Celon Pharma

Bloomberg: CLN WA, Reuters: CLN.WA

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Innovative business for PLN0.2bn?

Reiterating Outperform, TP down to PLN22 from PLN30

Celon Pharma hosted Investor Day last week but it did not disclose anything breakthrough. Additionally, it again appeared that clinical trials of the company's key projects need more time to be completed and the publication of their results was postponed from end-2022 into 1H 2023. With that, we believe any catalyst event is unlikely to happen yet this year. Having said this, we point out Celon has robust balance sheet (net cash of PLN173mn accounts for c. 26% of MCAP) while its generic medicines business continues to generate EBITDA of over PLN60mn annually. If we strip out net cash and generic medicines business (valued at PLN 296mn using 10x P/E) from the Market Cap, we arrive at implied value of innovative business of PLN190mn. The latter appears very low given the pipeline of five projects in clinical development. We reiterate our Outperform rating with the target price reduced to PLN22 from PLN30.

Innovative portfolio: Celon again postponed the publications of the readouts from its key projects in clinical phase (to 1H 2023) as recruitment of patients takes longer than previously anticipated. According to the CEO Wieczorek, all five projects in clinical development could be partnered in 2023 following the publication of the results of the studies. We are sceptical but believe that one good partnering deal should be enough to change the perception of the company.

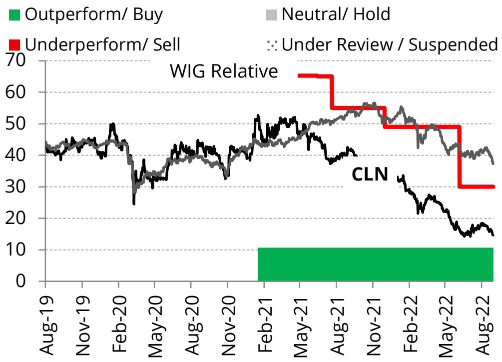
Falkieri: We are losing the faith there is any value in the project. We believe disappointing market performance of Janssen's Spravato reflects general worries about the use of esketamine, despite its sound efficacy. Celon has recently changed the advisor in charge of the selection of the partner for Falkieri but we are not convinced a deal with a substantial upfront payment is likely. Celon is set to be ready to start phase 3 study in 2Q 2023 but the launch is conditional upon finding a partner.

CPL'110 (FGFR inhibitor): We believe this is the most promising project now. Phase 1 study is ongoing, no serious adverse events were observed. The company said the majority of patients harbouring FGFR mutations achieved 'stable disease'. Now recruitment is focused on FGFR patients. In 2019-21 FDA approved three medicines (Balversa, Pemazyre and Truseltiq) that, like CPL'110, are FGFR inhibitors, and there are a few other FGFR projects in clinical studies. In 2021 Five Prime's bemarituzumab, FGFR2b inhibitor, showed positive result in phase 2 study for gastric cancer and subsequently Five Prime was acquired by Amgen for USD1.9bn – we believe this deal highlights the value of the opportunity in FGFR inhibitors.

Generic business: Despite patchy performance of the exports (strong 2Q after weak 1Q) and the persisting opex inflation (energy/ materials and HR) we forecast the business to generate sales of PLN163mn and EBITDA of PLN68mn in 2022E. We believe the challenges to profitability are mounting in the mid run: opex inflation is likely to continue while the company is unable to raise regulated prices in the domestic market (c. 60% of total sales). Planned launches of the new generic product in Poland might provide some cushion. CEO Wieczorek targets to double domestic sales in 2-3 years but we view this ambitious and do not factor it in our projections. Importantly, we still see Celon's generic business as a cash cow, financing innovative projects.

Valuation and risks. Our target price of PLN22 (reduced form PLN30) is based on 100% sum-of-the-parts model. The major risks are competitive landscape, regulatory environment, new medicines development.

Recommendation	**Outperform**
Target Price (Dec '23, PLN)	**22**
Price (PLN, 29 September 2022)	13.0
Market cap (PLNmn)	663
Free float	41%
Number of shares (mn)	51



The chart measures performance against the WIG index.

Main shareholders	**% of votes**
Maciej Wieczorek	68.2%

Source: Santander Brokerage Poland

Company description

Celon Pharma is a pharmaceutical company. It produces mainly generic plus medicines as well as has a pipeline of innovative products in oncology, neuropsychiatry, inflammatory diseases and metabolism.

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Fig. 1. Celon Pharma: Assumptions, Financials and Ratios

Key ratios	2018	2019	2020	2021	2022E	2023E	2024E
EPS (PLN)	0.41	-0.24	-0.02	-0.23	-0.92	-1.15	-1.27
DPS (PLN)	0.17	0.16	0.08	0.07	0.29	0.15	0.15
BVPS (PLN)	8.98	8.38	7.66	10.86	9.64	8.34	6.92
No of shares (mn)	45.0	45.0	45.0	51.0	51.0	51.0	51.0
MCAP (PLNmn)	1,429	1,877	1,767	2,156	663	663	663
EV (PLNmn)	1,286	1,815	1,749	1,943	511	575	649
P/E (x)	78.0	NM	NM	NM	NM	NM	NM
P/BV (x)	0.1	0.1	0.1	0.1	0.0	0.0	0.0
Dividend Yield	0.5%	0.6%	0.2%	0.1%	2.2%	1.2%	1.2%
EV/Sales (x)	8.9	14.9	10.9	9.8	2.6	2.7	2.7
EV/EBITDA Adj. (x)	34.5	NM	62.2	62.9	NM	NM	NM

Income statement (PLNmn)	2018	2019	2020	2021	2022E	2023E	2024E
Revenues	145.2	121.4	160.0	199.1	195.3	211.4	239.8
Generic medicines Poland	*93.4*	*90.1*	*94.1*	*92.6*	*101.9*	*107.0*	*110.4*
Generic medicines exports	*30.4*	*10.6*	*44.0*	*80.0*	*61.4*	*64.4*	*79.4*
Grants	*21.5*	*20.7*	*21.9*	*26.5*	*32.0*	*40.0*	*50.0*
Revenues growth, y/y		*-16%*	*32%*	*24%*	*-2%*	*8%*	*13%*
EBITDA	37.3	-0.4	28.1	30.9	-5.4	-15.7	-23.2
Generic medicines	49.5	24.0	55.6	54.6	67.6	69.3	76.8
Innovative medicines	-12.1	-24.3	-27.5	-23.7	-73.0	-85.0	-100.0
D&A	15.6	20.9	31.8	41.3	46.9	45.9	45.1
EBIT	21.7	-21.2	-3.7	-10.5	-52.3	-61.6	-68.2
Net financial costs	1.7	0.8	-1.9	-4.6	0.0	0.0	0.0
Pre-tax profit	23.5	-20.5	-5.6	-15.1	-52.4	-61.7	-68.3
Tax	5.1	-9.5	-4.7	-3.5	-5.2	-3.1	-3.4
Net profit	18.3	-11.0	-0.9	-11.6	-47.2	-58.6	-64.9

Balance sheet (PLNmn)	2018	2019	2020	2021	2022E	2023E	2024E
PPE	194.1	245.6	331.4	329.2	322.3	316.4	311.3
Intangibles	7.4	6.2	41.1	29.2	29.2	29.2	29.2
Other non-current assets	59.8	64.5	40.1	70.1	70.1	70.1	70.1
Cash	148.0	66.7	44.0	227.6	167.0	103.3	29.8
Other current assets	65.8	76.8	75.3	51.2	58.7	63.3	71.4
Total Assets	475.0	459.8	531.9	707.1	647.2	582.1	511.7
Equity	403.9	377.3	344.5	554.0	492.1	425.8	353.3
Short and Long term Debt	5.6	4.6	25.5	14.9	14.9	14.9	14.9
Grants	49.3	56.5	85.4	85.7	85.7	85.7	85.7
Other liabilities	16.2	21.3	76.4	52.5	54.5	55.7	57.9
Total Equity and Liabilities	475.0	459.8	531.9	707.1	647.2	582.1	511.7
Net debt / (cash) (PLNmn, lhs)	-142.4	-62.1	-18.5	-212.6	-152.1	-88.3	-14.9
Net debt to EBITDA (x, rhs)	-3.8	171.0	-0.7	-6.9	28.0	5.6	0.6

Cash flow (PLNmn)							
Operating CF, of which	30.4	-6.0	71.7	44.0	-5.8	-16.1	-25.8
Investing CF	-19.2	-60.7	-53.3	-121.0	-40.0	-40.0	-40.0
FCF pre financing	11.2	-66.7	18.5	-77.1	-45.8	-56.1	-65.8
Equity raised	0.0	0.0	0.0	202.6	0.0	0.0	0.0
Dividends paid	-7.7	-10.8	-3.6	-3.2	-14.8	-7.7	-7.7

Source: Company data, Santander Brokerage Poland estimates, Historical 2018-21 valuation ratios based on historical average prices

Quarterly results and earnings revisions

Fig. 2. Celon Pharma: Quarterly results and forecasts (PLNmn)

	1Q21	2Q21	3Q21	4Q21	2021	1Q22	2Q22	3Q22E	4Q22E	2022E
Revenues	47.4	57.7	41.1	52.9	199.1	41.9	52.8	44.0	56.5	195.3
Generic medicines Poland	*21.0*	*22.9*	*28.4*	*20.4*	*92.6*	*25.7*	*26.3*	*24.0*	*25.8*	*101.9*
Generic medicines exports	*23.4*	*26.4*	*10.6*	*19.6*	*80.0*	*7.5*	*19.5*	*13.0*	*21.3*	*61.4*
Grants	*3.1*	*8.4*	*2.1*	*12.9*	*26.5*	*8.7*	*7.0*	*7.0*	*9.4*	*32.0*
EBITDA	9.8	12.4	7.7	1.0	30.9	0.6	3.1	-5.2	-3.9	-5.4
Generic medicines	25.4	22.8	12.1	-5.6	54.6	14.4	22.4	14.8	16.0	67.6
Innovative medicines	-15.5	-10.4	-4.5	6.6	-23.7	-13.8	-19.3	-20.0	-19.9	-73.0
D&A	9.4	10.9	14.1	6.9	41.3	11.6	11.5	11.6	12.1	46.9
EBIT	0.4	1.5	-6.4	-6.0	-10.5	-11.1	-8.4	-16.8	-16.0	-52.3
Net financial costs	-2.1	0.3	-1.7	-1.1	-4.6	-0.6	-0.1	0.0	0.7	0.0
Pre-tax profit	-1.7	1.9	-8.1	-7.1	-15.1	-11.7	-8.5	-16.8	-15.3	-52.4
Tax	0.0	-0.2	-0.3	0.0	-3.5	-4.2	-0.4	-0.8	0.2	-5.2
Net profit	-1.7	2.0	-7.8	-4.1	-11.6	-7.5	-8.1	-16.0	-15.5	-47.2

Source: Company data, Santander Brokerage Poland estimates

Fig. 3. Earnings revisions (PLNmn)

	2022E			2023E			2024E		
	NEW	OLD	Ch.	NEW	OLD	Ch.	NEW	OLD	Ch.
Sales	195.3	195.5	0%	211.4	215.4	0%	239.8	243.6	0%
EBITDA	-5.4	-5.3	NM	-15.7	-37.4	NM	-23.2	-44.7	NM
EBIT	-52.3	-52.2	NM	-61.6	-83.3	NM	-68.2	-89.8	NM
Net profit	-47.2	-49.7	NM	-58.6	-79.2	NM	-64.9	-85.3	NM

*Source: Company data, Santander Brokerage Poland estimates *NOTE: rounded to the nearest integer*

Valuation

Sum-of-the-parts valuation

Our price of PLN22 is 100% based on the sum-of-the-parts model, in which we separately value the company's generics business (based on target multiples) and the risk-adjusted NPV of the innovative projects. In our model, we take into account innovative projects that we believe are advanced enough and have significant monetisation potential. Risk-adjustment is based on our subjective assessment of probability of success. In general, we use a 0-20% success rate for projects in pre-clinical development, 20-33% for projects in phase I and 33-66% for projects in phase II. Our NPV models use a WACC of 12%.

We have reduced our target price to PLN22 from PLN30 largely due to 1) lower valuation of generic business – we applied 10x P/E ratio instead of 15x used previously as regional generic peers have de-rated recently) and 2) a lower valuation for the Falkieri project (lack of ‚breakthrough therapy designation' from FDA, disappointing performance of Janssen's Spravato).

Fig. 4. Celon Pharma: Sum-of-the-parts valuation model

Asset	Valuation method	Value (PLNmn)	Value per share (PLN)	Success rate	Target price per share (PLN)	Assumptions
Generics business	Target P/E	296	5.8		5.8	Target P/E of 10
Falkieri (esketamine - neuropsychiatry)	NPV	726	14.2	5%	0.7	Milestones of USD50mn, 20% royalty, commercial launch in 2025, peak sales of USD0.3bn, 15-year lifetime
CPL'110 (FGFR Inhibitor - oncology)	NPV	1,490	29.2	20%	5.8	Milestones of USD100mn, 15% royalty, commercial launch in 2027, peak sales of USD1.0bn, 15-year lifetime
CPL'280 (GPR40 agonist - diabetes)	NPV	921	18.1	20%	3.6	Milestones of USD100mn, 15% royalty, commercial launch in 2027, peak sales of USD0.5bn, 15-year lifetime
CPL'36 (PDE10a - neuropsychiatry)	NPV	526	10.3	20%	2.1	Milestones of USD50mn, 15% royalty, commercial launch in 2027, peak sales of USD0.3bn, 15-year lifetime
CPL'116 (JAK/ROCK inhibitor – inflammatory d.)	NPV	526	10.3	20%	2.1	Milestones of USD50mn, 15% royalty, commercial launch in 2027, peak sales of USD0.3bn, 15-year lifetime
Net cash (debt) end 2023E		88	1.7		1.7	
Total*		**4,574**	**90**		**22**	

*Source: Company data, Santander Brokerage Poland estimates *NOTE: rounded to the nearest integer*

Fig. 5. Sensitivity of target price to probability of success

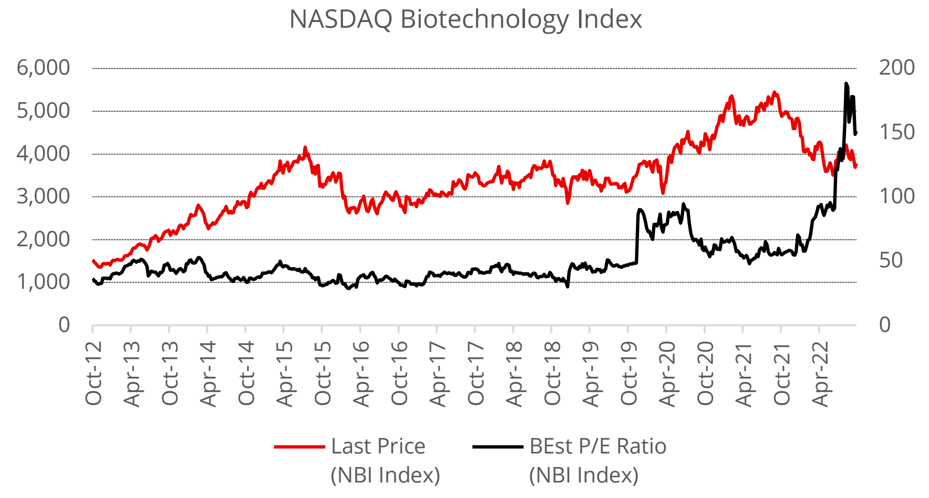
Probability of success	0%	10%	20%	30%	40%	50%	60%	70%	80%	90%	100%
Generics business	5.8	5.8	5.8	5.8	5.8	5.8	5.8	5.8	5.8	5.8	5.8
Falkieri (esketamine - neuropsychiatry)	0.0	1.4	2.8	4.3	5.7	7.1	8.5	10.0	11.4	12.8	14.2
CPL'110 (FGFR Inhibitor - oncology)	0.0	2.9	5.8	8.8	11.7	14.6	17.5	20.5	23.4	26.3	29.2
CPL'280 (GPR40 agonist - diabetes)	0.0	1.8	3.6	5.4	7.2	9.0	10.8	12.6	14.4	16.2	18.1
CPL'36 (PDE10a - neuropsychiatry)	0.0	1.0	2.1	3.1	4.1	5.2	6.2	7.2	8.3	9.3	10.3
CPL'116 (JAK/ROCK inhibitor – inflammatory d.)	0.0	1.0	2.1	3.1	4.1	5.2	6.2	7.2	8.3	9.3	10.3
Net cash (debt) end 2023E	1.7	1.7	1.7	1.7	1.7	1.7	1.7	1.7	1.7	1.7	1.7
Total*	**8**	**16**	**24**	**32**	**40**	**49**	**57**	**65**	**73**	**81**	**90**

*Source: Company data, Santander Brokerage Poland estimates*NOTE: rounded to the nearest integer*

Peer comparison

Numerous biotech companies have no recurrent earnings, which means earnings-based ratios are not meaningful. For illustrative purposes, we show the long-term P/E ratio of NASDAQ Biotechnology Index. It currently trades at c. 150x the forward P/E ratio.

Fig. 6. NASDAQ Biotechnology Index: price performance vs. P/E ratio



Source: Bloomberg, Santander Brokerage Poland

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Target prices set from January to June are for December 31st of the current year. Target prices set from July to December are for December 31st of the following year.

Periodicity: our recommendations/ target prices for each issuer are going to be reviewed at least once a year and whenever market events so warrant.

In the Technical Analysis reports (TA reports), Santander Brokerage Poland does not apply direct investment ratings, and all opinions and elements of analysts' assessment are included in a descriptive form in the study itself.
The period of validity of the TA report is a maximum of 30 days, while the publication of a new TA report for a given financial instrument means that the previously published study is no longer valid.
Due to the short time horizon of the Technical Analysis reports, Santander Brokerage Poland is not going to update them on a regular basis.

In preparing this report Santander Brokerage Poland applied at least one of the following valuation methods: discounted cash flows (DCF), comparative, mid-cycle, dividend discount model (DDM), residual income, warranted equity method (WEV), SOTP valuation, liquidation value.
The discounted cash flows (DCF) valuation method is based on expected future discounted cash flows. One advantage of the DCF valuation method is that it takes into account all cash streams reaching Issuer and the cost of money over time. Some disadvantages of the DCF valuation method are that a large number of parameters and assumptions need to be estimated; and the valuation is sensitive to changes in those parameters.
The comparative valuation method is based on the economic rule of "one price". Some advantages of the comparative valuation method are that the analyst need only estimate a small number of parameters; the valuation is based on current market conditions; the relatively large accessibility of indicators for companies being compared; and that there is an extensive knowledge of the comparative method among investors. Some disadvantages of valuation by the comparative method are the considerable sensitivity of the results of the valuation on the choice of companies to the comparative group; the method can lead to a simplification of the picture of the company which in turn can lead to omitting certain important factors (e.g. growth dynamics, extra-operational assets, corporate governance, the repeatability of results, differences in applied accounting standards); and the uncertainty of the effectiveness of a market valuation of companies being compared.
The mid-cycle multiple valuation is based on long-term average valuation multiples of a sector or a peer group. The methodology aims to calculate a fair, through the cycle value of the company. Among its shortfalls is that at peaks and/or troughs of the cycle, the implied fair value may deviate substantially from the market's value of an analysed stock as well as the methods' reliance on the quality of external data (we usually use Bloomberg or Damodaran databases). Simplicity and average through-cycle value allowing to capture over- as well as under-valuation of a given stock are the main advantages of this methodology.
The dividend discount model (DDM) valuation is based on the net present value of the future dividends that are expected to be paid out by the company. Some advantages of the DDM valuation method are that it takes into account real cash flows to equity-owners and that the methodology is used in respect to companies with long dividend payout history. Main disadvantage of the DDM valuation method is that dividend payouts are based on a large number of parameters and assumptions, including dividend payout ratio.
Residual income method is conceptually close to the discounted cash flows method (DCF) for non-financial stocks, the difference being that it is based on expected residual income (returns over COE) rather than expected future cash flows. One advantage of this valuation method is that it captures the excess of profit potentially available to shareholders and the cost of money over time. Main disadvantage of the valuation method is that a large number of parameters and assumptions need to be estimated; and the valuation is sensitive to changes in those parameters.
The warranted equity method (WEV) is based on the formula P/BV = (two year forward ROE less sustainable growth rate)/(Cost of equity less sustainable growth rate) which allows estimating a fair value (FV) of a given stock in two years' time. Subsequently the FV is discounted back to today. The main advantage of the WEV method is that it is a transparent one and based on relatively short term forecasts, hence substantially reducing the margin of forecasting error. The main disadvantage in our view is that the model is based on the principle that stock price should converge towards its fair value implied by company's ROE and COE.
SOTP valuation - different assets of a company are being valued according to different valuation methods, and the sum of these valuations represents the final valuation of the company. SOTP valuation advantages / disadvantages are identical to advantages and disadvantages of the specific valuation methods used.
Liquidation value method – liquidation value is the estimated amount of money that an asset or company could be quickly sold for, such as if it were to go out of business. Then, the estimated assets value is adjusted for liabilities and liquidation expenses. One advantage of this valuation method is its simplicity. This method does not account for intangible assets as goodwill, which is the main disadvantage.

In the opinion of Santander Brokerage Poland, this report has been prepared with all due diligence and excludes any conflict of interests which could influence its content. In Santander Bank Polska there are implemented internal regulations, which are designed to prevent conflicts of interest concerning recommendations. Physical and logic barriers are established, and the principles of documentation adequate to the type of Santander Bank Polska operations are implemented. Additionally, Santander Bank Polska introduced a number of obligations and restrictions relating to the protection of confidential information flow between organizational units.
The date and time on the first page of this report indicates the date of the production of the recommendation, and the dissemination of the recommendation takes place on the same day before the start of the session.

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