Chief Financial Officer's review

2018 saw the completion of the integration of Dharmacon and a new strategy focusing investment in high-growth opportunities.

Jayesh Pankhania, Chief Financial Officer

Jayesh joined Horizon in April 2018 as Interim CFO and was formally appointed as Group CFO on 29 January 2019. His initial focus was on delivering enhancements to corporate and financial governance and the development of the new strategy for the Group. This has focused investments on the highest growth segments of the market, concentrating on tools and assessing the capabilities and structure required to ensure sustainable growth. This included implementing a new commercial structure with dedicated business unit managers.

"During 2018, Horizon developed its strategy to focus on higher growth markets, enabling the delivery of strong growth in revenues, EBITDA and operating cash."

Revenue (£m)

£58.7m **+68%**

Gross margin (%)

67.3% **+620bps**

Loss before tax (£m)

£(40.7)m

EBITDA (£m)

£(32.5)m

Adjusted EBITDA (£m)

£0.7m **+3.7m**

Adjusted loss before tax (£m)

£(7.5)m **+37%**

Financial highlights

- Group revenue up 68%, driven by robust performance of research and applied product sales. Like for like business growth of 16%.
- Gross margin up 620bps to 67.3%.
- Adjusted loss before tax reduced by 37% to £7.5m.
- For the first time, we report a positive adjusted EBITDA of £0.7m.
- Review of In Vivo cash generating unit resulted in an impairment of £32.1m.

FY17 comparatives and growth numbers are presented or calculated after restatement for prior year adjustment, refer to Note 3 for details.

Group financial performance

During 2018, the Group delivered £58.7m of revenues (FY17: £35.0m), representing solid year-on-year growth of 68% (73% growth on a constant currency basis) highlighting the strong demand for Horizon's products and services. Like-for-like revenues (excluding Dharmacon) were £30.1m (FY17: £26.0m) representing a growth of 16% (£30.8m on a constant currency basis. Dharmacon continued its strong performance post-integration and delivered revenues of £28.6m (FY17: £9.0m), which would have been £29.7m on a constant currency basis.

Gross margins continued to improve to 67.3% (FY17: 61.1%) driven by a combination of the full-year effect of Dharmacon, increase in licence revenue, product optimisation and mix towards higher margin product revenues. Gross profit was £39.5m (FY17: £21.4m) an increase of 85% on the prior year.

The Group reports a loss after taxation of £35.8m (FY17: loss after tax of £11.0m) for the full year, which includes a £32.1m non-cash impairment charge in relation to the Group's In Vivo cash generating unit and a reduction in the associated deferred tax liability of £4.7m. The revenue growth coupled with a focus on cost management enabled the Group to report its first positive adjusted EBITDA of £0.7m (FY17: £3.0m loss).

Management consider the following as additional alternative performance measures to supplement statutory measures of performance as they provide additional insight. Constant currency is the measured current year revenues based on the prevailing foreign exchange rates from the prior year.

Adjusted EBITDA

	2018 £'000	2017 (Restated) £'000
Operating loss	(40,733)	(15,226)
Amortisation and depreciation	8,230	5,701
EBITDA	**(32,503)**	**(9,525)**
Exceptional items	33,185	3,708
Site closure	–	2,524
Unallocated credit	–	281
Adjusted EBITDA	**682**	**(3,012)**

Adjusted loss before tax

	2018 £'000	2017 £'000
Loss before tax	(40,654)	(15,666)
Exceptional items	33,185	3,708
Adjusted loss before tax	**(7,469)**	**(11,958)**

Like for like revenue

	2018 £'000	2017 £'000
Group revenue	58,733	34,954
Less Dharmacon	(28,655)	(9,040)
Like for like revenue	**30,078**	**25,914**

Chief Financial Officer's review continued

Revenue by operating segment

Research products

Research products delivered revenues of £31.3m (FY17: £12.6m), a growth of 148% (158% growth on a constant currency basis). Gross margins increased from 59% to 64% largely driven by the full year effect of Dharmacon. Dharmacon recorded revenues of £28.6m (FY17: £9.0m, £29.7m on a constant currency basis). The business is now fully integrated and is delivering single digit revenue growth driven by market share gains in RNAi in all territories and growth in CRISPR reagents, including CRISPR libraries used for CRISPR screening by AstraZeneca and other major pharmaceutical customers.

Applied products

Applied products reported a strong revenue growth at £15.0m (FY17: £8.7m), a growth of 72% (76% on a constant currency basis). Gross margin increased from 72.7% to 81% mainly due to a greater proportion of Bioproduction licences sold. Bioproduction, one of the areas identified as a high-growth opportunity in the strategic plan, delivered a robust performance in the second half of the year, including two commercial licences each in excess of £1m.

Revenues from Horizon's molecular diagnostic reference standards also grew during the year, and we continued to expand our offering with the launch of the largest cell-line derived reference, focused exclusively on myeloid cancer.

Services

Services revenues were £10.9 million (FY:17: £13.7m), a decline of 20% (18% decline on a constant currency basis). Gross margin increased slightly from 54% to 56% due to the mix of services provided. This area of the business was challenging due to difficulty in accessing markets which need specialist commercial teams or the price point of some services not aligning with customer demand.

We believe the demand for gene editing services remains strong. We are investing in automation to increase our capacity and bring down the cost of this service to expand the market opportunities available to us.

We continue to consolidate the lower growth areas of our existing screening capabilities as we refocus on our highest growth priorities, which include CRISPR screening.

Leveraged R&D

In line with our updated strategy, we have monetised certain leveraged R&D assets, delivering revenue of £1.6m (FY:17: £nil) at a gross margin of 82%. During the year we made a further investment of £1.4m into Avvinity our joint venture with Centauri Therapeutics.

Other operating income

Other operating income was £2.2m (FY17:£1.6m) and includes grant income, R&D tax credits and sublease income.

Sales, marketing and distribution costs

During 2018, Horizon continued to make substantial investments in building world-class commercial operations, resulting in sales, marketing and distribution expenses of £13.0m (FY17: £7.5m). This includes a full-year effect of the Dharmacon sales force in 2018 and the growth of the team. During the year, we commenced development of a new eCommerce platform which will be launched in 2019.

Research and development costs

Innovation remains central to sustainable value creation for the business. During 2018, we continued to invest in our innovation capability and our expenditure on research and development was £15.2m (FY17: £11.9m). The increase is driven by the full-year impact of Dharmacon in addition to increasing the number of scientists within the legacy Horizon business. It also includes expenditure on R&D, new product introduction, customer support, attendance at scientific conferences and training.

We are excited to have announced our agreement with Rutgers University with respect to the development and commercialisation of base editing, a gene editing approach which has the potential to provide significant benefits in cell therapy among other applications.

Corporate and administrative expenses

Corporate and administrative expenses of £20.7m (FY17: £14.7m) were incurred in the year. This reflects the full-year impact of the Dharmacon business and the Group expanded the corporate team to drive improved corporate and financial governance and strengthened the Group's resources in procurement, operations, finance and IT.

Exceptional items

Exceptional items, due to their size, nature or the expected infrequency of the events giving rise to them, are presented separately on the face of the income statement.

Impairment of In Vivo cash generating unit

As required by IAS 36 Impairment of Assets, goodwill, tangible and intangible assets in relation to the In Vivo cash generating unit are assessed for impairment annually. The assessment is supported by a discounted cash flow analysis and a key factor in supporting the carrying value is the expected growth rate in revenue. During 2018, it became apparent that the current commercial strategy has proved challenging to deliver and that the expected rate of growth in revenues would not meet expectations. Accordingly, the growth rate for the business has been reduced from a CAGR of 27.7% to a CAGR below 10%, which we believe is a more sustainable long-term growth rate for the business. This has led to an impairment of £32.1m in the financial statements. This impairment is non-cash in nature and does not affect business operations going forwards.

Other exceptional items

Other exceptional items include legal and advisory costs relating to the rejection of an unsolicited proposal and costs relating to the departure of former CEO Darrin Disley.

Prior year adjustment

In 2019, the Group became aware of potential revenue recognition matters in connection with certain license revenue contracts. As a result, the Group undertook a detailed review of all such contracts and determined that the terms and conditions in some of those contracts had been misinterpreted and as a consequence, the accounting periods in which the revenue is recognised have been reassessed, due to license revenues being recognised before they were committed. This has led to a prior year adjustment to the revenue recognised in 2017 of a reduction of £1.6m, and an associated reduction of £0.2m in expenses, and consequently the prior period numbers have been restated where applicable.

Balance sheet

Non-current business assets reduced by £29.4m to £112.5m (FY17: £141.9m) largely due to the impairment of the In Vivo cash generating unit and the amortisation and depreciation charge for the year, net of the impact of foreign exchange. Net current assets are slightly lower at £37.5m (FY17: £38.4m). This improvement is due to an enhanced EBITDA and better working capital movements. Non-current liabilities are lower at £6.6m (FY17: £10.5m), mainly due to reduced deferred tax liability.

Cashflow

The Group had cash resources at 31 December 2018 of £26.7m including £1.7m of cash received in error, which was returned in 2019. The group experienced a positive movement in cash flow versus the prior year due the improvement in the adjusted EBITDA performance coupled with a focus on working capital management.

Capital expenditure

During 2018, Horizon invested £0.9m (FY17: £1.7m and £39.8m recognised on acquisition of Dharmacon) in intangible assets and £2.7m (FY17: £2.3m and £2.2m recognised on acquisition of Dharmacon) in plant and equipment to enhance our intellectual property, automation and business infrastructure. In 2019, the Group is investing in programmes including automation and eCommerce which will enable Horizon to scale up operations and deliver further revenue growth.

Summary and financial outlook

2018 was a year that saw the completion of the integration of the Dharmacon business into the Horizon Group as well as a new strategy focussing investment on our high-growth opportunities. This, combined with an enhanced corporate and financial governance will provide a robust platform for continued, sustainable revenue growth. The additional investment in innovation, eCommerce and automation are key enablers of this growth.

J Pankhania

Jayesh Pankhania
Chief Financial Officer