FINANCIAL ACCOUNTS REPORTS

EU Financial accounts reports

David Citron

Phytopharm plc: Results for the six months to 28th February, 2002

Phytopharm, which describes itself as 'the first botanical pharmaceutical company', aims to develop plant extracts into full pharmaceutical products. Its targets cover the main therapeutic areas of obesity and metabolic disease, neural and muscular degeneration, inflammation and dermatology.

In March 2002 Phytopharm announced the opening of a new botanical supplies unit in South Africa to substantially expand production of P57 which is focused on obesity and obese onset diabetes. The company has been in partnership with Pfizer in this development since 1998, and it is this collaboration that accounted for the company's turnover of £1.5m in the year to August 2001 and the £1.1m in the half year to February 2002. It had been hoped that the renewal of the three-year agreement with Pfizer could have been announced when the February interims were published in May 2002, but no such announcement was forthcoming and the shares fell 5 per cent on the day to 486p.

Like any early-stage biotechnology company, Phytopharm continues to incur pre-tax losses: £2.9m for the year to August 2001 and a further £1.9m in the subsequent six months. While the 2001 annual report emphasised cost control and cited R&D spending up by 19 per cent while staff numbers increased by only 6 per cent, in the six months to February 2002 R&D grew by 44 per cent compared with the same period the year before.

Phytopharm takes advantage of the corporation tax cash refund amounting to 24 per cent of qualifying R&D expenditures made available by the Finance Act 2000 to non-profit-making small and medium sized companies. This generated £224,000 of cash in the first half of 2002.

In fact Phytopharm's cash position is strong, with balances of over £12m as at February 2002, partly thanks to an £11m equity issue which had taken place in November 2000. As a *Financial Times* report of 10th May, 2002, commented, the company 'has enough cash to last two years even if Pfizer pulls out.'

May 2002

SkyePharma plc: Results for 2001

SkyPharma specialises in the development of a broad range of drug delivery technologies, both for its own products and for the world's major pharmaceutical companies for which SkyePharma's expertise can be invaluable in extending patent protection.

The second half of 2001 was a watershed period for the company, in which it recorded a first time net profit. This amounted to £2.2m, although the overall result for the year was still a net loss of £9.4m. Sales for the year almost doubled to £46m, predominantly revenues from contract development including milestone payments.

While the group incurred a £5m loss at the operating level, it generated a positive £5.9m cash flow from operations. Much of the difference between these two results can be attributed to over £11m of deferred income, representing cash received during the year but not recognised as revenue in the 2001 Profit and Loss Account. It is generally recognised that we are now in a period when aggressive revenue recognition policies attract heightened criticism. It is in this atmosphere that both the

Professor David Citron
Faculty of Finance,
City University Business School,
Frobisher Centre,
Barbican Centre,
London EC2Y 8HB, UK

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

Chairman and the Finance Director refer to SkyePharma's conservative accounting, according to which contract revenues received are not recorded as income so long as there remains any chance of their being refundable.

It is interesting to observe a similar sign of the times, post-Enron, regarding the information provided on consultancy fees paid to the company's auditors PricewaterhouseCoopers. While the audit fee for 2001 came to £194,000, the auditors received almost four times as much again (£739,000) for other services. SkyePharma is at pains to point out that these comprise either services such as tax advice and due diligence reporting on acquisitions where the audit firm has special expertise and experience, or other assignments awarded on a competitive basis.

SkyePharma acquired RTP Pharma Inc. in stages over the year for a total of £39.4m, including £30m for goodwill. RTP specialises in making insoluble drugs soluble. Since SkyePharma owned only 40.2 per cent of RTP for about the last six months of 2001, the Profit and Loss Account includes a £578,000 operating loss in respect of RTP, being the appropriate percentage of RTP's operating loss for this half-year period. SkyePharma acquired complete control of RTP only on 27th December, 2001. As a result RTP's results will be fully consolidated for the first time only in the 2002 accounts. In this context it is worth noting that RTP incurred a retained loss of £4.8m in 2001.

Shareholders' funds totalled £95m at the end of 2001, although debt net of cash was relatively high at £47m. The key component of the company's debt is a £58m 6 per cent bond redeemable in June 2005 unless previously converted by the bondholders into ordinary shares. A cash boost was received in March 2002 when Paul Capital Royalty Acquisition Fund agreed to contribute US$30m over two years, principally to fund the development of new clinical pipeline products in return for a share of potential future revenues and royalties from various SkyePharma products.

The fact that alliances have their risks as well as benefits was illustrated by the company's partnership with Bioglan Pharma plc for the marketing of Solaraze, a cream for a pre-cancerous skin condition. A setback was caused when Bioglan entered administration early in 2002. On 13th May, 2002, however, SkyePharma announced the sale of the marketing rights to Shire Pharmaceuticals for what was regarded as a generous £15m plus royalties. This announcement helped a 3.5 per cent share price rise to 73p on the day.

SkyePharma's share price had peaked briefly at 190p in early 2000. Since then, however, it has traded in the 50p to 110p range, and stood at 79p towards the end of May 2002. The company was expecting a £6m pre-tax profit in 2002 (*Financial Times*, 10th April, 2002), which would represent an on-going improvement in the trend already witnessed in 2001, although this will probably benefit to some extent from the £11m of deferred income waiting to be credited to profits.

May 2002

Theratase plc: results for the year to 30 September 2001

Theratase was founded in 1971, changing its name from Enviromed early in 2000. The company manufactures and supplies specialist enzymes for use in medical diagnostics and in treatment. Theratase has roughly an 8 per cent share in the relatively small worldwide market for diagnostic enzymes which is estimated at US$120–150m. The far more significant market for therapeutic enzymes is estimated to reach US$3bn by 2005.

The company's name change in February 2000 was part of a wider capital restructuring exercise, which was approved by an extraordinary general meeting of the shareholders in order to ensure the company's financial viability. The crux of the problem was the

accumulation of preference dividends which were remaining unpaid due to the lack of distributable profits. At the time, the £15.6m accumulated deficit on the Profit and Loss Account made it difficult to envisage when any preference dividends, and hence any dividends on the ordinary shares, could be paid. This deficit was reduced at a stroke to £3.6m via a Court approved transfer from the company's otherwise non-distributable share premium account. At the same time the company and BIB Holdings (Bermuda) Limited, holder of 83.3 per cent of the preference shares, agreed to a schedule for payment of dividends in arrears and repayment of capital, to be spread over the period September 2002 to September 2005.

This situation is given expression on the group's September 2001 balance sheet. While this shows total shareholders' funds of £1.8m, this is analysed between an amount of £5.4m due to the preference shareholders and a corresponding deficit of £3.6m for the ordinary shareholders.

The repayment schedule shows that the first payment of £1.5m arrears of preference dividends is due by 30th September, 2002. Will the company be able to meet this payment? Theratase had a healthy net cash balance of £1.3m in September 2001, and generated £2.3m of operating cash flows in the year ended on that date.

While the liquidity position is reassuring, however, legally the company must also have sufficient distributable reserves in order to pay any dividends. These reserves were in deficit by £33,000 in September 2001. However, Theratase has a stable trading record. Sales in 2001 totalled £6.5m, an increase of 13 per cent, and post-tax profit was £1.7m, up 14 per cent. Clearly, no more than a repeat of this performance in 2002 should prove adequate to provide sufficient distributable reserves to meet the required payment of dividend arrears.

Theratase is looking to a strategy of acquisitions, collaborations and joint ventures to enter new business areas. It has a supply contract with a US partner ISTA Pharmaceuticals Inc. and in April 2002 was able to announce that ISTA was making some progress towards submitting a New Drug Application for the treatment of vitreous haemorrhage to the US Food and Drug Administration. And in October 2001 Theratase announced an agreement with the Dutch-based biotechnology start-up company PharmAAware Sepsis BV in which Theratase was to take a 15 per cent share and be the exclusive supplier of a key enzyme. The company was also looking for potential acquisitions in the UK.

The share price stood at 54p at the time of the February 2001 restructuring. Since then it peaked at 74p in early 2002 but was back down to 59½p by the end of May 2002. Acquisitions could be funded by equity if prospects look attractive enough, or by debt, an alternative that would also have to factor in the cash requirements of repayments to preference shareholders over the next three years.

May 2002