

PDL BioPharma

Financial update

Big in Japan

PDL reported Q218 revenues of \$46.6m, with Noden product revenue of \$25.9m (up 45.1% compared to Q118). Almost all of that growth came from increased sales in Asia thanks to the launch in Japan by distribution partner Orphan Pacific. Noden product revenue in the US was down slightly (1%) in the quarter compared to Q118, and the future of Tekturna in the US is now in question following a settlement agreement with Anchen Pharmaceuticals, which would allow it to enter with a generic in the US after March 1, 2019. Subsequently, the company reported a \$152.3m impairment of its Noden intangible asset with the estimated fair value now at \$40.1m.

Year end	Revenue (\$m)	PBT* (\$m)	EPS* (\$)	DPS (\$)	P/E (x)	Yield (%)
12/16	244.3	175.5	0.78	0.10	3.1	4.2
12/17	320.1	200.3	0.81	0.00	2.9	N/A
12/18e	176.1	47.8	0.37	0.00	6.4	N/A
12/19e	145.5	41.1	0.23	0.00	10.3	N/A

Note: *PBT and EPS are normalised, excluding amortisation of acquired intangibles, exceptional items and share-based payments.

Changing the Tekturna sales model in the US

With a generic entrant in Q119 now more likely and little traction from its contract salesforce of over 60 people, PDL has decided to change the way Noden sells Tekturna in the US. Noden will discontinue its contract salesforce and instead contract with Archer Healthcare and focus on email, direct mail and telesales. This should help improve profitability going forward.

A boost for Noden from Asia

Noden product revenue increased from \$18.3m in Q118 to \$25.9m in Q218. \$7.3m of that \$7.6m increase came from increased sales, mainly in Japan due to the recent launch of Tekturna/Rasilez by Orphan Pacific. Importantly, Lee's Pharmaceutical Holdings, Noden's partner in China, Hong Kong, Macau and Taiwan, is expected to launch Tekturna/Rasilez in China in H119.

The choice of acquiring assets or buying back stock

PDL continues to be in multiple discussions to acquire additional products for the Noden franchise; however, with the discontinuation of that salesforce, there would be fewer synergies. The company recently completed a \$25m share repurchase program and has stated the board will consider additional repurchase programs, a course of action that has been promoted by certain investors.

Valuation: \$783m or \$5.39 per share

We have adjusted our valuation from \$846m or \$5.62 per basic share to \$783m or \$5.39 per share. The lower total valuation was mainly due to adjusting Tekturna sales for upcoming generic competition as well as lower net cash. The per-share value was aided by the implementation of the share repurchase program, which has resulted in a reduction in the number of shares outstanding.

Pharma & biotech

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Price **US\$2.38**
Market cap **US\$346m**

Net cash (\$m) at 30 June 2018	245.7
Shares in issue	145.4m
Free float	94.2%
Code	PDLI
Primary exchange	NASDAQ
Secondary exchange	N/A

Share price performance



%	1m	3m	12m
Abs	(8.1)	(14.7)	(14.7)
Rel (local)	(9.4)	(18.0)	(25.9)
52-week high/low	US\$3.51	US\$2.3	

Business description

PDL BioPharma is reinventing itself as a healthcare-focused finance company through a three-pronged strategy: investing in royalty streams; providing high-yield financing to life science companies with near-term product launches; and specialty pharmaceutical sales through Noden Pharma.

Next event

China launch	H119
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Q218 results

PDL recently reported Q218 results with revenues of \$46.6m, up 20.9% compared to Q118. This increase was mainly due to strong sequential revenue growth from Noden products, which increased by 45.1% from \$18.3m to \$25.9m. Orphan Pacific's launch in Japan in March is the main driver behind this growth. Asia is becoming progressively more important for Noden, with Asian sales accounting for 33.7% of Noden product sales in the quarter, up from 7.7% of sales last quarter. This percentage is likely to rise as the Japan launch continues and with Lee's Pharmaceutical Holdings, which has licensed the rights to Tekturna/Rasilez in China, Hong Kong, Macau and Taiwan, expected to launch in China in H119. We don't currently include any revenues for Tekturna/Rasilez in China, so any meaningful sales there could provide additional upside. With regard to patent protection in Japan and China, Noden has formulation patents in both areas that expire in March 2025. There is also a composition of matter patent in Japan that expires in November 2021.

While Tekturna/Rasilez is currently doing well in Asia, its future in the US is in doubt. In June, the company entered into a settlement agreement with Anchen Pharmaceuticals, a subsidiary of Par Pharmaceuticals, and the sole abbreviated new drug application (ANDA) filer for a generic version of the product. As per the settlement agreement, Anchen Pharmaceuticals may market its generic version of Tekturna after March 1, 2019. However, this agreement only covers its proprietary formulation of the drug, which is not an identical copy to the currently marketed version, making it unclear if it would be substitutable or if it would require a specific prescription from the doctor. Also, the FDA has yet to approve Anchen's ANDA and it is unclear if Anchen will actually launch the product due to the difficulty of manufacturing it.

Due to the settlement, and greater likelihood for a generic entry, the company has written down \$152.3m of the value of the Noden intangible asset, leaving \$40.1m in value at the end of Q218. This was partially offset by a \$22.5m decrease in the fair value of the contingent liability as the company is less likely to need to pay certain milestones to Novartis, from which it acquired Tekturna/Rasilez.

The company has taken additional action by restructuring the commercial organization. Previously relying on a 60+ person contract salesforce, PDL has now decided to contract with Archer Healthcare and focus on email, direct mail and telesales. This change will be effective in August so there should be a boost in profitability going forward. It is unclear what the impact of discontinuing the contract salesforce will have on Tekturna/Rasilez sales in the US, but as it seems to have made little headway in reversing the exponential decline in prescriptions, the impact may be minimal.

Additionally, LENSAR, which was acquired in May 2017, saw Q218 revenues of \$5.9m up 18% compared to Q118. Profitability, however, declined with a loss of \$1.9m for the quarter compared to \$0.6m in Q118. Also, PDL amended its agreement with Depomed related to the Depomed royalties that cover a variety of type 2 diabetes products. In the original agreement, once total cash received by PDL totals \$481m (twice what PDL originally invested), Depomed is entitled to half of the future royalties from the products covered by the agreement. Originally, the company expected to hit the \$481m milestone in 2023 but now expects it to occur in late 2020 and has paid \$20m to Depomed to eliminate that royalty sharing so that PDL can fully benefit from the product royalties.

To buy or repurchase?

PDL continues to actively pursue additional products for the Noden franchise. Multiple sets of negotiations are currently underway, although the company has terminated several discussions due to price or information uncovered in due diligence. However, the prospects of PDL completing an

additional acquisition are uncertain. With markets near the highs, asset prices are anything but cheap and this management has historically been very price-sensitive with regard to acquisitions. It is possible that it may need to wait for a significant downturn in order to get a deal on favourable terms. Also, the logic of doing a deal following the restructuring of the Noden commercial franchise is unclear, as there would have been operational synergies in using one salesforce for multiple products – but those synergies are not there now, as there is no salesforce. Instead, the company may decide to focus more on stock buybacks that would be strongly earnings accretive and would make sense with the company trading far below its book value (\$4.85 per share as of end-Q218). So far, PDL has completed two stock repurchase programs totalling \$55m, lowering shares outstanding by approximately 11% since the first repurchase program in March 2017. And certain investors, such as activist SevenSai, have publicly called on the company to accelerate the pace of its buyback program.

Valuation

We have adjusted our valuation from \$846m or \$5.62 per basic share to \$783m or \$5.39 per share. The lower total valuation was mainly due to adjusting Tekturna sales for upcoming generic competition in the US (which reduced the value of Noden in our model from \$46.4m to \$23.8m), as well as lower net cash. The per-share value was aided by the completion of its \$25m share repurchase program in July, which has resulted in a reduction in the number of shares outstanding.

Exhibit 1: PDL valuation				
Royalty/Note	Type	Expiration Year	PDL Balance Sheet Carrying Value (\$m)	NPV (\$m)
Queen et al	Royalty	2015	N/A	N/A
Depomed	Royalty on Glumetza and other products	2024	\$214.1	\$281.8
VB	Royalty on Spine Implant	Undisclosed	\$14.7	\$16.5
University of Michigan	Royalty on Cerdelga	2022	\$26.1	\$14.4
Wellstat	Note (Impaired)	Unknown	\$50.2	\$50.2
Hyperion	Note (Impaired)	Unknown	\$1.2	\$1.2
Lensar	Equity		N/A	\$53.1
Acelrx	Royalty on Zalviso	2027	\$77.4	\$75.2
Careview	Note	2022	\$19.4	\$20.5
Noden	Equity	N/A	\$40.1	\$23.8
Kybella	Royalty	Unknown	\$2.8	\$0.9
Total				\$538
Net Cash (Q218) (\$m)				\$245.7
Total firm value (\$m)				\$783
Total basic shares (m)				145.4
Value per basic share (\$)				\$5.39
Total options				0.0
Total number of shares				145.4
Diluted value per share (\$)				\$5.39

Source: Edison Investment Research

Financials

We have increased our estimated FY18 revenues from \$156.6m to \$176.1m, but decreased our estimated FY19 revenues from \$158.8m to \$145.5m. The increase in FY18 revenue estimates was due to much stronger than expected sales for Noden due to the recent launch in Japan. The decrease in FY19 revenues was due to the expectation for generic competition in the US in Q119, but was partly mitigated by the strong sales in Japan. We have increased our SG&A estimates from

\$69.7m to \$74.0m for FY18, and from \$72.5m to \$76.9m for FY19, due to a higher than expected run rate. The company ended the quarter with \$395.7m in cash (\$245.7m in net cash).

Exhibit 2: Financial summary

\$000s	2016	2017	2018e	2019e
	US GAAP	US GAAP	US GAAP	US GAAP
PROFIT & LOSS				
Year-end 31 December				
Revenue	244,301	320,060	176,051	145,461
Cost of Sales	(4,065)	(30,537)	(45,465)	(27,116)
Gross Profit	240,236	289,523	130,586	118,345
General & Administrative	(43,287)	(63,324)	(73,979)	(76,938)
EBITDA	193,129	218,818	53,742	38,542
Operating Profit (before amort. and except.)	193,129	218,818	53,742	38,542
Intangible Amortisation	(12,028)	(24,689)	(15,077)	(15,077)
Other	0	0	0	0
Exceptionals	(51,699)	(349)	(129,595)	0
Operating Profit	129,402	193,780	(90,930)	23,465
Net Interest	(17,679)	(18,562)	(5,976)	2,521
Other	(2,353)	9,309	0	0
Profit Before Tax (norm)	175,450	200,256	47,766	41,063
Profit Before Tax (FRS 3)	109,370	184,527	(96,906)	25,986
Tax	(45,711)	(73,826)	7,569	(5,457)
Deferred tax	(0)	(0)	(0)	(0)
Profit After Tax (norm)	129,739	126,430	55,335	35,606
Profit After Tax (FRS 3)	63,659	110,701	(89,337)	20,529
Minority interest	(53)	(47)	0	0
Profit After Tax less Minority Interest (FRS 3)	63,606	110,654	(89,337)	20,529
Average Number of Shares Outstanding (m)	163.8	155.4	149.2	152.1
EPS - normalised (\$)	0.78	0.81	0.37	0.23
EPS - FRS 3 (\$)	0.39	0.71	(0.60)	0.13
Dividend per share (c)	10.03	0.00	0.00	0.00
Gross Margin (%)	98.3	90.5	74.2	81.4
EBITDA Margin (%)	79.1	68.4	30.5	26.5
Operating Margin (before GW and except.) (%)	79.1	68.4	30.5	26.5
BALANCE SHEET				
Fixed Assets	818,949	611,827	422,704	323,761
Intangible Assets	228,542	215,823	52,072	52,072
Tangible Assets	1,631	16,369	17,105	19,209
Royalty rights	402,318	349,223	315,061	226,844
Other	186,458	30,412	38,466	25,637
Current Assets	395,147	631,296	545,819	650,953
Stocks	0	0	0	0
Debtors	40,120	31,183	19,531	19,531
Cash	147,154	527,266	447,602	552,736
Other	207,873	72,847	78,686	78,686
Current Liabilities	(130,315)	(193,109)	(45,723)	(45,723)
Creditors	(7,016)	(19,785)	(11,212)	(11,212)
Short term borrowings	0	(126,066)	0	0
Other	(123,299)	(47,258)	(34,511)	(34,511)
Long Term Liabilities	(329,649)	(204,124)	(191,202)	(191,202)
Long term borrowings	(232,443)	(117,415)	(124,503)	(124,503)
Other long term liabilities	(97,206)	(86,709)	(66,699)	(66,699)
Net Assets	754,132	845,890	731,598	737,789
Minority Interests	0	0	0	0
Shareholder equity	754,132	845,890	731,598	737,789
CASH FLOW				
Operating Cash Flow	101,718	40,624	(7,936)	(653)
Net Interest	0	0	0	0
Tax	0	0	0	0
Capex	(109,963)	(1,297)	(8,949)	(1,455)
Acquisitions/disposals	13,082	128,415	78,198	102,754
Financing	0	0	0	0
Dividends	(16,583)	(222)	0	0
Other	(47,629)	212,592	(14,530)	4,488
Net Cash Flow	(59,375)	380,112	46,783	105,134
Opening net debt/(cash)	38,918	85,289	(283,785)	(323,099)
HP finance leases initiated	0	0	0	0
Exchange rate movements	0	0	0	0
Other	13,004	(11,038)	(7,469)	0
Closing net debt/(cash)	85,289	(283,785)	(323,099)	(428,233)

Source: PDL BioPharma accounts, Edison Investment Research

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