

PDL BioPharma

Financial update

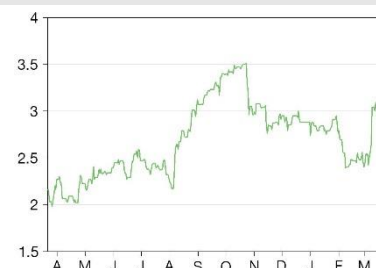
Pharma & biotech

21 March 2018

Price **US\$2.96**
Market cap **US\$457m**

Net cash (\$m) at 31 December 2017 288.6
 Shares in issue 153.8m
 Free float 90.3%
 Code PDLI
 Primary exchange NASDAQ
 Secondary exchange N/A

Share price performance



%	1m	3m	12m
Abs	18.2	(2.7)	32.1
Rel (local)	19.1	(3.8)	15.8
52-week high/low	US\$3.51	US\$1.98	

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 2018

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PDL recently reported results for 2017. Revenue grew by 31% compared to 2016 to \$320.1m as the company transitioned away from royalties related to the Queen et al. patents to product revenue related to its Noden and Lensar subsidiaries as well as royalties from the Depomed assets. The company also recently announced that it was abandoning the Neos buyout bid as the two parties could not agree on terms. We expect PDL to continue to pursue additional commercial assets for its portfolio.

Year end	Revenue (\$m)	PBT* (\$m)	EPS* (\$)	DPS (\$)	P/E (x)	Yield (%)
12/16	244.3	175.5	0.78	0.10	3.8	3.3
12/17	320.1	200.3	0.81	0.00	3.7	N/A
12/18e	173.8	61.6	0.36	0.00	8.2	N/A
12/19e	180.9	71.7	0.40	0.00	7.4	N/A

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

Tekturna/Rasilez licensing agreements in Asia

In December, PDL's subsidiary Noden Pharmaceuticals licensed the rights to Tekturna/Rasilez in China, Hong Kong, Macau and Taiwan to Lee's Pharmaceutical Holdings, a Hong Kong-based pharmaceutical company with approximately \$125m in revenues over the previous 12 months. As part of the agreement, Noden will receive guaranteed minimum payments. Noden has also entered into a distribution agreement with Orphan Pacific to distribute Tekturna/Rasilez in Japan.

50% sequential growth at LENSAR

Quarterly revenues for LENSAR, which PDL acquired in May 2017, were up 50% to \$7.5m compared to \$5m in Q317, mainly due to a number of transactions outside of the United States, predominantly in China. Importantly, expenses related to LENSAR were down slightly from \$10.6m in Q317 to \$10m in Q417, bringing the subsidiary closer to break even.

\$25m share repurchase program to be implemented

In September 2017, PDL announced a \$25m share repurchase program that will run through to September 2018. Blackout periods and the Neos buyout bid attempt have delayed the start of the program but these restrictions will soon lift and the program should start be implemented soon. With a book value (\$5.54 per share as of the end of 2017) that is much higher than the current stock price, share repurchases are strongly earnings accretive.

Valuation: \$858m or \$5.58 per share

Our valuation has increased to \$858m or \$5.58 per share from \$796m or \$5.16 per share. This was mainly due to a higher valuation for the Depomed assets due to the statutory corporate tax rate in the US decreasing from 35% to 21%. A higher net cash balance also increased the valuation. This was mitigated in part by a lower value for Noden as we raised our expense estimates going forward.

FY17 results

PDL recently reported 2017 results and provided an update on its assets. For the full year, revenues were up 31% to \$320.1m from \$244.3m in 2016. The change in fair value of royalty rights was \$162.3m for the year, up from \$16.2m last year. The Depomed assets accounted for \$165.6m of the \$162.3m (there were some fair value decreases in the other royalty assets, especially those related to Cerdelga and Kybella) as this investment continues to pay off. Through the end of 2017, PDL has received cash royalty payments of \$308.5m from its \$240.5m investment in the Depomed assets.

With regards to Noden, net revenue for the quarter was \$25.1m (14.5m in the US and \$10.6m in the rest of the world), up 66% from \$15.1m in Q317 (\$11.5m in the US and \$3.6m internationally) as the commercialization of Tekturna/Rasilez in Switzerland and the EU was transferred from Novartis to Noden in November 2017. As a reminder, prior to November, Noden booked revenue outside the US net of cost of goods as well as a separate fee to Novartis so the change has increased both revenues and cost of goods. The company will focus on selling in profitable countries and recently discontinued marketing in a few European countries, such as France, where the product was not making money.

In December, Noden licensed the rights to Tekturna/Rasilez in China, Hong Kong, Macau and Taiwan to Lee's Pharmaceutical Holdings, a Hong Kong-based pharmaceutical company with approximately \$125m in revenues over the previous 12 months. As part of the agreement, there will be guaranteed minimum payments due to Noden from Lee's. Also, Lee's is prepared to invest in combination studies with Tekturna/Rasilez and calcium channel blockers, which are much more commonly used in China, in order to increase uptake of the product. In Japan, Tekturna/Rasilez is now being distributed by Orphan Pacific, which has already started shipping product.

LENSAR, which was acquired in May 2017, saw Q417 revenues up 50% to \$7.5m compared with \$5m in Q317, mainly due to a number of transactions outside the US, predominantly in China. Importantly, expenses related to LENSAR were down slightly from \$10.6m last quarter to \$10m in Q417, bringing the subsidiary closer to break even.

With regards to the rest of PDL's portfolio, royalties from Tysabri continue to decrease as supplies of product manufactured before patent expiration are dwindling. PDL received \$4.5m in revenue related to Tysabri in Q417 and revenues associated with the product are expected to continue to fall over the course of 2018 and cease altogether after Q119. With regards to the CareView note receivable, the company entered into a modification agreement in February that saw the liquidity covenant lowered and the principal repayment delayed for a period up to the end of 2018. In exchange, the exercise price of 4.4m warrants owned by PDL was decreased and PDL was granted additional equity interests.

Valuation

Our valuation has increased to \$858m or \$5.58 per share from \$796m or \$5.16 per share. This was mainly due to a higher valuation for the Depomed assets as a result of the statutory corporate tax rate in the US decreasing from 35% to 21%. A higher net cash balance also increased the valuation. Our valuation of LENSAR has increased from \$50.2m to \$52.3m as our raised revenue assumptions have a positive effect on the company's long-term profitability. This is mitigated in part by a lower value for Noden (\$55.5m versus \$59.8m previously) as we have increased our expense estimates.

Exhibit 1: PDL valuation table

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	\$232.0	\$281.8
VB	Royalty on Spine Implant	Undisclosed	\$14.4	\$16.5
University of Michigan	Royalty on Cerdelga	2022	\$26.8	\$14.4
Wellstat	Note (Impaired)	Unknown	\$50.2	\$50.2
Hyperion	Note (Impaired)	Unknown	\$1.2	\$1.2
Avinger	Royalty	2018	\$0.4	\$0.4
Lensar	Equity		N/A	\$52.3
Acelrx	Royalty on Zalviso	2027	\$72.9	\$75.2
Careview	Note	2022	\$19.3	\$20.5
Noden	Equity	N/A	N/A	\$55.5
Kybella	Royalty	Unknown	\$2.7	\$1.7
Total				\$570
Net cash (Q417) (\$m)				\$288.6
Total firm value (\$m)				\$858
Total basic shares (m)				153.8
Value per basic share (\$)				\$5.58
Total options (m)				0.6
Total number of shares (m)				154.4
Diluted value per share (\$)				\$5.56
Source: Edison Investment Research				

Financials

PDL reported revenue of \$68.0m for Q417, which was higher than our \$43.2m estimate (due to higher than expected revenues from royalty assets, Noden and LENSAR) and up 8% sequentially from \$62.7m in Q317. We have increased our estimated FY18 revenues from \$104.2m to \$173.8m as we have increased our revenue estimates for Noden which is now booking ex-US revenues. We have also increased our LENSAR estimates due to a strong quarter. In addition, we introduce 2019 estimates which include \$180.1m in revenues, up 4.0% compared with 2018.

Due to the high COGS for Tekturna/Rasilez outside of the United States we have increased our estimate for COGS for 2018 from \$9.4m to \$37.8m. R&D and SG&A spending totaled \$17.0m in Q417, down slightly from \$17.6m in Q217. We have trimmed our estimates for these line items for 2018 from \$71.0m to \$69.5m. The company ended the quarter with \$527.3m in cash and \$4.8m in short-term investments. Subsequent to the quarter, the company paid back the principal (\$126.4m) plus \$2.6m in accrued interest on its 2018 convertible notes in February.

In September, PDL announced a \$25m share repurchase program that will run through to September 2018. Blackout periods and the Neos buyout bid attempt have delayed the start of the program. These restrictions will soon lift and the program should start be implemented soon. With a book value (\$5.54 per share as of the end of 2017) that is much higher than the current stock price, share repurchases are strongly earnings accretive.

Exhibit 2: Financial summary

	\$000s	2015	2016	2017	2018e	2019e
Year end 31 December		US GAAP	US GAAP	US GAAP	US GAAP	US GAAP
PROFIT & LOSS						
Revenue		590,448	244,301	320,060	173,841	180,875
Cost of Sales		0	(4,065)	(30,537)	(37,814)	(34,838)
Gross Profit		590,448	240,236	289,523	136,027	146,037
General & Administrative		(36,090)	(43,287)	(63,324)	(65,857)	(68,491)
EBITDA		550,379	193,129	218,818	66,479	73,855
Operating Profit (before amort. and except.)		550,379	193,129	218,818	66,479	73,855
Intangible Amortisation		0	(12,028)	(24,689)	(24,689)	(24,689)
Other		(3,979)	0	0	0	0
Exceptionals		0	(51,699)	(349)	0	0
Operating Profit		550,379	129,402	193,780	41,790	49,166
Net Interest		(26,691)	(17,679)	(18,562)	(4,900)	(2,118)
Other		6,450	(2,353)	9,309	0	0
Profit Before Tax (norm)		530,138	175,450	200,256	61,579	71,737
Profit Before Tax (FRS 3)		530,138	109,370	184,527	36,890	47,048
Tax		(197,343)	(45,711)	(73,826)	(7,747)	(9,880)
Deferred tax		(0)	(0)	(0)	(0)	(0)
Profit After Tax (norm)		332,795	129,739	126,430	53,832	61,857
Profit After Tax (FRS 3)		332,795	63,659	110,701	29,143	37,168
Minority interest		0	(53)	(47)	(47)	0
Profit After Tax less Minority Interest (FRS 3)		332,795	63,606	110,654	29,096	37,168
Average Number of Shares Outstanding (m)		163.4	163.8	155.4	151.3	154.3
EPS - normalised (\$)		2.04	0.78	0.81	0.36	0.40
EPS - FRS 3 (\$)		2.04	0.39	0.71	0.19	0.24
Dividend per share (c)		60.17	10.03	0.00	0.00	0.00
Gross Margin (%)		100.0	98.3	90.5	78.2	80.7
EBITDA Margin (%)		93.2	79.1	68.4	38.2	40.8
Operating Margin (before GW and except.) (%)		93.2	79.1	68.4	38.2	40.8
BALANCE SHEET						
Fixed Assets		733,468	818,949	611,827	543,717	440,037
Intangible Assets		0	228,542	215,823	191,134	191,134
Tangible Assets		31	1,631	16,369	11,826	14,284
Royalty rights		399,204	402,318	349,223	310,345	223,448
Other		334,233	186,458	30,412	30,412	11,170
Current Assets		279,731	395,147	631,296	608,226	734,715
Stocks		0	0	0	0	0
Debtors		0	40,120	31,183	31,183	31,183
Cash		218,883	147,154	527,266	504,196	630,685
Other		60,848	207,873	72,847	72,847	72,847
Current Liabilities		(36,662)	(130,315)	(193,109)	(67,043)	(67,043)
Creditors		(394)	(7,016)	(19,785)	(19,785)	(19,785)
Short term borrowings		(24,966)	0	(126,066)	0	0
Other		(11,302)	(123,299)	(47,258)	(47,258)	(47,258)
Long Term Liabilities		(283,485)	(329,649)	(204,124)	(210,691)	(210,691)
Long term borrowings		(232,835)	(232,443)	(117,415)	(123,982)	(123,982)
Other long term liabilities		(50,650)	(97,206)	(86,709)	(86,709)	(86,709)
Net Assets		693,052	754,132	845,890	874,210	897,017
Minority Interests		0	0	0	0	0
Shareholder equity		693,052	754,132	845,890	874,210	897,017
CASH FLOW						
Operating Cash Flow		301,465	101,718	40,624	25,264	22,462
Net Interest		0	0	0	0	0
Tax		0	0	0	0	0
Capex		(9)	(109,963)	(1,297)	(1,738)	(1,809)
Acquisitions/disposals		(71,593)	13,082	128,415	77,757	102,932
Financing		0	0	0	0	0
Dividends		(98,307)	(16,583)	(222)	0	0
Other		(8,046)	(47,629)	212,592	2,095	2,903
Net Cash Flow		123,510	(59,375)	380,112	103,377	126,488
Opening net debt/(cash)		160,347	38,918	85,289	(283,785)	(380,214)
HP finance leases initiated		0	0	0	0	0
Exchange rate movements		0	0	0	0	0
Other		(2,081)	13,004	(11,038)	(6,948)	(0)
Closing net debt/(cash)		38,918	85,289	(283,785)	(380,214)	(506,703)

Source: Company accounts, Edison Investment Research

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