

THE UK SHAREHOLDERS' ASSOCIATION INVESTIGATES AIM COMPANIES' ANNUAL REPORTS

Abcam plc – Number 3 in Investors Chronicle 'AIM 100' April 2015 & 2016

Annual Report for year ended 30 June 2015

INTRODUCTION

The company was started in 1998 by Dr Jonathan Milner because of the difficulty in getting antibodies to assist in his research into breast cancer. Worldwide sales are £144m (2014, £128m) with a gross margin of 70%, profit before tax of £45.5m (£43.5m) and high cash conversion. There are now 800 employees, including over 140 PhDs and internally generated growth is supplemented by occasional strategic acquisitions.

There has recently been a major change in the composition of the Board. Dr Milner has stepped down from being Chief Executive (CEO) to become a non-exec, there is a new Chairman and the Chief Operating Officer is retiring. The new Chairman and CEO both have strong marketing backgrounds and Abcam is significantly increasing marketing expenditure on its core antibody products. The immediate effect of this has been an increase in overheads, principally in R&D and marketing, leading to a fall in the margin before tax from 33% in the first half of fiscal 2015 to 31% in the second half; there has been a further fall to 26½% in the first half of the current year, but in his half year statement the Chairman says, "We are on track to deliver our stretching (sic) targets for FY 2016."

THE BUSINESS

What does Abcam do? This non-chemist found it impossible to say without outside references and that is wrong. At the very least there should be a glossary of all technical terms. The core business is the provision of reagents and is "... focused on providing research scientists with the tools to advance a global understanding of biology, causes of disease, and new approaches to defining and enhancing good health." One is left to assume that Abcam's core antibody products are in the reagent family and then turn to Wikipedia to learn that antibodies 'combine chemically with substances which the body recognises as alien' and that reagents are 'substances ...for use in chemical analysis'.

The company sells worldwide with the largest market being the US at 43% (Note 5 to the accounts). The company's currently addressable market for research antibodies is estimated to be \$2.4bn out of an estimated total, including therapeutics and diagnostics, of \$92bn.

One factor which is made clear is that, for a science based company, there is a strong emphasis on marketing backed by thorough market analysis and strategic planning, although this is unfortunately accompanied by many resounding but meaningless statements such as, "Our 'One Team' behaviours are: Focused on Success; Bold; Consumer Centric."

PRESENTATION

This annual report has 112 pages divided into three sections - the Strategic Report (26pp), Corporate Governance (41pp) and Financials (45pp). It is well produced with effective use of diagrams, and a praiseworthy level of disclosure. Having said that, it is far too long, is too detailed and is full of convoluted market-speak which often verges on the opaque; company reports to investors should not be distorted to make them marketing tools. In our view, the report would gain by being written in plain English and some of the information transferred to the website.

Because the Report is quite complex, an attempt is made to hold everything together by cross-referencing from one page to another, which is feasible with hard copy but less effective when reading online without a hyperlink. There is constant pressure on investors to read company reports online, but almost no thought is given – Abcam being an example – to the particular needs of those who try to do so. The clarity of presentation that is frequently lost by the use of coloured backgrounds for text can be even worse when reading on screen, adds to the cost of printing and, as with Abcam, often produces pages which need a magnifying glass to read. Reports should be readily legible, not pretty. White lettering on a light background may please a designer, but there is nothing so good as black on white for the reader.

STRATEGIC REPORT

The Strategic section opens with a brief summary of the year with highlights, including achievement against the company's five strategic priorities. This is followed by the report from the recently appointed Chairman who has a strong marketing background, which is evident from his opening summary, "We have made progress in high-value targeting, identifying and focusing on products and subsectors which offer both higher-value and higher-volume sales opportunities."

There are then six informative and well illustrated pages covering the Abcam history, business model and markets, with the Chief Executive Officer's report (7pp), which gives a clear operational review plus a very detailed analysis of the company's Strategic Priorities and an Operational Review including proposed future actions. Then we have 6 pages covering in full, Key Performance Indicators, Risks and Responsibilities.

CORPORATE GOVERNANCE

The Corporate Governance report is clear and concise but still manages to ask and answer just about every question possible, instead of concentrating on what is important. The real consumer of space is the Remuneration Report for which 23 pages has been required. It can be no accident that the longer a remuneration report is the less likely it is to be read, which is one reason why boardroom pay reaches the heights it does. Abcam should simplify its arrangements.

FINANCES

The shortest and clearest section of the report is from the Chief Financial Officer (CFO), with no cross references and three simple pages to state the facts. Cash conversion is high, with a year end cash balance of £58.7m (£56.9) after £17.6m of acquisition costs, £7.5m capex against depreciation of £2.9m, and a planned £7.5m increase in working capital, mainly in inventories (+£4.1m) to back up marketing efforts. In fact, sales did not increase in the following six months, so this inventory build was unnecessary, which surely merits a comment next time round. Goodwill (£87m) and intangibles (£45m), arising almost entirely from acquisitions, come to 62% of total equity of £214m. R & D is all expensed and intangibles include Patents/Technology/Trade Names at £35m which is amortised over 5-15 years and Software at £6m amortised over 1-5 years (including £1.0m of in-house work capitalised in the year).

It is interesting to check back on the web to fiscal 2010/11 when sales were £83m, with gross profit of 67.3% (2015, 70.5%) and profit before tax 38.5% (now 32%). While the increase in GP is creditable, the reduction in PBT% does need an explanation; it has come mainly from increased admin charges and while this may reflect increased sales and marketing expenditure some explanation is surely required. While R & D has increased from 4% to 5.5% of sales, this is a surprisingly low figure considering the company's past success and wide product range (137,000+).

DIRECTORS, EMPLOYEES & SHAREHOLDERS

At the balance sheet date there were three (male) executive directors and six (2f, 4m) non-executive – including Dr Milner who has moved to become Deputy Chairman. Day to day management is in the hands of the Executive Directors plus nine members (5f, 4m) of the Senior Leadership Team (SLT).

Only three directors were with the company before 2010, Dr Milner, Jeff Iliffe (CFO, 2007) and Jim Warwick (Technical Director, 2000, later Chief Operating Officer). The Chairman, Murray Hennessy, joined the board in 2011 and became chair in 2014; Alan Hirzel joined the company in 2013 as Chief Marketing Officer and became CEO in 2014.

Mr Warwick has recently announced his retirement and will be replaced by at least two appointments to the SLT, which raises the question as to whether management is becoming top heavy, but there is no attempt at justification.

The three executive directors had remuneration, including incentives, of £1.84m, with just under half being base salary. Options are at reasonable levels

Excluding directors, there were 779 employees earning £40.8k each, up from 731 and £34.4k in 2013/14.

Dr Milner owns 11.6% of the equity, followed by Mr Warwick (now retired) at 3%. There are five Institutions listed as holding more than 3%, with a total of 34%, and the largest being 10.5%.

CONCLUSION

It is not easy to see why such a commercially successful company should need to put so much effort into producing such an elaborate annual report, which then loses some of its impact by being too detailed and using business school language where simplicity and clarity would be more effective in communicating the facts.

HPB and the AIM Team April 2016

This report has been produced by the UK Shareholders' Association Policy Team to promote better reporting by AIM companies. It is not intended to provide any assessment of the suitability of the company as an investment.