

Selvita

Company update

Strong Q116, good order book for 2016

Selvita's strong Q116 results and expanding order book point to a good year. Our estimates are largely unchanged, forecasting double-digit organic sales growth in 2016 and 2017. The FDA's request of supplemental preclinical documentation for SEL24's IND application may delay the start of the Phase I trial previously scheduled for Q316. Selvita will announce more details in due course; currently our R&D timelines are unchanged, with our valuation increased slightly to PLN 363m.

Year end	Revenue (PLNm)	PBT* (PLNm)	EPS* (PLN)	DPS (PLN)	P/E (x)	Yield (%)
12/14	41.6	5.4	0.56	0.0	38.6	N/A
12/15	56.1	7.6	0.84	0.0	25.7	N/A
12/16e	66.9	5.8	0.44	0.0	49.1	N/A
12/17e	76.5	8.7	0.63	0.0	34.3	N/A

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

Strong Q116 and order backlog point to a good year

Selvita's total Q116 revenues of PLN13.5m grew by 11.3% year-on-year, or 35.7% excluding subsidies (PLN2.0m). The growth was mainly attributable to the Services business segment with a 66.1% increase year-on-year. The increase in total operating expenses was mainly related to higher internal R&D efforts and the expansion of the capacity, including new personnel hires and opening new facilities and international sales offices. Selvita reported a Q116 net profit of PLN621k versus PLN1.3m a year ago (adjusted for employee stock option program). The order backlog in May reached a total contract value of PLN42.4m for 2016, which is up 13% versus same period a year ago.

More preclinical data for SEL24 requested

Recently Selvita announced the FDA asked for some amendments of the clinical trial design and requested a supplemental preclinical assessment of SEL24 to be included in the IND application. While the former should not pose any problems, Selvita needs to conduct additional preclinical studies and examine additional properties of SEL24, which can influence interactions with other drugs used for the treatment of acute myeloid leukaemia patients. The company submitted the IND application on 15 April and, according to the guided timelines, SEL24 is expected to enter Phase I in Q316. It is unclear at this stage if the additional studies required will materially amend the expected timelines.

Valuation: Marginally up to PLN363m or PLN27.0/sh

Q116 results support our expectations of 19% total sales growth this year; therefore our forecasts are unchanged. Although there is some uncertainty over the start of the Phase I SEL24 trial, we maintain our timelines and valuation assumptions in our model, with the potential launch projected in 2023. Our valuation is slightly up to PLN363m or PLN27.0/share (PLN354m or PLN27.0/share previously) after updating for net cash, rolling our model forward and a slight increase in the number of shares.

Pharma & biotech

17 June 2016

Price

PLN21.60

Market cap

PLN289m

Net cash (PLNm) at end Q116	29.6
Shares in issue	13.4m
Free float	44%
Code	SLV
Primary exchange	WSE
Secondary exchange	N/A

Share price performance



%	1m	3m	12m
Abs	(3.7)	(3.1)	27.8
Rel (local)	2.9	6.5	73.8
52-week high/low	PLN25.2	PLN15.7	

Business description

Selvita is a drug discovery services provider based in Poland. It employs c 340 staff (30% with PhDs) and operates two main business units: the Innovations Platform (internal NME pipeline) and Research Services (medicinal chemistry/biology, biochemistry).

Next events

H116 results	30 August 2016
SEL24 Phase I start	Q316
SEL120 IND studies start	H216

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Q116 results

Total revenues of PLN13.5m grew 11.3% year-on-year in Q116, or 35.7% excluding subsidies (PLN2.0m), which can vary from quarter to quarter. This marks a strong start to 2016 even though Q1 has been the weakest quarter over the past three years (Exhibit 1). The growth mainly came from the Services business segment with a 66.1% increase year-on-year. Total operating expenses of PLN16.0m included a non-cash cost of PLN3.1m related to the employee stock options programme (ESOP). Adjusted for this, OPEX increased from PLN11.0m in Q115 to PLN 12.9m in Q116, mainly related to increased internal R&D efforts but also the expanding capacity, including new personnel hires as well as the opening of new facilities and international sales offices.

Segment performance: Services continue to lead

In addition to the Services and Innovation business segments, Selvita will now report Ardigen's performance as a third separate segment. The bioinformatics business was spun out into Ardigen in October 2015. As Selvita retained a 60% stake, it now consolidates the accounts.

Services to external customers (ie the Services segment excluding subsidies) again demonstrated excellent growth, with 66% revenue increase year-on-year from PLN4.2m in Q115 to PLN7.0m in Q116 (comparative data adjusted accordingly with bioinformatics sales now excluded and presented as separate segment from Q116). This was supported by expanding the scope of activities and gaining share in new markets. Revenues of PLN3.9m from the Innovation division (excluding subsidies) were up 7% versus a year ago. This segment includes advanced research agreements with large international pharmaceutical corporations offering potentially higher margins over the medium term and therefore is a long-term focus for Selvita. Subsidies in Q116 were PLN2.0m versus 3.6m in Q115. The 46% decrease was explained by the company largely as a result of switching EU Financial Frameworks – finishing significant R&D projects in 2015 and starting new ones in 2016.

Ardigen sales were slightly down 7% year-on-year to PLN525m. The logic behind its spin out was to increase the range of services within bioinformatics and IT solutions offering, but also to expand into new areas rapidly evolving with the global precision medicine trends. Ardigen now has stable existing business, which provides revenues and can explore expansion opportunities. We expect this segment to be largely neutral or minimally negative on Selvita's bottom line in 2016.

Exhibit 1: Quarterly revenue performance

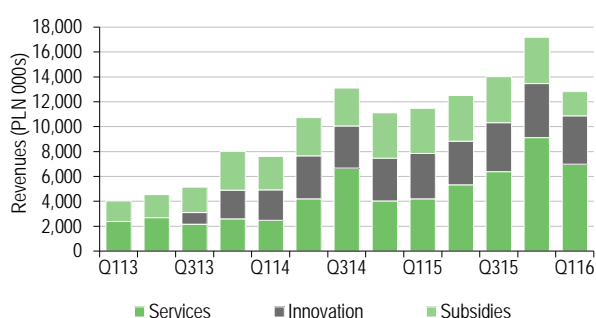
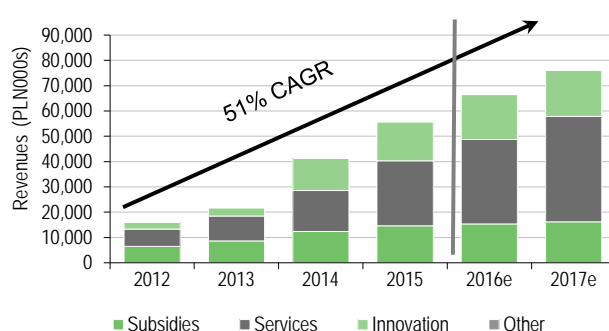


Exhibit 2: Annual revenue performance and estimates



Source: Edison Investment Research, Selvita

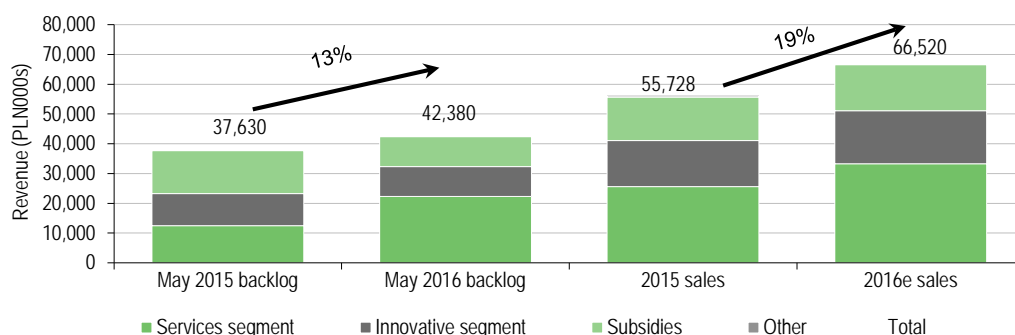
Source: Edison Investment Research, Selvita

Good progress in order book; estimates maintained

The commercial backlog (Exhibit 3) as of May was PLN42.4m for 2016, a 13% increase compared to the same period last year. The reported order backlog amounted to 64% of our FY16 revenue forecast. Excluding grants and subsidies (ie only looking at core operating activities), the corresponding growth rates are 39% (backlog in May 2015 vs May 2016) and 25% (2015 revenues vs our 2016 estimate).

Our estimates are largely unchanged and we continue to expect double-digit sales growth in 2016 and 2017. Our organic growth expectations are also supported by a rapid expansion of Selvita's sales capability with three international sales offices opened in 2015 and a new research facility in Poznan. As of May 2016 the cash position was PLN29.6m with virtually no debt. Based on this and combined with the profitable research services business, we believe there is sufficient cash for the internal drug candidates SEL24 and SEL120 to complete Phase I and pre-Phase I studies respectively. For these programmes to progress we anticipate additional financing and/or a partnership deal is needed.

Exhibit 3: Order book vs sales



Source: Edison Investment Research, Selvita

Valuation

We maintain our financial forecasts and the underlying assumptions for R&D projects. Using a DCF model for the services business and risk-adjusted NPV for the SEL24 and SEL120 projects we calculate our valuation of Selvita slightly higher at PLN363m (€83m) or PLN27.0/share after updating net cash, rolling our model forward and a slight increase in the number of shares (PLN354m or PLN27.0/share previously). There is some uncertainty over the start of the Phase I SEL24 trial; until Selvita provides an update, we keep our model's timing assumptions unchanged, with the potential launch projected in 2023.

Although our combined DCF and risk-adjusted NPV valuation is PLN363m, we note that due to the early stage of the lead R&D projects, the success probabilities typically range from 5% to 7.5%. In other words, if all programmes (in Exhibit 4) are a success, as per our model, the valuation would be PLN967m.

Exhibit 4: Selvita valuation model

Division	Metric	Non risk adj. value (PLNm)	Probability (%)	Risk-adj. value (PLNm)	Value per share (PLN)	Notes
Services/ research collaborations	DCF (Q216- 2021)	79	100%	79	5.88	Services: sliding scale pa growth 25-15% from 2016-2021; research collaborations: +7.0% pa growth; subsidies: +5.0% pa growth; tax = 2-11% sliding scale (2016-2021); 10% WACC.
	Terminal value	159	100%	159	11.85	0.75% growth on 2021 FCF
	Subtotal	238		238	17.73	
Internal pipeline	SEL24	319	7.5%	53	3.91	\$750m indicative peak sales (2029); launch in 2023; 5% royalty (pre-clinical); 7.5% probability of success (pre-clinical). Includes deal milestone estimates: \$15m up-front in 2017 (60%); \$10m on start of Phase II in 2018 (60%); \$20m on start Phase III in 2020 (15%); \$40m on NDA filing/approval in 2022 (7.5%). 12.5% WACC. Internal R&D Phase I costs of \$5m over 2016/2017.
	SEL120	293	5%	35	2.58	\$750m indicative peak sales (2029); launch in 2023; 5% royalty (pre-clinical); 5% probability of success (pre-clinical). Includes deal milestone estimates: \$3m upfront in 2017 (60% probability); \$5m on IND/Phase I start in 2017 (50%); \$15m on start Phase II in 2018 (25%); \$20m on start Phase III in 2020 (10%); \$40m on NDA filing/approval in 2022 (5%). 12.5% WACC. Internal R&D pre-Phase I costs of \$1m in 2016.
	Collaborations	87	5%	8	0.61	Indicative oncology projects to reflect the value of the partnership with Merck KGaA. Assume two projects in Phase I in 2020. Milestones of up to \$31.5m each relate to candidate selection, start of Phase I, initiation of pivotal trials, launch in major regions and sales thresholds. Royalties on annual sales of 0.5% up to \$500m, 1% on \$500m-1bn and 2% on sales greater than \$1bn+. Probability of 5% to market.
	Subtotal	699		95	7.10	
Net cash		30		30	2.20	
Selvita total		967		363	27.0	Based on 13.4m shares outstanding.

Source: Edison Investment Research

Exhibit 5: Financial summary

	PLN'000s	2013	2014	2015	2016e	2017e
Year end 31 December		IFRS	IFRS	IFRS	IFRS	IFRS
PROFIT & LOSS						
Revenue		21,914	41,557	56,077	66,862	76,456
of which: Services (research outsourcing)		9,812	16,121	25,612	33,279	41,598
Innovation pipeline funding		3,241	12,744	15,416	17,817	18,320
Subsidies		8,688	12,430	14,700	15,424	16,195
EBITDA		(146)	7,626	10,235	9,262	12,792
Operating Profit (before GW and except.)		(2,228)	5,272	6,802	5,823	8,729
Intangible Amortisation		0	0	0	0	0
Exceptionals/Other		0	0	(4,729)	(5,860)	(583)
Operating Profit		(2,228)	5,272	2,073	(37)	8,146
Net Interest		(198)	155	748	14	10
Exceptionals/Other		0	0	0	0	0
Profit Before Tax (norm)		(2,427)	5,427	7,550	5,838	8,739
Profit Before Tax (reported)		(2,427)	5,427	2,821	(22)	8,156
Tax		(19)	(45)	(5)	0	(245)
Deferred tax		0	468	3,417	0	0
Profit After Tax (norm)		(2,445)	5,850	10,962	5,838	8,495
Profit After Tax (reported)		(2,445)	5,850	6,233	(22)	7,912
Average Number of Shares Outstanding (m)		10.5	10.5	13.1	13.3	13.4
EPS - normalised (PLN)		(0.23)	0.56	0.84	0.44	0.63
EPS - reported (PLN)		(0.23)	0.56	0.48	(0.00)	0.59
Dividend per share (PLN)		0.0	0.0	0.0	0.0	0.0
BALANCE SHEET						
Fixed Assets		7,067	9,494	16,718	18,279	17,716
Intangible Assets		282	331	2,274	2,274	2,274
Tangible Assets		4,932	6,845	8,597	10,158	9,595
Other		1,854	2,318	5,847	5,847	5,847
Current Assets		11,191	17,310	48,524	40,639	48,332
Stocks		391	706	1,174	1,158	1,142
Debtors		5,161	10,314	17,961	17,961	17,961
Cash		5,418	4,878	28,807	20,937	28,646
Other		221	1,411	582	582	582
Current Liabilities		(11,401)	(15,271)	(16,319)	(16,315)	(16,560)
Creditors		(3,481)	(6,055)	(3,927)	(3,927)	(3,927)
Provisions		(2,104)	(2,801)	(3,327)	(3,327)	(3,327)
Deferred revenues		(5,455)	(4,617)	(7,384)	(7,384)	(7,384)
Short term borrowings		(161)	(91)	(33)	(33)	(33)
Other		(200)	(1,708)	(1,648)	(1,643)	(1,888)
Long Term Liabilities		(3,454)	(2,278)	(2,043)	(2,043)	(2,043)
Long term borrowings		0	0	0	0	0
Deferred revenues		(3,222)	(2,010)	(1,513)	(1,513)	(1,513)
Other long term liabilities		(232)	(268)	(529)	(529)	(529)
Net Assets		3,403	9,254	46,880	40,561	47,445
CASH FLOW						
Operating Cash Flow		(7,198)	(4,902)	(16,430)	(18,288)	(4,987)
Net Interest		0	0	0	0	0
Tax		0	0	0	(4)	0
Capex		(2,167)	(3,610)	(5,190)	(5,000)	(3,500)
Acquisitions/disposals		0	0	0	0	0
Financing		0	0	27,314	0	0
Dividends		0	0	0	0	0
Other (incl. subsidies)		9,567	7,972	18,354	15,424	16,195
Net Cash Flow		202	(540)	24,049	(7,868)	7,708
Opening net debt/(cash)		(5,192)	(5,257)	(4,787)	(28,773)	(20,904)
HP finance leases initiated		0	0	0	0	0
Exchange rate movements		0	0	0	0	0
Other		(137)	71	(63)	(1)	0
Closing net debt/(cash)		(5,257)	(4,787)	(28,773)	(20,904)	(28,612)

Source: Edison Investment Research, Selvita

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