

Abzena

FY18 results

FY18 results – clouds lifting

Following a stronger H2 and Abzena's FY18 results, we have made major changes to our model across both the services business and the Abzena *Inside* royalty portfolio. The FY18 reported revenues of £22.0m were ahead of our forecast and up c 18% over FY17. This was driven by 60% growth in bio-manufacturing where fortunately, most of the investment in capacity was directed in FY18. Last week's announcement of a proposed royalty monetisation will help to address the FY19 working capital requirement.

Year end	Revenue (£m)	PBT* (£m)	EPS* (p)	DPS (p)	P/E (x)	Yield (%)
03/17	18.7	(8.3)	(5.82)	0.0	N/A	N/A
03/18	22.0	(13.5)	(6.04)	0.0	N/A	N/A
03/19e	26.1	(10.0)	(4.52)	0.0	N/A	N/A
03/20e	34.1	(5.6)	(2.38)	0.0	N/A	N/A

Note: *PBT and EPS are normalised, excluding amortisation of acquired intangibles, exceptional items and share-based payments.

Positive FY18 announcement

After last year's trading update, the tone of Abzena's FY18 results announcement was much more upbeat. A stronger H2 resulted in FY18 revenues growing by about 18% to £22.0m (FY17, £18.7) and beat our £21.6m estimate. The investment programme increased the FY adjusted EBITDA loss to £12.0m (FY17 £7.5m, and our FY18 estimate of £10.8m). Encouragingly for the future, the value of the contracts secured in the second-half of FY18 was £15.4m; a 42% jump over the more sedate £10.8m in H118. The year-end cash position of £6.8m reflected the continued investment programme, which drove the FY loss to £14.2m.

Fundraisings will resolve working capital requirement

Last week's announcement of a proposed royalty monetisation transaction will help relieve the funding gap before break-even and should assist investors in valuing the Abzena *Inside* portfolio. We anticipate new cash inflows of £7.0m over two years (£5.0 before YE19 and £2.0m before YE20) are required to tide over the services business to break even in FY21.

Valuation: Cumulative changes post FY18 results

We have made significant changes to our model, which now forecasts FY19 revenues at £26.1m from £34.1m, and aligning with the slightly higher than 18% revenue growth discussed in the FY18 results. This is more than offset by the annual £2m operating cost savings over the next five years after which, operational costs are rebased. We have also taken into account the changes to the earlier-stage Abzena *Inside* portfolio and prudently reduced to zero the value of any preclinical products. The cost-saving programme and reduced capex adds c £50m to our valuation, while the Abzena *Inside* portfolio value declines by £25.8m. After the FY18 results, our valuation remains virtually unchanged at £89.9m or 42.1p per share from £90.0m or 42.1p per share but will need to be updated after any new cash inflow.

Healthcare equipment & services

19 June 2018

Price **10.40p**
Market cap **£22m**

US\$1.35/£

Net cash (£m) at 31 March 2018 6.8

Shares in issue 214.2m

Free float 39%

Code ABZA

Primary exchange AIM

Secondary exchange N/A

Share price performance



%	1m	3m	12m
Abs	(46.7)	(58.8)	(74.9)
Rel (local)	(45.8)	(61.3)	(75.7)

52-week high/low 52.2p 10.4p

Business description

Abzena is a UK group that offers a range of services and technologies for biopharmaceutical development including immunogenicity tests, protein engineering, bioconjugation, polymer/synthetic chemistry, biomanufacturing and ADC chemistry.

Next events

Interim 2019 results Q418

 Phase III results and further licences from Abzena *Inside* products 2018

Analysts

Andy Smith +44 (0)20 3077 5700

Alice Nettleton +44 (0)20 3077 5700

healthcare@edisongroup.com
[Edison profile page](#)

**Abzena is a research client of
Edison Investment Research
Limited**

Financials: Upbeat FY18 results

After last summer's trading update, the pre-close statement and the FY18 results announcement conveyed a welcome upbeat message that the clouds are lifting from Abzena's services business. After a stronger second half of the year, Abzena reported FY18 revenues of £22.0m, higher than our estimates and up 18% over FY17. The stars of the second half were bio-manufacturing and chemistry with c 60% and c 15% revenue growth, respectively. Immunology revenues dragged down the biology research services business, but this had been previously announced. The 14% decline in FY17 immunology revenues was due to increased competition but is hoped to be reversed in FY19. In the first bullet point of its FY18 results announcement, Abzena noted that its ambitious targets at the start of FY18 were missed and we interpret this as a sign of maturity for the company. Abzena has now moved beyond this stage and the board anticipates slightly higher revenue growth in FY19 compared to FY18. Our model now forecasts 19.1% revenue growth, or £26.1m for FY19 and 30.4% service revenue growth, or £34.1m for FY20 as increased capacity feeds through to sales in manufacturing and chemistry.

Abzena has completed a period of intense investment in the service business and in its facilities, particularly at the Babraham Research Campus in Cambridge, but also in equipment, services and real-estate costs. As a result, the adjusted EBITDA loss increased to £12.0m (FY17 £7.5m; our estimate £10.8m) but there are a number of important points of note here. The board announced that Abzena's current capacity can now generate annual revenues in excess of £60m per year and the company has disclosed that it expects to generate positive EBITDA on annual revenues above £38m. Therefore, there is significant revenue and profit capacity within the group. Further significant capital expenditures in FY19 are not expected (we forecast £2.1m in FY19 and then maintenance capital expenditures at c £0.3m until 2021, after which they increase by 1% annually) and we estimate a £10.1m operating loss in FY19. The c \$10m additional expansion of the Lusk Boulevard manufacturing facility will now follow the confirmation of customer demand, a contribution from the landlord and additional funding. Aside from the working capital requirement between FY19 and FY20 (see below), which will be partially addressed by last week's announcement of a proposed royalty monetisation transaction (although no details have currently been released), the only limiting step in Abzena's continued revenue growth would then be the execution by its business development group.

For a business that grew its total revenues by 18% in FY18 and 30% H118 to H218, Abzena's increased manufacturing capacity investment is logical because this is the fastest growing part of the business. As this capacity is sold, it will be the driver for revenue growth. We interpret the now-completed manufacturing investment as not just increasing sales via capacity, but also increasing efficiency and therefore margins. The newly commissioned 500L stirred-tank bioreactor completed its first production batch, and we will be interested to incorporate the implied margin improvements of this new capacity because stirred-tanks take fewer people to run and have faster batch turnaround times than Wave production. Two significant contracts for ADC conjugation manufacturing have been signed and will be delivered from the Bristol facility in FY19. We have not yet incorporated either these margin improvements or all of the capacity increases in our model but will revisit after the detail of the H119 interim results.

Addressing the working capital requirement

At the FY18 results, Abzena's board were exploring a number of options to address a working capital requirement in FY19. This will be partially resolved by last week's announcement of a proposed royalty monetisation transaction. While the FY18 results announcement mentioned the

raising of either debt or equity, we had viewed the most likely transaction to be the monetisation of a portion of the royalties and milestones from the Abzena *Inside* portfolio of product rights. There are many, mostly private equity, funds whose business is to acquire portions late-stage life science products and with two Phase III products in the Abzena *Inside* portfolio, this route has the significant advantages of avoiding further shareholder dilution or the issuance of expensive debt. The latter would be likely to be secured on Abzena's assets. Last week's announcement is expected to smooth Abzena's path to break even and a further modest debt or equity transaction is still expected, although this second tranche could be later in FY20. We currently forecast a total cash inflow of £7.0m between FY19 and FY20, which is currently simulated by long-term debt in our model. At the very least, the royalty monetisation transaction should help investors better value the Abzena *Inside* portfolio and validate the attractiveness of the two late-stage rights.

With the capital expenditure programme now largely complete, a cost-efficiency programme is also underway led by the recently appointed interim COO, Brian Johnson, who has no heritage with Abzena so is better placed to objectively reduce its operating expenses by c £2m per year. We have included these cost savings in our model and phased them in to reach £2m a year by the end of FY19. In our model this programme is extended until FY24. This lower rebased operational cost base has magnified effects on our valuation because the lower spend is risk-adjusted from FY20, the cost savings appear early in the NPV valuation and when R&D and SG&A start growing again from FY25, they do so from a much lower level than in our previous model.

More yin than yang in the product royalty portfolio

The move of Bioverativ's (now Sanofi's) sutimlimab (formally BIVV009) into Phase III means that Abzena now has royalty rights to two Phase III products. The discontinuation of Vascular Pharmaceuticals' VPI-2690B in Phase II and the removal of the Halozyme's ADC products have reduced our valuation of the product royalty portfolio by £1.1m and £3.4m, respectively. Until they enter clinical development, we have also reduced to zero the rNPV of the royalties and milestones from any preclinical assets in the Abzena *Inside* portfolio. In addition, we have reduced the royalty rate to reflect an average of 0.625% across the portfolio.

There have not been any other material changes in the two most advanced products in the Abzena *Inside* portfolio. Gilead Sciences' andecaliximab (MMP9 monoclonal antibody antagonist) for gastric cancer and solid tumours remains in Phase III and Phase I, respectively. Bioverativ's sutimlimab (anti-C1s antibody for cold-agglutinin disease) started two Phase III studies in November 2017. Bioverativ was recently acquired by Sanofi for \$11.6bn. Should the board complete a monetisation transaction that would help validate the Abzena *Inside* portfolio, it is likely to involve one or both of these late-stage assets to a private equity fund.

Model update across services and royalties

We have incorporated changes in our model that include the revised revenue growth in the services business, the £2m annual cost savings in operational expenditure and the discontinuations and rebasing of preclinical assets in the Abzena *Inside* portfolio. The effect of the £2m annual cost savings over five years across SG&A and R&D is magnified in the valuation as these costs are risk-adjusted from FY20. These changes are summarised in Exhibit 1.

Exhibit 1: Abzena model valuation changes

	December 2017 rNPV (£m)	December 2017 rNPV per share (p)	June 2018 rNPV (£m)	June 2018 rNPV per share (p)	June 2018 % rNPV
Services business	18.2	8.5	52.0	24.3	57.8
Abzena <i>Inside</i> portfolio	56.9	26.6	31.1	14.6	34.6
Sub-total	83.2	35.1	83.1	38.9	92.4
Cash	14.9	7.0	6.8	3.2	7.6
Total valuation	90.0	42.1	89.9	42.1	100

Source: Edison Investment Research, Abzena announcement

We have introduced our FY20 revenue forecasts in the biology, bio-manufacturing and chemistry businesses of £6.0m, £16.9 and £10.7m, respectively.

We had also incorporated the end-FY18 cash position of £6.8m at the FY results, but last week's announcement implied cash inflows in FY19 and FY20, which we anticipate will total £7.0m, and will address the working capital shortfall before Abzena reaches break-even.

Cumulatively, these changes across the service and royalty businesses keep our valuation virtually unchanged at £89.9m or 42.1p per share.

M&A comes to life science tools

A recent May 2018 report by Bourne Partners on the contract development and manufacturing organisation (CDMO) sector, or life science tools space, noted the drivers that are expected to result in increased consolidation of small- to mid-sized companies in the pharmaceutical services sector. These included large CDMOs such as Lonza, looking to acquire novel development and analytical capabilities to bolster their value chains, but also the involvement of private equity like the Carlyle Group as financial roll-up players in the CDMO space.

Exhibit 2: Financial summary

£000s	2016	2017	2018	2019e	2020e
Year end 31 March	IFRS	IFRS	IFRS	IFRS	IFRS
PROFIT & LOSS					
Revenue	9,854	18,654	21,950	26,135	34,089
of which: Biology	5,299	5,719	4,926	5,535	6,037
Manufacturing	2,096	5,316	8,483	10,100	16,868
Chemistry	2,174	6,961	8,024	10,000	10,684
Total Service revenues	9,569	17,996	21,433	25,635	33,589
Licenses/milestones/royalties	285	658	517	500	500
Cost of Sales	(5,319)	(10,547)	(12,315)	(13,715)	(17,970)
Gross Profit	4,535	8,107	9,635	12,420	16,119
R&D expenses	(4,216)	(3,849)	(3,568)	(3,175)	(2,834)
SG&A expenses	(9,047)	(14,611)	(21,193)	(20,329)	(19,845)
EBITDA	(6,817)	(7,430)	(12,516)	(7,601)	(3,110)
Operating Profit (before amort. and except.)	(7,618)	(8,607)	(13,683)	(10,105)	(5,632)
Intangible Amortisation	(588)	(723)	(726)	(579)	(528)
Depreciation	(801)	(1,177)	(1,167)	(2,504)	(2,522)
Exceptionals	(2,542)	0	0	0	0
Other	(155)	(412)	(533)	(400)	(400)
Operating Profit	(10,903)	(9,742)	(14,942)	(11,084)	(6,560)
Other	0	0	0	0	1
Net Interest	244	277	188	68	72
Profit Before Tax (norm)	(7,374)	(8,330)	(13,495)	(10,037)	(5,560)
Profit Before Tax (reported)	(10,659)	(9,465)	(14,754)	(11,016)	(6,488)
Tax	961	347	593	384	486
Profit After Tax (norm)	(6,413)	(7,983)	(12,902)	(9,653)	(5,074)
Profit After Tax (reported)	(9,698)	(9,118)	(14,161)	(10,632)	(6,002)
Average Number of Shares Outstanding (m)	109.4	137.2	213.6	213.6	213.6
EPS - normalised (p)	(5.86)	(5.82)	(6.04)	(4.52)	(2.38)
EPS - reported (p)	(8.86)	(6.65)	(6.63)	(4.98)	(2.81)
Dividend per share (p)	0.0	0.0	0.0	0.0	0.0
BALANCE SHEET					
Fixed Assets	27,347	33,494	34,649	33,666	30,916
Intangible Assets	23,177	25,882	23,135	22,556	22,029
Tangible Assets	4,170	7,612	11,514	11,110	8,888
Other	0	0	0	0	0
Current Assets	22,108	11,267	19,640	19,300	15,448
Stocks	1,379	1,876	1,939	1,939	1,939
Debtors	5,436	4,982	10,170	10,170	10,170
Cash	13,724	4,135	6,785	7,191	3,339
Other	1,569	274	746	0	0
Current Liabilities	(5,850)	(6,319)	(6,903)	(6,903)	(6,903)
Creditors	(5,488)	(6,032)	(6,557)	(6,557)	(6,557)
Short term borrowings	0	0	0	0	0
Short term leases	0	(169)	(213)	(213)	(213)
Other	(362)	(118)	(133)	(133)	(133)
Long Term Liabilities	(2,549)	(2,508)	(3,697)	(8,697)	(10,697)
Long term borrowings	0	0	0	(5,000)	(7,000)
Long term leases	0	(494)	(448)	(448)	(448)
Other long term liabilities	(2,549)	(2,014)	(3,249)	(3,249)	(3,249)
Net Assets	41,056	35,934	43,689	37,366	28,764
CASH FLOW					
Operating Cash Flow	(11,330)	(8,100)	(15,913)	(7,669)	(3,182)
Net Interest	244	277	188	68	72
Tax	371	1,665	39	39	486
Capex	(2,047)	(3,320)	(6,107)	(2,100)	(300)
Acquisitions/disposals	(9,357)	0	0	0	0
Equity financing	20,013	(89)	23,913	0	0
Dividends	0	0	0	0	0
Other	31	(22)	500	68	72
Net Cash Flow	(2,075)	(9,589)	2,620	(9,594)	(2,852)
Opening net debt/(cash)	(15,799)	(13,724)	(4,135)	(6,755)	(2,161)
HP finance leases initiated	0	0	0	0	0
Other	0	0	0	0	0
Closing net debt/(cash)	(13,724)	(4,135)	(6,755)	(2,161)	(1,309)

Source: Edison Investment Research, company reports

Edison is an investment research and advisory company, with offices in North America, Europe, the Middle East and AsiaPac. The heart of Edison is our world-renowned equity research platform and deep multi-sector expertise. At Edison Investment Research, our research is widely read by international investors, advisers and stakeholders. Edison Advisors leverages our core research platform to provide differentiated services including investor relations and strategic consulting. Edison is authorised and regulated by the [Financial Conduct Authority](#). Edison Investment Research (NZ) Limited (Edison NZ) is the New Zealand subsidiary of Edison. Edison NZ is registered on the New Zealand Financial Service Providers Register (FSP number 247505) and is registered to provide wholesale and/or generic financial adviser services only. Edison Investment Research Inc (Edison US) is the US subsidiary of Edison and is regulated by the Securities and Exchange Commission. Edison Investment Research Pty Limited (Edison Aus) [46085869] is the Australian subsidiary of Edison. Edison Germany is a branch entity of Edison Investment Research Limited [4794244]. www.edisongroup.com

DISCLAIMER

Copyright 2018 Edison Investment Research Limited. All rights reserved. This report has been commissioned by Abzena and prepared and issued by Edison for publication globally. All information used in the publication of this report has been compiled from publicly available sources that are believed to be reliable, however we do not guarantee the accuracy or completeness of this report. Opinions contained in this report represent those of the research department of Edison at the time of publication. The securities described in the Investment Research may not be eligible for sale in all jurisdictions or to certain categories of investors. This research is issued in Australia by Edison Investment Research Pty Ltd (Corporate Authorised Representative (1252501) of Myonlineadvisers Pty Ltd (AFSL: 427484)) and any access to it, is intended only for "wholesale clients" within the meaning of the Corporations Act 2001 of Australia. The Investment Research is distributed in the United States by Edison US to major US institutional investors only. Edison US is registered as an investment adviser with the Securities and Exchange Commission. Edison US relies upon the "publishers' exclusion" from the definition of investment adviser under Section 202(a)(11) of the Investment Advisers Act of 1940 and corresponding state securities laws. As such, Edison does not offer or provide personalised advice. We publish information about companies in which we believe our readers may be interested and this information reflects our sincere opinions. The information that we provide or that is derived from our website is not intended to be, and should not be construed in any manner whatsoever as, personalised advice. Also, our website and the information provided by us should not be construed by any subscriber or prospective subscriber as Edison's solicitation to effect, or attempt to effect, any transaction in a security. The research in this document is intended for New Zealand resident professional financial advisers or brokers (for use in their roles as financial advisers or brokers) and habitual investors who are "wholesale clients" for the purpose of the Financial Advisers Act 2008 (FAA) (as described in sections 5(c) (1)(a), (b) and (c) of the FAA). This is not a solicitation or inducement to buy, sell, subscribe, or underwrite any securities mentioned or in the topic of this document. This document is provided for information purposes only and should not be construed as an offer or solicitation for investment in any securities mentioned or in the topic of this document. A marketing communication under FCA Rules, this document has not been prepared in accordance with the legal requirements designed to promote the independence of investment research and is not subject to any prohibition on dealing ahead of the dissemination of investment research. Edison has a restrictive policy relating to personal dealing. Edison Group does not conduct any investment business and, accordingly, does not itself hold any positions in the securities mentioned in this report. However, the respective directors, officers, employees and contractors of Edison may have a position in any or related securities mentioned in this report. Edison or its affiliates may perform services or solicit business from any of the companies mentioned in this report. The value of securities mentioned in this report can fall as well as rise and are subject to large and sudden swings. In addition it may be difficult or not possible to buy, sell or obtain accurate information about the value of securities mentioned in this report. Past performance is not necessarily a guide to future performance. Forward-looking information or statements in this report contain information that is based on assumptions, forecasts of future results, estimates of amounts not yet determinable, and therefore involve known and unknown risks, uncertainties and other factors which may cause the actual results, performance or achievements of their subject matter to be materially different from current expectations. For the purpose of the FAA, the content of this report is of a general nature, is intended as a source of general information only and is not intended to constitute a recommendation or opinion in relation to acquiring or disposing (including refraining from acquiring or disposing) of securities. The distribution of this document is not a "personalised service" and, to the extent that it contains any financial advice, is intended only as a "class service" provided by Edison within the meaning of the FAA (ie without taking into account the particular financial situation or goals of any person). As such, it should not be relied upon in making an investment decision. To the maximum extent permitted by law, Edison, its affiliates and contractors, and their respective directors, officers and employees will not be liable for any loss or damage arising as a result of reliance being placed on any of the information contained in this report and do not guarantee the returns on investments in the products discussed in this publication. FTSE International Limited ("FTSE") © FTSE 2018. "FTSE®" is a trade mark of the London Stock Exchange Group companies and is used by FTSE International Limited under license. All rights in the FTSE indices and/or FTSE ratings vest in FTSE and/or its licensors. Neither FTSE nor its licensors accept any liability for any errors or omissions in the FTSE indices and/or FTSE ratings or underlying data. No further distribution of FTSE Data is permitted without FTSE's express written consent.