# CFO's Letter

## Moving into a new era of profitability

Andrew J. Oakley
Chief Financial Officer

Dear Shareholders,

The continued dynamic growth of Actelion in markets around the globe was reflected in our strong financial performance in 2004, when our company crossed the threshold of profitability according to US GAAP criteria. To have reached this milestone so early in the company's life is a remarkable achievement. It is also testimony to our commitment to shareholders to realize financial independence so that Actelion can fully capitalize on the long-term growth opportunities arising from our Research and Development activities.

The 2004 operating profit of CHF 85.6 million and a net profit after tax of CHF 87.2 million compares to an operating loss for 2003 of CHF 1.7 million and a net loss of CHF 9.9 million. The improvement in profitability was achieved as a result of stronger than initially foreseen growth in sales revenues, from CHF 300.3 million in 2003 to CHF 455.3 million in 2004. Commensurate with this growth, operating expenses increased in a controlled manner from CHF 309.2 million in 2003 to 386.3 million in 2004.

**Revenue growth fueled by Tracleer® sales performance**

Net revenue for 2004 totaled CHF 471.9 million, compared to total net revenues in 2003 of CHF 307.5 million, an increase of 164.4 million or 53%. Tracleer® was again the main contributor to both the revenue line and to growth, as the product continued to build on its position as market leader and cornerstone therapy in pulmonary arterial hypertension (PAH). These impressive results were achieved with the addition of only one major market: Australia.

Zavesca® sales in 2004 started to show momentum, with sales growing to 6.1 million from CHF 0.7 million in 2003. During the year under review, Zavesca® became commercially available in several European Union member states. In the United States, the product was launched in early 2004.

Contract revenues grew substantially in 2004 to CHF 16.5 million from CHF 7.2 million in 2003. This growth can be entirely attributed to the global collaboration in the field of renin inhibition with Merck, Inc. Actelion received the first payment of USD 10 million from this collaboration in December 2003 and earned its first milestone payment of USD 15 million in March 2004. Revenues from this collaboration are being recognized over a three-year period from the agreement date, which is the expected period of Actelion's lead in development.

**Further improvement in gross margins**

Cost of sales in 2004 was CHF 45.9 million or 10.1% of sales revenues, an improvement in margin terms from 2003 when cost of sales was CHF 31.8 million or 10.6%. The absolute increase in cost of sales is attributable to the growth in sales revenues, while the margin improvement is attributable to the increasing proportion of Tracleer® sales outside the United States, as US sales entail a higher rate of royalty payment. At the end of 2004, we were successful in terms of gaining regulatory approval for our second-generation production process for Tracleer®, which achieves two important goals. First, it will reduce the cost of manufacture for this product. Second and more importantly, it ensures overlapping production capacity to further increase supply chain flexibility.

**Operating expenses – balancing current and future needs**

Strategically, the company is committed to maintaining a balance between short-term growth in profitability and the long-term need of investing in our pipeline to deliver innovative products that meet high unmet medical needs. In 2004 this revenue-based expenditure release strategy saw operating expenses, excluding cost of goods sold, increase to CHF 340.4 million from 277.4 million in 2003, an increase of 23%, compared to an increase in revenues of 53%.

Research and Development expenses in 2004 increased to CHF 136.3 million, from CHF 79.2 million, an increase of CHF 57.1 million. A major cost factor in 2004 was the VERITAS trial, which evaluated tezosentan in acute heart failure. This program was stopped for futility at the second interim analysis point in November 2004. The year under review also saw significant progress in many other clinical trials, with several that involve potential line extensions for Tracleer® and Zavesca® successfully completing enrollment. The Phase IIa program with palosuran also completed patient recruitment and the Phase IIb/III program with clazosentan was commenced late in 2004. Significant progress was also made in research, with one new compound beginning clinical trials in the second half of 2004. A number of research projects also neared the decision point for full preclinical development stage, which substantially increased costs.

Marketing and advertising expenses in 2004 increased to CHF 101.7 million from CHF 79.8 million in 2003, an increase of CHF 21.9 million. Included in these costs are our promotional efforts for both Tracleer® and Zavesca®, including participation at major medical congresses throughout the year, medical marketing operations and Phase IIIb/IV clinical trials. All of these activities, as in the past, focused on increasing disease and product awareness in physicians with a high likelihood of treating patients at high risk of developing PAH. The company will continue to focus its activities on expanding the market for its products, particularly in view of expected new therapeutic options available to PAH patients.

Selling, general and administrative expenses in 2004 increased to CHF 95.7 million from CHF 69.6 million in 2003. In the second half of 2004, we announced a substantial increase in our sales force, from 150 to 200 territory managers. This had only a minor impact in 2004 in terms of costs; the full effect both in terms of costs and revenues will be felt in 2005. In an environment increasing in both complexity and oversight, basic expenses of general management and administration are also increasing. Nevertheless, Actelion is applying strong measures to limit overhead infrastructure and keep costs under control.

**Non operating income driven by convertible bond costs**

Interest expense in 2004 amounted to CHF 0.4 million, which practically offset interest income of CHF 1.0 million. This compares to interest expense in 2003 of 0.9 million and interest income of CHF 0.9 million.

A full year's amortization of debt discount and bond issuance costs in 2004 resulted in a non cash expense of CHF 7.4 million compared to two months of costs in 2003 for an expense of CHF 1.5 million.

Other financial income in 2004 was CHF 3.1 million, compared to CHF 2.6 million in 2003. This includes foreign exchange gains and losses from hedging operations and intercompany accounts payable balances. Despite satisfactory insurance hedging operations in 2004, the fall in the US dollar resulted in the net translation exposure at the operating profit level being higher than the gains from transactional hedging. This is an exposure that the company has limited ability to control.

Income tax expense in 2004 was CHF 4.3 million, compared to CHF 0.8 million in 2003. In the fourth quarter of 2004, given that there was sufficient evidence of sustainability of profit, the company was required to book a deferred tax asset, which resulted in a reduction of the overall tax rate for 2004.

The first quarter of 2004 saw the completion of the sale of our contract research subsidiary Hesperion to Cerep. Correspondingly, the gain from discontinuing operations included the profit on disposal of CHF 9.6 million. This compares to a loss from discontinued operations in 2003 of CHF 7.5 million.

**Net profit and earnings per share**

Net profit for 2004 was CHF 87.2 million, compared to a net loss in 2003 of CHF 9.9 million. Non-diluted earnings per share increased in 2004 to CHF 3.96 per share compared to a loss per share in 2003 of 0.46. On a fully diluted basis, earnings per share in 2004 were CHF 3.78.

**Balance sheet – improving net worth**

With a strong operational performance in terms of net profit, the major balance sheet effect was an improvement in net equity and a general strengthening of the financial position of the company.

Expansion as seen in 2004 generally places working capital management in clear focus and this was certainly the case for Actelion. Overall cash increased markedly despite an increase in net working capital. In particular, trade and other receivables increased dramatically to CHF 109.6 million at the end of December 2004 from CHF 66.7 million. This is partly due to an overall increase in the level of sales, but also because of the deterioration in the average terms of trade throughout the year. This deterioration is solely due to an increasing proportion of sales coming from territories with longer payment terms.

In the second quarter of 2004, the company opportunistically acquired land adjacent to the new research building, which is currently being constructed on behalf of Actelion. This acquisition, at a cost of CHF 7.8 million, will ensure that sufficient space is available to Actelion for future expansion in Allschwil, Switzerland. In the near- to mid-term, our strategy is to remain monocentric in terms of both Research and Development. Actelion believes that substantial synergies exist from focusing on a single center of excellence.

During the year under review, Actelion repaid, in accordance with the loan agreement, the CHF 40 million loan from Basel Kantonal Bank undertaken in late 2002. As of 31 December 2004, the company had no financial debt other than the convertible bond issued in October 2003.

**Cash generation at the operational level**

A major feature of 2004 was the company's ability to generate cash from operations, despite the increasing investment in working capital. During 2004, the company generated CHF 91.7 million in cash from operations, an increase of 53.4 million from 2003, when cash from operations was CHF 38.3 million. This increase in cash is obviously predominantly driven by increased profitability. Another factor was the receipt in the first quarter of a USD 15 million milestone payment from Merck as part of the global renin inhibitor alliance.

**Concluding remarks and outlook**

The year 2004 has seen the company make many improvements in both infrastructure and processes necessary to continue to ensure full financial accountability, also in view of changes to US GAAP such as accounting for employee stock options in the profit and loss statement using the fair value methodology.

I would like to take this opportunity to thank the entire finance team at Actelion for the tireless dedication shown throughout the year. We have all benefited from the oversight and input from the Finance and Audit Committee, headed in 2004 first by Rudolf Maag and then by Fred Meyer. Both of them have now left the Actelion Board of Directors. I would like to express my deeply felt gratitude towards both of these highly experienced and dedicated individuals.

In 2005, I expect Actelion to continue its expansion. I anticipate that Actelion will further increase both total net revenues as well as operating expenses to appropriately invest into long-term growth opportunities.

The company is well prepared to manage expected growth so as to further improve profitability in absolute terms.

I look forward to documenting our progress throughout the year.

Andrew J. Oakley
Chief Financial Officer