

Vernalis

Equity fund-raising

Cash cushion for cough cold growth

The issue of 80m new shares at 50p/share has raised £40m (gross), which enables Vernalis to focus on executing its operational plan and removes uncertainty over whether it is sufficiently funded through to sustainable profitability in FY19 (on our new forecasts). Near-term investment into the commercial cough cold platform will underpin future sales growth. Ongoing initiatives to improve physician awareness, stocking and formulary coverage should increase Tuzistra's XR market share in the longer term.

Year end	Revenue (£m)	PBT* (£m)	EPS* (p)	DPS (p)	P/E (x)	Yield (%)
12/13	14.1	(4.7)	(0.8)	0.0	N/A	N/A
06/15**	19.9	(6.9)	(1.0)	0.0	N/A	N/A
06/16e	11.3	(25.8)	(5.4)	0.0	N/A	N/A
06/17e	17.3	(24.5)	(4.5)	0.0	N/A	N/A

Note: PBT and EPS are normalised, excluding intangible amortisation, exceptional items and share-based payments. **18-month reporting period, 12 months thereafter.

Use of proceeds

With £40m of new funds and end-FY15 cash of £54m, Vernalis has sufficient working capital for a "conservative risk-adjusted roll-out plan" for Tuzistra XR, forthcoming Moxatag re-launch and the planned roll-out of the other four products in the cough cold franchise (two of which remain on track for NDA filing by end-2016). The proceeds will also facilitate increased promotional activity, if appropriate.

Focus on execution

The commercial focus for Vernalis's 80-strong salesforce is working on improving physician awareness of Tuzistra XR to drive prescription growth, as well as ensuring patients can fill their Tuzistra XR scrip. Accessibility to Tuzistra XR both physically (through pharmacy stocking) and financially (by gaining formulary coverage and minimising out-of-pocket expenses) are critical factors for facilitating the latter. Incremental improvements should help Vernalis increase market share and facilitate continued prescribing of Tuzistra XR into the next cough cold season.

A more certain foundation going into year two

The first two years of Tuzistra XR launch are critical in laying the foundations for the cough cold franchise. Vernalis is focused on addressing all the major factors affecting its potential market share and rate of Tuzistra XR uptake. However, limited revenue visibility remains at present, reflecting the early stage of the Tuzistra XR launch and the mild 2015/16 cough cold season. We have decreased our near-term forecasts to better reflect a more gradual revenue build. The second year on the market should provide better insight into Tuzistra XR's ultimate sales potential.

Valuation: DCF valuation of £393m (75p per share)

Increased cash (£92.5m: £54m at-end December 2015 plus assumed net proceeds of £38.5m), offsets the impact of moderating our cough-cold and Moxatag revenue trajectory over the next two years, increasing our DCF valuation to £393m (from £384m previously). However, due to the dilution impact of the 80m new shares, this translates to a lower per-share value of 75p vs 86p/share previously.

Pharma & biotech

25 May 2016

Price **45p**

Market cap **£236m**

£/\$1.43

Net cash* (£m) at 31 December 2015 92.5

*Post pro forma equity issue in May 2016

Shares in issue 525.1m

Free float 64%

Code VER

Primary exchange AIM

Secondary exchange N/A

Share price performance



% 1m 3m 12m

Abs (11.6) (18.2) (33.6)

Rel (local) (10.7) (22.9) (25.9)

52-week high/low 86.5p 43.0p

Business description

Vernalis is a UK speciality pharma company with an FDA-approved, prescription-only cough cold treatment, Tuzistra XR; an FDA-approved amoxicillin, Moxatag; and a late-stage US cough cold pipeline of four products. Vernalis also has an early- to mid-stage R&D pipeline of CNS and cancer projects. Its primary focus is on commercialising Tuzistra XR in the US.

Next events

FY16 results (estimated) September 2016

CCP-07 NDA filing 2016

CCP-08 NDA filing 2016

Moxatag launch 2016

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Valuation

We have updated our DCF valuation to incorporate the impact of the fund-raise and a more gradual build of cough cold revenues over the next two years. We also expect a slower Moxatag sales trajectory given the new uncertainty over routine supply. Vernalis has sufficient launch stocks, with launch remaining on track for summer 2016. An update from management is anticipated at prelims in September.

Based on pro forma net cash of £92.5m (£54m of cash at-end December 2015 plus assumed net proceeds of £38.5m) and 525.13m shares outstanding, our DCF valuation increases to £393m (from £384m previously). Due to the impact of dilution, the per-share value falls to 75p per share (from 86p per share). Our underlying assumptions are presented in Exhibit 1.

Exhibit 1: Vernalis rNPV valuation summary

Source	rNPV (£m)	rNPV/share (p)	Assumptions
US Rx cough cold portfolio	557.8	106.2	Net of \$12-14m of per product milestones due to Tris. 30% COGS (including Tris royalty payaway). Aggregate sales >\$500m by 2024; UK tax rate of 21% from 2021. Tuzistra XR (£415m rNPV): Peak sales of \$240m; launched September 2015. CCP-07 (£53.7m rNPV): peak sales of \$65m; launch 2018; 75% success probability (PoC achieved). CCP-08 (£49.8m rNPV): peak sales of \$65m; launch 2018; 75% success probability (PoC achieved). CCP-05 (£19.6m rNPV): peak sales of \$65m; launch 2021; 65% success probability. CCP-06 (£19.6m rNPV): peak sales of \$65m; launch 2021; 65% success probability.
Moxatag	22.1	4.2	Peak sales of \$20m; launch 2017. Undisclosed royalties/milestones payable to Pragma
NCE pipeline	8.7	1.7	Tosedostat (£1.4m rNPV): peak AML sales \$150m; launch 2020; 15% success probability; 5% royalty. RPL554 (£4.9m rNPV): peak COPD sales \$200m; launch 2019; 25% success probability, 6% royalty. Servier 1 (£0.5m rNPV): peak cancer sales \$150m; launch 2023; 10% success probability, 5% royalty. V81444 (£1.9m rNPV): peak immunoncology sales \$200m; launch 2022; 15% success; 7% royalty.
Frova royalty stream	5.8	1.1	Europe: royalties of 25%, patent expiry Dec 2015, generics have entered some markets but not others, pricing and volume pressure seen overall. US: minimum sales level not reached.
Total pipeline rNPV	594.4	113.2	
R&D	(42.8)	(8.2)	Includes offset for research collaborative funding.
SG&A	(241.4)	(46.0)	Includes cost of US sales infrastructure (included in R&D before Tuzistra launch).
Capex	(9.6)	(1.8)	Tangible assets (intangible capex, ie milestones paid to Tris, captured in cough cold portfolio rNPV).
Cash	92.5	17.6	Reported net cash at end-December 2015 plus net proceeds of the £40m equity issuance.
Valuation	393.1	74.9	

Source: Edison Investment Research. Note: Assumes WACC of 12.5% for all products with the exception of Tuzistra XR and Frova at 10% WACC, 525.1m shares outstanding and £/\$ rate of 1.43.

Financials

In addition to updating our model to reflect the fund-raise, we decrease our FY15/16 Tuzistra XR revenue forecasts from £1.26m to £700k on the basis of prescription data trends to date and implied stocking levels at end-December 2015. Given the limited revenue visibility that remains at present – reflecting the early stage of the Tuzistra XR launch – we now also assume a more gradual sales ramp during FY17 and FY18. Moxatag forecasts have also been trimmed in FY17 and FY18 following confirmation that sole source supplier Suir Pharma has been placed in provisional liquidation. Vernalis has Moxatag launch stocks, but we would expect promotional efforts and therefore sales to be more muted until routine supply is re-established.

Based on our updated Tuzistra XR and Moxatag sales estimates for FY17 and FY18, the launch of CCP-07 and CCP-08 in FY18 (coupled with the expectation of higher spending on cough cold promotion in that year) and the timing of success-based milestone payments to Tris (\$46m or c £32m in aggregate), we now expect that Vernalis will reach sustainable profitability one year later, in FY19.

Our April 2016 report, [Establishing a firm foundation](#), previously highlighted a potential short-term funding requirement in 2018 should Tuzistra XR sales fall short of our expectations; the £40m raise removes this uncertainty by providing an ample cash cushion on current forecasts (summarised in Exhibit 2 overleaf). We have updated our financial model to reflect the proceeds of the equity raise and the increased number of shares. Assuming net proceeds of £38.5m, pro forma net cash is £92.5m, with end-FY16e cash boosted to c £73.3m.

Exhibit 2: Financial summary

	£'000s	2013	2015	2016e	2017e	2018e
Year end 30 June (from 2015) previously December		IFRS	IFRS	IFRS	IFRS	IFRS
PROFIT & LOSS						
Revenue		14,084	19,882	11,299	17,336	41,850
of which: Cough/cold portfolio & Moxatag		0	0	699	7,692	32,168
Frova royalties		6,684	6,648	2,600	1,843	1,382
Collaborative income (R&D funding and milestones)		7,150	13,022	7,600	7,500	8,000
Other		250	212	400	300	300
Cost of Sales		(2,244)	(1,373)	(1,252)	(3,401)	(11,380)
Gross Profit		11,840	18,509	10,048	13,934	30,471
Sales, General & Admin		(3,299)	(8,635)	(26,059)	(27,948)	(33,111)
Research & Development		(14,416)	(22,563)	(12,020)	(12,659)	(10,339)
Other		180	611	225	0	0
Operating Profit reported		(5,695)	(11,835)	(27,806)	(26,673)	(12,979)
Intangible Amortisation		(1,349)	(571)	(782)	(909)	(1,591)
Exceptionals		1,608	243	2,630	0	0
Share-based payment		(876)	(1,855)	(876)	(876)	(876)
EBITDA		(4,652)	(8,855)	(28,341)	(24,522)	(10,150)
Operating Profit (norm)		(5,078)	(9,652)	(28,778)	(24,888)	(10,513)
Net Interest		420	2,733	2,988	366	199
Other financial income		(999)	(157)	0	0	0
Profit Before Tax (norm)		(4,658)	(6,919)	(25,790)	(24,521)	(10,313)
Profit Before Tax (as reported)		(6,274)	(9,259)	(24,818)	(26,306)	(12,780)
Tax		2,273	2,858	1,306	630	1,998
Profit from discontinued operations		0	0	0	0	0
Profit After Tax (norm)		(2,385)	(4,061)	(24,484)	(23,891)	(8,315)
Profit After Tax (as reported)		(4,001)	(6,401)	(23,512)	(25,676)	(10,782)
Average Number of Shares Outstanding (m)		442.1	442.3	451.0	525.1	525.1
EPS - normalised fully diluted (p)		(0.8)	(1.0)	(5.4)	(4.5)	(1.6)
Dividend (p)		0.0	0.0	0.0	0.0	0.0
Gross Margin (%)		84.1%	93.1%	88.9%	80.4%	72.8%
EBITDA Margin (%)		-33.0%	-44.5%	-250.8%	-141.5%	-24.3%
Operating Margin (before GW and except.) (%)		-36.1%	-48.5%	-254.7%	-143.6%	-25.1%
BALANCE SHEET						
Fixed Assets		7,730	15,066	23,202	33,372	41,837
Intangible Assets		6,292	12,895	19,635	29,824	38,023
Tangible Assets		1,438	1,637	2,032	2,013	2,278
Other		0	534	1,535	1,535	1,535
Current Assets		83,298	71,509	77,474	45,305	28,114
Stocks		130	0	1,888	1,864	3,118
Debtors		4,443	7,017	2,554	3,800	9,173
Cash		76,918	61,258	73,280	39,890	16,072
Other (tax and derivatives)		1,807	3,234	(248)	(248)	(248)
Current Liabilities		(4,501)	(5,215)	(5,024)	(7,824)	(9,004)
Creditors		(3,384)	(3,373)	(2,899)	(5,699)	(6,879)
Other creditors		0	(5)	(61)	0	0
Short term borrowings		0	0	0	0	0
Deferred income		(962)	(1,688)	(1,101)	(1,101)	(1,101)
Provisions and other current liabilities		(155)	(154)	(1,024)	(1,024)	(1,024)
Long Term Liabilities		(4,283)	(4,254)	(2,593)	(2,593)	(2,593)
Long term borrowings		0	0	0	0	0
Deferred income		(156)	(744)	(2,105)	(2,105)	(2,105)
Provisions and other long-term liabilities		(4,127)	(3,510)	(488)	(488)	(488)
Net Assets		82,244	77,106	93,059	68,259	58,353
CASH FLOW						
Operating Cash Flow		(3,486)	(12,135)	(28,266)	(22,942)	(15,597)
Net Interest		446	353	232	366	199
Tax		1,929	1,887	4,548	630	1,998
Capex		(646)	(1,005)	(266)	(347)	(628)
Purchase of intangibles		(1,976)	(7,474)	(3,500)	(11,098)	(9,790)
Acquisitions/disposals		0	0	(2,386)	0	0
Financing		0	13	38,814	0	0
Dividends		0	0	0	0	0
Other		0	1,644	0	0	0
Net Cash Flow		(3,733)	(16,717)	9,177	(33,390)	(23,818)
Opening net debt/(cash)		(81,555)	(76,918)	(61,258)	(73,280)	(39,890)
HP finance leases initiated		0	0	0	0	0
Exchange rate movements		(904)	1,057	1,000	0	0
Other		0	0	1,845	0	0
Closing net debt/(cash)		(76,918)	(61,258)	(73,280)	(39,890)	(16,072)

Source: Edison Investment Research, Vernalis accounts

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