

# OPERATIONAL AND FINANCIAL REVIEW

## CFO STATEMENT



**“OUR DISCOVERY PORTFOLIO IS IMPORTANT TO THE FUTURE DEVELOPMENT OF THE CORE PORTFOLIO AS IT PROVIDES A CRÈCHE TO DEVELOP EMERGING INNOVATION AND EXPLORE COMMERCIAL OPPORTUNITIES”**

**James Rawlingson**  
Chief Financial Officer

### Overview

The year to December 2018 has been one of significant financial progress, particularly in driving growth in our Gross Portfolio Value, which has increased to £175.5m (2017: £53.9m). This is reflected in the increased strength of the Group balance sheet, where the Net Asset Value (NAV) of the Arix Group has grown by over £100m to £270.2m (2017: £146.4m).

This growth in Group NAV has been supported by a strong net revaluation gain for the year of £51.2m (2017: £5.5m) which has helped deliver a profit before tax of £42.8m (2017: £9.5m loss).

The Gross Portfolio Value (GPV), comprising our Core Portfolio, and Discovery Portfolio, is shown at fair value at £175.5m (2017: £53.9m) at the year-end, representing an increase of 225% over the last 12 months.

The remaining component of Investments is our Other Interests. At the balance sheet date these are held at a fair value of £8.5m (2017: £17.4m), the movement being predominantly due to impairments to the carried interest of The Wales Life Sciences Investment Fund and in BioMotiv.

### Core Portfolio

The Core Portfolio has grown from nine companies to 11 in 2018, with the value of these companies increasing from £50.6m to £169.3m, driven by both the investment activity in the year and the strong revaluation gains enjoyed in the period – notably by Autolus, which listed on the Nasdaq exchange in June.

Autolus was not alone, as Iterum Therapeutics and LogicBio Therapeutics also listed during 2018. In addition, Harpoon Therapeutics was in preparation for its IPO at year-end and went on to successfully list early in 2019.

All of our quoted investments are shown at the closing market price at the balance sheet date. The valuation of Harpoon reflects a portion of the uplift arising between its November 2018 funding round and its February 2019 IPO.

### Discovery Portfolio

Our emerging investments are held within our Discovery Portfolio. This asset class is important to the future development of the Core Portfolio as it provides a crèche to develop emerging innovation and explore commercial opportunities.

The Discovery Portfolio is held at a fair value of £6.2m (2017: £3.3m) and includes a number of pre-clinical investments plus other seed investments made during the year.

As new projects become established they will be moved from the Discovery Portfolio to the Core Portfolio.

## Portfolio Valuation Methodology

I have highlighted in previous reports the strong focus on high levels of integrity when it comes to the valuation of our investments. This is both embedded in our culture and in our governance as it is overseen by our Audit and Risk Committee. Arix follows International Private Equity and Venture Capital (IPEV) Guidelines, which are compliant with International Financial Reporting Standards. You can read the detailed accounting policy on pages 108 to 109.

In determining the valuation of its portfolio, Arix applies a valuation hierarchy; for example, a quoted market price has the highest integrity and is used as a source of valuation wherever possible.

As an alternative for unquoted stocks, Arix may use a recent arm's length market transaction as this is considered to have an acceptably high level of integrity.

A Discounted Cash Flow (DCF) methodology is considered to have the lowest level of integrity and is not used where a methodology with a higher level of integrity is available. No investments within our Core Portfolio or Discovery Portfolio have been valued using DCF methodology at December 2018.

## Consolidated Profit and Loss

Strong performance in the year has delivered a Profit Before Tax (PBT) of £42.8m (2017: loss of £9.5m). The key feature of the Consolidated Statement of Comprehensive Income is the net revaluation gains of £51.2m (2017: £5.5m).

This strong PBT has created the need for a deferred tax liability of £5.9m this year.

The net revaluation gains of £51.2m were driven principally by Autolus Therapeutics, which showed a positive revaluation of £55.9m in the year, along with LogicBio Therapeutics, which also had a significant upward valuation in the period of £14.1m. These were partially offset by Iterum Therapeutics, which following its successful IPO recorded a negative revaluation of £8.4m in the period.

Revenues of £1.3m (2017: £1.9m) are predominantly management fees in Arix Capital Management; these have decreased year-on-year in line with expectations as the fully invested Wales Life Sciences Investment Fund enters the second half of its investment life. A significant exit for the fund was successfully completed early in 2019 and this will contribute to a reduced fee level going forward.

Administrative expenses for the year were £11.7m (2017: £11.0m). These costs included CEO search fees of £0.3m.

The Board changes announced on 19 February 2019 enable a leaner management team in Arix. The cost savings from these changes, along with other expected savings from a premises review which is currently under way, will reduce annual run-rate costs by approximately £1.5m going forwards; 2019 will reflect the part-year implementation of these cost reductions.

## Cash Position

Cash and deposits on the balance sheet has also strengthened during the year to £91.2m (2017: £74.9m) following a successful capital raising in March 2018, which delivered net proceeds of £83.5m. This cash position will allow investment momentum to be carried into 2019.

The consolidated balance sheet shows that of the £91.2m held, £60.2m is held on long term deposit, which is defined as a term of over three months. The use of longer term deposits has contributed to improved levels of interest income earned this year.

## Treasury Policy

The main objectives of the Treasury Policy are the preservation of shareholders' funds for investment purposes and the mitigation of counterparty risk. The policy achieves these twin aims by requiring that cash balances are held at a number of UK banks with strong credit ratings.

The Treasury Policy was revised and reapproved by the Board this year to allow a greater proportion of funds to be placed as term deposits, and as a result net interest income increased to £0.7m (2017: £nil).

Speculation on currency movements is specifically not permitted by the policy and foreign currency hedging transactions are also outside of the policy. Therefore, no currency hedging transactions were entered into during the year and balance sheet assets in foreign currency are not hedged against sterling.

The impact of currency exchange rates is shown on the face of the Consolidated Statement of Comprehensive Income as a gain of £4.6m; however, it should be noted that these are not realised amounts.

During the second half of 2018, due to the foreseen risk of Brexit weakening sterling particularly against US dollars, our cash balances held in non-sterling were positioned to include sufficient US dollars to allow us to match our known future dollar funding commitments to portfolio companies for 2019.

In this way we have been able to protect our investment activity against expected volatile foreign exchange rates for the coming year.

## Employee Benefit Trust

During the year under review an Employee Benefits Trust (EBT) was created. This Trust is managed by an independent Board of Trustees.

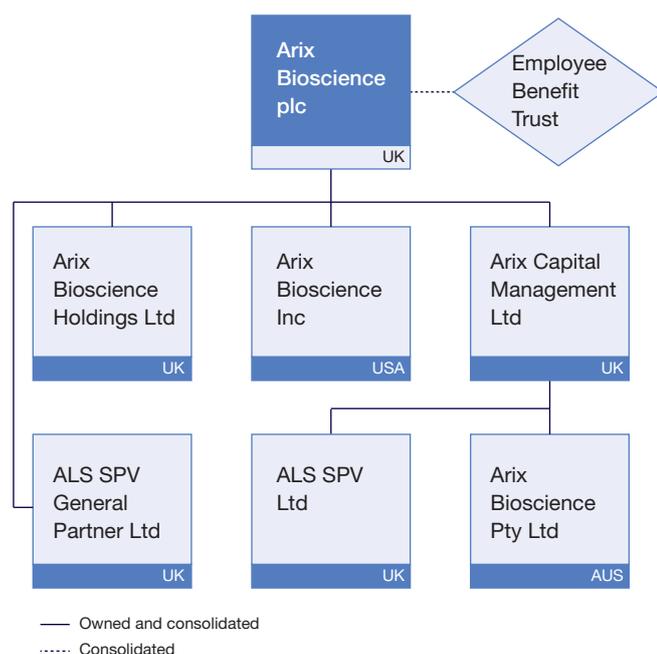
The role of the Trust is to efficiently provide employment benefits to Arix employees, which is particularly important to the retention proposition for key staff such as our investment team.

In line with International Financial Reporting Standards, the results of the Trust are consolidated into the Group financials within this Annual Report. A diagram showing the consolidated entities that make up our consolidated balance sheet, including the EBT, is shown on the next page.

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### Principal entities consolidated into these results



### Impact of Brexit

The Arix business model requires the sourcing and funding of biotech and life science investment opportunities and this is not expected to materially change after Brexit. This is because Arix sources investment opportunities globally and is not constrained to the UK or European markets.

There is a risk that possible reductions in research grants could affect the number of biotech investment opportunities becoming available, but this is considered unlikely to have a material impact on Arix's global pipeline of opportunities.

### Future trends

The implementation of new CFIOUS legislation in the US is intended to protect US technology from foreign interest and will bring increased administration and operational risk to many US investment opportunities, including those in the biotech sector.

Whilst Arix as a UK company is well positioned to continue to take part in US biotech investment opportunities going forward, we will continue to monitor this and other emerging legislation as we go through 2019.

### Emerging regulation

Arix Capital Management is a subsidiary of Arix Bioscience plc and regulated by the FCA. Accordingly, it will be subject to the new Senior Management & Certification Regime (SM&CR) with effect from 9 December 2019.

The SM&CR is part of the UK regulator's drive to improve culture, governance and especially accountability across the financial services sector and preparation is under way to ensure a seamless adoption of SM&CR ahead of the implementation date later this year.

### After the balance sheet date

On 14 February 2019, Harpoon Therapeutics, one of our Core Portfolio companies, successfully listed on Nasdaq at \$14 per share. This is above its fair value included in these consolidated financial statements. Arix invested a further £4.6m at IPO, and now owns 12.1% of Harpoon.

On 19 February 2019, changes were announced to the membership of Arix's Board. Joe Anderson, previously Chief Investment Officer, was appointed Chief Executive Officer; Jonathan Peacock, previously Executive Chairman, became Non-Executive Chairman; and Sir Chris Evans, previously Deputy Chairman, stepped down from the Board but will remain a consultant with the Company. These changes enable a leaner management team in Arix and will bring associated cost savings.

On 15 March 2019, Arix completed an investment in Imara Therapeutics, Inc., committing £11.3m (US\$15.0m) for a 9.9% stake on a fully diluted basis.

## Investment summary

	31 December 2017 Value £m	Net Investment in Period £m	Change in Valuation (including FX) £m	31 December 2018 Value £m	Fully Diluted Equity Interest %	Funding Committed, Not Yet Invested £m	Fully Diluted Equity Interest When Fully Committed %
<b>CORE</b>							
Amplix Pharmaceuticals	2.8	–	0.4	<b>3.2</b>	2.9%	1.9	3.7%
Artios Pharma	3.7	5.8	1.4	<b>10.9</b>	13.4%	4.3	12.4%
Atox Bio	3.0	–	0.2	<b>3.2</b>	3.7%	3.1	6.4%
Aura Biosciences	2.5	1.2	0.2	<b>3.9</b>	6.6%	–	6.6%
Autolus	20.1	5.5	55.9	<b>81.5</b>	7.9%	–	7.9%
Harpoon Therapeutics	5.1	10.3	8.5	<b>23.9</b>	11.3%	–	11.3%
Iterum Therapeutics	5.7	7.0	(8.4)	<b>4.3</b>	7.8%	–	7.8%
LogicBio Therapeutics	4.8	5.4	14.1	<b>24.3</b>	12.9%	–	12.9%
Pharmaxis	–	8.0	(1.6)	<b>6.4</b>	11.1%	–	11.1%
VelosBio	–	5.1	0.1	<b>5.2</b>	8.9%	3.4	11.3%
Verona Pharma	2.9	–	(0.4)	<b>2.5</b>	2.5%	–	2.5%
	<b>50.6</b>	<b>48.3</b>	<b>70.4</b>	<b>169.3</b>		<b>12.7</b>	
<b>DISCOVERY</b>							
Depixus	1.1	0.3	–	<b>1.4</b>	18.6%	0.1	19.2%
Mitoconix Bio	0.4	0.4	(0.6)	<b>0.2</b>	3.5%	0.8	9.0%
OptiKira	1.3	–	(0.3)	<b>1.0</b>	21.9%	–	21.9%
PreciThera	0.5	0.7	(0.1)	<b>1.1</b>	20.9%	4.6	23.4%
New SeedCo	–	2.4	0.1	<b>2.5</b>	25.6%	2.8	32.2%
	<b>3.3</b>	<b>3.8</b>	<b>(0.9)</b>	<b>6.2</b>		<b>8.3</b>	
<b>GROSS PORTFOLIO VALUE</b>	<b>53.9</b>	<b>52.1</b>	<b>69.5</b>	<b>175.5</b>		<b>21.0</b>	
Other Interests	17.4	3.2	(12.1)	<b>8.5</b>	N/A	–	N/A
<b>TOTAL INVESTMENTS</b>	<b>71.3</b>	<b>55.3</b>	<b>57.4</b>	<b>184.0</b>		<b>21.0</b>	