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Roche’s pricey move reinvigorates biotech fever

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As the markets digest Roche’s $8.3bn acquisition of InterMune over the weekend, expensive-looking biotech takeover targets have emerged as some of the main beneficiaries.

Understandably, sellside analysts covering Roche have reacted with barely concealed amazement; to come close to justifying InterMune’s price tag calls for highly optimistic takes on generic exclusivity and cost savings. The Swiss group has a reputation for caution, and has repeatedly warned of unrealistic biotech valuations, yet it is hard not to see InterMune as extremely overpriced.

After all, some analysts following InterMune had basically admitted that the group was fully valued – and even this stretched the limits of valuation methodology. Roche paying 35% above such bullish estimates will be seen as the main reason why the Nasdaq biotechnology index today exceeded its February peak.

Obviously, positive data for InterMune’s sole clinical asset, the idiopathic pulmonary fibrosis (IPF) project Esbriet, provided the trigger for a takeout (*Esbriet data show widening gap over competitors, May 20, 2014*). And the group reportedly hiring advisors to explore strategic options shortly afterwards implies the presence of multiple bidders, which would naturally have hiked the price.

That said, the potential Roche sees in Esbriet must exceed even that of JP Morgan analysts, who in June estimated that it would be priced at $50,000 a year and generate peak global sales of $1.4bn.

They valued InterMune at $5.5bn, simply applying a 6-7x multiple to 2019 forecast sales – a methodology that glosses over the costs associated with running the business and selling Esbriet. Consensus numbers compiled by *EvaluatePharma* show Esbriet selling $1.3bn in 2020, and yield a net present value of only $2.2bn.

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How could Roche have justified paying so much more? One issue is the ambiguity over Esbriet’s market exclusivity. The main composition-of-matter patent has expired, and the product will rely on orphan drug exclusivity until around 2021 in Europe and the US.

A US formulation patent claims coverage until 2026, and some analysts do not foresee generics before then. Leerink, on the other hand, assumes a 30% probability that Esbriet will have only until the end of orphan exclusivity, and the *EvaluatePharma* model takes the bearish view, assuming that sales fall off from 2021.

Moreover, the NPV calculation assumes a 30% tax rate and a relatively high SG&A margin. Roche aims to use its own US sales force and European infrastructure to market Esbriet, so savings should be considerable; UBS assumes cost cuts of $200m a year, while Leerink pencils in $340m, or a staggering 77% reduction in SG&A.

EvaluatePharma’s NPV Analyzer tool can be used to adjust the calculation inputs, but even setting patent expiry at 2026, cutting the tax to 15% and slashing most of the SG&A spending off the income statement does not result in a product NPV anywhere near $8.3bn.

Esbriet is neck and neck with Boehringer Ingelheim’s nintedanib to become the first US IPF drug, and has a PDUFA date of November 23 – the first tangible indication of whether Roche is backing the right horse.

Financial considerations aside, the move makes sense for the Swiss group, which had collaborated with InterMune before, and which could add Esbriet to a late-stage respiratory portfolio that includes the anti-asthma assets Xolair and lebrikizumab. But analysts covering Roche have been lukewarm.

The normally bullish Alexandra Hauber, at UBS, wrote that to justify the price Esbriet IP needs to hold beyond 2025, or else the drug's sales have to exceed $4bn. Bryan Garnier analysts questioned Roche’s assertion that the takeover would be neutral to per-share earnings next year. The Swiss group forecasts EPS accretion from 2016.

It is probably little more than a footnote that InterMune bought out Esbriet rights from Marnac in a deal worth only $13.5m up front and up to $53.5m in milestones, just as the credit crunch took hold in 2007. Marnac no longer appears to be in business.

Seeing InterMune's long-suffering investors banking such a massive return it is probably not surprising that Biomarin, Puma Biotechnology, Intercept, Achillion and Medivation were among the stocks that closed up yesterday.

None of these can exactly be called cheap, but then $8.3bn for InterMune shows that in biotech today anything is possible.

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