

GRADIENT ANALYTICS' EARLY RESEARCH IDENTIFIED SAME ISSUES AS CHARGES IN SEC COMPLAINT AGAINST BIOVAIL

SEC Credits Analysts Who Questioned Biovail, but Retaliation Against Independent Researchers Through Lawsuits Continues

FOR IMMEDIATE RELEASE

Scottsdale, AZ (March 25, 2008) — Gradient Analytics said today its research into Biovail from 2002 to 2003 identified the same issues that are now the centerpiece of the accounting-fraud charges supporting the U.S. Securities and Exchange Commission complaint against the pharmaceutical company. The SEC's complaint confirms the validity of Gradient's critical analysis of Biovail but raises serious questions about how companies retaliate against analysts with threats, intimidation, and lawsuits.

The SEC yesterday announced accounting-fraud charges and a \$10 million fine that Biovail agreed to pay. In 2006, Biovail sued Gradient, alleging that its critical analysis caused company stock to drop. The SEC investigated both Biovail and Gradient. In February 2007, the SEC terminated its investigation of Gradient and recommended no enforcement action.

Of the three accounting fraud charges against Biovail, Gradient wrote about two, beginning in December 2002. Gradient also wrote about the truck-accident incident, which Bank of America analyst Dave Maris questioned in his first report on Biovail in October 2003. The other charge, a "phony bill and hold transaction" also was reflected in the unusual trends in accounts receivable noted by Gradient at the time.

"The SEC action demonstrates our research was not only valid but also essential for a free and efficient marketplace," said Gradient President and CEO Brad Forst. "While we have fought Biovail's lawsuit every step of the way, we fear the threat of lawsuits and other forms of retaliation stifles the critical analysis and independent research that the marketplace needs to function properly. Given the upheavals in the mortgage and credit markets today, independent research is more important than ever."

Yesterday, the director of the SEC's New York Regional Office, Mark Schonfeld, gave credit to analysts who raised questions about Biovail:



“Part of the credit does go to people who were asking a lot of questions and were rightfully skeptical when the company was making representations that just didn’t quite make sense,” said Schonfeld in a CNBC interview.

Following is an overview of the “accounting schemes” that the SEC raised in its complaint, which Gradient forensic accounting service identified in the contemporaneous periods:

SEC:

“Biovail, over several reporting periods in 2001 and 2002, improperly moved off its financial statements and onto the financial statements of a special purpose entity approximately \$47 million in expenses incurred in the research and development of some of Biovail's products.”

Gradient:

Gradient’s review of the original GlaxoSmithKline R&D and co-promotion agreement for Wellbutrin Once-Daily revealed unusual features, which could have helped to overstate profits in 2002 and 2003. On December, 18, 2002, Gradient warned: “The convoluted nature of the BVF-GSK agreements, as well as the potential for a short run boost to earnings, is of significant concern.”

On March 11, 2003, Gradient specifically warned clients that the company was using off-balance sheet entities, including Pharma Tech, as a way to transform R&D expenses into a capitalized cost, thereby overstating current period profits.

Gradient wrote: “As a result of two fourth-quarter acquisitions (Pharma PASS and a private development partner), BVF took a \$167.7 million in-process research and development (IPR&D) charge, representing 21.3% (191.1%) of revenues (net income) in 2002. While an immediate write-off of any acquired research and development is required by GAAP, the amount of the charge represents a material portion of the total price paid for both acquisitions. ... Due to the subjectivity permitted in the projection and discounting of cash flows associated with IPR&D, management has ample room to write down assets that would otherwise require amortization in future periods. Furthermore, IPR&D charges are essentially ignored by the company and other analysts as “nonrecurring” and excluded from earnings per share, allowing a firm to boost future earnings without adversely impacting the current share price. Thus, we are concerned that BVF may have used the recent IPR&D write-offs as a means of boosting future earnings.”

On June 20, 2003, Gradient added more clarity to the issue, very specifically identifying the likely use of Pharma Tech to conduct off-balance sheet R&D.

Gradient wrote: “The recent acquisition of private development partner Pharma Tech appears to be structured in a manner similar to the Intelligent Polymers transaction. As previously mentioned, 97.8% of the \$61.9 million paid for Pharma Tech was written off as acquired in-process research and development. According to BVF, Pharma Tech is a development-stage company engaged in the application of drug delivery technologies.

Before the acquisition, the company Pharma Tech contracted with a variety of third parties, including BVF, to conduct research and development services on its behalf. Through its research agreement with Pharma Tech, BVF earned revenues of \$2.8 million (\$2.2 million) in 2002 (2001). And, although BVF recorded underlying costs of services of \$2.1 million and \$1.7 million in 2002 and 2001, respectively, the company also received reimbursement payments of \$2.5 million and \$1.4 million that effectively eliminated any associated expenses.”

SEC:

“Biovail concocted a fictitious bill and hold transaction to record approximately \$8 million in revenue in the second quarter of 2003.”

Gradient:

On July 31, 2003, Gradient warned that aggressive accounting concealed the fundamental weakness experienced in the first half of 2003. “[W]e maintain the view that the firm’s strategy of developing into a “full-service pharmaceutical company” has failed to produce tangible benefits to shareholders. ... Management has obscured the extent of the failure by aggressive accounting tactics that have boosted both sales and earnings per share.”

On September 16, 2003, Gradient warned that the unusual increase in receivables as well as a decline of accounts-receivable turnover for the period ended June 30, 2003, appeared highly questionable and cautioned that future charges may have to be taken to write down the carrying value of receivables. It now turns out that Gradient had, in fact, detected the fraudulent June 2003 bill-and-hold transaction. Gradient wrote: “BVF’s receivables turnover also decreased markedly during the period, dropping 25.6% from 6.185 to 4.601 turns per annum; this decline places the company’s turnover rate 34.7% below the average of its peers. Taken together, the unusual increase in receivables, potentially inadequate allowance for doubtful accounts and declining turnover suggest that the quality of receivables is well below average. Consequently, we are concerned that there is an increased risk of future charges (against earnings) that may be necessary to write down the carrying value of receivables.”

The Truck Incident:

Gradient was also among the first to throw a red flag at Biovail’s now infamous “truck accident” explanation for a material earnings miss for the quarter ended September 30, 2003, and outlined to clients why management’s explanation did not hold water. Gradient wrote on October 7, 2003: “First, a truck carrying \$15 million to \$20 million of Wellbutrin XL was involved in an accident outside of Chicago on October 2. The truck had left BVF’s Manitoba factory on September 30, meaning that revenues for the product would have just barely been booked in the third quarter. The company also indicated that it is hopeful that some of the loss will flow through earnings in Q4 (after the Wellbutrin XL involved in the accident is evaluated for salability). ... First, the fact that the company had expected to book \$15-\$20 million in Wellbutrin XL sales (i.e., as much as 2/3 of anticipated sales for the quarter) on the last day of the quarter suggests that the

firm was struggling to meet guidance for the quarter even before the unfortunate event occurred.”

And on October 30, 2003, Gradient wrote: BVF lowered third-quarter revenue guidance from a range of \$260-\$300 million to between \$215 million and \$235 million due primarily to a traffic accident (which occurred on 10/02/03) involving up to \$20 million in Wellbutrin. While some analysts have questioned the accuracy of the loss figures reported by BVF management, we believe that the greater concern is a high likelihood of channel stuffing. In this context, the truck left Manitoba on September 30, just barely placing the Wellbutrin sales — representing as much as 2/3 of anticipated sales for the quarter — in Q3.”

Gradient Analytics is the country’s leading independent equities research firm. Gradient’s research has been shown to uncover issues that have a significant impact on equity valuations but often are not impounded into securities’ prices. Gradient’s financial engineers routinely conduct directed research related to earnings quality and accounting practices for 2,400 publicly traded companies.

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CONTACT:

Karen Hinton

Hinton Communications

703-798-3109

Karen@hintoncommunications.com