Biotech Daily

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Daily news on ASX-listed biotechnology companies

Dr Boreham's Crucible: Cryosite

By TIM BOREHAM

ASX code: CTE

Share price: 36 cents

Market cap: $17.6 million

Shares on issue: 48,809,563

Chief executive officer: John Hogg

Board: Bryan Dulhunty (chair), Andrew Kroger, Nicola Swift and Steven Waller

Financials (year to June 30, 2021): revenue $10.1 million (up 12%), underlying profit $1.12 million (up 39%), net profit $652,574 (down 55.9%), cash of $3.9 million (down 4%)

Identifiable major holders*: Andrew Kroger (and related entities) 41.5%, BNP Nominees 12%, Gary Griffith Robins and Allan James Robins 6%, DMX Capital Partners 5%

***** Cell Care Australia disposed of its 15 percent stake in March 2021. Investors purchasing its stake included DMX Capital Partners and individual shareholders under the BNP Nominees banner.

Not too many companies would thank a competition regulator that both blocked a proposed merger and levied a $1 million fine on them, albeit in highly unusual circumstances.

But there's not much usual about Cryosite, which operates a Sydney storage facility for cord blood (stem cell) material and other biological samples for use in clinical trials.

The reason for Cryosite's gratitude to the Australian Competition and Consumer Commission is that by disallowing the sale of its cord blood business to Cell Care Australia in 2017, the company retained a low-growth, run-off operation that's become nicely profitable.

And eventually the company recouped the $1 million penalty, not from the ACCC but from its external legal advisers.

The accidental breach of the law related to "jumping the gun" provisions. But we won't jump the gun with the narrative, we'll explain it further below.

Meanwhile, the pandemic has also proved an accidental boon for Cryosite, because pharmaceutical companies migrated many of their trials to (relatively) Covid-free Australia.

Frozen in time

Cryosite was founded in 1999 and listed in May 2002 after raising $8.5 million at 40 cents apiece (for a total market cap of $7.6 million).

Back then Cryosite held itself out as the only collector, processor and storer of cord blood stem cells with its south Granville facility in western Sydney, winning Therapeutic Goods Administration approval.

More broadly, Cryosite is about the ultra-low temperature storage of other biological material including cells, micro-organisms, proteins and genes.

And klutzes such as your columnist can relax if they think the company has a massive electricity bill: the samples are stored in liquid nitrogen.

One of Cryosite's many quirks is that its three-person board has remained unchanged for many years (until today – see above), but the CEO role has changed more times that Australia's carbon emissions target.

The CEO baton is now held by former production manager John Hogg.

Cryosite's register is tighter than a Tasmanian family reunion, with former stockbroker Andrew Kroger (brother of Liberal heavyweight Michael) holding more than 40 percent.

Trial emphasis is no error

In the last financial year, Cryosite gleaned three-quarters of its revenue, $7.5 million, from storing material for research trials.

With the company traditionally spending little on capex (capital expenditure), management invested $1.3 million over the last two years and plans to splurge another $750,000 this year.

“Revenue is going through the roof,” Mr Dulhunty says.

“We thought it would take years to get to maximum capacity, but it is full now.”

He says most of the large pharmaceutical companies treated Europe as one entity, so when borders closed, they struggled to ship between countries.

The flow-on effect is they shipped the requisite material to Australia ahead of time.

Mr Dulhunty says taking on a large pharma client will involve 12 months of due diligence and mutual bottom-sniffing.

“But once you have the customer locked in, they are with you for a very long time.”

Laughing all the way to the blood bank

Speaking of bottom-sniffing, in a case of ‘man bites dog’ Cryosite’s sideline clinical trials business has become the main event over the years.

But the cord blood storage side of the business is fighting back.

Collected at birth, the stem cells in cord blood and tissues allegedly can be used to treat certain blood disorders - and also could come in handy for any number of emerging stem-cell treatments.

Cryosite has been storing cord blood samples for up to 20 years, under 18-year contracts. It does not accept new samples, having ceded this business to Cell Care and its superior marketing power.

But Cryosite hatched a cunning plan of contacting the legacy clients ahead of contract expiry, offering contracts of up to 10 years, renewed annually for $175.

The company expected to be throwing out most of the samples, or donating them to research organizations.

After all, the donors - now adults - legally own the material and how many 18-year-olds are interested in shelling out $175 of beer money every year?

But having paid thousands of dollars for the initial contract, parents (and grandparents) have stepped-in to fund the extensions.

“They clearly believe in the future of stem cell science,” Mr Dulhunty says.

“We are getting an exceptionally high take-up rate. What was essentially a long-tail liability … over time will generate a very significant revenue flow at pretty much zero extra cost.”

Not just sprinters jump the gun

In June 2017, Cryosite said it would licence (in effect sell) the cord blood bank business to Cell Care Australia.

The ACCC reviewed the transaction, but then discontinued its public review process and the deal foundered.

In its first "gun jumping" action, the ACCC launched legal action against Cryosite for alleged cartel conduct.

"Jumping the gun" does not refer to overzealous sprinters but Cryosite advising new customers to go to Cell Care instead of themselves, ahead of the anticipated merger.

Cryosite reasoned those new customers ought to know the business was about to close its doors, but admitted to the unintended cartel behavior and copped the $1 million penalty plus $100,000 of legal fees (on a negotiated 10-year instalment plan).

The $1 million (less $41,000 of fees) was later recovered from the legal firm dispensing the relevant advice.

Founded by ex-Macquarie Bank types, Cell Care went on to buy a Canadian blood bank, before being acquired by private equity interests for $US100 million.

The group last year was taken over - again - for $US200 million.

Along the way, Cell Care retained a 19.9 percent holding but sold out in March this year after reducing the stake to around 15 percent.

"Cell Care wasn't a natural holder,' Mr Dulhunty says.

New competition?

Cryosite is an 'orphan' in ASX listed terms, but bears some similarities with Bluechiip which provides "cryogenic consumables" notably wireless trackers.

Meanwhile, a Ballarat mob called Vitrafy Life Science has raised $7.9 million ahead of a vaunted ASX listing in 2021.

We're yet to spy a prospectus, though.

The "biomedical cryo-preservation" company is supported by a cabal of institutions including Ryder Capital, Regal Funds Management and Thorney Holdings, as well as former Bellamy's chairman Rob Woolley.

The raising was organized by Bell Potter, so there's more heavyweights involved than a sumo wrestling final.

Finances and performance

In the year to June 30, 2021, Cryosite recorded a net profit of $652,574, which ‘officially’ was down 56 percent but up 39 percent discounting the previous year’s $1 million legal settlement.

For a small company, Cryosite’s balance sheet - and, consequently, profit and loss statement - is replete with complexities.

The balance sheet items include a $20 million deferred asset and a $18 million deferred liability.

Mr Dulhunty says investors should focus on the cash flow statement, which showed an inflow of $488,000 this year compared with last year’s $357,000 (excluding the legal settlement).

In the troubled 2017-’18-year, cash outflows were $200,000 and the company recorded an $800,000 pre-tax loss.

Over the last year the quasi-illiquid Cryosite shares have changed hands between 45 cents (January 29 this year) and 16 cents (March 10).

This low point reflects a savage investor reaction after Cell Care’s share sell-down was revealed.

Management prepared to mount a share buy-back to mop up the share overhang. Instead, Cell Care organized a group of shareholders to acquire the scrip.

This introduced DMX Capital to the register, as well as a gaggle of monied individuals represented by BNP Nominees

Frozen in time

Here’s a fun fact:

When we last covered Cryosite in November 2018, the company had exactly 46,859,563 shares on issue and as of June 30 this year the company had - yep - 46,859,563 shares on issue

Way back in 2005 the company had - you guessed it - 46,859,563 shares on issue.

This highlights how the tightly-held company has survived by relying on internal funds generated.

This extraordinary stasis was interrupted only in September this year when Messrs Dulhunty and Hogg exercised 1.95 million in-the-money options, thus boosting shares on issue by 2.5 percent.

Dr Boreham's diagnosis:

Previously we opined that Cryosite had lost its way - and management didn't argue with that.

"Since then, we have refocused, reinvested in and revitalized the business," Mr Dulhunty says.

Given its patchy corporate history and tight register, Cryosite has not been an active self-promoter, but plans to sing its song more lustily over the next 12 months.

While management plans a trading update at its December 8 AGM, Mr Dulhunty has already flagged a "very strong" current year (to June 30, 2022).

"Cryosite is largely a fixed cost business," he says. "Now the restructuring is pretty much behind us the revenue growth will pretty much all drop to the bottom line."

Clinical trials aside, Cryosite is eyeing expansion into other cold-storage activities, notably medical marijuana and oncology products (the company is licenced by NSW's health mandarins to store the former).

"We are doing some novel things which may prove very successful," Mr Dulhunty says.

The cord blood side is a slow burn, but there's significant value in a $175 annual fee over, say, 30 years and it's possible that someone like Cell Care will buy the company.

Your columnist believes Cryosite is materially undervalued with a $17 million market valuation, but we caution the business won't exactly become 10 times bigger.

As Mr Dulhunty says: "we are not trying to build an empire, we are trying to build a business with very strong cash flow and revenue growth."

Disclosure: Dr Boreham is not a qualified medical practitioner and does not possess a doctorate of any sort. He knows he doesn't have any umbilical cords stored in his freezer, but the old tomatoes look like they are growing their own children.