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Cephalon buys Gemin X but cannot buy investor love

Jonathan Gardner

Cephalon's attempts to plug a gap in its revenue might help in the short term but it really needs its pipeline to perform. The Pennsylvania group’s acquisition of private Canadian oncology specialist Gemin X Pharmaceuticals signals that it is still looking to beef up R&D despite the imminent loss of revenues when blockbuster anti-sleepiness drug Provigil loses patent protection in just over a year.

Cephalon has been on a mini buying spree in the last 12 months: Swiss generics maker Mepha, an acquisition that solved near-term revenue issues and will add more than a half-billion dollars in sales in 2016, along with Ception, Gemin X and a potentially huge licensing deal with Mesoblast (*Cephalon closes the blast doors for a rocketing stem cell deal, December 8, 2010*). Yet shares have lost one-fifth of their value over the last year and slumped 2% today on the Gemin X deal; the signs are that Cephalon's shareholders would much rather the company sign deals to bridge its near-term revenue gap than beef up its pipeline.

Building pipeline

Purchasing Gemin X for $225m upfront and $300m in milestones chiefly brings on board obatoclax, which is near the end of a phase IIb trial in advanced small-cell lung cancer (*Therapeutic focus – Cephalon buy points to rare win in small cell lung cancer, March 22, 2011*).

The pan-B cell lymphoma 2 (Bcl-2) inhibitor joins CEP-701, E/CEP-18770 and a mesenchymal stem cell bone marrow transplantation project in Cephalon’s mid and late-stage oncology pipeline. The latter of those was brought on board with the Mesoblast deal.

It is, at first glance, a healthy looking pipeline: Cephalon has five active oncology candidates in clinical development, not counting obatoclax, and is looking to add first-line treatment of non-Hodgkins lymphoma to the indications for marketed product Treanda. These are just a small part of a pipeline that boasts 18 active clinical stage products.

Yet investors are not valuing Cephalon's pipeline at all. Its market capitalisation of $4.3bn equals the net present value of its eight proprietary products, according to '*EvaluatePharmas NPV Analyzer*, with no analysts yet ascribing any tangible value to its pipeline. In the words of Summer Street Research analysts, the current R&D offerings are simply “small, too far out, or too risky to call.”

Investors remain as unconvinced about Gemin X as they have been about the past year’s strategy overhaul – shares were down 2% to $55.78 in early trading today.

Value lagging

In buying the McGill University spinout, Cephalon provides an exit to venture capital investors who poured $24m into the firm last year to support the phase IIb trial of obatoclax, and a further $115m over the past 13 years to develop a pipeline that consists of two clinical stage products.

Commenting on the deal, analysts from UBS said that while the Gemin X purchase is less risky than the Mesoblast deal on stem cells, they are cautious because the Bcl-2 target is unproven. Investors do not have confidence that these assets will be able to fill the dent Cephalon will suffer in the Provigil/Nuvigil franchise after the former’s patent expiry.

That may be a big dent. Based on a physician survey, analysts from Oppenheimer believe that generic competitors to Provigil will result in flat Nuvigil sales after 2012, and with recent setbacks in jetlag the next best hope for extending the franchise may be in bipolar depression (*Clinical and regulatory events over the Christmas period, January 4, 2011*). In fact, phase III data in that indication is seen as one of the biggest near-term catalysts for the share - due in the fourth quarter of this year.

Therefore, the company should be relieved for the generics income brought in by the Mepha purchase; it neatly keeps revenue from declining too much. Without the $558m contribution from generics in 2016, Cephalon sales would be $1.76m, a $1bn decline from 2010.

But the joint strategy of filling a patent cliff with generics and boosting research will come at a price: with R&D and SG&A expenses set to be maintained at their current level, operating profit margin will drop from nearly 38% last year to less than 25% by 2016, forecast data shows.

Thus, in the absence of an acquisition with existing revenues or at the very least the prospect of near-term R&D returns, investors are likely to stay on the sidelines.