EDISON

Imperial Innovations

FY14 results

A demonstrative year

Investment companies

Imperial Innovations reported a record year in 2014, in terms of portfolio value growth, up £69.4m to £252m, and profits (£27.4m). The main driver was Circassia's IPO, which realised a £33.2m fair value gain to Innovations' portfolio, demonstrating the potential value that can be unlocked from a maturing portfolio of companies. To date, Circassia has delivered an IRR of 32% and a 3x return on investment. Yet the top 10 private companies in the portfolio are modestly valued at just 1.3x cash invested, highlighting the potential for further value creation in 2015 and beyond.

Year end	Net portfolio value (£m)*	Cash** (£m)	Net fair value gain (£m)	Net asset value (£m)	NAV/share (p)	DPS (p)
07/13	182.6	65.6	10.8	230.5	231.3	0.0
07/14	252.0	176.5	40.5	404.8	295.1	0.0
07/15e	314.5	118.0	12.5	408.9	298.1	0.0
07/16e	389.5	48.5	15.0	415.1	302.7	0.0

Note: *Net value, excludes provisions. **Cash, cash equivalents and short-term investments.

Adding value to the portfolio

Innovations' net portfolio value increased in FY14 by £69.4m (+38%) to £252m as of 31 July 2014. This was attributed to a £40.5m net fair value gain (mainly Circassia IPO; vs £10.8m in FY13), £32.8m invested in 25 portfolio companies (£22.2m in 28 companies in FY13), less £3.9m after the sale of an undisclosed ICT company. Of note in 2014, four of IVO's companies went public such that the value of the quoted portfolio (Circassia, Abzena, Oxford Immunotec and Ixico) now accounts for 42% (£104.9m) of the total. However, 87% of investments in FY14 went into unlisted companies, maintaining IVO's core investment strategy.

Profit and cash boost

IVO's net asset value also increased significantly in FY14, up 76% to £404.8m, mainly as a result of the portfolio value gain (which resulted in a record net profit of £27.4m vs £3.8m in FY13), and £146.8m in net cash proceeds from the £150m equity issue in June. IVO now has £176.5m in cash and short-term investments to deploy into existing and new companies, with a further £15m EIB loan available.

A maturing portfolio

IVO's portfolio is maturing nicely with its lead companies seeking to raise >£100m in total over the next 12 months. IVO's greater cash resources should help provide the required funding to advance these companies to the next valuation inflection points (eg technology validation/partnerships/trade-sale/IPO). IVO has guided to a £60m annual investment target (phased over a few years), vs £30-35m historically.

Valuation: FY14 performance supports NAV premium

IVO's shares trade at c 50% premium to the NAV (295p per share at 31 July 2014), which we believe is justified by the portfolio performance in FY14, which unlocked a significant amount of previously 'hidden' value. While the FY14 result may not be repeated in FY15 (Circassia IPO may prove unusual), we see multiple opportunities for further value creation, given the modest carrying values of unlisted companies.

24 October 2014

Price	**452.5p**
Market cap	**£621m**

Net cash (£m) at 31 July 2014	161.6
Shares in issue	137.2m
Free float	11%
Code	IVO
Primary exchange	LSE
Secondary exchange	N/A

Share price performance

%	1m	3m	12m
Abs	(3.7)	(2.2)	5.2
Rel (local)	(0.1)	3.3	9.1
52-week high/low		471.00p	362.50p

Business description

Imperial Innovations is a technology transfer, incubation and venture investment company. It invests in ventures from Imperial College London, Cambridge and Oxford universities and UCL. >90% of its portfolio value is in 20 companies, with the majority (c 70%) of its investments in healthcare.

Next events

Cell Medica: Start Phase II with T-cell immunotherapy CMD-003 in lymphoma	Q414
PsiOxus: Start Phase II with enadenotucirev	Q414
Veryan: EU commercialisation strategy for BioMimics 3D stent	H115
Nexeon: Silicon anode production validation and scale-up	2015

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Edison profile page

Imperial Innovations is a research client of Edison Investment Research Limited

A breakthrough year

Fiscal 2014 was a year of significant progress for Imperial Innovations. A stand-out performance in value added to the portfolio, dominated by the £200m IPO of Circassia (the biggest ever biotech IPO in the UK), coupled with the £150m equity raise, puts Innovations in a strong position to meet the demands of a maturing portfolio. Its lead companies are seeking to raise over £100m in total over the next 12 months. With greater financial resources available (£176.5m in cash), Innovations can not only help to provide the required funding for these companies, the group can maintain or even grow its share of the equity held in these companies, such that it benefits even more from potential upside that is created.

Aside from a commitment to increase its annual investment in the portfolio to £60m (vs £30m-35m historically), to be phased over a few years, Innovations has also indicated it may actively seek to increase the proportion of the future funding into its maturing companies. Equity stakes may also increase, from 30% historically to closer to 50%, providing greater influence and upside potential.

Further value creation potential

In Exhibit 1 we display Innovations' key company portfolio and net fair value movements in FY14. We would highlight two key features of the portfolio:

- With four IPOs in FY14, the dynamics within the portfolio have changed vs FY13, with 42% (£104.9m) now attributed to public companies. The carrying value of these investments are now valued according to the bid price of the respective shares.

Exhibit 1: Innovations' portfolio and net fair value movements in FY14

Company	Net investment carrying value	Cash invested/ (divested)	Fair value movement	Net investment carrying value	Cumulative cash invested	% Issued share capital held	Value added	Multiplier
	01-Aug-13	Year to 31-Jul-14	Year to 31-Jul-14	31-Jul-14	31-Jul-14	31-Jul-14		
	£'000	£'000	£'000	£'000	£'000	%	£'000	(x)
Circassia Holdings	45,148	-	33,211	78,359	25,500	14.0%	52,859	3.07
Nexeon*	34,086	-	-	34,086	22,373	40.0%	11,713	1.52
Veryan Medical*	16,267	1,842	-	18,109	10,968	44.0%	7,141	1.65
Abzena	11,153	4,000	2,845	17,998	10,475	23.6%	7,523	1.72
Plaxica*	5,571	3,875	-	9,446	8,997	45.7%	449	1.05
Cell Medica*	6,479	1,500	-	7,979	4,810	25.2%	3,169	1.66
PsiOxus Therapeutics*	7,892	-	-	7,892	7,476	26.7%	416	1.06
Oxford Immunotec	7,542	-	275	7,817	6,033	4.7%	1,784	1.30
Stanmore Implants*	6,268	-	-	6,268	5,000	16.4%	1,268	1.25
Econic*	1,550	2,850	1,745	6,145	4,400	56.10%	1,745	1.40
Autifony*	5,050	-	1,010	6,060	5,000	25.7%	1,060	1.21
TopiVert*	4,100	1,853	2	5,955	5,853	33.1%	102	1.02
Cortexica*	7,156	2,200	-3,928	5,428	5,553	30.0%	-125	0.98
EVO Electric	3,786	-	-	3,786	3,344	34.1%	442	1.13
Cambridge Communications	1,499	-	2,173	3,672	1,200	9.0%	2,472	3.06
Crescendo	-	3,250	-	3,250	3,250	17.4%	0	1.00
Mission Therapeutics	1,374	1,463	137	2,974	2,796	20.0%	178	1.06
Just Yoyo	-	1,967	890	2,857	1,967	36.2%	890	1.45
Nascient	1,500	1,250	-	2,750	2,750	78.80%	0	1.00
Abingdon Health	3,685	230	-	3,915	5,019	35.5%	-1,104	0.78
Other companies	12,463	2,596	2,189	17,248	13,094	-	4,154	1.32
Net total	**182,569**	**28,876**	**40,549**	**251,994**	**155,858**		**96,136**	**1.62**
Value of listed investments	*0*			*104,900*		*42%*		
Value of un-listed investments	*182,569*			*147,100*		*58%*		
Public companies (CIR/OXFD/ABZA)				104,174	42,008		62,166	2.48
Top 10 private companies*				107,368	80,430		26,938	1.33

Source: Imperial Innovations FY14 results; Edison Investment Research. Note: Shading indicates public company; * = top 10 private companies.

- The relatively modest carrying value of many of the leading private companies, in comparison to the cumulative cash invested. Unlisted investments are valued according to IPEVC (International Private Equity and Venture Capital) guidelines, which typically use the last funding round and total cash invested as the main valuation metrics. Indeed, Innovations has highlighted the following with regard to the carrying value of its unlisted portfolio:
  - £21.5m (14.6%) is valued at cost.
  - £104.9 (71.3%) is valued as of the last financing round.
  - £20.7m (14.1%) is valued using an enterprise value (which may result in the value being higher than the last round if significant progress has been made, or lower if impairment is required after setbacks or restructuring).

To illustrate the point further, in Exhibit 1 we compare the value added (vs cash invested) of the public companies listed (Circassia, Abzena and Oxford Immunotec) against the top 10 private companies within the portfolio. To date the public companies have increased value by approximately 2.5x, whereas the leading private companies are valued at just 1.3x. Of course this may well be a reflection of the greater relative progress that the public vs private companies have made, but it certainly highlights the potential for further value creation should a number of these leading private companies make significant progress in FY15.

With this in mind, we highlight Innovations' five most valuable private companies in Exhibit 2, with potential events over the next 12 months that may provide triggers for deals or valuation uplifts.

Exhibit 2: Largest five private portfolio companies

Company	Carrying value (31 July 2014)	IVO stake (%)	Description	Potential newsflow/catalyst
Nexeon	34.1	40.0	Battery and licensing silicon anodes for the next generation of lithium-ion (Li-ion) batteries addressing consumer product/electric vehicle markets.	■ Samples to customers for evaluation (2015). ■ Scale-up volume production (2015).
Veryan Medical	18.1	44.0	3D helical stent for peripheral vascular use. Positive 24-month clinical study data vs market comparator.	■ EU launch, with or without partner (2015). ■ Start US clinical studies required for PMA authorisation (2015).
Plaxica	9.4	45.7	Versalac technology to produce high-purity lactic acid at low cost from low-grade raw materials (waste products). Multiple potential uses: propylene glycol (industrial de-icer), acrylic acid (nappies) and PLA (electronic goods).	■ Complete validation of Versalac technology (2015). ■ First license sale (2015).
Cell Medica	8.0	25.2	Developing T-cell immunotherapy for treatment of virally associated cancers and viral infection post-bone marrow transplant. Cytovir CMV (for cytomegalovirus infection following bone marrow transplant) is available in the UK. Cytorex EBV (CMD-003) is entering a Phase II study for EBV (Epstein Barr virus)-related NK/T cell lymphoma.	■ Cytovir CMV: EU commercialisation with STAGE Cell Therapeutics (Q414). ■ Cytorex EBV (CMD-003): start 30-pt Phase II study (CITADEL) for aggressive EBV+veNK/T-cell lymphoma (Q414). Single arm, open label, potentially qualifies for accelerated approval.
PsiOxus Therapeutics	7.9	26.7	Developing novel therapeutics for diseases related to cancer: an oncolytic virus enadenotucirev (ColoAd1) for solid tumour indications (colorectal/ovarian cancer), and MT-102 for cachexia.	■ Commence Phase II efficacy portion of EVOLVE study with enadenotucirev (ColoAd1) (2015). ■ Potential further development of MT-102: +ve Phase II cachexia data reported (Nov 2013).

Source: Edison Investment Research, Imperial Innovations.

Exhibit 3: Innovations' public portfolio

Company	Carrying value (31 July 2014)	IVO stake (%)	Exchange / market cap* / listing date	Description	Potential newsflow / catalyst
Circassia	78.4	14.0	LSE / £560m / March 2014	Developing and commercialising a range of immunotherapies (ToleroMune technology) for the treatment of allergies.	■ HDM-SPIRE: start Phase IIb (Q414). ■ Ragweed-SPIRE: Phase IIb data (Q115). ■ Cat-SPIRE: Phase III data (H116).
Abzena	18.0	23.6	AIM / £79m / July 2014	Contract services/licences focused on enhancing bio-pharmaceuticals, including antibody conjugation and engineering technologies and immunogenicity screening.	■ M&A opportunities to expand service and technology offerings (2015). ■ Progress with licensed technology in partner portfolios (Gilead: simtuzumab/GS-5745 + Opsona: OPN-305 + NKT Thera: NKTT120).
Oxford Immunotec	7.8	4.7	NASDAQ / $280m / November 2013	Commercial stage diagnostics company focused on immunology. T-cell based technology (T-SPOT).	■ Commercial growth of T-SPOT TB: sales, marketing and geographic expansion.

Source: Edison Investment Research. Note: Excludes Ixico with <£1m carrying value. *Market cap as of 31 July 2014.

Similarly, in Exhibit 3 we summarise the three main public companies within Innovations' portfolio, given the potential impact that the share price performance of these companies may have on the overall portfolio. Given that the Circassia holding currently accounts for 30% of Innovations' portfolio value, we would expect clinical trial data from Circassia's allergy technology to cause the biggest potential positive or negative variation. In Exhibit 4 we display Circassia's upcoming clinical milestones for its various programmes, with the Ragweed-SPIRE Phase IIb data in Q115 and the Cat-SPIRE Phase III results in H116 the biggest potential catalysts.

Exhibit 4: Circassia's clinical milestones

Programme	Date*	Subjects	Description	Ref.	
HDM-SPIRE	19 May '14	109	Observational study reports	TH003	✓
HDM-SPIRE	13 June '14	72	Phase IIb 2 year follow-up reports	TH002A	✓
HDM-SPIRE	Q3'14	30	Phase II controlled asthmatic study reports	TH004	
HDM-SPIRE	Q4'14	660	Initiate phase IIb field study	TH005	
Ragweed-SPIRE	Q4'14	48-60	Phase II controlled asthmatic study reports	TR007	
Grass-SPIRE	Q4'14	Up to 118	Phase IIb third season follow-up reports	TG002B	
Cat-SPIRE	Q4'14	1,182	Complete phase III recruitment	CP007	
Ragweed-SPIRE	Q1'15	280	Phase IIb chamber study reports	TR006	
Grass-SPIRE	H1'15	Up to 120	Observational study reports	TG003	
Grass-SPIRE	H1'15	48-60	Phase II controlled asthmatic study reports	TG004	
Cat-SPIRE	H2'15	At least 12	Pilot paediatric safety study reports	CP009	
Ragweed-SPIRE	H2'15	-	Enrolment into phase III field study	-	
Cat-SPIRE	H1'16	At least 1,182	Phase III study reports	CP007	
Grass-SPIRE	H1'16	-	Enrolment into phase III field study	-	
Cat-SPIRE	H2'16	-	File for marketing approval	-	

Source: Circassia H114 presentation (29 July 2014)

Valuation

Imperial Innovations' shares (at 453p) currently trade at a c 50% premium to its NAV (at the last balance sheet date of 31 July 2014) of c £405m or 295p/share. Innovations has historically traded at a significant premium to its NAV, which can be ascribed to the unrecognised value of its portfolio assets (many of which are valued at cost or the valuation of their last financing) and its technology pipeline agreement with Imperial College and collaborations with other leading UK universities (Oxford, Cambridge, UCL), and other research organisations (eg Babraham Institute).

We believe this premium is justified, particularly given the portfolio performance in FY14, which unlocked a significant amount of previously 'hidden' value. While the FY14 result may not be repeated in FY15 (the Circassia IPO was the biggest UK biotech listing so is unlikely to be matched), we see multiple opportunities for further value creation. This is on the basis of the relatively modest carrying values of unlisted companies within the portfolio, as discussed above, and Innovations' significant financial resources (£176.5m) to help provide the required funds for its late-stage companies to advance to their respective next valuation inflection points.

While the record £69.4m net portfolio value increase in FY14 is unlikely to be matched in FY15, we would still expect further portfolio value uplift in FY15, driven by greater investment in existing and new portfolio companies (£50m estimated investment), and some net fair value gains as a result of positive progress by a few of the leading companies. We estimate a net fair value gain at £12.5m for FY15 (vs £40.5m in FY14), and £15m for FY16, generated from the normal course of business, with scope for further upside from exceptional events such as trade-sales or IPOs.

IPOs played a significant role in releasing value in FY14, and may do so again in FY15, but we would still expect strategic trade sales and new financing rounds to contribute.

Sensitivities

Imperial Innovations' investment case rests on the success of its investment strategy, in particular its ability to achieve increases in portfolio value (and hence NAV) over and above net new investment. The company is exposed to the business success of its larger portfolio holdings, especially now that its investment portfolio includes four publicly listed companies. The share price performance of the public portfolio companies (particularly Circassia, which currently accounts for 30% of the total portfolio value) may affect the total portfolio value either negatively or positively, with the carrying values of these investments marked to market at each financial period end.

Imperial Innovations is also very tightly held, with four shareholders accounting for a total of 89% of the equity, including Invesco (42%), Imperial College (20%), Lansdowne (13.7%) and Woodford (13.4%). This provides limited free-float (11%) within the stock, which may increase volatility even on low trading volumes.

Financials

Imperial Innovations' net investment portfolio was valued at £252m as of 31 July 2014, a 38% (+£69.4m) increase from £182.6m as at 1 August 2013, reflecting £28.9m of net investment and a £40.5m net fair value gain; £33.2m of this fair value gain was attributable to Circassia.

During FY14, Innovations invested a gross sum of £32.8m in 25 portfolio companies (vs £22.2m in 28 companies in FY13), which collectively raised a total of £315.4m including from third-party investors (the Circassia IPO raised £200m). Innovations had cash and short-term liquidity of £176.5m as of 31 July, which coupled to a £15m second tranche of the EIB loan available for draw down means that it has £191.5m of funds in total available for investment. The cash balance was boosted in June 2014 following the sale of 37.5m new shares at 400p per share, generating gross proceeds of £150m (£146.8m net). Invesco, Lansdowne and Woodford were the primary investors in this offering.

According to Innovations' guidance to increasing its portfolio investments from the historical range of £30-35m, we model gross portfolio investments of £50m in FY15 and £60m in FY16.

Revenues from direct licensing activity, provision of services and corporate finance activities amounted to £3.6m in FY14 (£3.3m in FY13), at a cost of sales (revenue sharing with ICL) of £1m (£0.8m in FY13). We model essentially flat revenues in FY15 and FY16, of £3.5m and £3.7m respectively, although Innovations has highlighted the potential for greater revenue growth over the medium to long term. Administrative expenses in FY14 were £11m (vs £9.5m), with modest increases expected in FY15 and FY16. A £4.8m charge was also applied to its carried interest plan (long-term incentive) in FY14, although no cash payment will be made to members of the carried interest plan until Innovations achieves significant cash realisations.

Innovations reported a £27.4m pre-tax profit in FY14 on account of the £40.5m increase in the net fair value of its investments. With relatively stable operating expenses, Innovations' profitability is dependent on the level of fair value gains/losses in specific periods taken through the P&L. Gains and losses are inherently difficult to predict, hence we conservatively estimate net fair value gains of £12.5m in FY15 and £15m in FY16; this assumes a modest increase on the average gains over the past five years, in keeping with expectations that further value can be unlocked from a maturing company portfolio. We note there is scope for further upside from exceptional events such as trade-sales or IPOs.

Exhibit 5: Financial summary

	£'000s	2012	2013	2014	2015e	2016e
Year end 31 July		IFRS	IFRS	IFRS	IFRS	IFRS
PROFIT & LOSS						
Revenue		**4,255**	**3,290**	**3,636**	**3,500**	**3,700**
Cost of sales		(1,225)	(788)	(1,005)	(967)	(1,023)
Gross profit		3,030	2,502	2,631	2,533	2,677
EBITDA		**(6,153)**	**(6,940)**	**(8,385)**	**(9,312)**	**(10,059)**
Operating profit (before GW and except.)		(6,187)	(6,972)	(8,418)	(9,345)	(10,092)
Fair value gains/losses		14,691	10,794	40,549	12,500	15,000
Impairments		(2,254)	(3,492)	0	0	0
Share-based payment		(3,401)	2,358	(4,821)	0	0
Operating profit		**2,849**	**2,688**	**27,310**	**3,155**	**4,908**
Net interest		2,227	1,072	106	953	514
Profit before tax (norm)		**(3,960)**	**(5,900)**	**(8,312)**	**(8,392)**	**(9,577)**
Profit before tax (FRS 3)		**5,076**	**3,760**	**27,416**	**4,108**	**5,423**
Tax		0	0	0	0	0
Profit after tax (norm)		**(3,960)**	**(5,900)**	**(8,312)**	**(8,392)**	**(9,577)**
Profit after tax (FRS 3)		**5,076**	**3,760**	**27,416**	**4,108**	**5,423**
Average number of shares outstanding (m)		62.7	81.2	102.4	137.2	137.2
EPS - normalised (p)		**(6.3)**	**(7.3)**	**(8.1)**	**(6.1)**	**(7.0)**
EPS - FRS 3 (p)		**8.1**	**4.6**	**26.8**	**3.0**	**4.0**
Dividend per share (p)		0.0	0.0	0.0	0.0	0.0
BALANCE SHEET						
Fixed assets		**155,711**	**188,261**	**258,327**	**320,241**	**395,233**
Tangible assets		64	36	26	18	10
Intangible assets		0	0	0	0	0
Investment Portfolio		155,135	187,649	257,105	319,605	394,605
UCSF (University Challenge Seed Fund) investments		512	517	543	543	543
UCSF loans		0	0	0	0	0
Other		0	59	653	75	75
Financial asset		0	0	0	0	0
Current assets		**85,900**	**67,130**	**177,800**	**119,316**	**49,893**
Cash and cash equivalents		43,883	65,597	176,462	118,028	48,532
Financial asset		36,583	0	0	0	0
Other investments		0	0	0	0	0
Accounts receivable, net		5,434	1,533	1,338	1,288	1,361
Current liabilities		**(4,322)**	**(3,391)**	**(4,900)**	**(4,900)**	**(4,900)**
Trade accounts payable		(4,322)	(3,391)	(4,900)	(4,900)	(4,900)
Long-term liabilities		**(9,079)**	**(21,542)**	**(26,445)**	**(25,773)**	**(25,101)**
Long term borrowings		0	(14,814)	(14,830)	(14,830)	(14,830)
UCSF		(542)	(605)	(640)	(640)	(640)
Provisions		(8,537)	(6,123)	(10,975)	(10,303)	(9,631)
Net assets		**228,210**	**230,458**	**404,782**	**408,884**	**415,125**
NAV/share (p)		**229**	**231**	**295**	**298**	**303**
CASH FLOW						
Operating cash flow		**(5,610)**	**(7,465)**	**(6,523)**	**(9,362)**	**(9,985)**
Net Interest		954	921	44	953	514
Tax		0	0	0	0	0
Capex		0	(4)	(23)	(25)	(25)
Purchase of trade investments		(37,899)	(22,185)	(32,826)	(50,000)	(60,000)
Proceeds from sale of trade investments		2,173	396	3,370	0	0
Revenue share paid on asset realisations in trade investments		(600)	(172)	0	0	0
Equity financing		36,990	36,990	146,823	0	0
Short term liquidity investments		0	(1,581)	0	0	0
Net cash flow		(3,992)	6,900	110,865	(58,434)	(69,496)
Opening net debt/(cash)		**(48,848)**	**(43,883)**	**(50,783)**	**(161,632)**	**(103,198)**
Other		(973)	0	(16)	0	0
Closing net debt/(cash)		**(43,883)**	**(50,783)**	**(161,632)**	**(103,198)**	**(33,702)**

Source: Imperial Innovations accounts; Edison Investment Research

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