Therapeutic (a division of Japan's Mitsubishi Pharma) for these companies' drugs to be delivered through its technology.

The second is Profile Pharma (PP) which develops drugs to treat severe respiratory diseases for delivery through PDD's technology. In particular the company submitted its first drug, Promixin, for UK approval in March 2002 and was expecting approval during the first quarter of 2003, with marketing in Europe anticipated to follow a year later.

The 62 per cent growth in the company's 2001/2 R&D spend to £5m was largely due to the need to make progress with PDD's and PP's projects, and some reduction in future R&D expenditure was expected. Writing in September 2002, Chairman John Burke stated that the results for 2001/2 were 'consistent with our expectation of achieving profitability within five years of flotation without raising additional equity.'

If the company is not to return to the market, what sources of funds is it planning to draw upon? These are fourfold. First as at June 2002 there were £8.3m of cash and short-term deposits, albeit sharply down from £14.4m a year earlier. Second, as mentioned above, the Profile Respiratory Systems business provides an internal source of positive cash flows. Thirdly it was hoped that access or development payments would be received from collaborative partners. And finally, and of particular interest, was the three-year committed revolving credit £5m bank facility secured in September 2002 with the Bank of Scotland.

It is surely just as well that the company is not envisaging the need to raise new equity. Unlike most companies, Profile provides readers of its annual report with its recent share price history. This shows an approximate 70 per cent drop between the March 2000 flotation and June 2002, although it should be pointed out that the FTSE techMARK index, which the company uses as its comparator, suffered an almost identical fall over the same period. Both the company's share price and the techMARK index have unfortunately suffered a further 40 per cent drop from June 2002 up until mid-January 2003.

January 2003

Cobra Bio-Manufacturing plc: results for year to 30th September, 2002

Cobra, formerly a subsidiary of ML Laboratories, was floated on the Alternative Investment Market in June 2002, a difficult time for the stock market. The spin-off, part of ML's reorganisation strategy, raised £7m at a price of at 100p per share.

ML listed the benefits it would gain as increased business focus; a remaining 46 per cent holding in Cobra; and use of £3m of the flotation proceeds to pay off Cobra's overdraft, thus increasing ML's financial flexibility.

Cobra had been founded in 1992 as a start-up biotechnology company specialising in gene therapy, and was acquired by ML Laboratories in March 2000 for £10.4m plus contingent deferred consideration which did not become payable. Prior to the flotation Cobra had two main businesses – a manufacturing division focused on the manufacture of both DNA and protein-based pharmaceuticals, and a research and development division focusing on the development of DNA-based products.

As part of the spin-off arrangement, Cobra sold its R&D business to ML immediately prior to its listing, for which it received about £3m cash. It thus remains focused on the manufacturing operation, which had begun to grow after 1988 when manufacturing services were first offered to the pharmaceutical industry. Cobra now has an international customer base with 22 major accounts covering Europe, the USA and Australia. It is now one of the world's leading contract manufacturers of DNA vaccines for HIV/AIDS.

The unaudited preliminary results for the year to September 2002 show sales revenues of £2.5m from the ongoing manufacturing business, up 124 per cent on the year before, and a healthy gross profit margin of 34 per cent. While R&D spending totalled almost £2m, Cobra will save about 90 per cent of this in future years thanks to the disposal of the R&D business. Focusing, then, on continuing operations Cobra nevertheless incurred a £0.8m operating loss for the year.

Despite this, the Chairman David Thatcher remains upbeat in his maiden preliminary statement (issued in December 2002). While recognising that 'the biotechnology industry as a whole is beset by funding problems', he points to the buoyancy of the worldwide market for biopharmaceuticals manufacture as well as to Cobra's 'healthy order book'.

Being mindful of the Chairman's concerns about funding, however, it is worth noting that Cobra's September 2002 cash balance came to £2.6m. Against this, the operating cash outflow for the year had been £3m, although at a rough estimate about one-half of this would be saved in future owing to the significantly lower R&D spend. With the mid-January 2003 share price down at 77p, cash management will nevertheless remain a key priority.

January 2003

Evotec OAI AG: results for the nine months to 30th September, 2002, and preliminary results for the year 2002

Evotec OAI was formed towards the end of 2000 by the merger of the German company Evotec with Oxford Asymmetry International. Based mainly in Hamburg and Abingdon, the company provides services and products to facilitate the identification of new drugs. It utilises technologies in biology, chemistry and screening, and has to date completed over 1,200 projects with 150 companies, including all of the top 20 global pharmaceutical companies and major biotechnology companies.

Evotec is listed on the Neuer Markt, Frankfurt. Having peaked at over €90 in February 2000 prior to the merger, the company's share price has since then experienced more or less continuous decline and was, in March 2003, languishing at under €2.

Sales revenues are derived predominantly from drug discovery services, 50 per cent in Europe and 50 per cent in the USA. For the nine months to September 2002 sales totalled €47m, up 20 per cent on the year before. However, the company announced that quarter 3 revenues had grown at only 8 per cent owing to the difficult business environment, with some customers delaying orders to conserve their cash positions. Thus, when Evotec published its unaudited preliminary results for the whole year 2002, it announced sales of €69.5m, only a 10 per cent increase on 2001.

Gross margins for the nine months to September 2002 declined from 49 per cent to 44 per cent, partly because the Abingdon facility was not being fully utilised and also because of a shift to lower margin projects. After deducting R&D and other operating expenses, but before goodwill amortisation costs, the company incurred an operating loss of €14.4m for the nine months compared with only $11.9m the year before. Evotec announced plans to reduce R&D and selling and administration costs in 2003.

Despite these operating difficulties, Evotec argued that its performance in 2002 was fundamentally strong. To some extent it hoped that the sluggish business environment would work in its favour as pharma companies would increasingly look to companies such as Evotec to improve the effectiveness of their own R&D units. The company was particularly pleased to announce in October 2002 a three-year extension to its long-term collaboration with Pfizer, an agreement with a potential value in excess of $25m. Other partners included Amgen, Pharmacia, Roche and Merck, and in quarter 3 British Biotech was added to their customer list.

The company's depressed share price, however, was exercising the minds of its financial people, since this meant that its market value of about €70m was well below its 30th September, 2002, net balance sheet value of €318m. As the balance sheet included €222m of goodwill, it was looking very much as if the market valuation was discounting this goodwill.

Evotec, which draws up its accounting using US generally accepted accounting principles (GAAP), pointed out that a radical change in US standards on goodwill accounting could mean that it would have to account for much of the shortfall in its market value as an impairment write off in quarter 4 of 2002.This new standard, known as SFAS No. 142, will affect goodwill and intangible asset accounting in all companies using US GAAP in their 2002 accounts onwards. Instead of systematically charging a percentage of goodwill against profits each year, SFAS No. 142 requires goodwill to be tested at least annually for any impairment in value, with any such loss in value to be written off against profits. The US accounting regulator admits that the new approach is likely to result in greater volatility in reported income because impairment losses are likely to occur irregularly and in varying amounts. In its quarter 3 announcement Evotec stated that it was expecting to have to make an impairment charge of this sort of €110–130m in its quarter 4 accounts.

Evotec's December 2002 cash balance amounted to €21m, up from €15m three months earlier, thanks to cost cutting and efficient working capital management. In January 2003 its order book totalled €45m, accounting for almost 60 per cent of total projected revenues for 2003. Management's task is to build effectively on these healthy fundamentals so that the company's share price benefits accordingly.

March 2003