

# PDL BioPharma

Seeking additional commercial products

Financial update

Pharma & biotech

20 November 2017

**Price** **US\$2.84**

**Market cap** **US\$438m**

Net cash (\$m) at 30 September 2017 277.3

Shares in issue 154.3m

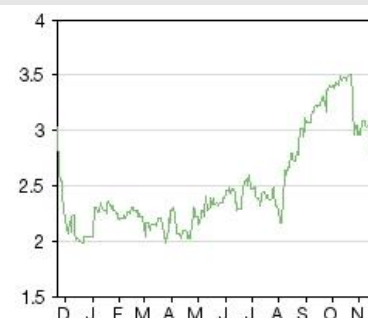
Free float 90.3%

Code PDLI

Primary exchange NASDAQ

Secondary exchange N/A

## Share price performance



% 1m 3m 12m

Abs (17.7) 4.0 (5.3)

Rel (local) (18.3) (2.0) (19.7)

52-week high/low US\$3.5 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

## Analysts

Maxim Jacobs +1 646 653 7027

Nathaniel Calloway +1 646 653 7036

[healthcare@edisongroup.com](mailto:healthcare@edisongroup.com)

[Edison profile page](#)

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PDL BioPharma recently reported strong Q317 earnings, mainly due to royalties related to Depomed as well as an increase in the fair value of the Depomed assets due to a settlement agreement with Valeant related to underpayment. In addition, PDL made public its attempt to acquire Neos Therapeutics, an attention deficit hyperactivity disorder (ADHD) focused specialty pharmaceutical company, for \$10.25 per share (approximately \$300m based on the latest share count). Neos declined the offer, which expired on 8 November. PDL has expressed that it believes this is a fair offer and has not indicated that it will increase it.

Year end	Revenue (\$m)	PBT* (\$m)	EPS* (\$)	DPS (\$)	P/E (x)	Yield (%)
12/15	590.4	530.1	2.04	0.60	1.4	21.1
12/16	244.3	175.5	0.78	0.10	3.6	3.5
12/17e	295.2	189.5	0.77	0.00	3.7	N/A
12/18e	104.2	6.4	0.09	0.00	31.6	N/A

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

## Neos buyout bid

On 26 October 2017, PDL made a hostile bid at \$10.25 per share in cash for the acquisition of Neos Therapeutics (~40% premium to the stock price at the time), which currently markets two products in the US for ADHD (both are extended release oral disintegrated tablet versions of the current standards of care for ADHD) and will launch a third product early in 2018. The offer expired on 8 November and next steps are unclear.

## Cash boost from kaléo note sale

In September, PDL sold its entire interest in the kaléo note for \$141.7m, which included a small premium on the principal and accrued interest. This may have been done to improve its cash balance as it attempted to acquire Neos as well as to allow flexibility for future potential transactions.

## New share repurchase program

In September, PDL announced a \$25m share repurchase program that will run through September 2018. Previously, it had announced a \$30m share repurchase program in March 2017, which it completed the following June. With a book value approximately double the stock price (\$5.40 as of the end of Q317), share repurchases are strongly earnings accretive.

## Valuation: \$796m or \$5.16 per share

Our valuation has increased slightly from \$793m or \$5.15 per share to \$796m or \$5.16 per share. This was mainly due to a higher cash balance and a higher value for Noden as we rolled forward NPVs. This was mitigated by a lower value for Lensar as we have increased our expense estimates for this year as well as the sale of the kaléo note.

## Quarterly update

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PDL recently reported results for Q3 and provided an update on numerous assets. Revenue from the change in fair value of royalty rights was \$35.4m thanks to continued strength in the Depomed royalty franchise. In addition, Valeant recently settled a lawsuit brought by Depomed and PDL due to suspected underpayment of royalties related to Glumetza. Under the terms of the settlement, PDL received \$13m. While the cash was received in November, PDL accounted for it as part of the fair value of the Depomed assets in Q3, boosting results.

With regards to Noden, net revenue for the quarter was \$15.1m (\$11.5m in the US and \$3.6m internationally; as a reminder, PDL books revenue outside the US net of cost of goods as well as a separate fee to Novartis). This was down 6.8% from the \$16.2m in revenues (\$12.9m in the US and \$3.3m internationally) reported in Q217. In August, the company significantly increased the size of the dedicated contract salesforce from around 40 sales representatives and four district managers to around 60 sales representatives and six district managers. It is still too early to tell if they are having a positive impact. Internationally, in November commercialization of Tekturna/Rasilez was transferred to the company from Novartis in Switzerland and the EU. The company expects to focus on selling in profitable countries and recently discontinued marketing in France, where the product was not making money. The company is also seeking licensing or distribution in China and Japan where marketing authorizations should transfer over in 2018.

For LENSAR, Q317 was the first full quarter that it was consolidated in PDL's financial statements. Revenue for the quarter was \$5.0m. Last quarter, PDL had only reported a partial quarter (11 May to 30 June) for LENSAR and revenues were \$2.6m. Expenses appear to be up at a higher rate than revenues as the reported loss for LENSAR increased to \$5.6m from \$1.2m last quarter.

Unfortunately, the Queen et al. royalty stream appears to be finally petering out. PDL only recognized \$1.4m in the quarter compared to \$16.3m in the previous quarter as product manufactured after the expiration of the patents (December 2014) is not subject to the royalty. Biogen has notified PDL that it expects to pay \$4.5m in royalties in Q4 and reduced royalties afterward.

Finally, with regards to the note agreements, in September PDL sold its entire interest in the kaléo note for \$141.7m, which included a small premium on the principal and accrued interest. Company management has not stated their reasoning for selling the kaléo note, which had an attractive 13% interest rate. It may have been sold to improve the cash balance as they attempted to acquire Neos as well as to allow them flexibility for future potential transactions.

## Third time not the charm with Neos

On 26 October 2017, PDL publicly announced a \$10.25 per share takeover bid for Neos Therapeutics. Neos is a pharmaceutical company with an ADHD-focused portfolio with two commercialized products, Adzenys XR-ODT (amphetamine) and Cotelma XR-ODT (methylphenidate), which launched in May 2016 and October 2017, respectively, and a third FDA-approved product, Adzenys ER (amphetamine) extended-release oral suspension, which was approved in September 2017 and is expected to launch in early 2018. The company's propriety extended-release (XR) orally disintegrating tablet (ODT) and XR-oral suspension technologies serve as the foundation for its portfolio and pipeline. Neos's XR-ODT and XR-oral suspension products are developed, manufactured, and commercialized in-house. This buyout offer marks PDL's third attempt to acquire the ADHD-focused pharmaceutical company (the previous two undisclosed attempts occurred this summer). Neos has declined this offer as well and the offer expired on 8 November. PDL has expressed that it believes the offer to be fair and has not

indicated that it will increase it. The next steps with regards to Neos are unclear, but PDL continues to seek additional commercial products to acquire.

## Valuation

Our valuation has increased slightly from \$793m or \$5.15 per share to \$796m or \$5.16 per share. This was the result of a few adjustments related to its investments/segments as well as a higher cash balance. We increased the value of Noden from \$53.4m to \$59.8m, mainly due to rolling forward NPVs, which increased the valuation as certain acquisition costs (i.e. the anniversary payment for Noden) are now behind the company, though this was mitigated by a slight decrease in our revenue assumptions and higher SG&A assumptions. We also reduced the value of LENSAR from \$54.6m to \$50.1m as we increased its operating expense assumptions for 2017. The sale of the kaléo note was a net negative NPV event as we valued it at \$153.6m while it was sold for \$141.7m.

<b>Exhibit 1: PDL valuation table</b>				
<b>Royalty/note</b>	<b>Type</b>	<b>Expiration year</b>	<b>PDL balance sheet carrying value (\$m)</b>	<b>NPV (\$m)</b>
Queen et al	Royalty	2015	N/A	N/A
Depomed	Royalty on Glumetza & other products	2024	\$222.7	\$231.3
VB	Royalty on Spine Implant	Undisclosed	\$15.4	\$17.7
University of Michigan	Royalty on Cerdelga	2022	\$35.4	\$12.7
Wellstat	Note (Impaired)	Unknown	\$50.2	\$50.2
Hyperion	Note (Impaired)	Unknown	\$1.2	\$1.2
Avinger	Royalty	2018	\$0.9	\$0.8
Lensar	Equity		N/A	\$50.1
AcelRx	Royalty on Zalviso	2027	\$74.1	\$72.5
CareView	Note	2022	\$19.2	\$20.6
Noden	Equity	N/A	N/A	\$59.8
Kybella	Royalty	Unknown	\$3.6	\$1.7
Total				\$519
Net cash (Q317) (\$m)				\$277.3
<b>Total firm value (\$m)</b>				<b>\$796</b>
Total basic shares (m)				154.3
<b>Value per basic share (\$)</b>				<b>\$5.16</b>
Total options (m)				1.2
Total number of shares (m)				155.5
Diluted value per share (\$)				\$5.12
Source: Edison Investment Research				

## Financials

PDL reported revenue of \$62.7m in Q317, which was higher than our \$38m estimate (due to higher than expected Glumetza royalties and the Valeant settlement) but down from \$143.8m last quarter, as Q217 included a \$54.2m jump in the fair value of the Depomed assets, increased royalties from the launch of an authorized generic of Glumetza, a one-time lump-sum payment of \$19.5m from Merck in a patent settlement and \$14.9m higher Tysabri royalties. We have increased our estimated 2017 revenues from \$264.2m to \$295.2m due to the higher than expected Q317 revenues as well as the inclusion of \$4.5m in Tysabri royalties. However, we have lowered our 2018 revenue estimates from \$122.2m to \$104.2m, mainly due to the loss of interest revenue related to the kaléo note. R&D and SG&A spending totaled \$17.6m in Q317, down from \$19.2m in Q217, mainly due to a reduction in R&D spending as pediatric trials for Tekturna were completed though this was partially offset by higher SG&A spending (which we have increased by \$3.8m for 2017 and by \$6.6m for 2018). The company ended the quarter with \$510.1m in cash and \$6.4m in short-term investments.



In September, PDL announced a \$25m share repurchase program, which will run through September 2018. Previously, it had announced a \$30m share repurchase program in March 2017, which it completed the following June. With a book value approximately double the stock price, share repurchases are strongly earnings accretive.

**Exhibit 2: Financial summary**

	\$000s	2015	2016	2017e	2018e
Year end 31 December		US GAAP	US GAAP	US GAAP	US GAAP
<b>PROFIT &amp; LOSS</b>					
Revenue		590,448	244,301	295,189	104,209
Cost of Sales		0	(4,065)	(15,330)	(9,396)
Gross Profit		590,448	240,236	279,858	94,813
General & Administrative		(36,090)	(43,287)	(63,848)	(67,388)
EBITDA		550,379	193,129	208,753	23,797
Operating Profit (before amort. and except.)		550,379	193,129	208,753	23,797
Intangible Amortization		0	(12,028)	(24,452)	(24,452)
Other		(3,979)	0	0	0
Exceptionals		0	(51,699)	(3,349)	0
Operating Profit		550,379	129,402	180,952	(655)
Net Interest		(26,691)	(17,679)	(19,209)	(17,419)
Other		6,450	(2,353)	3,995	0
Profit Before Tax (norm)		530,138	175,450	189,544	6,377
Profit Before Tax (FRS 3)		530,138	109,370	165,738	(18,075)
Tax		(197,343)	(45,711)	(70,179)	7,411
Deferred tax		(0)	(0)	(0)	(0)
Profit After Tax (norm)		332,795	129,739	119,365	13,788
Profit After Tax (FRS 3)		332,795	63,659	95,559	(10,664)
Minority interest		0	(53)	(47)	(47)
Profit After Tax less Minority Interest (FRS 3)		332,795	63,606	95,512	(10,711)
Average Number of Shares Outstanding (m)		163.4	163.8	155.5	157.0
EPS - normalised (\$)		2.04	0.78	0.77	0.09
EPS - FRS 3 (\$)		2.04	0.39	0.61	(0.07)
Dividend per share (\$)		0.60	0.10	0.00	0.00
Gross Margin (%)		100.0	98.3	94.8	91.0
EBITDA Margin (%)		93.2	79.1	70.7	22.8
Operating Margin (before GW and except.) (%)		93.2	79.1	70.7	22.8
<b>BALANCE SHEET</b>					
Fixed Assets		733,468	818,949	583,810	512,183
Intangible Assets		0	228,542	216,060	191,608
Tangible Assets		31	1,631	20,346	12,038
Royalty rights		399,204	402,318	318,969	280,102
Other		334,233	186,458	28,435	28,435
Current Assets		279,731	395,147	651,462	583,640
Stocks		0	0	0	0
Debtors		0	40,120	17,465	17,465
Cash		218,883	147,154	560,533	492,711
Other		60,848	207,873	73,464	73,464
Current Liabilities		(36,662)	(130,315)	(194,132)	(69,210)
Creditors		(394)	(7,016)	(10,448)	(10,448)
Short term borrowings		(24,966)	0	(124,922)	0
Other		(11,302)	(123,299)	(58,762)	(58,762)
Long Term Liabilities		(283,485)	(329,649)	(207,060)	(207,060)
Long term borrowings		(232,835)	(232,443)	(116,052)	(116,052)
Other long term liabilities		(50,650)	(97,206)	(91,008)	(91,008)
Net Assets		693,052	754,132	834,080	819,553
Minority Interests		0	0	0	0
Shareholder equity		693,052	754,132	834,080	819,553
<b>CASH FLOW</b>					
Operating Cash Flow		301,465	101,718	55,010	(18,152)
Net Interest		0	0	0	0
Tax		0	0	0	0
Capex		(9)	(109,963)	(1,160)	(1,042)
Acquisitions/disposals		(71,593)	13,082	148,566	77,734
Financing		0	0	0	0
Dividends		(98,307)	(16,583)	(21)	0
Other		(8,046)	(47,629)	210,983	86
Net Cash Flow		123,510	(59,375)	413,378	58,625
Opening net debt/(cash)		160,347	38,918	85,289	(319,559)
HP finance leases initiated		0	0	0	0
Exchange rate movements		0	0	0	0
Other		(2,081)	13,004	(8,531)	(1,525)
Closing net debt/(cash)		38,918	85,289	(319,559)	(376,659)

Source: PDL BioPharma accounts, Edison Investment Research

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