THE UK SHAREHOLDERS' ASSOCIATION INVESTIGATES AIM COMPANIES' ANNUAL REPORTS

GW Pharmaceuticals plc (GWP) – Number 2 in Investors Chronicle 'AIM 100' April 2015

Annual Report & Accounts for year ended 30 September 2015

NB. GWP is no longer quoted on AIM. It was delisted on 5th Dec 2016. It is now quoted as GWPH on NASDAQ in the form of ADRs, where one ADR is a package of 12 ordinary shares. According to GWPH, the ADRs are eligible for BPR/IHT relief since NASDAQ is not a 'recognised exchange' under the HMRC rules and the ADR is merely a wrapper for the ordinary shares.

INTRODUCTION

This is a pharmaceutical company having minimal product sales, a large R & D/Marketing programme, a depleting cash pile, no mention of making a profit but plenty of meaningless prose.

GWP produces cannabinoid extracts from the Cannabis Sativa plant, which are seen to have potential applications for treatments in a wide range of illnesses. The result is a complex annual report, written by people who are immersed in their own world and would have benefited from the advice 'A picture is worth a thousand words'.

I phoned the company secretarial department to ask for a hard copy of the report in my capacity as both an investor in the company and as an UKSA representative. After being asked why I didn't print it out myself, followed by a lot of huffing and puffing, I was promised one but it never arrived, which fits in with my impression that the company is starting to regard shareholders as a nuisance and also conflicts with its stated strategy of 'responding promptly' to requests.

Reading the report suggests that it may have been more influenced by PR consultants than its proper function, namely to give clear information to shareholders. For a clearer picture of GWP, it would be much better to go to the web site and then start at the Consolidated Income Statement (p47) of the report there, but that is not how it should be.

HISTORY

GWP was started by the Chairman, Dr Geoffrey Guy, in 1998 and the Chief Executive (CEO), Justin Gover, joined him in 1999. The company floated on AIM in 2001 at a price of 220p; it did not return to this level until the beginning of 2014, after it had also floated on NASDAQ. The market cap now stands at £1.2bn, having peaked at £2bn in 2015.

The report states that R & D spending since inception (funded by equity, milestone payments and external research backing) has been over $1bn. So far, one product has emerged onto the market, Sativex, an oral spray for the treatment of multiple sclerosis related spasticity. This is registered in 28 countries and sales over the last 2 years have been flat at £4m pa.

The current calendar year is expected to show regulatory progress in the treatment of childhood epilepsy (Epidiolex), cancer pain (also Sativex) and type 2 diabetes, with several other applications following.

Because of the legal objections to cannabis in its street form which GWP has had to overcome, the company currently has a unique position, considerable know-how and useful patent protection, but none of this is readily apparent because the information is buried under a lot of verbiage.

REPORT PRESENTATION

The report is 84 pages long which isn't too bad, but the good news stops there.

- The cover bears the coloured imprints from five childish hands, which presumably is meant to signify the link with childhood epilepsy; it is more like obscurity combined with mawkishness.
- There is an over-simplified statement of the company's strategy on the cover and then we go straight into a brief but complex Highlights page without any further explanation of what the company actually does or is seeking to achieve.
- The index is tucked at the bottom of the Highlights page
- There is an extensive use of acronyms (usually, but not always, expanded on first appearance); there are 11 in the Highlights section alone.
- The use of a grey type face may be artistic but doesn't lead to easy reading on a screen and is almost invisible when printed at home as the company would like its readers to do.
- From the pre-clinical to the released product stage, GW is tackling at least 10 speciality areas, several with 2 or 3 sub-groups, which leads to complexity in the text. A simple bar chart with time as the horizontal axis, listing each product from pre-clinical evaluation to projected market release, would have made the reader's job a lot easier. The suspicion arises that simplicity has been avoided because timescales depend so much on the Federal Drug Administration's processes.

STATEMENTS

The Chairman opens his statement with the resounding words *"GW has accelerated its focus..."* (which must surely be a leading contender for this year's gobbledegook prize) and continues in this breathless vein with words and phrases such as *"product candidate"*, *"pivotal"*, *"exciting, truly important"* and *"our* *whole organisation is stirred by the compelling and emotional stories that regularly emerge from…our.. programme*." Later we are told, *"In 2016, our key objective is* [surely "objectives are"?] *to complete successfully the Epidiolex Phase 3 clinical programme, submit the NDA to the FDA and continue the build-out of a world class US commercial organisation in anticipation of a future launch."* All this flim-flam is a pity, because the framework of the statement is actually quite reasonable.

The CEO also jumps into the 'accelerated focus' trap and then goes on to give an exhaustive progress report on every product, actual and potential. This could have been made shorter and easier to understand by introducing diagrams and possibly by concentrating on the practicalities and putting the technicalities into a separate section.

The Chief Financial Officer's comments are clear but unfortunately he omits any discussion of a note that appears on page 22 of the Corporate Governance Report which states that GWP has identified *"…a material weakness ….relating to the accounting for completeness and valuation of clinical trial accruals"*; a similar "material weakness" was reported the previous year. This later problem has been picked up by commentators and has also put the US litigators on GWP's trail.

STRATEGY & RISKS

In general, reporting of these aspects is satisfactory in regard to development of products but there is no plan for creating a revenue stream and the word 'profit' is never mentioned. The nearest we get is *"The Group operates a business model that allows us to create value by developing a broad pipeline of potential future products."* From this we could conclude that either the products or the company are being fattened up for sale.

The market strategy varies with the product. For Sativex, GWP has sold territorial marketing rights to several major groups; for cancer pain, a Japanese company has largely funded R & D; for niche products the company will fund all development and retain the marketing rights.

Flotation on NASDAQ has enabled GWP to issue shares and build a cash pile of £235m at 30.09.15, after cash outflow for the year of £64.4m (£46.5 from operations and £17.9 from capex). The CFO forecasts (p10) cash outflow from operations in the range £32/37m in the first half of fiscal 2016 and says that the outflow for the second half will *"be highly dependent on the timing of key decisions to be taken re the scaling up of our commercial team,"* so we must assume a figure in excess of £37m. This suggests that, assuming success of the current trials, cash outflow from operations for the year is likely to be at least £75m plus forecast capex of £13/15m to give a total outflow approaching £100m and significantly reducing the available cash. The risk report says *"We have significant and increasing liquidity needs and may require additional funding,"* but nowhere is there any mention of how this problem is to be addressed.

DIRECTORS & DIRECTORS' REMUNERATION REPORT

There are 9 directors, all male, 6 executive and 3 non-executive. With the exception of the CFO, they have all spent most of their working lives in the pharmaceutical/biotech fields. The age range is 44 to 63 with an average of 54. It is difficult to see how three non-execs can exercise proper control over the founder, the CEO and their four executive appointees..

The Directors' Remuneration Report takes up 20 pages. Total board remuneration, including incentives, was £4.9m, with the Chairman and MD each accounting for £1.3m. In addition, the exercise of options, principally it appears by the CEO, has given them £5.6m. The Chairman holds 5.5% of the equity, the CEO under 1%, directors' options are about 2% and the largest institutional holder has 14%.

Excluding directors and their remuneration (the way figures are presented makes it difficult to be precise about this), there were 322 employees averaging £56k pa each.

TOTAL SHAREHOLDER RETURN

In a section of the remuneration report not subject to audit there are two graphs on page 32 which are intended to show a performance which justifies the directors' take home pay. These are not particularly easy to interpret. First to the share price facts:

June 01	AIM Flotation	182p
30.09.08	07/08 year end	36p
30.04.13	Before NASDAQ Flotation	62p
15.07.15	All time high	686p
30.09.15	14/15 year end	495p
16.12.15	Report goes to print(est.)	387p
24.2.16	Latest seen	265p

Now, any reasonable person would surely look at the long term return from AIM flotation to, say December 2015, as a measure of the directors' success – 113% gain in 14 ½ years, or just short of 6% pa compound, all achieved from an appreciating share price. The directors choose to view things differently, as the use of the graphs demonstrates.

The second graph covers the longer period, but it takes 30.09.08 as its base point (ie 36p) and therefore starts from a point 80% below the flotation price (absent from the graph). At the all time high this shows a 1800% return and still shows a 1275% gain at the cut-off point of 30.09.15 but the price has continued falling.

The first graph starts at 30.04.13 and shows the same picture as graph two, starting from a point 66% below the flotation price and then closely following the movement of the Nasdaq Biotech Index, which has since fallen further.

It is difficult to escape the conclusion that GWP directors have been overpaid for the shareholder return achieved to date.

HPB February 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.