Financial Review

James McCarthy
Chief Financial Officer

2021 highlights

- The business finished 2021 debt free with a cash balance in excess of £100 million.
- Successful integration of IT-IS business
- Underlying EBITDA margin 39%

Financial performance

Novacyt Group's underlying business performed well in a challenging and diverse COVID-19 market in 2021, generating revenue of £95.8 million, of which COVID-19 products accounted for 86% of revenue, compared with 95% of revenue in 2020. Revenue to private laboratories increased by 98% year-on-year to £55.9 million, compared with £28.3 million in 2020 including £10.5 million from NGOs.

Primerdesign delivered revenue of £89.9 million (2020: £272.8 million) and remains the main generator of revenue for the Group, of which £84.0 million (93%) related to COVID-19 revenue and £5.0 million non-COVID-19 revenue (7%). Following the launch of one of the world's first approved polymerase chain reaction (PCR) tests in Q1 2020, the business launched 15 new assays since the beginning of 2021 to support laboratories, clinicians, and private testing of COVID-19. In addition, the business launched VersaLab™ mobile processing laboratories and VersaLab™ Portable to expand near-patient testing opportunities in private sector testing.

Core distributor and reseller business across UK and international markets delivered £32.2 million revenue, with sales to over 80 countries. Despite price erosion and market competition, the distributor business retains a strong global footprint and has increased its contribution from 18% of total revenue in 2020 to 36% in 2021.

The private sector testing market delivered £55.9 million revenue in 2021, equating to 62% of total revenue, compared with £32.1 million revenue and 12% of total revenue in 2020. 2021 includes £10.5 million revenue from NGOs, such as UNICEF, and saw a large shift in market demand, principally in the travel and media sectors.

The Asia-Pacific region saw growth of 37%, taking revenue to £7.3 million for 2021 driven by strong distributor sales. The European region maintained strong revenue of £31.0 million in 2021, in line with the prior year. Strong revenue of q16/q32 instruments continued in 2021, helping to grow the installed base with over 300 instruments placed during the year.

UK revenues fell significantly in 2021 as a result of significantly lower revenue with DHSC/UK Health and Security Agency compared with 2020.

IT-IS International delivered revenue of £9.3 million in 2021 compared with £6.9 million of post-acquisition revenue in 2020. The £9.3 million included £6.5 million intercompany sales that are eliminated in the Group's consolidated accounts. The business placed over 500 instruments in its MyGo product range in over 35 countries.

Financial Review continued

Lab21 Products sales fell by £0.6 million in 2021 to £4.6 million, compared with sales of £5.2 million in 2020. The £4.6 million included £1.4 million intercompany sales that are eliminated in the Group's consolidated accounts. This intercompany revenue relates to services that Microgen Bioproducts® provided to Primerdesign in support of manufacturing COVID-19 kits, rather than outsourcing to a third party and thus diluting the gross profit. The Lab21 Products business continued to be impacted in 2021 by its core customers diverting testing from veterinary and food testing to COVID-19 testing.

The Group delivered an underlying gross profit of 68% or £65.4 million which is below the 2020 gross profit of 76%. This is due to two main factors: i) a higher stock provision based on obsolescence of COVID-19 products as variants drove product proliferation; and ii) margin dilution as result of increased instrument placements as the Group builds its installed base.

Due to the ongoing commercial dispute with the DHSC, £35.8 million of exceptional costs of sales have been incurred in 2021 that are one-off and non-recurring. The two largest items making up the £35.8 million are a £26.1 million stock provision, as a result of the Group buying stock to fulfil expected future DHSC orders that did not materialise, and the expensing of £6.9 million of stock delivered to the DHSC which has not been paid for as it is now part of the ongoing contract dispute. This reduces the overall Group gross profit to 31% or £29.7 million.

Group operating costs fell by £7.0 million year-on-year to £28.4 million in 2021, compared with £35.4 million in 2020. This is mainly due to the £19.0 million Long-Term Incentive Plan ("LTIP") expense in 2020 that was not repeated in 2021 offset by higher investment in R&D and sales and distribution resources. Headcount increased from 237 at the end of December 2020 to 283 at the end of December 2021.

The Group delivered an EBITDA before cost of sales exceptional items of £37.1 million (39%) in 2021 compared with £176.1 million in 2020, driven mainly by significantly reduced sales. After cost of sales exceptional items, the Group EBITDA was £1.3 million (1%).

The Group generated a recurring operating profit before cost of sales exceptional items of £35.1 million compared with £174.8 million in 2020, due to lower year-on-year revenue. Amortisation and depreciation increased to £2.0 million from £1.3 million in 2020. Depreciation charges increased to £1.3 million (2020: £0.6 million) as a result of increased capital expenditure, as we have in-sourced more manufacturing work and reduced our reliance on sub-contractors, whilst amortisation charges remained flat year-on-year at £0.7 million. The 2021 depreciation charge included £0.4 million IFRS 16 leasing costs, predominantly covering the rental charges for Novacyt premises. After cost of sales exceptional items, the Group moved to a recurring operating loss of £0.7 million.

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The Group delivered an operating profit before cost of sales exceptional items of £28.0 million including non-recurring charges of £7.1 million compared with £167.4 million in 2020. The 2021 non-recurring charges comprise a £5.8 million impairment charge in relation to the goodwill associated with the Lab21 Products and IT-IS International businesses, £0.8 million legal and professional costs in relation to the ongoing Department of Health and Social Care contract dispute and £0.5 million restructuring costs, predominantly covering redundancy payments. After cost of sales exceptional items, the Group moved to an operating loss of £7.8 million.

The Group generated a profit after tax before cost of sales exceptional items of £19.2 million compared with £132.4 million in 2020. After cost of sales exceptional items the Group moved to a loss after tax of £9.7 million, stated after charging other financial expenses of £2.0 million (2020: £0.9 million) and a tax credit of £0.1 million (2020: charge of £32.7 million). Other financial expenses in 2021 are primarily comprised of foreign exchanges losses which are mainly driven by revaluations of the 2017 to 2020 LTIP scheme and bank and intercompany accounts held in foreign currencies. The tax charge, that mainly represents corporation tax due in the UK, has significantly decreased, moving to a credit position as the Group has swung from a profit before tax position in 2020 to a loss before tax position in 2021. Gross borrowing costs fell to £nil in 2021 from £1.4 million as a result of settling all outstanding debt during 2020.

2021 reported a £0.14 loss per share versus a £1.94 profit per share in 2020.

Balance Sheet

Goodwill has fallen from £17.9 million in 2020 to £11.5 million in 2021. Following the 2021 impairment review, goodwill associated with the acquisition of IT-IS International Ltd has been impaired by £4.0 million. The key drivers for this are reduced COVID-19 demand and not receiving further DHSC orders, which reduces the future expected cash flow. In addition, the remaining goodwill associated with the Lab21 Products acquisition has been fully impaired resulting in a £1.8 million charge to the income statement. The remaining £0.6 million goodwill decrease is due to exchange revaluations on balances held in Euros.

A deferred tax asset of £3.1 million has been recorded in 2021 compared with £3.0 million in 2020. £2.1 million of the balance relates to the portion of the Long-Term Incentive Plan charge that was recognised in the accounts in 2020, but that will not be deducted for taxation until the remaining payments are made in 2022. £0.3 million arises from the elimination of internal profit on products and services purchased by Primerdesign from Microgen Bioproducts® and IT-IS International and still held in stock at the year end. The remaining £0.7 million relates to UK losses that can be carried forward to offset future tax liabilities.

Other non-current assets (excluding right-of-use assets) have increased to £8.5 million from £6.1 million in 2020. Other intangible assets have fallen by £0.6 million, but include £0.3 million additions predominantly relating to patent filling costs due to the launch of new products, offset by amortisation and foreign exchange revaluations totalling £0.9 million. Property, plant and equipment has increased by £3.0 million, and includes £3.8 million of capital expenditure offset by depreciation totalling £0.8 million.

Total inventories and work in progress has fallen significantly to £11.5 million at December 2021, predominantly due to the booking of a large stock provision. Inventory levels were built up as a result of the Group's direct response to support the UK Government's call for UK manufacturers to build manufacturing capacity and supply chain flexibility in response to the COVID-19 pandemic and was based on likely demand indicated by the DHSC. As future material contracts were not secured with the DHSC in 2021, a large stock provision was booked. The Group continues to explore opportunities to drive value from this inventory.

Trade and other receivables have fallen to £38.5 million from £79.6 million in 2020, mainly due to receiving £47.9 million from the DHSC in 2021 to clear a 2020 invoice. The closing 2021 trade receivable balance includes a £24.0 million DHSC invoice raised in December 2020, in respect of products delivered during 2020, that remains unpaid at the date of signing the accounts. Recovery of the invoice is dependent on the outcome of the contract dispute. Also included in trade and other receivables is a £8.2 million VAT receivable balance (2020: £0.3 million), that mainly relates to UK VAT paid on sales invoices in dispute with the DHSC. As the associated sales have not been recognised in accordance with IFRS 15, the revenue, trade receivable and VAT element of the transactions have been reversed, resulting in a VAT debtor balance. An expected credit loss provision of only £0.1 million (2020: £0.2 million) was booked at year-end demonstrating a robust credit control process.

A tax receivables balance of £5.0 million existed at the end of 2021 versus a £nil balance in 2020. The main item making up the tax receivable balance is a £4.2 million overpayment of 2020 UK corporation tax. The Group received a refund of the overpayment from HMRC in March 2022. The remaining balance predominantly relates to 2021 losses that can be offset against 2020 taxable profits.

Other current assets have fallen to £2.0 million from £3.7 million in 2020, driven by a £1.7 million reduction in prepayments. The key balances at 31 December 2021 include prepayments for the annual Group commercial insurance, rent, rates and prepaid support costs. The balance at 31 December 2020 included a large amount of prepaid stock that was delivered in 2021, which was not repeated in 2021.

Financial Review continued

All outstanding debt was fully repaid during 2020 using cash generated in the year and as at 31 December 2021 the Group remained debt free.

Contingent consideration fell from £1.8 million to £0.8 million in 2021 as a result of settling the first of two earnout milestones associated with the IT-IS International acquisition. The final tranche is expected to be paid in late 2022 upon the achievement of certain deliverables.

Short-term provisions remained flat year-on-year at £20.0 million (2020: £19.9 million). A product warranty provision for £19.8 million booked in 2020 to cover Management's view of the maximum cost of replacing products in relation to the ongoing commercial dispute with the DHSC remained unchanged in 2021.

Trade and other liabilities fell to £17.2 million from £36.8 million in 2020. Trade payables and accrued invoices have fallen by £8.3 million in line with reduced fourth quarter sales. The UK VAT liability has fallen by £16.7 million to £0.1 million in 2021 due to sales in November and December 2020 being substantially higher than sales in the corresponding months of 2021. These reductions have been offset by the increase in other liabilities, moving from £5.6 million to £11.2 million, as the balance now includes the two remaining tranches of the LTIP, which are forecast to be paid during 2022.

No corporation tax was due at the end of 2021 as the Group was in a loss-making position, compared with a £15.1 million liability in 2020.

Other long-term liabilities is £nil in 2021, the £5.6 million 2020 balance related to the third tranche of the LTIP payment that is due to be paid in November 2022 and has therefore been reclassified to short-term liabilities.

Cash held at the end of 2021 increased to £101.7 million from £91.8 million in 2020, driven by the strong underlying trading performance of the business when excluding cost of sales exceptional items. Net cash generated from operating activities was £15.7 million compared with £103.0 million in 2020 driven by the EBITDA profitability of the business after cost of sales exceptional items of £1.3 million combined with a working capital inflow of £14.4 million.

Net cash used in investing activities fell to £5.0 million from £8.0 million in 2020. Capital expenditure increased by £3.0 million to £4.1 million in 2021, as more manufacturing work has been brought in-house to reduce our reliance on sub-contractor manufacturing. This was offset by a £6.0 million reduction in acquisition-related cash outflows in 2021. During 2021, £1.0 million was paid to settle the first IT-IS International contingent milestone, whereas the net cash outflow for the IT-IS International acquisition in 2020 totalled £6.9 million; the remaining £0.1 million variance was as a result of receiving an earnout milestone payment in 2021 associated with the sale of Lab21 Ltd.

Net cash used in financing activities in 2021 totalled £0.6 million verses £5.0 million in 2020. The main financing cash outflow in 2021 related to lease payments and the associated interest payments. The year-on-year decrease is due to Novacyt clearing all outstanding debt in 2020. In addition, all warrants had been converted in 2020.

Post Balance Sheet Events

In March 2022, Novacyt received confirmation that the UK Intellectual Property Office had granted the key patent (ORF1a/b), with patent number GB2593010. This means that subject to a number of adjustments, the effective rate of tax on profits derived from the sale of products covered by this patent is close to 10% rather than the current UK corporation tax rate of 19% (due to increase to 25% in 2023) and will be claimed from the time the patent application was made in October 2020. This will be treated as a corporation tax credit against future profits rather than a refund for prior periods.

In April 2022, the Company concluded a review of its Lab21 Healthcare and Microgen Bioproducts® businesses. The review confirmed that the costs associated with updating the existing portfolios in these businesses to comply with IVDR and ISO regulations are prohibitive versus the sales opportunity it presents. Therefore, Novacyt is proposing to discontinue both businesses, which will be treated as discontinued under IFRS 5 for 2022 accounting. The estimated sales impact of this decision is circa £2.9 million in 2022, with a gross margin reduction of £1.45 million, which is expected to be fully offset by cost savings. A cash restructuring charge of circa £0.5 million is expected; however, this should be fully financed from in-year savings and the release of working capital to make the closure of the businesses cash neutral in 2022.

The Company remains in dispute with the DHSC in relation to a supply contract entered into in Q4 2020, which became a legal claim in April 2022. The Company is disappointed a satisfactory resolution has not yet been found and continues to believe it has strong grounds to assert its contractual rights in the claim. The Board is determined to carry on with the core business and to use the Company's balance sheet to invest in both continued organic growth and M&A opportunities to support its strategic aims.

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