Evaluate Vantage

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Finding the next Vertex

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Other groups with large disconnects between sellside and investor expectations include Beigene, Alnylam and Acceleron.

Vertex's $70bn market capitalisation, before its big correction last week, showed that investor optimism can outstrip even the usually bullish expectations of the sellside. And with the biopharma sector riding high, it is not hard to find other examples of frothy valuations.

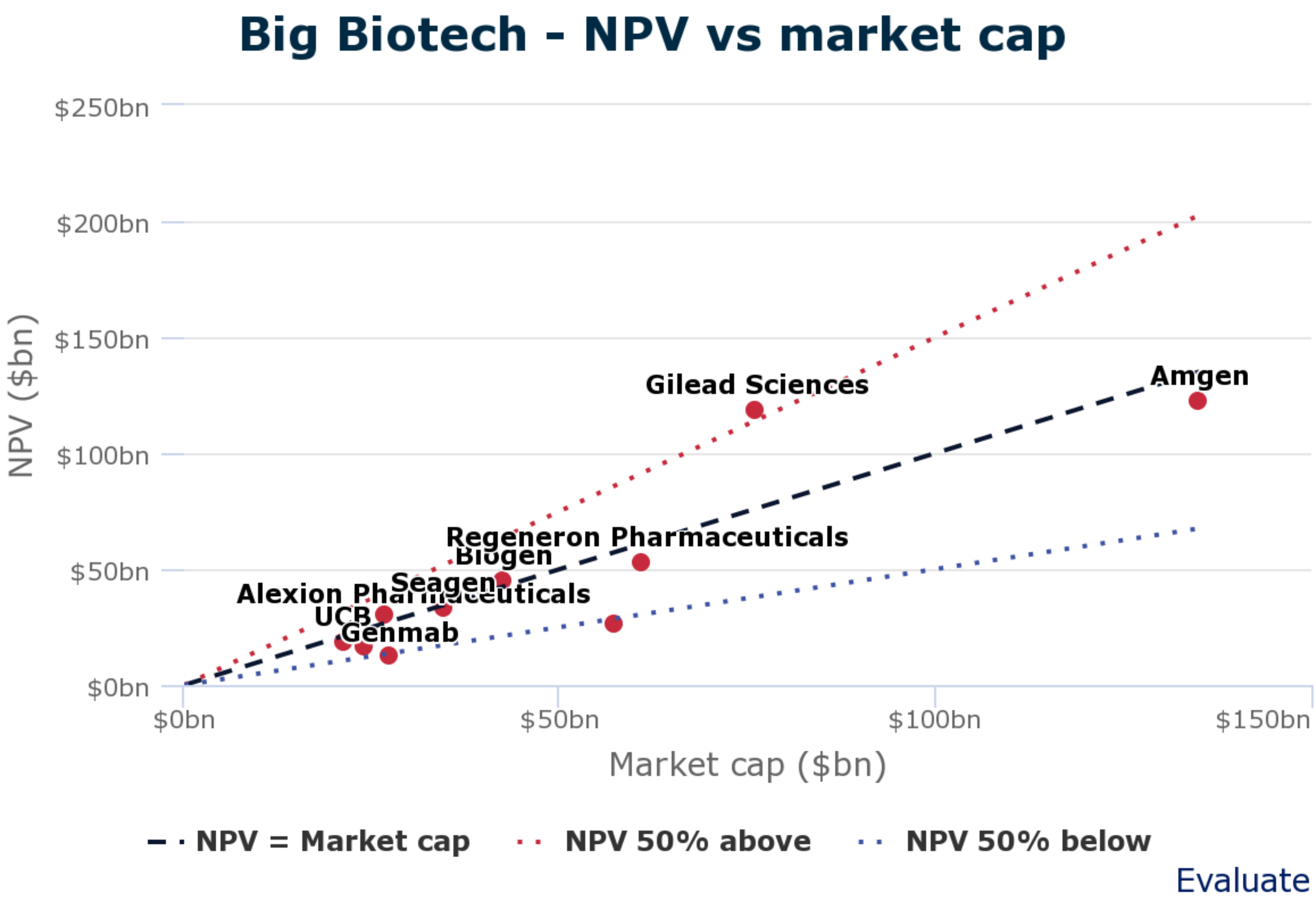
Even after its 21% share price collapse last week Vertex still looks keenly valued by the market, according to an *Evaluate Vantage* analysis; jittery biotech investors might be reassured to know that few other big biotechs peers look so expensive, with the exception of Beigene. But among the mid-sized biotechs it is a different story, with Alnylam and Acceleron looking particularly vulnerable to setbacks.

To look for valuation disconnects between investors and equity analysts, *Evaluate Vantage* compared the market cap of biotechs to the net present value of their assets, computed by *Evaluate Omnium* from sellside forecasts. A separate analysis was carried out for big groups – defined here as companies worth over $20bn – and up-and-coming players with a valuation of $5-20bn.

Biopharma companies whose current valuation has been inflated by their involvement in the development of Covid-19 vaccines and/or therapies were excluded, as were generics and speciality players.

The chart below shows how Vertex is a clear outlier in the big biotech cohort, with its market cap more than double the total NPV of its marketed and R&D assets (*Clinical setback lays bare Vertex's weakness, October 15, 2020*).

Beigene is not far behind. The Chinese group has seen its market cap more than double since this time last year, when it signed a big deal with Amgen. Although Beigene is also developing a Covid-19 antibody candidate, the company's core focus remains cancer, with most hopes focused on the BTK inhibitor Brukinsa and anti-PD-1 MAb tislelizumab.



Of course market caps reflect much more than the future value of revenue streams, particularly when it comes to larger, established companies with manufacturing capabilities and proven R&D competence. Given Vertex's track record in dominating cystic fibrosis, it could perhaps be argued it deserved a premium valuation.

According to the chart above, investors are far less optimistic about other big biotechs.

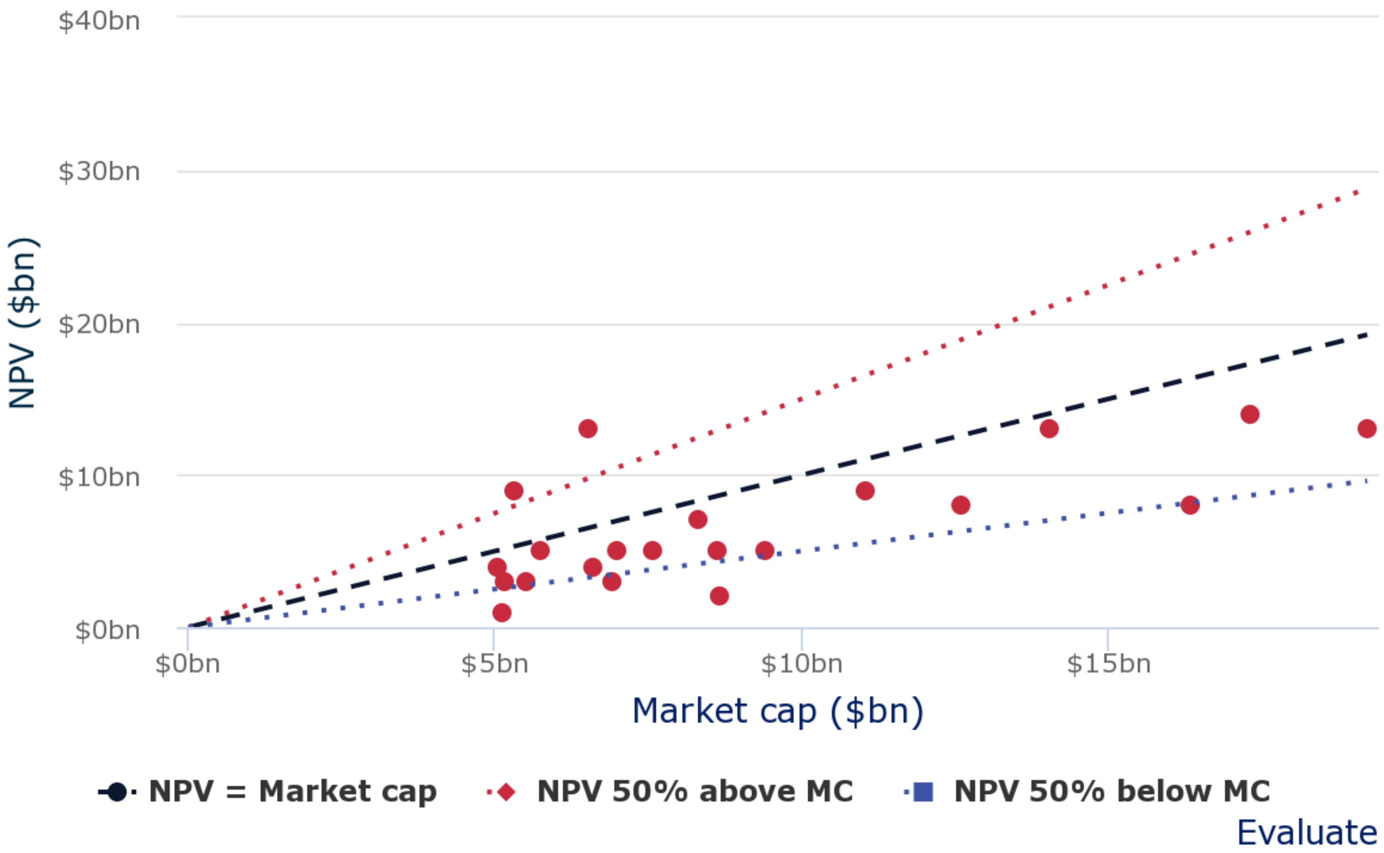
Amgen, for example, has faced calls to buy in new growth after its setback with the heart failure project omecamtiv mecarbil earlier this month. Gilead, with sentiment in the doldrums, looks like the mirror image of Vertex. The former’s stock is sitting at five-year lows following the FDA’s rejection of filgotinib and fears it might have overpaid for Immunomedics.

It is also worth noting that sellside forecasts tend to be on the optimistic side. This is particularly relevant for smaller drug developers whose valuation rests solely on the potential of the pipeline. The chart below shows that the market caps of many up-and-coming biotechs have exceeded the NPVs of their assets.

Many of the up-and-coming players with a big gap between NPV and market cap are developmental-stage groups in much-hyped spaces. Mirati, which has ridden high on hopes that Kras inhibition could be the next big thing in cancer, is a case in point – a big takeover premium already looks to have been priced in here.

Arrowhead is also the subject of high investor expectations, this time hinging on the group’s RNAi platform. A big test is coming shortly, with full phase II data on ARO-AAT due at the AASLD meeting in November.

Up and coming - NPV vs market cap



There are always high-risk, high-reward bets to be made in biotech, and certain investors will always be willing to chase a market that could become huge, no matter how hyped.

Crispr Therapeutics is a good example of this: the group's $7.6bn market cap is incredible for a company that only has a few assets in early-stage trials. If Crispr/Cas9 gene editing does turn out to have clinical utility the possibilities could be endless, of course.

Huge valuation disconnects also exist for those with marketed products, although arguably these are more deserved.

With a leading position in RNAi Alnylam has earned itself a premium, while it also has the launches of Onpattro and Givlaari under its belt. Meanwhile, Acceleron's Reblozyl, licensed to Bristol Myers Squibb via Celgene, is off to a decent launch, and the group recently scored a mid-stage win in January with its wholly owned pulmonary arterial hypertension asset, sotatercept.

Neurocrine with Ingrezza and Horizon with Tepezza have also overseen successful solo launches, although these companies need to keep up the momentum.

Given that biotech is enjoying a bull run it is not surprising that many of these valuations look high. But Vertex's collapse last week suggests that the market remains sensitive to disappointment, which is perhaps a warning for investors in those companies where the disconnect is wide.

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