

# Faron Pharmaceuticals

## Company report

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✓ Inderes corporate customer

This report is a summary translation of the report "Tutkimusohjelma etenee suunnitellusti" published on 1/10/2023 at 7:32 am

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# Research program progressing as planned

We have updated our assessment of the progress of Faron's research program and based on that, the commercial potential of the company's drug candidates. The individual studies of the research program have largely progressed as we expected and the changes to our model are moderate in size. The most important change is the increased number of blood cancer patients who could potentially benefit from bexmarilimab (BEX). However, since October, the share price has increased more than our fair value, which weakens the share's risk/return ratio. We believe the share is close to the upper limit of its fair value range. With the updates to the model, we raise Faron's target price to EUR 3 and revise our recommendation to Reduce.

## The estimate model changes with research results and plans

Our Faron estimates are based on risk-adjusted modeling, where the commercial potential of drug candidates is assessed based on the number of patients, market share, expected sales price and royalty share. These estimates consider the probability of market entry based on the clinical stages of drug development, which we have described in more detail in our [extensive report](#). We regularly evaluate these probabilities and different parameters of the model as new data is collected. Individual studies usually last 1-3 years, so market entry probabilities typically change slowly.

## The net effect of estimate changes is slightly positive

News about the progress of Faron's research program in late 2022 have concerned cancer drug candidate bexmarilimab (BEX). There are no news concerning the two other candidates, traumakine and haematokine, that affects modeling. Faron has reported on the results of the early stage of the blood cancer study BEXMAB in [October](#) and [December](#). In addition, the company has provided updates on its research in investor presentations in [September](#) and [December](#). The key changes in our model based on new data are 1) a higher expected number of patients in blood cancers as the indications have expanded and 2) the slight increase in the commercialization probability of BEX based on the initial results of BEXMAB. The net effect of the changes on the estimated cash flows is slightly positive.

## Share close to the upper limit of the fair value range

The DCF calculation indicates that the fair value of the share is around EUR 3, but due to the high uncertainty of the assumptions, the tolerances are high. The pricing of Faron's share is starting to be challenging relative to our neutral DCF scenario. Considering the large tolerances, we do not find the overvaluation blatant, but due to the lowered expected return thanks to the increased share price in the past few weeks we take a more cautious view of the share. Relative to Nordic drug development companies Faron is priced (partly justifiably) higher than its peers which also partly justifies a narrower upside for the share in the short term. We point out that if Faron's drug development is successful, the share is probably far more valuable than currently, but on the other hand, failure in development would probably lead to a loss of capital. Thus, the company is a high-risk investment as typical in the industry. In Faron's near future, we focus on research funding that the company can approach with share issues, by making a commercialization agreement and, to a limited extent, through debt financing.

## Recommendation

### Reduce

(previous Accumulate)

### EUR 3.00

(previous EUR 2.50)

### Share price:

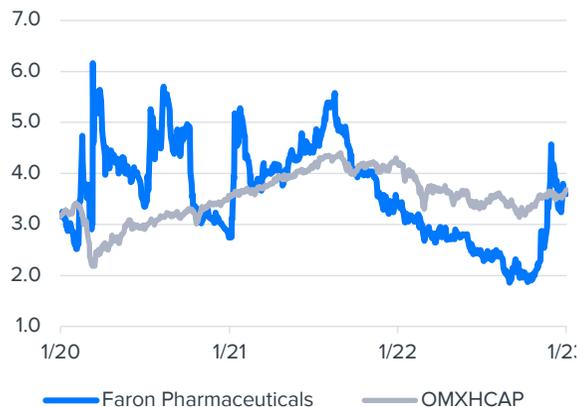
3.71



## Guidance

Faron does not provide any guidance

## Share price



Source: Millstream Market Data AB



### Value drivers

- High need for new cancer drugs
- Target market is estimated to grow to USD 140 billion by 2030 (CAGR 16.8 %)
- Very defensive sector
- Possibility of globally sold drugs whose annual revenue potential is calculated in billions and Faron's cash flow in hundreds of millions
- Potential can also materialize through a cooperation agreement or acquisition



### Risk factors

- Drug development requires substantial front-loaded investments
- Failed drug development is likely to result in permanent loss of invested capital
- Success depends on the safety and efficacy of drug candidates, which may prove insufficient in studies
- If market entry is successful, the market share, sales price and royalties involve uncertainties

Valuation	2022e	2023e	2024e
Share price	3.71	3.71	3.71
Number of shares, millions	59.8	59.8	59.8
Market cap	222	222	222
EV	234	235	237
P/E (adj.)	neg.	neg.	neg.
P/E	neg.	neg.	neg.
P/FCF	neg.	neg.	neg.
P/B	neg.	neg.	neg.
P/S	>100	>100	>100
EV/Sales	>100	>100	>100
EV/EBITDA	neg.	neg.	neg.
EV/EBIT (adj.)	neg.	neg.	neg.
Payout ratio (%)	0.0 %	0.0 %	0.0 %
Dividend yield-%	0.0 %	0.0 %	0.0 %

Source: Inderes

# Changes in the estimate model

## Indication expansion in blood cancers

In the past, we modeled the use of BEX in blood cancers for acute myeloid leukemia and myelodysplastic syndrome, reflecting BEXMAB's research design. Our previous model was based on the use of the drug in patients whose second line treatment has failed or stopped working. The BEXMAB study also includes patients whose first line treatment has failed. Based on the research design and preliminary promising treatment outcomes, we believe that BEX could also be suitable for earlier stage patients. We have therefore increased the number of patients who may benefit from BEX in our model. This contributes to increasing cash flows.

Due to the rapid progress of the BEXMAB study and

the possibility of early marketing authorization, we have also modeled some revenue for 2025 (previously 2026).

## Changes in the probabilities of commercialization

Due to the dose-escalation studies progressing (BEXMAB) and partial funding being secured for BEXCOMBO we slightly raise the probability of success for phase II of the BEXCOMBO study. We also raise the probability of success for the current phase I/II of BEXMAB due to promising initial results.

The increased probabilities are also based on additional information on BEX's safety from the MATINS and BEXMAB studies. More than 200 patients have been treated with BEX and no serious adverse reactions have occurred. We consider it

unlikely that BEX's development would fail due to safety shortcomings.

## Updates do not affect estimates until 2025

We do not expect sales-based income from Faron's drug candidates this or next year, so our estimate changes do not affect near-term figures. In our estimates, Faron will receive a small sales-based royalty income from 2025 onwards and revenue will start to accumulate more extensively in 2026.

Estimate revisions MEUR / EUR	2022e		Change %	2023e		Change %	2024e		Change %
	Old	New		Old	New		Old	New	
Revenue	0.0	0.0		0.0	0.0	0%	0.0	0.0	0%
EBIT	-22.1	-22.1	0%	-0.8	-0.8	0%	-1.7	-1.7	0%
PTP	-22.3	-22.3	0%	-1.1	-1.1	0%	-2.0	-2.0	0%
EPS (excl. NRIs)	-0.37	-0.37	0%	-0.02	-0.02	0%	-0.03	-0.03	0%
DPS	0.00	0.00		0.00	0.00		0.00	0.00	

Source: Inderes

# Valuation has become more challenging

## The valuation is based on risk-adjusted estimates

Our valuation is based on risk-adjusted estimates that consider the binary risk of research failure. We also discussed our estimate model in more detail in our recent [extensive report](#). In the absence of revenue and profitability, our valuation is based on the DCF model and peer analysis.

## Slight upward revision in the DCF value

The risk adjusted DCF gives the share a value of EUR 3, which is around one-fifth below the market cap. We point out that the model is very sensitive to the assumptions used, so changes in assumptions can change the share value indicated by the model a lot. Modeling is based on historical probabilities of drug development being successful and high-quality epidemiological and medical data (GlobalData). Nevertheless, we believe investors should look at DCF in this type of share more as indicative than a precise tool for valuation.

The average cost of capital (WACC) is 11.0% in our DCF model, and therefore at a typical level for drug development companies. From a business perspective, WACC is raised by uncertainty of the timing of revenue, the drug's sales price, the achievable revenue, and the terms of possible cooperation agreements, including the royalty percentage. On the other hand, the industry's defensive nature and the strong cash flows resulting from market entry limit the risk level.

The present value of Faron's share is strongly based on 2027-2031 cash flows. Years 2032-2038 are less important. The impact of loss-making 2022-2026 is negative on the present value of the share.

## Valuation is highish compared to peers

As peer companies, we use listed clinical stage drug development companies in the Nordic countries. The median market cap of the peers is EUR 63 million, clearly below Faron's EUR 222 million. The difference compared to clinical stage II companies is even greater (median market cap 46 MEUR). We believe Faron deserves a higher valuation than its peers based on its large target market and the potential of its three drug candidate programs. However, the valuation difference to the peers has, in our opinion, become unjustifiably large.

## Target price rises with estimate changes

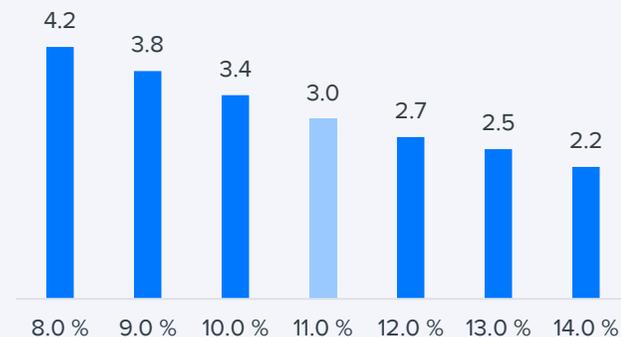
Our target price rises to EUR 3 indicated by the DCF value and we revise our recommendation to Reduce. Our view of the risk level of the company's business remains unchanged, i.e. the risk is at the highest level of 4 indicating the risk of losing capital related to the investment. We feel that the share price has increased more quickly than its internal value since October. Thus, we estimate that the expected return and risk ratio has deteriorated and the value of the share is close to the top of the fair value range we estimate.

We remind investors of the importance of diversification, as the failure of drug development can lead to ultimate loss of invested capital. The nature of a share investment also includes potential large movements in one direction or another, for example through unexpected research or financial news.

Valuation	2022e	2023e	2024e
Share price	3.71	3.71	3.71
Number of shares, millions	59.8	59.8	59.8
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EV	234	235	237
P/E (adj.)	neg.	neg.	neg.
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P/FCF	neg.	neg.	neg.
P/B	neg.	neg.	neg.
P/S	>100	>100	>100
EV/Sales	>100	>100	>100
EV/EBITDA	neg.	neg.	neg.
EV/EBIT (adj.)	neg.	neg.	neg.
Payout ratio (%)	0.0 %	0.0 %	0.0 %
Dividend yield-%	0.0 %	0.0 %	0.0 %

Source: Inderes

## Share price sensitivity to WACC used in the DCF model



# Income statement

Income statement	H1'20	H2'20	2020	H1'21	H2'21	2021	H1'22	H2'22e	2022e	H1'23e	H2'23e	2023e	2024e	2025e
Revenue	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	4.8
EBITDA	-7.0	-9.4	-16.4	-10.3	-10.5	-20.8	-13.3	-8.6	-21.9	-0.3	-0.3	-0.4	-1.3	-18.8
Depreciation	-0.1	-0.1	-0.3	-0.2	-0.2	-0.3	-0.1	-0.1	-0.2	-0.1	-0.1	-0.4	-0.4	-0.4
EBIT (excl. NRI)	-7.1	-9.5	-16.7	-10.4	-10.7	-21.1	-13.4	-8.7	-22.1	-0.4	-0.4	-0.8	-1.7	-19.1
EBIT	-7.1	-9.5	-16.7	-10.4	-10.7	-21.1	-13.4	-8.7	-22.1	-0.4	-0.4	-0.8	-1.7	-19.1
Share of profits in assoc. compan.	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Net financial items	-0.2	-0.1	-0.3	-0.1	0.0	-0.1	0.3	-0.5	-0.2	-0.2	-0.2	-0.3	-0.3	-0.3
PTP	-7.3	-9.6	-16.9	-10.6	-10.6	-21.2	-13.1	-9.2	-22.3	-0.6	-0.6	-1.1	-2.0	-19.4
Taxes	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Minority interest	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Net earnings	-7.3	-9.6	-16.9	-10.6	-10.6	-21.2	-13.1	-9.2	-22.3	-0.6	-0.6	-1.1	-2.0	-19.4
EPS (adj.)	-0.16	-0.20	-0.36	-0.20	-0.20	-0.40	-0.24	-0.15	-0.37	-0.01	-0.01	-0.02	-0.03	-0.33
EPS (rep.)	-0.16	-0.20	-0.36	-0.20	-0.20	-0.40	-0.24	-0.15	-0.37	-0.01	-0.01	-0.02	-0.03	-0.33

Source: Inderes

# Balance sheet

Assets	2020	2021	2022e	2023e	2024e
<b>Non-current assets</b>	<b>0.9</b>	<b>1.1</b>	<b>1.7</b>	<b>1.8</b>	<b>2.0</b>
Goodwill	0.0	0.0	0.0	0.0	0.0
Intangible assets	0.6	0.9	1.0	0.8	0.6
Tangible assets	0.4	0.2	0.7	1.0	1.3
Associated companies	0.0	0.0	0.0	0.0	0.0
Other investments	0.0	0.0	0.0	0.0	0.0
Other non-current assets	0.0	0.0	0.0	0.0	0.0
Deferred tax assets	0.0	0.0	0.0	0.0	0.0
<b>Current assets</b>	<b>7.4</b>	<b>12.1</b>	<b>0.0</b>	<b>0.0</b>	<b>0.0</b>
Inventories	0.0	0.0	0.0	0.0	0.0
Other current assets	0.0	0.0	0.0	0.0	0.0
Receivables	3.3	5.2	0.0	0.0	0.0
Cash and equivalents	4.1	6.9	0.0	0.0	0.0
<b>Balance sheet total</b>	<b>8.4</b>	<b>13.2</b>	<b>1.7</b>	<b>1.8</b>	<b>2.0</b>

Source: Inderes

Liabilities & equity	2020	2021	2022e	2023e	2024e
<b>Equity</b>	<b>-1.9</b>	<b>2.9</b>	<b>-11.0</b>	<b>-12.1</b>	<b>-14.0</b>
Share capital	2.7	2.7	2.7	2.7	2.7
Retained earnings	-96.6	-116.3	-138.6	-139.7	-141.6
Hybrid bonds	0.0	0.0	0.0	0.0	0.0
Revaluation reserve	0.0	0.0	0.0	0.0	0.0
Other equity	92.0	117	125	125	125
Minorities	0.0	0.0	0.0	0.0	0.0
<b>Non-current liabilities</b>	<b>3.7</b>	<b>3.1</b>	<b>0.5</b>	<b>0.5</b>	<b>0.5</b>
Deferred tax liabilities	0.0	0.0	0.0	0.0	0.0
Provisions	0.0	0.0	0.0	0.0	0.0
Long term debt	2.7	2.9	0.0	0.0	0.0
Convertibles	0.0	0.0	0.0	0.0	0.0
Other long term liabilities	1.0	0.2	0.5	0.5	0.5
<b>Current liabilities</b>	<b>6.4</b>	<b>7.2</b>	<b>12.1</b>	<b>13.3</b>	<b>15.5</b>
Short term debt	0.0	0.4	12.1	13.3	15.5
Payables	6.4	6.7	0.0	0.0	0.0
Other current liabilities	0.0	0.0	0.0	0.0	0.0
<b>Balance sheet total</b>	<b>8.3</b>	<b>13.2</b>	<b>1.7</b>	<b>1.8</b>	<b>2.0</b>

# DCF calculation

DCF model	2021	2022e	2023e	2024e	2025e	2026e	2027e	2028e	2029e	2030e	2031e	2032e	2033e
Revenue growth-%	0.0 %	0.0 %	0.0 %	0.0 %	119831.6 %	328.9 %	64.3 %	60.5 %	28.2 %	20.6 %	8.1 %	7.9 %	4.1 %
EBIT-%	-527700.0 %	-551975.0 %	-20292.5 %	-41800.6 %	-399.1 %	1.5 %	40.1 %	61.5 %	68.6 %	73.0 %	74.2 %	75.3 %	75.5 %
<b>EBIT (operating profit)</b>	<b>-21.1</b>	<b>-22.1</b>	<b>-0.8</b>	<b>-1.7</b>	<b>-19.1</b>	<b>0.3</b>	<b>13.6</b>	<b>33.3</b>	<b>47.7</b>	<b>61.2</b>	<b>67.2</b>	<b>73.6</b>	<b>76.9</b>
+ Depreciation	0.3	-0.1	0.4	0.4	0.4	0.4	0.4	0.5	0.5	0.5	0.5	0.6	0.6
- Paid taxes	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	-13.4	-14.7	-15.3
- Tax, financial expenses	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	-0.1	-0.1	-0.1
+ Tax, financial income	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
- Change in working capital	-1.5	-1.5	0.0	0.0	0.0	-1.0	-0.7	-1.0	-0.8	-0.7	-0.3	-0.4	-0.2
<b>Operating cash flow</b>	<b>-22.4</b>	<b>-23.7</b>	<b>-0.4</b>	<b>-1.3</b>	<b>-18.8</b>	<b>-0.3</b>	<b>13.4</b>	<b>32.8</b>	<b>47.4</b>	<b>61.0</b>	<b>54.0</b>	<b>59.1</b>	<b>61.9</b>
+ Change in other long-term liabilities	-0.8	0.3	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
- Gross CAPEX	-0.5	-0.5	-0.5	-0.5	-0.5	-0.6	-0.6	-0.6	-0.6	-0.6	-0.7	-0.7	-0.7
<b>Free operating cash flow</b>	<b>-23.6</b>	<b>-23.8</b>	<b>-0.9</b>	<b>-1.8</b>	<b>-19.3</b>	<b>-0.9</b>	<b>12.8</b>	<b>32.2</b>	<b>46.8</b>	<b>60.4</b>	<b>53.3</b>	<b>58.5</b>	<b>61.2</b>
+/- Other	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
FCFF	-23.6	-23.8	-0.9	-1.8	-19.3	-0.9	12.8	32.2	46.8	60.4	53.3	58.5	61.2
<b>Discounted FCFF</b>		<b>-23.9</b>	<b>-0.8</b>	<b>-1.5</b>	<b>-14.2</b>	<b>-0.6</b>	<b>7.6</b>	<b>17.3</b>	<b>22.6</b>	<b>26.3</b>	<b>20.9</b>	<b>20.6</b>	<b>19.5</b>
Sum of FCFF present value		169	193	194	195	209	210	202	185	163	136	115	94.7
<b>Enterprise value DCF</b>		<b>169</b>											
- Interesting bearing debt		-3.3											
+ Cash and cash equivalents		6.9											
-Minorities		0.0											
-Dividend/capital return		0.0											
<b>Equity value DCF</b>		<b>173</b>											
<b>Equity value DCF per share</b>		<b>2.9</b>											

Wacc			
Tax-% (WACC)	20.0 %	2022e-2026e	-55%
Target debt ratio (D/(D+E))	0.0 %	2027e-2031e	
Cost of debt	10.0 %		
Equity Beta	1.37		
Market risk premium	4.75 %	2032e-2038e	28%
Liquidity premium	2.00 %		
Risk free interest rate	2.5 %		
<b>Cost of equity</b>	<b>11.0 %</b>		
<b>Weighted average cost of capital (WACC)</b>	<b>11.0 %</b>		

Cash flow distribution

■ 2022e-2026e ■ 2027e-2031e ■ 2032e-2038e

Source: Inderes

# Summary

Income statement	2019	2020	2021	2022e	2023e	Per share data	2019	2020	2021	2022e	2023e
Revenue	0.0	0.0	0.0	0.0	0.0	EPS (reported)	-0.31	-0.36	-0.40	-0.37	-0.02
EBITDA	-12.9	-16.4	-20.8	-22.1	-0.4	EPS (adj.)	-0.31	-0.36	-0.40	-0.37	-0.02
EBIT	-13.1	-16.7	-21.1	-22.1	-0.8	OCF / share	-0.27	-0.36	-0.42	-0.40	-0.01
PTP	-13.3	-16.9	-21.2	-22.3	-1.1	FCF / share	-0.27	-0.35	-0.44	-0.40	-0.02
Net Income	-13.3	-16.9	-21.2	-22.3	-1.1	Book value / share	0.04	-0.04	0.06	-0.18	-0.20
Extraordinary items	0.0	0.0	0.0	0.0	0.0	Dividend / share	0.00	0.00	0.00	0.00	0.00
Balance sheet	2019	2020	2021	2022e	2023e	Growth and profitability	2019	2020	2021	2022e	2023e
Balance sheet total	10.2	8.4	13.2	1.7	1.8	Revenue growth-%	-79%	0%	0%	0%	0%
Equity capital	1.6	-1.9	2.9	-11.0	-12.1	EBITDA growth-%	-35%	27%	27%	6%	-98%
Goodwill	0.0	0.0	0.0	0.0	0.0	EBIT (adj.) growth-%	-34%	27%	27%	5%	-96%
Net debt	-4.6	-1.4	-3.5	12.1	13.3	EPS (adj.) growth-%	-53%	18%	10%	-6%	-95%
Cash flow	2019	2020	2021	2022e	2023e	EBITDA-%	-321575%	-409275%	-520050%	-553250%	-10420%
EBITDA	-12.9	-16.4	-20.8	-22.1	-0.4	EBIT (adj.)-%	-327525%	-416350%	-527700%	-551975%	-20293%
Change in working capital	1.0	-0.7	-1.5	-1.5	0.0	EBIT-%	-327525%	-416350%	-527700%	-551975%	-20293%
Operating cash flow	-11.8	-17.1	-22.4	-23.7	-0.4	ROE-%	-1340.3 %	14063.1 %	-3920.3 %	555.3 %	9.7 %
CAPEX	-0.1	-0.2	-0.5	-0.5	-0.5	ROI-%	-400.8 %	-676.3 %	-588.9 %	-593.8 %	-66.7 %
Free cash flow	-11.7	-16.6	-23.6	-23.8	-0.9	Equity ratio	15.8 %	-22.1%	22.3 %	-661.4 %	-679.3 %
						Gearing	-287.8 %	73.9 %	-119.5 %	-110.6 %	-110.6 %
Valuation multiples	2019	2020	2021	2022e	2023e						
EV/S	>100	>100	>100	>100	>100						
EV/EBITDA (adj.)	neg.	neg.	neg.	neg.	neg.						
EV/EBIT (adj.)	neg.	neg.	neg.	neg.	neg.						
P/E (adj.)	neg.	neg.	neg.	neg.	neg.						
P/B	88.7	neg.	58.8	neg.	neg.						
Dividend-%	0.0 %	0.0 %	0.0 %	0.0 %	0.0 %						

Source: Inderes

# Disclaimer and recommendation history

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## Recommendation history (>12 mo)

Date	Recommendation	Target price	Share price
08-08-22	Accumulate	2.80 €	2.44 €
26-08-22	Accumulate	2.80 €	2.22 €
17-10-22	Accumulate	2.50 €	1.97 €
10-01-23	Reduce	3.00 €	3.71 €



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