TPE 2023 – Case Study Sample Solution

Derma

Draft Briefing Paper

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From: Alex, Clifton LLP

Subject: Derma Limited – funding and marketing advice

Date: November Yr. 38

I have analysed and provided recommendations on funding options for Derma, outsourcing clinical testing and the marketing of Peau and set out my findings in the sections below.

1.0 Funding options

There are a number of funding options which Derma could explore at this critical time for investment which I have set out below.

Debt financing

The first option would be debt financing, which means taking out a loan for the £500,000 required. This would beneficial as it means you would retain control of the company and not dilute your shareholding any further. In addition, the interest payable on a loan is tax deductible, meaning if a tax loss is built up this can be used against future profits going forward. Interest is also a fixed amount which will be known so that Derma can plan and manage the cash flow of the business effectively.

However, it may be difficult for the company to obtain bank finance given the loss-making position for the past two years, and a high rate of interest would have to be charged by the bank to mitigate the risk of non-payment due to the long development time required for the products. It is likely that the bank will require security over any loan issued and as Derma has limited fixed assets, using your house as security is likely the best option. This would mean a great deal of personal risk is taken on by yourself if the company were to default on any loan payments, although it would be seen as a positive sign by the bank that you are willing to commit to personal guarantees.

To obtain the loan a business plan would have to be drawn up with detailed information about the business, such as a background on the board members, financial track record and what the funding is to be used for. This can be a time-consuming process and may require the help of an expert in order to ensure the plan is produced to a high standard.

If financing is obtained, it is likely that the bank will impose covenants on Derma, meaning they may require certain targets to be hit or levels of debt to be maintained which will be monitored closely. This may restrict the trading activities of Derma, for example the company may not be allowed to start investing in a new project until existing ones have been completed or part of the loan has been repaid. If a covenant is breached, this could result in the loan becoming instantly repayable which would put your property at risk.

Rights issue

Another option for fundraising is a rights issue. This would involve creating new ordinary shares of the company and giving existing shareholders the option to purchase additional shares based on their current shareholding. For example, if Derma issued a two for one rights issue, you could purchase two new shares for every existing share held. Each shareholder has the option whether to purchase the shares, sell the rights or ignore the rights issue.

A rights issue would allow the company to remain debt free. This would mean there would be no fixed repayment amounts each month or year, and instead Derma could decide on a level of dividends to pay out based on the financial performance each year. This approach offers more flexibility as Derma could choose not to pay a dividend if the company is short on cash.

Covenants would not be required, and your personal assets would not be at risk, only the capital which you have invested in the company.

It may be difficult to value Derma since it is a private company and does not have a share price, meaning the price at which the rights issues should be sold could be difficult to determine. This may involve having an expert value the company based on a comparable quoted company which could be costly and time consuming.

As you and the other board members cannot currently afford to purchase any additional shares personally, this would mean that Hywell could increase his shareholding and reduce the amount of control held by yourself which is currently 53% of the shares and voting rights. It would appear that the other board members are unsure about Hywell increasing his share so this should be taken into consideration when deciding on a funding option.

Listing on AIM

The Alternative Investment Market (‘AIM’) is a stock exchange platform used as a stepping stone for small, growing companies before launching onto the main London Stock Exchange market. There are several benefits to listing the company on AIM as there are much more relaxed regulations compared with the main market and there are no requirements relating to the minimum value of the company or any previous track record. Hywell has experience with the AIM market as he has previously invested in several Biopharma AIM companies which may be beneficial as he may have knowledge of the requirements to list on this market.

Selling shares of Derma on AIM would mean that anyone could buy them, so voting rights would be awarded to people you have not dealt with before, although there is no requirement for 25% of the shares to be in the hands of the public, as there is for the main market. A document similar to a business plan, known as a prospectus, would be required to be drawn up and there are extensive record keeping requirements of being listed on AIM. This would increase the burden of administration, which is currently handled by only one office manager, so Derma may have to look to hiring additional staff or outsourcing this service.

Recommendation

It is recommended that Derma use a mixture of debt financing and list on the AIM market in order to raise the £500,000 funding required. It is unlikely that a bank would be willing to lend the whole amount, therefore half of the funds could be raised via a bank loan, while the other half could come from selling shares via a rights issue. This would give additional flexibility as Derma would not have to pay interest on the full £500,000, and Derma could limit the number of shares issued to ensure that you retain control of the company.

Derma should also consider exploring other funding options such as government grants or additional LEC funding which it has successfully been awarded in the past. These options are generally cheaper as a low rate of interest is paid on funds borrowed, or nothing at all if a full grant is awarded.

2.0 Outsourcing testing

I have analysed the implications of outsourcing the clinical testing to Chemtest and set out my findings below.

Deadline for completion of testing

Derma is tied into deadlines for the delivery of clinical testing by Medsanta, meaning the intellectual property rights of RetinX6 could be lost if the deadlines are not met. This would be a significant set-back for Derma as the chemical compound is required for use in many products included Peau. Therefore, it would be in Derma's best interest to have the testing done as quickly as possible. Chemtest have advised that they have a track record of completing tests ahead of the industry average time, and only two weeks' notice is required to begin testing. This would allow some pressure to be taken off meeting the deadlines and help to ensure that they are met, and the IP rights are protected.

Consideration paid

Chemtest have requested payments at key stages of the testing, with nothing to be paid up front and 30% to be paid by Yr. 40 in two years' time when Phase 1 is completed, a further 30% by Yr. 42 on completion of Phase 2 and the final 40% along with 300,000 ordinary shares at completion of Phase 3 in Yr. 44. As no consideration is required to be paid up front, this would allow testing to begin immediately and give Derma some time to raise funds and benefit from the profits of Peau to meet the consideration required in the future.

If an additional 300,000 ordinary shares are issued, this would mean Derma has total share capital of 1,800,000 and Chemtest would hold 17% of the shares. More importantly, your shareholding would be diluted to only 44%, meaning that your overall control of the company would have to be sacrificed, though you would still remain the largest shareholder and therefore have the biggest influence over the decisions taken by the company.

This is a main factor for consideration as it would mean Chemtest have an influence over the future direction of Derma.

In-house testing

An assessment should be carried out as to the costs of performing the clinical trials in-house, along with an estimated timescale. It is likely that funding would be required immediately to begin the testing which may further delay the testing and risk not meeting the deadlines set by Medsanta.

Chemtest due diligence

Further information should be gathered on Chemtest to ensure they are a reputable company and that the clinical testing will be carried out to a high standard. There is a risk that because Chemtest is set to have a shareholding in Derma, the testing carried out could not be objective as it would be in their interest that the product passes the clinical trials.

Before any contract with Chemtest is entered into, a legal expert on contracts should be consulted to thoroughly review it as Chemtest have advised they will draw up the contract. There may be hidden clauses, so it is important that professional advice is sought before the contract is signed.

Recommendation

There is a high risk of losing the IP rights to RetinX6 if the clinical testing deadlines are not met which would be detrimental to the future of Derma, so an assessment of the costs and timings to perform the testing in-house should be carried out as a matter of urgency. If it becomes clear that Derma cannot complete the testing on time in-house, and Chemtest is vetted through a due diligence exercise, then the contract should be entered into.

Relinquishing control of Derma may be a small price to pay if it means the IP rights are retained within the company as several projects rely on this chemical compound.

3.0 Marketing options for Peau

I have analysed the financial and non-financial implications of the three options for selling and marketing Peau, along with the risks and benefits associated with each option below.

3.1 Sale of rights

The first option presented by Skindeep plc is an outright sale of the rights to sell Peau for a one-off payment of £1,200,000.

Financial implications

- £1,200,000 cash would be received up-front which would solve Derma’s current funding issues and allow investment to continue in other key projects such as RetinX6 and HA156, which still have a long way to go in the development process before they will generate any revenue.

- The cash flow position of the company would greatly improve, and Derma would be able to undertake planning for the future and investigate future projects.

- Having a strong balance sheet may make it easier to obtain finance and the company could commit part of the funding to any new projects.

Non-financial implications

- Derma would not have any production costs or risks associated with Peau, nor would the company receive any of the benefits associated with the sale of the product.

- It may be difficult to let go of a product which has been developed by yourself using the RetinX6 chemical.

Benefits

- Derma could focus its efforts on the drugs market which it currently has three products in without becoming side-tracked in the cosmetics industry.

- Derma will not have to worry about manufacturing and selling the product as currently the only staff of the company are involved in research and administration roles, so additional staff and facilities may be required which could be costly.

Risks

- It is difficult to value a product which has not yet been to market, and there is a risk that Derma may be selling the rights to Peau far too cheaply. Skindeep have based their assessment on sales over a ten-year period, meaning 8,000 units would have to be sold at each year for them to make their money back. This assumes the £15 contribution is achievable as suggested by Skindeep.

- No ongoing income would be received from Peau meaning once the initial consideration was spent, the company may find itself in a difficult financial situation again.

- Handing over the formula for a modified RetinX6 chemical may lead to IP issues as it could give Skindeep enough information to copy the product.

3.2 Licencing agreement

The second option put forward by Skindeep is for Derma to licence the sale and marketing of Peau exclusively to them.

Financial implications

- A guaranteed minimum annual income of £45,000 will be received with no effort required from Derma with the potential for additional income as £15 will be received for every unit sold.

- Having a steady annual income may improve the company's track record and make it easier to obtain finance in the future.

Non-financial implications

- Derma's name will still be associated with the product without the company having any control over how Peau is marketed and sold, so reputational damage could be incurred if there were any scandals such as false claims made about the product by Skindeep.

- The product will have a limited market if sold by Skindeep as their products are only available in department stores, pharmacies and airports.

- A legal expert will be required to draw up the licencing contract to ensure it is fair and clear on the terms set out.

Benefits

- The five-year licencing period is relatively short so offers flexibility if Derma wish to regain the rights to sell the product if it is successful or renew the licence to Skindeep for a further period of time.

- Derma will receive a guaranteed income with no cost or effort required.

- There will be minimal risks to the company if the product is unsuccessful as Derma will not have invested in the facilities and campaign required to market Peau.

- Skindeep is experienced in the cosmetics industry so are likely to have extensive knowledge of how to market and sell Peau effectively, making it more likely to be a success.

Risks

- If there is a dispute with Skindeep regarding Peau it may be difficult or costly to exit the licencing agreement early.

- Skindeep has many other products and brands to focus on meaning Peau may be neglected and not reach its full selling potential.

- Only the minimum amount of income would be received if the product performs poorly.

3.3 In-house marketing

The final option is for Derma to retain the rights to Peau and sell and market the product itself.

Financial implications

- No up-front or guaranteed annual income would be received meaning Derma would have to source additional funding in order to launch the product when the financial situation is already unfavourable.

- The costs of marketing a product can be significant, especially for a new-entry product so significant investment would be required by Derma for the Peau to be successful.

Non-financial implications

- Derma does not currently have the facilities or staff with skills to manufacture and sell products, as all of the time is currently devoted to research. This would mean further investment in recruitment, training and facilities in order to manufacture and sell Peau.

- None of the current board members have any experience in business or with marketing a product, therefore it may be difficult to create a targeted marketing campaign which would be successful.

- Market research would have to be carried out on the feasibility of the product before it is launched along with a capability assessment of whether Derma has the capacity to bring Peau to market, which may be time consuming and costly.

Benefits

- If the rights to sell and market Peau are kept by Derma, this would mean that 100% of the profits made are retained by the company, rather than any amount going to Skindeep.

- Generally high margins are received on cosmetic products of up to 80% so up to £40 could be made on sales per unit compared to £15 under the licencing agreement.

- Derma would retain full control over how to produce, manufacture and sell Peau.

Risks

- Derma would have to comply with the relevant legislation such as advertising standards and be careful not to make false claims about the product or else they could face fines and legal action.

- Derma would bear all the risks if the product is not successful which may result in losses being made.

- The company may become caught up in managing Peau and lose focus of the main drug projects which are ongoing.

- If the RetinX6 chemical compound is found to be unsafe at clinical drug trials, it is likely that Peau will have to come off of the market as consumers would not wish to purchase a product containing dangerous chemicals, which could result in significant losses for Derma as well as reputational damage.

3.4 Recommendation

It is recommended that Derma licence the rights of Peau to Skindeep. This option would provide a guaranteed income of at least £45,000 each year with minimal risks to the company. It is also the most flexible option as Derma can choose to retain the rights after an initial period of five years if the product is a success.

No investment would be required by Derma. Skindeep would have all of the responsibilities to sell and market the product, areas which the current board lacks experience in. Given Skindeep's area of expertise is cosmetics and they are already an established company, it is likely that the product will perform well.

REPORT TO THE BOARD OF DERMA LIMITED
FUTURE PROSPECTS OF DERMA LIMITED

PRIVATE AND CONFIDENTIAL

PREPARED BY: Clifton LLP
DATE: December Yr. 38

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1.0 Introduction

This report has been prepared for the Board of Derma Limited relying on information provided by the board and its contents must not be made available to third parties without our written consent. It is intended that the report be made available and be used as a basis of decision making by the board. It is not intended for any external use.

We must emphasise that the share valuations used in this report is not a formal valuation. The value used is a preliminary valuation for illustrative purposes only. More detailed information will be required before a formal valuation can be made.

We have evaluated only the information that you provided, which does not substitute for a full due diligence exercise.

2.0 Executive summary

- The board should act quickly to make a decision as the company is struggling financially and may not meet the next month's financial obligations.

- Overall it is recommended that Derma is sold to Medsanta as continuing the company without the rights to RetinX6 would be risky and could result in insolvency.

- The price which the company is sold for should be negotiated as the £2m current price offered by Medsanta is only half of what Derma's IP alone is valued at.

- Legal advice should be sought before any agreement is reached to ensure all necessary steps have been followed and shareholders are receiving a fair deal.

- Derma should consider using statutory procedures to purchase its own shares if any of the shareholders disagree with the decision to sell the company and refuse to sell their shareholding.

- Staff will have to be informed of the developments once agreed and advised that their contracts should be protected under TUPE legislation.

- Legal action should not be taken against Chemtest as a result of the animal testing as this would be a long and costly process to pursue.

3.0 Selling the rights to RetinX6

Medsanta have the option to take over the rights of RetinX6 from Derma for the price of £1m.

3.1 Implications of the sale

Selling the rights to RetinX6 would mean that Derma could no longer play a part in developing, marketing or selling the product. Similar to the implications discussed when considering the sale of Peau to Skindeep, this would mean that all of the risks and costs associated with developing RetinX6 would be passed on to Medsanta, however the company would be forfeiting any future benefits receivable.

A legal contract would have to be drawn up with Hywell confirming the terms of the loan arrangement and any interest chargeable, as well as any additional rights or security which he would be granted. A legal expert should be consulted to draw up such a contract.

3.2 Valuation and viability

The LEC have valued the rights to RetinX6 at £1.5m, which would mean that Medsanta would be underpaying for the rights by half a million pounds. This is a significant difference, and the contract should be checked carefully by a legal expert to determine whether this amount can be increased to reflect the true value of the rights.

Based on the workings carried out in Appendix 1 and 2, there is evidence that the company will be profitable and make a significant amount of cash in the future even without RetinX6 and looking at the worst case scenario for sales. A valuation of a minimum £3.5m, up to £5m in the best-case scenario using the discounted cash flow method could be achievable. This method of valuation is subjective and is better used for significant minority shareholdings so should not be used to value the company in the case of Medsanta purchasing it.

Both a best- and worst-case scenario for sales would see the company reaching positive net cash inflows by Yr. 42/43, which would be five years into the business. This would mean that Hywell would have to lend Derma significant amounts of cash for several years before any return is met and the company becomes profitable. Under the best case scenario there would be a cash deficit of £37k in the second year of the project and a further £274k for the next two years, a total of £311k to be loaned by Hywell.

3.3 Opportunities

Hywell has agreed to loan the company sufficient working capital to meet the development costs required going forward. Derma would still be able to develop and eventually market the other drugs, HA156 and BU39, along with the cosmetic Peau as although it contains the chemical RetinX6, this is not included within the IP rights.

The company could use the £1m received for the rights of RetinX6 to meet some of its cash obligations for the following year and use the money to continue developing the drugs mentioned above. Provided that Hywell can meet the cash obligations the company could become much more valuable than the £2m offered by Medsanta, as discussed in section 3.2 above.

3.4 Risks

Tanya would no longer be involved in the RetinX6 project which she has been working on for so long so there is a risk that she may wish to exit the business having become disheartened with the remaining projects. This could lead to failure of the company as Tanya is the driving force behind its operations.

The company is already struggling financially with doubt over whether next month's wage obligations can be met, therefore there is a real risk that the company would struggle to continue without the rights to RetinX6. Even with Hywell offering to lend the money to continue, there is a risk that his personal finances could fall short and the company would no longer be viable.

Even if all of the working capital costs could be met, the company may struggle to pay back the £311k loan from Hywell in the future if the products do not perform as well as anticipated and the company could face going insolvent in order to meet the debt obligation. There is an additional risk to directors as if the company is trading whilst knowingly insolvent which could result in being banned from being a director and even a prison sentence.

There may be significant reputational damage suffered by Derma following the animal testing scandal, which may be difficult to recover from and could result in protests and anger from animal rights groups. If the company were to continue, PR advice should be sought to mitigate any negative publicity so the company can remain viable.

4.0 Selling Derma Limited

The second option faced by Derma is for the entire company to be purchased by Medsanta for the price of £2m.

4.1 Implications of the sale

If the entire company is to be taken over by Medsanta, there are a number of implications which must be considered.

Selling the company to Medsanta would mean all of the existing shareholders must sell their shares for consideration of £2m, which works out at £1.33 per share. Selling Derma would mean that none of the shareholders personal capital will be at risk any longer, which is a great benefit given the current financial situation of the company. It is likely that the non-executive directors will want to sell their shares given that they have not been paid for six months.

It is likely that there will be a great deal of upset and distress if employees hear that the company is being sold, therefore the situation should be handled carefully. Existing contracts with bodies such as the Medical Council of Research should be looked at and the organisation should be contacted, as the sale of the company may make the contract invalid.

The tax considerations of selling the shares should be considered. Capital gains tax will be payable on any gain made by each shareholder on the sale of the shares. This may be difficult to meet as Tanya and the NEDs have indicated they do not currently have sufficient cash.

4.2 Valuation and viability

From the workings carried out in Appendix 3, the company has been valued at a minimum of £3.5m using the discounted cash flow method. If the shareholders were to accept the sales price of £2m they would only be receiving half of what the company's IP alone is thought to be worth. This would be a significant underpayment and Derma should investigate whether there is scope for negotiation on this figure.

4.3 Opportunities

Medsanta have offered to retain Tanya for the length of the RetinX6 project until it is licenced, which includes a substantial remuneration package. This would allow Tanya to remain involved in the project which she has been working on for many years and appears attached to, whilst also allowing an exit route for the remaining shareholders.

Any negative publicity and reputational damage received because of the animal testing scandal would no longer be an issue as the company would be taken over by Medsanta and it would not have any effect on the shareholders.

4.4 Risks

It appears that Hywell is reluctant for the company to be sold. This may present challenges if this route was chosen as a shareholder cannot be forced to give up or sell their shareholding. This may pose difficulties as Medsanta will wish to purchase the entire company and a dissident shareholder could put them off the entire deal. Derma should consider taking statutory procedures to purchase back the shares of the company to remove a dissident shareholder.

5.0 Overall recommendation

We recommend that the entire company is sold to Medsanta. The price of £2m however should be negotiated as per the LEC valuation the company IP alone is worth £4m, therefore a price much closer to this should be agreed upon before a deal is accepted.

This is the least risky option as Derma is in a financial distress and many further years of negative cash flows would follow if the company were to continue on, which has a great risk of resulting in insolvency of the company. Selling the company is likely to please the majority of the board, with the NEDs being able to exit and Tanya still being involved in the project and receiving a healthy remuneration package.

It is not recommended that Derma take steps to sue Chemtest because of the animal testing due to the amount of time and money involved in pursuing legal action.

Appendix 1

Cash Flow Forecast for Derma Limited										
Best case scenario										
	38/39	39/40	40/41	41/42	42/43	43/44	44/45	45/46	46/47	47/48
Cash inflows										
RetinX6	1,000,000									
MRC development fee	50,000	50,000	50,000	50,000						
Release of grant income	100,000	100,000								
Revenue from Peau		160,000	160,000	160,000	160,000	160,000	160,000	160,000	160,000	160,000
Revenue from HA156					1,200,000	1,200,000	1,200,000	1,200,000	1,200,000	1,200,000
Revenue from BU39									600,000	600,000
	1,150,000	310,000	210,000	210,000	1,360,000	1,360,000	1,360,000	1,360,000	1,960,000	1,960,000
Total cash inflows										
Cash outflows										
Fixed costs										
Peau		16,000	16,000	16,000	16,000	16,000	16,000	16,000	16,000	16,000
HA156					90,000	90,000	90,000	90,000	90,000	90,000
BU39									240,000	240,000
Variable costs										
Peau		24,000	24,000	24,000	24,000	24,000	24,000	24,000	24,000	24,000
HA156					400,000	400,000	400,000	400,000	400,000	400,000
BU39									90,000	90,000
Marketing costs										
Peau		8,000	8,000	8,000	8,000	8,000	8,000	8,000	8,000	8,000
HA156					40,000	40,000	40,000	40,000	40,000	40,000
BU39									30,000	30,000
Development costs										
Peau	400,000									
HA156	150,000	150,000	150,000	150,000						
BU39	100,000	100,000	100,000	100,000	100,000	100,000	100,000	100,000		
Admin costs	49,000	49,000	49,000	49,000	49,000	49,000	49,000	49,000	49,000	49,000
Total cash outflows	699,000	347,000	347,000	347,000	727,000	727,000	727,000	727,000	987,000	987,000
Net cash inflow/outflow	451,000	(37,000)	(137,000)	(137,000)	633,000	633,000	633,000	633,000	973,000	973,000

Assumptions

- The rights to RetinX6 are sold and all of the costs and revenues associated have not been included in the cashflow
- Assume development fees stop being paid once product is completed
- Development costs to completion spread evenly over years until completion
- No other costs or salaries have been included in the calculation
- Tax has not been included within these computations
- Finance costs or income have not been included within these computations

Appendix 2

Cash Flow Forecast for Derma Limited										
Worst case scenario										
	38/39	39/40	40/41	41/42	42/43	43/44	44/45	45/46	46/47	47/48
Cash inflows										
RetinX6	1,000,000									
MRC development fee	50,000	50,000	50,000	50,000						
Release of grant income	100,000	100,000								
Revenue from Peau		100,000	100,000	100,000	100,000	100,000	100,000	100,000	100,000	100,000
Revenue from HA156					800,000	800,000	800,000	800,000	800,000	800,000
Revenue from BU39									450,000	450,000
	1,150,000	250,000	150,000	150,000	900,000	900,000	900,000	900,000	1,350,000	1,350,000
Total cash inflows										
Cash outflows										
Fixed costs										
Peau		16,000	16,000	16,000	16,000	16,000	16,000	16,000	16,000	16,000
HA156					90,000	90,000	90,000	90,000	90,000	90,000
BU39									240,000	240,000
Variable costs										
Peau		12,000	12,000	12,000	12,000	12,000	12,000	12,000	12,000	12,000
HA156					160,000	160,000	160,000	160,000	160,000	160,000
BU39									45,000	45,000
Marketing costs										
Peau		4,000	4,000	4,000	4,000	4,000	4,000	4,000	4,000	4,000
HA156					16,000	16,000	16,000	16,000	16,000	16,000
BU39									15,000	15,000
Development costs										
Peau	400,000									
HA156	150,000	150,000	150,000	150,000						
BU39	100,000	100,000	100,000	100,000	100,000	100,000	100,000	100,000		
Admin costs	49,000	49,000	49,000	49,000	49,000	49,000	49,000	49,000	49,000	49,000
Total cash outflows	699,000	331,000	331,000	331,000	447,000	447,000	447,000	447,000	647,000	647,000
Net cash inflow/outflow	451,000	(81,000)	(181,000)	(181,000)	453,000	453,000	453,000	453,000	703,000	703,000

Assumptions

- The rights to RetinX6 are sold and all of the costs and revenues associated have not been included in the cashflow
- Assume development fees stop being paid once product is completed
- Development costs to completion spread evenly over years until completion
- No other costs or salaries have been included in the calculation
- Tax has not been included within these computations
- Finance costs or income have not been included within these computations

Appendix 3

Discounted cash flow valuations of Derma Limited based on best case and worst-case scenario cash flow forecasts prepared in appendices 2 and 3.

Best Case Scenario

Discount rate		10%	
Year	Net cash flow	Discount factor	NPV
1	451,000	0.9091	410,004
2	(37,000)	0.8264	(30,577)
3	(137,000)	0.7513	(102,928)
4	(137,000)	0.6830	(93,571)
5	633,000	0.6209	393,030
6	633,000	0.5645	357,329
7	633,000	0.5132	324,856
8	633,000	0.4665	295,295
9	973,000	0.4241	412,649
Terminal	7,784,000	0.3855	3,000,732
			4,966,818

Worst Case Scenario

Discount rate		10%	
Year	Net cash flow	Discount factor	NPV
1	451,000	0.9091	410,004
2	(81,000)	0.8264	(66,938)
3	(181,000)	0.7513	(135,985)
4	(181,000)	0.6830	(123,623)
5	453,000	0.6209	281,268
6	453,000	0.5645	255,719
7	453,000	0.5132	232,480
8	453,000	0.4665	211,325
9	703,000	0.4241	298,142
Terminal	5,624,000	0.3855	2,168,052
			3,530,442

Note: Based on a terminal multiplier of 8.

Presentation – Slides & Notes

Types of Cybercrime

- Several different forms of cybercrime
- Ransomware
- Phishing
- Virus attacks
- Spyware

Speaker notes:

- Cybercrime is on the increase and is now the biggest risk to businesses of using internet-enabled systems.
- There are many different types of cyberattack. Firstly, there is ransomware as you experienced which can disrupt systems operating.
- Phishing is an attack which aims to gain person details such as log in information, and often comes in the form of spam emails.
- Viruses can come in many different forms and could have an effect of anything from halting the system entirely to corrupting files held on the network. Spyware is used to gather data such as keystrokes to gather sensitive data such as passwords.

Risks of Cybercrime

- Non-compliance with data protection laws
- Commercially sensitive data being accessed
- Systems unable to operate
- Loss of data

Speaker notes:

- There are a number of risks the company faces when it comes to cybercrime. If the company were to suffer another cyberattack, there is a risk that sensitive data such as payroll information is accessed.
- This would be in breach of the data protection laws under GDPR and Derma could face significant fines. Also, there is a risk that sensitive information relating to product testing is leaked which could result in competitors copying the drugs currently being developed.
- Many forms of cyber-attack aim to halt the systems making it impossible for Derma to operate and carry out its research. There is also the risk that valuable data obtained is lost which could be costly to replace or reproduce.

Mitigating the risks

- Use of firewalls
- Back-up of data
- Training staff
- Use of encryption
- Strong passwords

Speaker notes*:*

- In order to mitigate the risks discussed earlier here are some suggestions to improve cyber-security which Derma should consider implementing.
- Firstly, firewalls are a useful tool and should remain active at all times. If the system has to shut down, a back-up firewall should be in place to prevent further attacks.
- Derma should continue to back-up all of the data so that nothing is lost.
- Staff should be trained to look out for suspicious emails and report them, ensuring that they do not click on them which could lead to viruses. All staff when accessing the system should have strong passwords in place which are changed regularly, such as every 30 days, to prevent unauthorised access to systems.
- Derma should also ensure that data is encrypted so that if anything is stolen, it cannot be read by outside parties.

Email

To: Husain

From: Alex

Subject: Derma Limited -R&D Tax credits

Date & Time: December Yr. 38

I have assessed the R&D statement prepared by Tanya and set out my findings below.

Contract work

*W*ork done under contract or licence for a large company is not eligible for R&D tax relief. Currently, the RetinX6 drug is prepared under contract with Medsanta, a very large company. This means that R&D tax credits should not be claimed for expenses in relation to this project, therefore any costs relating to RetinaX6 should be removed from the return.

Although R&D tax credits cannot be claimed, the company may be eligible for RDEC if certain conditions are met. This would allow Derma to reclaim 13% of eligible costs on this project. We should find out further information about the circumstances whereby a small company can use RDEC to assess whether Derma qualifies and can claim the 13% of eligible costs back.

Specified subsidies

The BU39 drug received a grant from Bristol University of £100,000. We should confirm whether this is a specified subsidy under the terms of the EU-UK Trade and Cooperation Agreement and revise the calculation accordingly.

In addition, the HA156 drug receives an annual development fee of £50,000 from the Medical Research Council. Again, we must ascertain whether this money would be classed as a specified subsidy and also needs to be adjusted.

As mentioned above, if these projects do receive specified subsidies and are not eligible for R&D tax credits, we must ascertain whether Derma is eligible for RDEC as projects funded by specified subsidies are still eligible for RDEC.

Going concern issue

Currently, as Derma is facing an uncertain future with potential to sell the entire company, it could be argued that Derma is not currently a going concern. This would mean that R&D tax credits could not be claimed at all as they are only allowed on the condition that the company is a going concern.

Conclusion

Overall I believe that there are a number of contentious areas which I have discussed above which require further investigation and consideration.

We should not submit the R&D tax return at this time. The return should only be submitted when Tanya agrees to correct the return for any potential adjustments which have been discussed above.

Kind regards,

Alex

Memorandum

From: Husain

To: Ethics partner

Subject: Derma Limited – ethical concerns

Date: December Yr. 38

I have identified a number of ethical concerns when working on Derma Limited which I have set out below.

Animal testing

Derma has been involved in a scandal relating to a company they used to test their drugs having been found to test on animals. It appears that Tanya was aware of the animal testing which suggests a lack of integrity on her part.

It may cause us reputational damage if we are associated with a company involved it such practices.

Other pharmaceutical clients

As the firm works for a number of pharmaceutical clients there is a risk that confidentiality could be breached, and we are not seen to be objective as we could pass on sensitive information or business practices to another company. We must ensure that separate teams are in place if we are dealing with pharmaceutical companies who may wish to become involved with each other, for example a takeover bid, as this could lead to one party receiving privileged information. We should ensure that information does not flow between them.

Going concern

There is a going concern risk with Derma as the company is currently facing a difficult situation and may not be able to continue. We should monitor the situation carefully and consider whether we should continue to prepare work for them as they may be unable to meet our fees.

Pressure from Tanya

Tanya has been pressuring the firm to submit the R&D tax credit return in order that she can receive the cash quickly even though it may be incorrect. We should be careful not to be intimidated by clients and ensure that all the necessary checks are carried out before submitting any work. If we were to submit incorrect tax returns this may lead to reputational damage for Clifton if the firm is seen to be incompetent.

Board disputes

Currently Derma is facing a difficult situation which has resulted in disagreements on the board. We should be careful when acting for the client so as not to aggravate any existing tensions.

If we were to act personally for a member of the board and advise them on any decisions which should be taken regarding their personal investments, a separate letter of engagement should be drawn up and separate teams used than those members of staff acting for the company as a whole in order that we remain objective.

If you wish to discuss the above matters further, please let me know.

Kind regards,

Husain