Vernalis continues transformation with Frova royalty deal

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In comic books the hero is usually freed with one bound. For Vernalis the process of becoming debt free has taken several leaps, with what looks to have been the final one executed today with the announcement of a share placing to raise £30m to cancel out its debt and buy back the rights to 100% of the royalties on sales of Frova (frovatriptan), sold by Menarini, by terminating its 2008 agreement with Paul Capital Healthcare.

As part of the deal Vernalis will pay Paul Capital, which specialises in buying royalty streams from companies, a one off fee of £21m ($32.6m) to get back its right to 25.25% of net sales of the migraine treatment outside of the US. Paul Capital in return will subscribe to 2.1m Vernalis warrants.

Speaking to EP Vantage about the decision to get back the rights to the product Ian Garland, Vernalis chief executive, said. “We effectively had a third party in control of a significant part of our business even if it was ring fenced around frovatriptan. It was a distraction and it was also a valuable asset that we did not have an economic interest in.”

Mr Garland added that as well as allowing the group to become debt free, it has extended the cash runway till 2013 and brings a sustainable and growing revenue stream. “It should also reduce our dependence on our shareholders and give more flexibility in deciding the future direction of the group,” he said.

Last year, Menarini reported a 15% increase in sales to €32.4m ($44.1m) for Frovatriptan. While the Italian group is thought to be planning on expanding sales of the product outside of Europe to some of the BRIC countries, Mr Garland admitted that the growth reported for 2009 is likely to slow.

But even if this does happen the group still has a useful revenue stream to which it previously had no access. At the current sales levels Vernalis would be adding an extra £7.16m a year to its funds. This additional money is important because under the terms of the US licensing agreement with Endo Pharmaceuticals, Vernalis is only entitled to royalties once sales of the product exceed $85m.

In 2008, Endo reported sales of $58m for Frova, and last year’s sales are forecast to be almost flat at $59m, meaning that current sales would have to increase by around 50% for Vernalis to realise any US royalties from the product, something that appears highly unlikely at the moment.

So adding in the European royalty stream should allow Vernalis to achieve some of the plans that it set out last year (EP Vantage Interview – Vernalis CEO lays out ambitious growth plans, August 11, 2009). Today, Mr Garland said that the additional money and the increase in cash would help it to move some in-house programmes forward as well as in-license other projects.

“Over this year and the next I would be looking to add new products to the pipeline.”

Any acquisitions considered by the group are likely to remain with Vernalis’ core focus of neurology, pain and oncology. With £26.4m in cash on the balance sheet and the additional £7.50m expected from the placement after expenses, the group is in a good position to either buy a pre-clinical, phase I or phase II ready product.

A matter of faith

The fact that this is the second time that Vernalis has been able to raise a significant amount of money again underlines the belief that investors have in both Mr Garland and the management team to turn round the company, that was dealt a severe blow when Frova was rejected for broader use in the US, in 2007.

To date, that confidence has been rewarded with the group not only restructuring its debt, but landing a deal in August last year with GlaxoSmithKline for the option to license any experimental drugs developed by the
group for an undisclosed cancer target, for a $3m upfront fee and a 3.4% stake in the company.

With the company now on an even more solid financial footing, the next catalyst that could move the shares, which are due to undergo a share capital reorganisation following the fundraising, is the phase II data from its most advanced un-partnered asset, V381 in neuropathic pain, which are due in March.

This is a pivotal event for the company as it will determine the next big step for Vernalis, which alongside partnering talks for the drug could start to think about M&A to give it more scale, an event that if it does come off could really make Vernalis a hero of UK biotech.