Evaluate Vantage

October 09, 2009

QLT clears the mist but vision still not 20/20

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After almost two years, QLT has finally completed its transformation into a company solely focused on ophthalmology. The sale of prostate cancer treatment Eligard, announced last week for up to $230m, was the final step.

The break up of the disparate Canadian company, following a collapse in investor confidence, was certainly needed. The cash generated has been spent wisely, putting the company on a firmer financial footing, some even returning to shareholders via a buyback programme. However, a few issues remain outstanding before investors can be fully convinced that QLT's vision for the future is free from dark clouds.

Waving the white flag

QLT initiated the break up of the company at the tail end of 2007 (*QLT waves the white flag, November 29, 2007*). Its macular degeneration treatment Visudyne, sold by Novartis, was struggling against newer market entrants whilst acne treatment Aczone was rendered commercially unviable by onerous FDA monitoring requirements; at the same time debt repayments were looming.

The first sale was Aczone, snapped up by Allergan for $150m in June last year, vindication of the company's long struggle to have the onerous blood monitoring restrictions removed, which the FDA finally granted a few months previously (*QLT break up plans given boost by FDA, March 18, 2008*).

In August, Reckitt Benckiser bought rights to the Atrigel sustained-release drug delivery technology for $25m up front, and last week the final asset sale was announced. QLT's US subsidiary, essentially the Eligard asset, was sold to Tolmar Holding for up to an aggregate $230m. Tolmar, which manufactures the LHRH agonist, will pay $20m upfront, $10m by October next year and the remainder on a quarterly basis, out of the royalties received from the companies that market the product around the world.

This means that Eligard will essentially continue to provide a healthy royalty stream to the remaining QLT business; royalty revenue of $10.5m was booked in the second quarter of this year. Astellas Pharma and Sanofi-Aventis, who market the drug globally, reported combined sales of $277m last year for the product; analysts forecast this growing to $380m by 2014.

To complete the break up, the group also literally sold its own backyard, for C$66m ($66m), and will lease back the premises.

Use of cash

The group has used a large portion of the cash to pay back debt, and buy back $50m worth of shares. As of the end of June, QLT had $135m of cash in the bank.

Unfortunately, an ongoing legal spat could eat into that cash, over royalties due on sales of Visudyne. After losing a case against Massachusetts Eye and Ear Infirmary, costing QLT $127m in back payments, the Massachusetts General Hospital has now filed a suit, claiming that it is also entitled to higher royalties.

Another ongoing struggle is Visudyne. Both QLT and Novartis have been running studies in an attempt to reinvigorate sales which have been flagging in the face of competition from Lucentis. They have been trying to establish whether combining the two drugs can produce a better outcome for patients with macular degeneration, or at least reduce the need for treatments, particularly relevant considering the huge cost of the Roche drug.

Two trials, called Radical and Mont Blanc, reported encouraging results in June, and Novartis should reveal results from the final study before the end of the year.

Considering the Swiss pharma giant's clear commitment to the ocular market, most notably through the purchase of a stake in Alcon last year, Visudyne should not be written off just yet. However, analysts are still forecasting a gradual decline in sales; from a peak of $484m in 2005 sales totalled just $142m last year and $71m is forecast for 2014. Unless signs of a resurgence materialises, Novartis is unlikely to support the product forever.

Internal programmes

QLT's internal efforts are focused on a punctal plug programme, bought in 2007 via the acquisition of ForSight Newco for $42m.

The drug delivery system is being developed to treat glaucoma. If spotted early enough the condition can be treated with eye drops, however poor compliance normally means the disease progresses and more invasive procedures are required to lower the pressure in the eye. QLT hopes by developing a plug that can be inserted in the eye to release the drug continuously, disease progression can be more effectively controlled.

Its latanoprost Punctal Plug Delivery System (L-PPDS) delivers the blockbuster eye drop currently sold by Pfizer under the brand name Xalatan, which last year generated sales of $1.75bn; the patent is due to expire in June next year. QLT has been refining the dose and delivery system, and hopes to commence a large phase II trial next year.

Until robust phase II data is generated, investors are likely to remain cautious over this programme, despite the company's obvious enthusiasm about its potential. Concern about Visudyne's future and the threat of another big legal settlement will also weigh.

Still, QLT shares have advanced 60% this year to $3.80 currently, giving the company a market value of $208m. Of course, this recovery is from a very low base – the stock touched a record low of $1.41 in March – and a large proportion of that valuation will reflect the $135m of cash in the bank.

Until the issues above are resolved, QLT's stock is unlikely to travel much higher. But with a bit more clarity on the future, the company could well start putting that not insignificant cash pile to good use.