Celltrion's cash flow comes under doubt

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Celltrion’s headquarters in Incheon. Some experts are raising concerns over the financial health of the biosimilar drug maker. / Yonhap

This is the fifth of a series highlighting industry leaders that struggle to deal with their flaws or mistakes. — ED.

Experts question financial health of biosimilar drug maker

By Kim Tae-gyu

Celltrion has been a darling of the Seoul bourse as the biosimilar drug maker’s share price has jumped around five-fold since 2010 so as to become the largest-capitalized corporation on the country’s tech-heavy KOSDAQ.

The long standing love affair is understandable in light of the Incheon-based outfit’s solid performances — last year it chalked up 528 billion won in sales and 254 billion won in operating income.

But doubts linger on the legitimacy of the seemingly wonderful figures, which critics say are too good to be true.

“How can investors not be attracted by a large company whose operating profit ratio approaches 50 percent?

They have good reason to channel money into the highly profitable firm," said an accountant.

"However, a closer examination of Celltrion's financial reporting prompts me to raise a few questions which investors have to think about before spending their money."

The biggest issue seems to be that most of Celltrion's revenue came from selling products to Celltrion Healthcare, which has the right to market them overseas — the proportion is well above 95 percent.

In other words, Celltrion churns out drugs through copying well-established medications that are off-patent and Celltrion Healthcare buys them all to sell across the world.

The two firms have no shares in each other but Celltrion's founding CEO Seo Jung-jin is the largest shareholder of both.

The thing is that Celltrion Healthcare fails to offload the products so that inventory piles up. Hence, its inventory assets keep rising from 931.6 billion won in 2013 to 1.1 trillion won in 2014 and 1.4 trillion won last year.

In particular, last year's number was disappointing because it shattered hopes that the inventory assets would go down once Remsima, Celltrion's flagship item in its pipeline, starts being sold well.

Also at issue are Celltrion's sales accounts receivables that amounted to 619 billion won last year, compared to annual sales of 528 billion won, which some argue are far from normal.

"Let me give an example. I fry chickens and sell them to a company run by my wife for a high price. But my wife fails to sell them to people. What will be the result? I am rich in the accounting books but not in the real world and my wife will eventually go under," the accountant said.

Included in Celltrion's investors are Temasek, Singapore's sovereign wealth fund, and JP Morgan's internal fund, One Equity Partners.

Warning flags

This is not the first time that experts have raised a warning flag on Celltrion's unique way of making money.

A vice president of a local bank recollected that Celltrion's financial status was not proper for them to extend loans.

"When I was in charge of corporate credit, Celltrion asked for loans. But we had no choice but to reject the request after looking into its financial reports. Simply put, it seemed quite risky," said the vice president.

An operator of a domestic early-warning system concurred that Celltrion may "round-trip" cash to inflate its turnover and revenue. In other words, she said that true end-market sales may be a fraction of its reports.

"Our early-warning system shows that Celltrion's financial health is not so good. Its adorable top line and bottom line are based on transactions, which are not followed by immediate cash flow," she said.

"Financial regulators should investigate Celltrion because any problems will cause great harm to investors. Worse, a vast majority of Celltrion shares are owned not by institutions but by individuals."

On Feb. 29 this year, Ghost Raven Research officially accused Celltrion of doctoring the figures by disposing of unwanted products at Celltrion Healthcare. Unidentified authors of it contended that Celltrion Healthcare was established "for no other purpose than to allow Celltrion to fabricate sales and hide excessive levels of debt and inventory."

"We believe that Celltrion today has actual revenue 90 percent below what they claim, and operating expenses more than 50 percent above what they claim," the report said.

"The true financial picture is that Celltrion is a tiny company burning tons of cash, with way too much inventory and way too much debt. Were Celltrion to report accurate financial statements, we believe it would collapse as one of the largest frauds in world history."

It also takes issue with the fact that Chairman Seo and other Celltrion executives worked for Daewoo Group, which collapsed in the aftermath of unprecedentedly massive accounting rigging. The now-defunct group was led by discredited Chairman Kim Woo-choong.

The research company concluded "Celltrion is misleading the market by overstating its true revenue and earnings, Celltrion burns cash, and Celltrion is over-levered."

Celltrion fires back

Ghost Raven Research, which did not disclose the identities of the reports' authors, made no secret of the information that the aggressive report was geared toward profit gains through short-selling.

"You should assume that as of the publication date of our reports and research, Ghost Raven Research along with our clients and/or investors and/or their clients and/or investors has a short position in all stocks and bonds converted herein, and therefore stands to realize significant gains in the event that the price of either declines," it noted in a disclaimer.

Celltrion wasted no time dismissing the report as a short-selling gambit — Ghost Raven Research has a strong incentive to drive down the share price of Celltrion in consideration of its position.

"We believe that the short sellers of Celltrion stocks must have taken huge losses, and they are circulating these false reports to recover their damages," the firm said in an announcement.

And Celltrion boasted of its capability in global competition including the fact that it received approval from the Federal Drug Administration (FDA) of the United States this April.

The FDA approved Remsima, a biosimilar version of Janssen's Remicade, the autoimmune disorder drug that racked up sales of $4.5 billion in the U.S. and $9.9 billion in total last year.

Seeking a preliminary injunction to prevent Celltrion from selling Remsima, Janssen filed a complaint in June but the district court ruled in favor of Celltrion and Janssen vowed to appeal.

Believing the verdict would not be overturned, Celltrion shipped its first batch of Remsima to the U.S. last month. The drug has been a hit in Europe since its launch in 2013. It now accounts for some 30 percent of the market and the share is expected to exceed 40 percent in the not-so-distant future.

In addition, U.S. powerhouse Pfizer signed a contract with Celltrion so as to take charge of Remsima sales in the world's largest pharmaceutical market under the brand name of Inflectra.

Celltrion Healthcare also has dismissed doubts on its high inventory assets saying that pharmaceutical distributors are required to secure enough products so that it will not miss surging demand in the short term.