

# PDL BioPharma

Depomed paying off

Financial update

Pharma & biotech

PDL BioPharma recently reported strong Q217 earnings mainly due to royalties related to the authorized generic of Glumetza as well as an increase in the fair value of the Depomed royalty assets as a whole. Also, LENSAR, which became a wholly-owned subsidiary on 11 May, was consolidated in the results, with \$2.6m in revenues and \$3.8m in expenses. The company continues to receive royalty payments for Tysabri for longer than expected; it was paid \$16.3m in Q217.

Year end	Revenue (\$m)	PBT* (\$m)	EPS* (\$)	DPS (\$)	P/E (x)	Yield (%)
12/15	590.4	530.1	2.04	0.60	1.3	22.7
12/16	244.3	175.5	0.78	0.10	3.4	3.8
12/17e	264.2	157.9	0.59	0.00	4.5	N/A
12/18e	122.2	19.9	0.14	0.00	18.9	N/A

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

## Tekturna transfer process continues

The company is continuing to work on transferring the marketing authorizations for Tekturna/Rasilez from Novartis to Noden (PDL currently owns 100% of Noden). The transfers for the EU, Switzerland, Canada and Japan are expected to occur in Q417. In the US, Q217 was the first full quarter in which the company had a contract salesforce selling Tekturna, though sales have continued their multi-year decline. It is too early to tell if the contract salesforce is having any impact.

## LENSAR now included in financial statements

As of May 11, 2017, LENSAR, a laser cataract surgery system company, is a wholly owned subsidiary of PDL. Both revenues and expenses are relatively low but importantly there are \$114m in net operating loss carryforwards that the company can utilize to lower its tax payments.

## New share repurchase program under consideration

In March, PDL announced a \$30m share repurchase program that would last until March 2018. The company has already utilized all \$30m to buyback 13.3m shares at an average cost of \$2.25 per share and is evaluating the possibility of a new program. With a book value approximately double the stock price, this would make a tremendous amount of sense.

## Valuation: \$793m or \$5.15 per share

Our valuation has changed to \$793m or \$5.15 per share, from \$816m or \$5.07 per share. The total value declined as we are taking a more conservative view of Noden's potential as well as slightly lower Avinger and Kybella valuations. This was partially offset by a higher cash balance and an increase in value for LENSAR, as the debt has converted to equity and we are able to include the net operating loss carryforwards. The value on a per share basis increased due to a reduction in the number of shares following the buyback.

10 August 2017

**Price** **US\$2.64**  
**Market cap** **US\$407m**

Net cash (\$m) at 30 June 2017	122.5
Shares in issue	154.1m
Free float	90.1%
Code	PDLI
Primary exchange	NASDAQ
Secondary exchange	N/A

### Share price performance



%	1m	3m	12m
Abs	10.9	16.3	(12.0)
Rel (local)	8.7	12.7	(22.4)
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 Q2 and provided an update on numerous assets. Revenue from the change in fair value of royalty rights was \$83.7m, up from \$13.1m in Q1. This was primarily due to royalties received as a result of the launch of the authorized generic in February 2017 as well as an increase in the fair value of the Depomed assets, which includes Glumetza, from \$161.6m last quarter to \$215.8m. The Depomed assets have now returned \$253.1m in cash, which is above their initial investment of \$240.5m just 3.5 years ago.

With regards to Noden, the company is continuing to work on transferring the marketing authorizations for Tekturna/Rasilez from Novartis. The transfers for the EU, Switzerland, Canada and Japan are expected to occur in Q417. Until that happens, PDL books revenue outside the US net of cost of goods as well as a separate fee to Novartis. This quarter, PDL booked \$2.9m in revenue outside the US. In the US, Q217 was the first full quarter in which the company had a contract salesforce selling Tekturna. Prescriptions continue their multi-year downward trend, falling around 10% as compared to Q117. It is too early in the launch to tell if the contract salesforce is having any impact.

For the first time, LENSAR is now being consolidated in PDL's financial statements. As a reminder, it is a laser cataract surgery system company, which filed for voluntary bankruptcy with the co-operation of PDL in December 2016. It emerged out of bankruptcy on 11 May 2017, and as most of PDL's debt was converted into company equity, LENSAR became a wholly owned subsidiary. Revenues for the partial quarter (11 May to 30 June) were \$2.6m and expenses were \$3.8m. Importantly, there are \$114m in net operating loss carryforwards that PDL can utilize to lower its tax payments.

Notably, the company reported \$16.3m in royalty revenue from the Queen et al. royalty stream. This revenue is based on the sales of Tysabri over Q117. 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 though they have continued far longer than originally expected.

In addition, PDL received a one-time, lump-sum payment of \$19.5m in exchange for a royalty-free, non-exclusive license to certain Queen et al. patent rights as part of a patent settlement with Merck related to Keytruda, its humanized antibody product for various cancers.

Finally, with regard to the note agreements, the company previously wrote off \$51.1m of its Direct Flow Medical assets in Q416 and has been able to monetize \$8.1m of assets so far this year. There remain \$1.9m worth of foreclosed assets that are being recorded as assets held for sale (but no carrying value within notes receivable). CareView, with which PDL entered into a credit agreement in 2015 for up to \$40m in two tranches, will not be receiving the second tranche of \$20m as the company did not hit previously agreed upon product placements and financial targets. However, it remains current on interest payments for the first \$20m tranche.

## Valuation

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Our valuation has changed to \$793m or \$5.15 per share, from \$816m or \$5.07 per share. The main driver for the lower total valuation was more conservative assumptions for Tekturna as the sales downtrend is continuing despite the contract salesforce coming on line. This reduced our value for

Noden from \$103.5m to \$53.4m. We have also reduced the value of the Kybella royalty from \$5m to \$1.7m as sales appear to have plateaued much sooner than expected. The Avinger asset also fell from \$2.2m to \$1.3m simply due to the fact that it is set to expire next year so there are just fewer payments left. This decline in total value was partially offset by a higher cash balance and an increase in value for LENSAR, as the debt has converted to equity and we are able to include the net operating loss carryforwards (which account for the vast majority of the value of that asset based on our estimates). The value on a per share basis increased due to a reduction in the number of shares following the share buyback.

**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	\$215.8	\$231.3
VB	Royalty on Spine Implant	Undisclosed	\$15.3	\$17.7
University of Michigan	Royalty on Cerdelga	2022	\$35.6	\$12.7
Wellstat	Note (impaired)	Unknown	\$50.2	\$50.2
Hyperion	Note (impaired)	Unknown	\$1.2	\$1.2
Avinger	Royalty	2018	\$1.1	\$1.3
Lensar	Equity		N/A	\$54.6
Kaleo	Note	2029	\$146.7	\$153.6
AcelRx	Royalty on Zalviso	2027	\$71.8	\$72.5
CareView	Note	2022	\$19.1	\$20.7
Noden	Equity	N/A	N/A	\$53.4
Kybella	Royalty	Unknown	\$3.4	\$1.7
Total				\$671
Net cash (Q217) (\$m)				\$122.5
<b>Total firm value (\$m)</b>				<b>\$793</b>
Total basic shares (m)				154.1
<b>Value per basic share (\$)</b>				<b>\$5.15</b>
Total options (m)				0.7
Total number of shares (m)				154.8
Diluted value per share (\$)				\$5.13
Source: Edison Investment Research				

## Financials

PDL reported revenue of \$143.8m, up significantly from \$45.4m last quarter due mainly to a jump in the fair value of the Depomed royalties and the \$19.5m settlement payment from Merck. As a result of this, we have increased our estimated 2017 revenues from \$182.1m to \$264.2m. However, we have lowered our 2018 revenue estimates from \$142.2m to \$122.2m, mainly due to lower Tekturna estimates. R&D and SG&A spending totaled \$19.2m in Q217, up from \$16.9m in Q117, mainly due to the consolidation of LENSAR expenses. The company ended the quarter with \$349.4m in cash, \$10.9m in short-term investments and \$75m in a long-term certificate of deposit, which serves as collateral for the remaining portion of the Tekturna acquisition cost due to Novartis. That \$75m long-term certificate of deposit has since been terminated (along with an additional \$14m guarantee to Novartis) as the \$89m anniversary payment was made on 3 July 2017, after the end of the quarter.

In March, PDL announced a \$30m share repurchase program that would last until March 2018. The company has already utilized all \$30m to buy back 13.3m shares at an average cost of \$2.25 per share and is evaluating the possibility of a new program. With a book value approximately double the stock price, this would make a tremendous amount of sense.

**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	264,152	122,236
Cost of Sales		0	(4,065)	(12,717)	(9,580)
Gross Profit		590,448	240,236	251,435	112,656
General & Administrative		(36,090)	(43,287)	(60,014)	(60,792)
EBITDA		550,379	193,129	176,812	37,255
Operating Profit (before amort. and except.)		550,379	193,129	176,812	37,255
Intangible Amortization		0	(12,028)	(24,191)	(24,191)
Other		(3,979)	0	0	0
Exceptionals		0	(51,699)	(2,649)	0
Operating Profit		550,379	129,402	149,972	13,064
Net Interest		(26,691)	(17,679)	(18,959)	(17,323)
Other		6,450	(2,353)	6,271	0
Profit Before Tax (norm)		530,138	175,450	157,853	19,932
Profit Before Tax (FRS 3)		530,138	109,370	137,284	(4,259)
Tax		(197,343)	(45,711)	(64,208)	1,746
Deferred tax		(0)	(0)	(0)	(0)
Profit After Tax (norm)		332,795	129,739	93,645	21,678
Profit After Tax (FRS 3)		332,795	63,659	73,076	(2,513)
Minority interest		0	(53)	(47)	(47)
Profit After Tax less Minority Interest (FRS 3)		332,795	63,606	73,029	(2,560)
Average Number of Shares Outstanding (m)		163.4	163.8	157.8	159.3
EPS - normalized (\$)		2.04	0.78	0.59	0.14
EPS - FRS 3 (\$)		2.04	0.39	0.46	(0.02)
Dividend per share (\$)		0.60	0.10	0.0	0.0
Gross Margin (%)		100.0	98.3	95.2	92.2
EBITDA Margin (%)		93.2	79.1	66.9	30.5
Operating Margin (before GW and except.) (%)		93.2	79.1	66.9	30.5
<b>BALANCE SHEET</b>					
Fixed Assets		733,468	818,949	738,292	667,873
Intangible Assets		0	228,542	216,321	192,130
Tangible Assets		31	1,631	20,462	13,100
Royalty rights		399,204	402,318	316,666	277,799
Other		334,233	186,458	184,843	184,843
Current Assets		279,731	395,147	502,627	440,252
Stocks		0	0	0	0
Debtors		0	40,120	20,799	20,799
Cash		218,883	147,154	401,696	339,321
Other		60,848	207,873	80,132	80,132
Current Liabilities		(36,662)	(130,315)	(189,894)	(63,494)
Creditors		(394)	(7,016)	(10,385)	(10,385)
Short term borrowings		(24,966)	0	(126,400)	0
Other		(11,302)	(123,299)	(53,109)	(53,109)
Long Term Liabilities		(283,485)	(329,649)	(208,894)	(208,894)
Long term borrowings		(232,835)	(232,443)	(116,052)	(116,052)
Other long term liabilities		(50,650)	(97,206)	(92,842)	(92,842)
Net Assets		693,052	754,132	842,131	835,737
Minority Interests		0	0	0	0
Shareholder equity		693,052	754,132	842,131	835,737
<b>CASH FLOW</b>					
Operating Cash Flow		301,465	101,718	60,295	(12,524)
Net Interest		0	0	0	0
Tax		0	0	0	0
Capex		(9)	(109,963)	(705)	(1,222)
Acquisitions/disposals		(71,593)	13,082	208,815	77,734
Financing		0	0	0	0
Dividends		(98,307)	(16,583)	(21)	0
Other		(8,046)	(47,629)	(13,843)	86
Net Cash Flow		123,510	(59,375)	254,541	64,073
Opening net debt/(cash)		160,347	38,918	85,289	(159,244)
HP finance leases initiated		0	0	0	0
Exchange rate movements		0	0	0	0
Other		(2,081)	13,004	(10,009)	(47)
Closing net debt/(cash)		38,918	85,289	(159,244)	(223,269)

Source: Edison Investment Research, PDL BioPharma accounts

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