

# PDL BioPharma

## Q1 earnings

Financial update

Pharma &amp; biotech

PDL BioPharma recently reported Q117 earnings. Its subsidiary Noden Pharma (of which it currently owns 98%) started commercialization efforts for the Tekturna franchise in late February with a ~40 person salesforce and has co-pay cards and 30-day starter pack vouchers in place. It is too early to tell how successful they have been, but physician feedback and recent prescription data have been positive. Also, the company continues to receive royalty payments for Tysabri for longer than expected; it was paid \$14.2m in Q117. It is also set to receive \$19.5m as part of a patent settlement with Merck related to Keytruda.

Year end	Revenue (\$m)	PBT* (\$m)	EPS* (\$)	DPS (\$)	P/E (x)	Yield (%)
12/15	590.4	530.1	2.04	0.60	1.1	26.4
12/16	244.3	175.5	0.78	0.10	2.9	4.4
12/17e	182.1	78.5	0.34	0.00	6.7	N/A
12/18e	142.2	39.6	0.20	0.00	11.4	N/A

Note: \*PBT and EPS are normalized, excluding amortization of acquired intangibles, exceptional items and share-based payments.

## Tekturna may have reached the bottom

Tekturna (aliskiren) is a mature product that has had steadily declining sales due to stroke and renal concerns as well as a lack of Novartis detailing. With commercialization efforts by Noden only initiating in late-February, it is too early to tell if prescription declines have been slowed or even reversed, but recent data from Wolters Kluwer for the month of March have been positive.

## Keytruda patent settlement

In 2015, PDL filed a complaint against Merck for patent infringement related to its oncology product Keytruda. The patent litigation is now settled and Merck will pay PDL a one-time payment of \$19.5m in exchange for a license.

## Repurchase of shares underway

In March, PDL announced a \$30m share repurchase program that would last until March 2018. Since inception of the program, the company has already repurchased around 7.6m shares for a total of \$16.4m at an average price of \$2.16.

## Valuation: \$816m or \$5.07 per share

We have increased our valuation of PDL from \$791m or \$4.78 per share to \$816m or \$5.07 per share. This was mainly due to a higher than expected Q117 net cash balance and a fall in the number of shares outstanding due to the share repurchase program. We expect to review our valuation pending further clarity on Tekturna sales trends as well as the acquisition of additional products for the Noden Pharma commercial organization to sell.

10 May 2017

Price

US\$2.27

Market cap

US\$365m

Net cash (\$m) at 31 March 2017 99.2

Shares in issue 161.0m

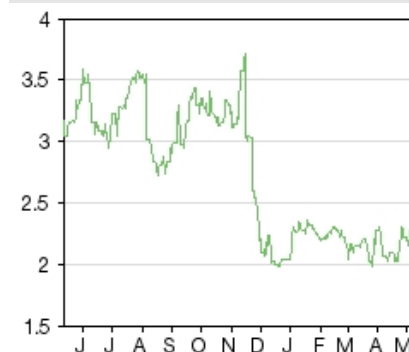
Free float 90.8%

Code PDLI

Primary exchange NASDAQ

Secondary exchange N/A

### Share price performance



% 1m 3m 12m

Abs 10.2 1.8 (29.9)

Rel (local) 8.3 (2.0) (39.8)

52-week high/low US\$3.7 US\$2.0

### 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 purchasing approved drugs to be sold by Noden Pharma.

### Next events

Acquire additional products for Noden platform 2017/18

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## Quarterly update

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PDL recently reported results for Q1 and provided an update on numerous assets. Notably, the company reported \$14.2m in royalty revenue from the Queen et al. royalty stream. This revenue is based on the sales of Tysabri over Q416. The royalty agreements for the other Queen et al. products have stopped, but the royalties for Tysabri are tied to product manufactured during 2014. Biogen continues to draw down this inventory, which will likely provide additional revenue. We do not include this revenue in our forecasts and valuation due to lack of insight into these inventory levels and the fact that these payments could stop at any time.

Also, PDL announced a patent settlement (related to Queen et al.) with Merck related to Keytruda, its humanized antibody product for various cancers. PDL will receive a one-time, lump-sum payment of \$19.5m (to be recorded by the company in Q217) in exchange for a royalty-free, non-exclusive license to certain Queen et al. patent rights. Beyond this case, there does not appear to be any ongoing litigation with regards to the Queen et al. patents so we do not expect other such settlements.

Noden's ~40 person salesforce is now up and running and commercializing the Tekturna franchise in the US (it is also set to assume commercialization activities in the rest of the world in H217). A few challenges helped suppress Tekturna sales in the quarter, including commercialization efforts starting later in the quarter than expected, some negative formulary changes and the continuation of the prescription erosion that has been seen over the last several years. It is too early to tell how successful the Noden salesforce is in reversing the negative trends but prescription data from Walters Kluwer indicate that prescriptions in the month of March were up 11.3% compared to February. Due to a greater number of selling days, March prescriptions are typically higher in number than those for February, but this recent jump is higher than the jump normally seen at this time period for Tekturna (6-10% since 2014). Also, the CEO of Noden Pharma resigned on 20 April for undisclosed reasons. It is unclear what impact this change in leadership will have on the commercialization efforts, if any.

With regards to its note agreements, the company previously wrote off \$51.1m of its Direct Flow Medical assets in Q416 and was able to monetize \$7.9m of assets in Q117. As of the end of Q1, the only Direct Flow assets remaining on the books are foreclosed assets recorded as assets held for sale and have a carrying value of \$2.1m. In April, a bankruptcy court approved the reorganization plan for LENSAR, a laser cataract surgery system company that filed for bankruptcy in December. It is expected to emerge from bankruptcy later in May and become one of PDL's operating subsidiaries.

## Valuation

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We have increased our valuation of PDL from \$791m or \$4.78 per share to \$816m or \$5.07 per share. This was mainly due to a higher than expected Q117 net cash balance and a fall in the number of shares outstanding due to the share repurchase program. We expect to review our valuation pending further clarity on Tekturna sales trends as well as the acquisition of additional products for the Noden Pharma commercial organization to sell.

**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	\$161.6	\$231.3
VB	Royalty on Spine Implant	Undisclosed	\$15.2	\$17.7
University of Michigan	Royalty on Cerdelga	2022	\$35.7	\$12.7
Direct Flow	Note (Impaired)	2018	\$2.1	\$2.1
Wellstat	Note (Impaired)	Unknown	\$50.2	\$50.2
Hyperion	Note (Impaired)	Unknown	\$1.2	\$1.2
Avinger	Royalty	2018	\$1.6	\$2.2
Lensar	Note (Impaired)	2018	\$43.9	\$43.9
Kaleo	Note	2029	\$146.7	\$153.6
AcelRX	Royalty on Zalviso	2027	\$69.6	\$72.5
CareView	Note	2022	\$19.1	\$20.7
Noden	Equity	N/A	N/A	\$103.5
Kybella	Royalty	Unknown	\$10.3	\$5.0
Total				\$717
Net cash (Q117) (\$m)				\$99.2
<b>Total firm value (\$m)</b>				<b>\$816</b>
Total basic shares (m)				161.0
<b>Value per basic share (\$)</b>				<b>\$5.07</b>
Total options (m)				0.2
Total number of shares				161.2
Diluted value per share (\$)				\$5.06

Source: Edison Investment Research

## Financials

PDL reported revenue of \$45.4m for the quarter, down sequentially from \$66.5m in Q416 due to a large jump in the fair value of its royalty rights in Q416 as well as lower Noden revenues in Q117. However, we have increased our estimated 2017 revenues from \$152.2m to \$182.1m mainly due to the Tysabri royalty and Merck settlement. R&D and SG&A spending totaled \$16.9m in Q117, up from \$15.0m last quarter, mainly due to higher sales and marketing expenses related to Noden. The company ended the quarter with \$314.3m in cash, \$20.0m in short-term investments and \$75m in a long-term certificate of deposit, which serves as collateral for the remaining portion of the Tekturma acquisition cost due to Novartis in July 2017. In March, the company announced a \$30m share repurchase program that would last until March 2018. Since inception of the program, the company has already repurchased around 7.6m shares for a total of \$16.4m at an average price of \$2.16.

**Exhibit 2: Financial summary**

\$000s	2015	2016	2017e	2018e
	US GAAP	US GAAP	US GAAP	US GAAP
<b>PROFIT &amp; LOSS</b>				
Year end 31 December				
Revenue	590,448	244,301	182,052	142,231
Cost of Sales	0	(4,065)	(13,522)	(12,542)
Gross Profit	590,448	240,236	168,530	129,689
General & Administrative	(36,090)	(43,287)	(63,929)	(65,530)
EBITDA	550,379	193,129	97,537	57,095
Operating Profit (before GW and except.)	550,379	193,129	97,537	57,095
Intangible Amortization	0	(12,028)	(24,057)	(24,057)
Other	(3,979)	0	0	0
Exceptionals	0	(51,699)	(1,442)	0
Operating Profit	550,379	129,402	72,038	33,038
Net Interest	(26,691)	(17,679)	(19,010)	(17,524)
Other	6,450	(2,353)	0	0
Profit Before Tax (norm)	530,138	175,450	78,527	39,571
Profit Before Tax (FRS 3)	530,138	109,370	53,028	15,514
Tax	(197,343)	(45,711)	(22,657)	(6,361)
Deferred tax	(0)	(0)	(0)	(0)
Profit After Tax (norm)	332,795	129,739	55,869	33,210
Profit After Tax (FRS 3)	332,795	63,659	30,370	9,153
Minority interest	0	(53)	(188)	(188)
Profit After Tax less Minority Interest (FRS 3)	332,795	63,606	30,182	8,965
Average Number of Shares Outstanding (m)	163.4	163.8	161.8	163.4
EPS - normalized (\$)	2.04	0.78	0.34	0.20
EPS - FRS 3 (\$)	2.04	0.39	0.19	0.05
Dividend per share (\$)	0.60	0.10	0.0	0.0
Gross Margin (%)	100.0	98.3	92.6	91.2
EBITDA Margin (%)	93.2	79.1	53.6	40.1
Operating Margin (before GW and except.) (%)	93.2	79.1	53.6	40.1
<b>BALANCE SHEET</b>				
Fixed Assets	733,468	818,949	754,111	667,392
Intangible Assets	0	228,542	204,485	180,428
Tangible Assets	31	1,631	3,730	5,134
Royalty rights	399,204	402,318	266,194	227,078
Other	334,233	186,458	279,702	254,752
Current Assets	279,731	395,147	443,922	417,717
Stocks	0	0	0	0
Debtors	0	40,120	21,679	21,679
Cash	218,883	147,154	395,885	370,180
Other	60,848	207,873	26,358	25,858
Current Liabilities	(36,662)	(130,315)	(190,465)	(64,065)
Creditors	(394)	(7,016)	(17,956)	(17,956)
Short term borrowings	(24,966)	0	(126,400)	0
Other	(11,302)	(123,299)	(46,109)	(46,109)
Long Term Liabilities	(283,485)	(329,649)	(203,213)	(203,213)
Long term borrowings	(232,835)	(232,443)	(116,052)	(116,052)
Other long term liabilities	(50,650)	(97,206)	(87,161)	(87,161)
Net Assets	693,052	754,132	804,356	817,830
Minority Interests	0	0	0	0
Shareholder equity	693,052	754,132	804,356	817,830
<b>CASH FLOW</b>				
Operating Cash Flow	301,465	101,718	70,627	23,430
Net Interest	0	0	0	0
Tax	0	0	0	0
Capex	(9)	(109,963)	(534)	(1,422)
Acquisitions/disposals	(71,593)	13,082	176,876	78,234
Financing	0	0	0	0
Dividends	(98,307)	(16,583)	(21)	0
Other	(8,046)	(47,629)	9,430	500
Net Cash Flow	123,510	(59,375)	256,378	100,741
Opening net debt/(cash)	160,347	38,918	85,289	(153,433)
HP finance leases initiated	0	0	0	0
Exchange rate movements	0	0	0	0
Other	(2,081)	13,004	(17,656)	(47)
Closing net debt/(cash)	38,918	85,289	(153,433)	(254,128)

Source: Edison Investment Research, PDL BioPharma accounts

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