Financial Review

It gives me great pleasure to present my first Financial Review for the Novacyt Group.

James McCarthy
Chief Financial Officer

2020 highlights

- The business finished 2020 debt free with a cash balance in excess of £90 million
- All key territories saw year-on-year growth, with UK market sales increasing to £219.4 million in 2020 vs £2.1 million in 2019
- Profit after tax of £132.4 million in 2020 vs a loss of £5.7 million in 2019

The business finished 2020 debt free with a cash balance in excess of £90 million.

Financial performance

Group revenue increased (20x) to £277.2 million), compared to £11.5 million for the full year of 2019. This was driven by the continued successful global commercialisation of the Company's COVID-19 product portfolio, underpinned by one of the world's first approved polymerase chain reaction ("PCR") tests for the virus. Primerdesign accounted for the major part of this growth achieving £272.8 million of revenue in 2020 compared with £5.5 million in 2019.

All key territories saw year-on-year growth, with the UK market seeing sales increase to £219.4 million in 2020 compared with £2.1 million in 2019, largely driven by contracts supporting the UK testing pandemic response. Sales to Europe (excluding the UK) were £32.0 million in 2020 compared with £2.7 million in 2019, driven by increased distributor sales of our range of COVID-19 tests. Sales to the Americas were £10.3 million compared £2.3 million in 2019.

Primerdesign sales grew by over 4,800% to £272.8 million, and was principally responsible for the Group's growth during 2020, due to the success of the COVID-19 product portfolio, following the launch of one of the world's first approved polymerase chain reaction ("PCR") tests in Q1 2020. All geographical regions have experienced significant growth during 2020, with the UK, Middle East, Germany and US accounting for the main revenue growth. Primerdesign has been at the forefront of the global response to COVID-19 testing requirements, selling into over 85 countries in 2020. There have been several product launches to address emerging market needs including multiple gene tests, test panels to help differentiate COVID-19 from common winter diseases and new reagents to aid PCR testing workflow for users.

Lab21 sales decreased by £0.8 million in 2020 to £5.2 million, compared with sales of £6.0 million in 2019. There is £1.9 million of intercompany sales included in the £5.2 million of Lab21 Products segment sales that are eliminated at a Group level in the consolidated Group accounts. This intercompany revenue relates to services that Microgen Bioproducts provided to Primerdesign in its manufacturing of COVID-19 kits, rather than outsourcing the task to a third party and thus diluting the gross margin. The Lab21 Products business was severely impacted in 2020 by its core customers diverting testing from veterinary and food testing to COVID-19 testing. As a result of strong partnerships built over many years, a number of Lab21 Products distributors migrated to purchasing COVID-19 tests from Primerdesign and significant sales were generated from key Lab21 Products customers as a result.

IT-IS International sales for the period post acquisition, 15 October to 31 December 2020, totalled £6.9 million. There is £5.8 million of intercompany sales included in the £6.9 million of IT-IS International segment sales that are eliminated at a Group level in the consolidated Group accounts.

Group gross profit increased to £211.5 million in 2020 compared with £7.3 milion in 2019, giving a Group gross margin of 76.3% in 2020 compared with 64.0% in 2019. This continues the trend of increased gross margin every year since 2014, driven by Primerdesign increasing its share of Group revenue to 98% from 48% in 2019, and Primerdesign delivering a gross margin of 77% in 2020 compared with 85% in 2019, demonstrating strong control of margins as the business is scaled. During H1, Novacyt identified that it had operational capacity constraints due to its facility footprint and thus, to quickly scale the business and meet increasing demands, elements of manufacturing were outsourced. This, however, did not have a detrimental impact on the gross margin of the Group.

Group operating costs increased year-on-year by £28.2 million, to £35.4 million in 2020 compared with £7.2 million in 2019. To support the growth in the business, significant investment has been made in the workforce and headcount increased from 110 at the end of December 2019 to 237 at the end of December 2020.

The acquisition of the IT-IS International business in Q4 resulted in an additional £0.3 million of operating costs in Q4 and the effect in 2021 will be bigger as the annualised impact is seen. The main driver for the year-on-year cost increase was the Long Term Incentive Plan ("LTIP") that commenced in November 2017 and vested in November 2020, which was linked to the Company's share price.

As a result of the significant share price increase in 2020, driven by the financial performance of the business, the LTIP liability that crystallised in 2020 accounts for £19 million of the year-on-year cost increase.

The Group delivered an EBITDA of £176.1 million in 2020 compared with breakeven in 2019 (£0.2 million), driven by significantly increased sales. In 2019, the NOVAprep® business continued to be reported under IFRS 5 and is disclosed as discontinued operations in the income statement, which did not impact EBITDA.

2020 delivered recurring operating profit of £174.8 million verses a recurring operating loss of £1.1 million in 2019, delivering an improvement of over £175 million, driven by increased sales. Amortisation and depreciation remained flat year-on-year at £1.3 million in 2020, as the significant scale up in manufacturing has been largely supported by third party manufacturers rather than significant capital investments.

Total depreciation charges of £0.6 million (2019: £0.6 million) and amortisation charges of £0.7 million (2019: £0.7 million) for 2020 are consistent with 2019. The 2020 depreciation charge includes £0.3 million of IFRS 16 leasing costs, predominantly covering the rental fees for Novacyt premises.

The Group has moved from an operating loss in 2019 of £1.6 million to an operating profit of £167.4 million in 2020 and is stated after non-recurring charges amounting to £7.4 million. The 2020 charges comprise a £5.8 million impairment charge in relation to the goodwill associated with the Lab21 Products business, a £1.1 million impairment charge in relation to intangible assets associated with the Omega Infectious Diseases business and other non-recurring costs totalling £0.5 million. The other non-recurring costs include acquisition related expenses, site closure costs and other miscellaneous costs.

The Group generated a total net profit of £132.4 million in 2020, compared with a net loss in 2019 of £5.7 million, and is stated after £1.6 million of gross borrowing costs (2019: £1.0 million), other financial expenses of £0.7 million (2019: £0.9 million) and tax of £32.7 million (2019: £nil) based on the increased profit generated by the Group in the year.

2020 saw a profit per share being generated of £1.94 vs a loss per share in 2019 of £0.13, as a result of the Group delivering a total net profit for the year compared with a loss in 2019.

Post balance sheet event / DHSC Dispute

On 9 April 2021, Novacyt announced it was in dispute with the DHSC in relation to its second supply contract and made a further update on 21 May 2021. The dispute primarily relates to Q4 2020 revenue totalling £129.1m in respect of a specific product supplied to the NHS. The Company has taken independent legal advice and a provision has been made in the financial statements with the Board's estimate at this time in respect of this claim with DHSC.

The Board has formed a judgment that, in accordance with the contractual terms, and if required, it should be possible to replace the product in dispute and a product warranty provision has been made accordingly. The Board's best estimate of the cost to replace is up to a maximum of £19.8 million, the timing of any outflow is dependent on settlement of the dispute. If no settlement is achieved and legal action is required, the timing of any possible outflow will be extended.

It is possible, but not probable, that the DHSC's claim for a refund under the limited assurance warranty will be successful. The timing of any cash outflow is dependent upon the success of the claim and the terms negotiated for repayment. If the resolution of the claim is materially different from the Board's determination of replacing the product,

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the financial statements with regard to revenue and the provision for product warranty could be significantly impacted.

Of the Q4 2020 revenue, invoices amounting to £24.0 million in respect of product delivered to the DHSC remain outstanding at the date of signing the financial statements and recovery of this amount is also dependent on the outcome of the dispute. In addition, after the year-end, a further £49.0 million of product delivered and invoiced to the DHSC in 2021 remains unpaid and is now also part of the dispute. The unpaid invoices total £73.0 million and include VAT.

Balance sheet

Goodwill has increased to £17.9 million in 2020 from £13.6 million in the previous year. Goodwill totalling £9.4 million was recognised on the acquisition of IT-IS International. This has been partially offset by a reduction in Lab21 Products goodwill following the annual impairment process, where an impairment charge of £5.8 million has been recorded, reflecting a prudent view of the future expected discounted cash flows generated from the business. The remaining £0.7 million goodwill increase is due to exchange differences on balances based in Euros.

A deferred tax asset of £3.0 million has been recorded in 2020, compared with a £nil prior year balance. £2.1 million of the balance relates to the portion of the LTIP charge that is recognised by Novacyt in the UK books, but will be deducted for taxation when payments are made in 2021 and 2022. The remaining balance of £0.9 million arises from the elimination of the internal margin on products acquired by Primerdesign from Microgen and IT-IS International, and still held in stock at the year end.

Other non-current assets have increased to £6.1 million from £4.9 million in 2019. Other intangibles have increased by a net £0.6 million, but includes additions totalling £2.6 million, predominantly relating to the assets created as part of the IT-IS International acquisition (customer relationships and brands) offset by disposals (impairment of the Omega ID business intangible assets) and amortisation totalling a combined £2 million. Property, plant and equipment has increased by a net £0.8 million, and includes £1.2 million of capital expenditure offset by charges (mainly depreciation) totalling £0.4 million. The remaining £0.2 million decrease relates to the reduction in other long-term assets and financial assets.

Inventory increased in the year by £27.8 million (1,335%) to £29.9 million to support the Group's revenue growth, with significant finished goods being held in stock ready for immediate dispatch. As the lead time for obtaining some key raw materials is significant, bulk orders were placed to ensure there were no supply shortages, which also contributed to the higher inventory balance in 2020.

Trade and other receivables have increased in the year by £77.7 million (4,200%) to £79.6 million. Novacyt finished the year with strong sales in Q4 and this balance is reflective of that trading, with most of the balance being less than 30 days old. An expected credit loss provision of only £0.2 million was booked at year end, demonstrating a strong credit control process.

Other current assets have increased to £3.7 million in 2020 from £0.4 million in 2019, driven by a £3.3 million increase in prepayments. The key balances at 31 December 2020 include prepayments for annual Group commercial insurance, stock that was not delivered to Primerdesign in 2020, rent, rates and support costs.

All outstanding debt as at 31 December 2019, totalling £7.1 million, was fully repaid during 2020 using cash generated in the year. The Group is now debt free and the closing 2020 balance is £nil.

The contingent consideration balance increased from £nil in 2019 to £1.8 million in 2020 as a result of the two earnout milestones associated with the IT-IS International acquisition. It will be settled in two payment tranches, due in September 2021 and 2022, upon the achievement of certain deliverables.

Short-term provisions increased to £19.9 million in 2020 from £0.04 million in 2019. A product warranty provision for £19.8 million has been booked in 2020 to cover management's view of the maximum cost of replacing products after receiving notification of a product warranty claim.

Trade and other liabilities increased to £36.8 million in 2020 from £3.9 million in 2019. Trade payables and accrued invoices have increased by £10.7 million in line with increased trading activity. In addition, the improved Group liquidity position has meant that credit facilities have been secured with many suppliers who previously did not offer such terms. The closing year end Value Added Tax ("VAT") liability payable to HMRC in the UK, covering the months of November and December, has increased by £16.7 million from 2019. The other key increase for £5.6 million is for the second tranche of the LTIP payment that is due to be paid in November 2021.

Corporation tax due at the end of 2020 totalled £15.1 million from £nil in 2019, which reflects the UK corporation tax liability of the Group. The amount represents the tax due at the full UK rate (19%) on taxable profits, although in due course, if patents are granted and a Patent Box claim is made, future taxable profits should be taxable at a much lower rate.

Other long-term liabilities relates to the third tranche of the LTIP payment that is due to be paid in November 2022. The closing 2020 balance was £5.6 million, from £nil in 2019.

Cash flow

Cash has increased to £91.8 million in the year from £1.5 million in 2019, driven by the strong trading performance of the business. Net cash generated from operating activities increased to £103.0 million in 2020 driven by the EBITDA profitability of the business of £176.1 million offset by working capital expenditure of £73.2 million.

Net cash outflow from investing activities increased to £8.0 million in 2020 from £1.0 million in 2019. £6.9 million of the 2020 balance is due to the net cash consideration paid for IT-IS International, where the cash paid in 2020 totalled £11.6 million less the £4.7 million cash acquired. Capital expenditure increased year-on-year to £1.1 million in 2020, to support the growth in the business, this being less than 1% of revenue.

Net cash outflow from financing activities in 2020 totalled £5.0 million vs a net inflow in 2019 of £2.5 million. The 2020 cash outflow was primarily due to Novacyt paying down all outstanding debt as at 31 December 2019. Debt repayments covering capital and interest, totalled £6.2 million, a short-term financing facility was repaid in full totalling £0.7 million, lease payments of £0.3 million were made and these outflows were offset by a net cash inflow from the conversion of warrants totalling £2.2 million.

James McCarthy
Chief Financial Officer

Group revenue £'000
£277,204
for 2020
(2019: £11,468)

Group gross margin £'000
£211,500
for 2020
(2019: £7,340)

Group EBITDA £'000
£176,145
for 2020
(2019: £174)