THE UK SHAREHOLDERS' ASSOCIATION INVESTIGATES AIM COMPANIES' ANNUAL REPORTS

CLINIGEN PLC – Number 5 in the Investors Chronicle 'AIM 100', April 2016

Annual Report for year ended 30 June 2016

INTRODUCTION.

The company operates in the pharmaceutical distribution sector, its principal objective being to deliver "*the right medicine to the right patient at the right time*" and become the global preferred provider of unlicensed and short supply branded or generic medicines, all manufactured by the brand owners or other third parties. About 80% of the world's population have very little or no access to the drugs which they need.

Clinigen started with its present strategy in 2010, led by Peter George, its retiring Chief Executive, and joined AIM in September 2012. Internal growth and significant acquisitions using shares and cash have led to rapid progress and a 3-fold increase in the share price since flotation. There is a small dividend. There are five divisions and the recent additions of Idis and Link Healthcare have more than doubled revenue and increased the workforce from 120 in 2 locations to 500 in 11 places around the world. 85% of sales originate abroad.

THE REPORT

It took three attempts to get a hard copy of the report; not good investor relations!
There are 102 pages, including covers, with a separate Company balance sheet and notes, taking up 10 pages. We would normally regard 92 pages as being on the high side but in this case it works because there is so much going on which merits detailed description and analysis; for example, each division gets 2 pages in the Operational Review. However, a better explanation of '*unlicensed medicines'* would be helpful for a newcomer. Little space is wasted on PR chatter or pictures but the art-work on the front cover (and inside) is puzzling if you don't know what the contents of a petri dish look like. The text is well laid out and is free from jargon or unexplained acronyms, although opinion was split on readability, particularly online where it is difficult to decipher the headings and highlighted passages, which use white lettering on a light green background (and vice versa). Added to this a small, grey typeface is used for the text; black is much clearer.

The reports by the Chairman, Chief Executive (CEO), the CEO designate and the Chief Financial Officer (CFO) are clearly written. What is lacking is any comment on future profit growth or examination in depth of how the revenue growth is going to be turned into enhanced profitability.

There are 3 financial Key Performance Indicators (KPIs), £ Gross Profit, £ Earnings Before Interest, Tax, Depreciation and Amortisation (EBITDA) and, lastly, Working Capital as a Percentage of Revenue. The first two are a measure of activity, not profitability which we would prefer to see getting more emphasis. The non-financial KPIs and all the Strategic Priorities are also aimed at medical, marketing and selling targets. There is no mention of competition. Although future strategy is discussed, the statements made by the Chairman, CEO and CFO do not give any useful comments on the profit outlook.

The reports on corporate governance, risk management and remuneration are standard and concise.
The detail provided by the accounts and notes is excellent.

DIVISIONS

For comparative purposes, the figures for the individual divisions below show annualised results for recent acquisitions. The impression given by the report is that the group is focusing on developing and under-developed markets. Whilst this may be where the future lies, the current revenues come from UK/Europe 56%, USA 29½% and ROW 14½%. The GP for the group is £102m (29½%) but this falls to £70m (23%) if Clinigen Speciality Pharma (CSP, GP 86%, see below) is excluded. CSP accounts for only 11% of Group sales but a back of the envelope calculation suggests that it produces around 60% of the underlying profits. The main areas of activity, turnover and gross profit for each of the five divisions are as follows:

- **Clinigen Technical Trial Services (CTS).** Supply of comparator medicines and services to clinical trials. 83% of revenue comes from 10 customers. Revenue £138m, GP £20m (14½%).
- **Idis Managed Access.** Access to early stage medicines for markets and diseases with high unmet needs, working on behalf of major pharmas/biotechs. Revenue £101m, GP 27m (26½%).
- **Idis Global Access.** Supply of 'on demand' unlicensed or short supply medicines to patients via physicians. Revenue £40m, GP £14m (35%).
- **Link Healthcare**. Commercial access to licensed and unlicensed products in Africa, Australia and Asia. Revenue £29m, GP £10m (34½%).
- **Clinigen Speciality Pharma (CSP).** Speciality pharma, with rights for mature, niche hospital and critical care products. 61% of revenues come from Foscavir, an anti-viral used primarily in bone marrow transplants; acquired from Astra Zeneca in 2010 and revamped. Revenue £37m, GP £32m (86%).

ACCOUNTS

As with so many companies, the balance sheet comprises a wealth of intangibles - £334m compared with Shareholders' Equity of £237m; three years ago, on 30/06/2013, these figures were £39m and £51m respectively. Over this period the company has made acquisitions at an estimated cost of just over £300m, £154m being paid for in shares and the remainder from borrowings (£68m) and cash flow. As the company is essentially a trading business, it has no manufacturing facility. All property is leased and capital expenditure, therefore, is negligible. Cash conversion is excellent because inventories plus receivables are neatly balanced by payables.
Understanding the income statement is less straightforward because, for example, the 2015/16 underlying net pre-tax profit of £35.7m is subject to adjustments of £22.2m (including £15m amortization of intangibles) to give a declared figure of £13.5m (2015, £21m-15 = 6). Most of these adjustments are acquisition related and some contain a subjective element. An outside observer, having looked at the detail, might choose, say, £32m as an underlying profit level. This gives a 13½% return on equity compared with 39% (£20m on £51m and revenue £123m) in 2012/13. If we were to assume that the base business is only ticking over, then £300m spent on acquisitions has added £222m of sales and no more than £16m annualised underlying profit. This may be acceptable provided that it is part of a coherent long term strategy. However, the management now needs to put the emphasis on profitability and margin enhancement rather than volume. The highlighted GP numbers may show a 90% increase, which came mainly from acquisitions, but the pro forma increase is only 7% which is not so exciting.

DIRECTORS, EMPLOYEES & SHAREHOLDERS

There are 8 directors, all male; 2 are executive, now that Mr George, the previous CEO, has become non-exec. The previous CFO is also a non-exec. Mr George had remuneration of £6.1m, including £5.66m from a Long Term Incentive Plan (LTIP) and his successor received £3.3m (incl. £2.8 LTIP). The Chairman and FCO had no LTIP and received £0.55m and £0.4m respectively.
Mr George owns 5% of the equity and the other directors 2½%.

The average number of employees, excluding directors, was 462 and earnings per employee were £55.6K. There is a defined contribution pension scheme. Full marks for clearly separating the directors from the other employees, a detail which we have not seen yet in any of the other reviewed companies.

There is no mention of major shareholders which we regard as being a significant omission.

SUMMARY

The Chairman says *"…we are committed…to ensure* (sic) *that the Group is managed in accordance with the principles set out in the UK Corporate Governance Code"* and, in general, the Report bears him out although the lack of any female representation on the board is regrettable.. There is perhaps scope for moving part of the descriptive sections to the web site (which itself is worth a visit) but the detail provided by the accounts and notes is difficult to fault. Looked at from an investor's standpoint, one would like to hear how the rapid increase in revenues

can be turned into increased profitability by increasing Gross Margins – which essentially means changing product mix, putting pressure on suppliers, increasing prices, or a mixture of all of these.

RT/HPB
16/12/2016