

Selvita

Q417 company update

New funds enable expanded R&D programme

Selvita's FY17 revenues were PLN105.9m, up 59% y-o-y, with adjusted operating profit rising from PLN4.7m to PLN13.2m. This reflects strong organic growth, but profitability was also boosted by the SEL24 out-licensing deal to the Menarini Group, which contributed PLN13.0m to profit. The share issue completed in February 2018 raised PLN134m gross. This new money and funds from additional sources will support Selvita's new R&D-focused strategy, which we have already included in our model. Our updated valuation is slightly higher at PLN1.30bn or PLN81.7/share.

Year end	Revenue (PLNm)	PBT* (PLNm)	EPS* (PLN)	DPS (PLN)	P/E (x)	Yield (%)
12/16	66.7	4.6	0.64	0.0	N/M	N/A
12/17	105.9	10.2	0.51	0.0	N/M	N/A
12/18e	100.3	0.3	0.02	0.0	N/M	N/A
12/19e	116.8	2.4	0.14	0.0	N/M	N/A

Note: *PBT and EPS are normalised, excluding amortisation of acquired intangibles, exceptional items and share-based payments.

Successful financing and ramping up R&D

In February, Selvita issued 2.2m new shares (16% of previous shares in issue) at close to market price. The proceeds of PLN134m cover a part of the total expected funding of around PLN390m from various sources intended to support Selvita's new business plans for the next several years, as discussed in detail in our [outlook report](#). The R&D update provided with the FY17 results indicated that Selvita is now executing on the overhauled R&D-focused strategy. New released details include the news that the Phase I/II trial with SEL24 (a dual inhibitor of PIM and FLT3 kinases) in AML has resumed after the clinical hold had been lifted by the FDA in December 2017. Preparations for the clinical development of SEL120 (first-in-class selective CDK8 inhibitor) are ongoing. Selvita plans to file an IND application in 2018, with a Phase I trial following subsequently.

Solid organic growth in FY17

Total FY17 revenues of PLN105.9m were spot on our estimate and up by an impressive 59% y-o-y. Commercial revenues (ie excluding subsidies/grants) were PLN87.8m, up 62%, while subsidies (allocated to all three business segments) accounted for PLN17.6m, up 46%. Operating profit of PLN13.2m (adjusted for ESOP costs) was also in line with our expectation and up from PLN4.7m in FY16. The disclosed end-March 2018 cash position was PLN159m, which includes proceeds from the share issue. Debt at end-FY17 was PLN4.9m.

Valuation: Increased to PLN1.30bn or PLN81.7/share

We have increased our Selvita valuation from PLN1.09bn or PLN79.1/share to PLN1.30bn or PLN81.7/share mainly due to the higher cash position, rolling our model forward and modest revision of our estimates. Near-term catalysts include data readout from the Phase I/II trial with SEL24 run by the Menarini Group, the initiation of the SEL120 Phase I trial and potential out-licensing of a preclinical project from the early pipeline.

Pharma & biotech

16 April 2018

Price **PLN60.00**
Market cap **PLN958m**

Net cash (PLNm) at end March 2018	158.7
Shares in issue	16.0m
Free float	40%
Code	SLV
Primary exchange	WSE
Secondary exchange	N/A

Share price performance



%	1m	3m	12m
Abs	(2.1)	(2.3)	9.2
Rel (local)	(0.3)	7.4	5.6
52-week high/low	PLN68.2	PLN41.6	

Business description

Selvita is an R&D and drug discovery services company. It operates two main business units: Innovations Platform (internal R&D pipeline) and Research Services (medicinal chemistry/biology, biochemistry).

Next events

SEL120 Phase I study start	H218
Q118 report	22 May 2018
Out-licensing/sale of a preclinical project	2018

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Executing R&D-focused strategy

In our view, the main message in Selvita's R&D update was that the company is now executing the overhauled strategy first introduced in August 2017, which we discussed in our latest [outlook report](#) and reflected it in our model. Selvita's preliminary estimate is a total investment of around PLN390m over 2017-2021, which will be financed from internal reserves, secured public grants (PLN164m), bank loans and the completed share issue (PLN134m). Multiple strategic goals over the next several years include:

- R&D-related investments estimated at PLN260-290m will support Selvita's main platforms:
 - **Targeted therapeutics.** Total expected investment of around PLN120m (PLN70m for SEL120 and PLN50m for other projects). Selvita will fund the Phase I development of SEL120 which will create value; if successful, the company plans to out-license the asset in Phase II. We assume that Selvita will file an IND application for SEL120 in 2018, SEL120 will be ready for Phase II in 2021 and the licensing deal will happen in the same year. Selvita also plans to partner one other research project in discovery or preclinical stage in 2018.
 - **Cancer metabolism and immunometabolism.** Total expected investments of around PLN70m. One research project partnered in a preclinical or clinical stage in 2019.
 - **Immunology and immunooncology.** Total expected investments of around PLN80m. One project partnered in a preclinical or clinical stage in 2020.
- PLN73m will be used to build and develop new [laboratory infrastructure](#) (Research and Development Center for Innovative Drugs). This will substantially increase Selvita's R&D capacity to proceed with the drug discovery platforms mentioned above.
- PLN27m will be used to develop the Services business. The company expects a shift in "product mix" – increasing the number of high-margin integrated projects (the higher end of drug discovery services) and fewer low-margin, fixed-fee projects (commodity-like services). The bioinformatics segment is also expected to grow, driven by internal R&D efforts and rolling out innovative products.

Other positive recent news was Nodthera's £8.7m fundraising and a further commitment of £25.3m under certain conditions from a consortium of investors until 2020. This indicates that Nodthera is making progress after it was established together with Epidarex Capital in 2016, based on the scientific programme originated and developed at Selvita since 2012.

Financials

Selvita reports in three business segments: Services, Innovation and Bioinformatics. Subsidies are allocated to each of the segments. Total 2017 revenues of PLN105.9m were exactly in line with our estimate and up by an impressive 59% y-o-y (Exhibit 1). Commercial revenues (ie excluding subsidies/grants) were PLN87.8m, up 62%, while subsidies (allocated to all three segments) accounted for PLN17.6m, up 46%.

- Commercial revenues from the **Innovation segment** grew 100% to PLN36.7m in 2017. The out-licensing of the most advanced product SEL24 to the Menarini Group in March 2017 was one of the main reasons for such a strong performance last year. The upfront payment was PLN20.3m, but because Selvita has capitalised certain costs associated with SEL24 development, the profit booked in the P&L was PLN13m. Commercial revenues from this segment come from payments related to different partnerships, such as milestone payments from drug discovery collaborations, and therefore tend to be volatile from quarter to quarter, but

offer potentially higher margins. Our current expectations include lower income in this segment for 2018 (see below) as we do not expect such large deals this year. In the longer term, the Innovation segment includes Selvita's own R&D pipeline activities so developing it is a strategic goal, which will be supported by substantial investments.

- The **Services segment** generated sales of PLN44.2m (excluding subsidies) in FY17, an increase of 36% y-o-y, which reflects solid organic growth. Business portfolio expansion, entering new markets, an increasing number of FTE and integrated contracts were the growth drivers indicated by Selvita. As an example, four years ago around 90% of all services were provided under a fixed price, while now 70% of all services are provided in a form of an integrated project or a full time equivalent model (high-end offering).
- While a small business on an absolute basis (6.5% of total Selvita revenues in FY17) the **Bioinformatics (Ardigen) segment** has been a positive surprise to us since the spinout in October 2015 (Selvita has 51.6%, consolidates the accounts and reports as a third business segment). FY17 sales were PLN6.9m, a 101% y-o-y increase.

Operating profit of PLN13.2m (adjusted for ESOP costs) was also in line with our expectation and up from PLN4.7m in FY16. Total FY17 operating expenses (excluding ESOP costs) increased to PLN92.7m from PLN62.1m in FY16, as Selvita has been growing its staff count and has opened new facilities in Poznan as well as new international sales offices. Reported net profit of PLN7.9m was below our forecast of PLN11.0m (both adjusted for ESPO costs) due to higher than expected financial expenses and a write-off associated with deferred income tax assets, which are related to tax relief for companies operating in special economic zones (notably, deferred income tax assets increased significantly a year ago).

Reported FY17 capex (tangible and intangible) was PLN21.6m versus PLN21.2m a year ago reflecting mainly organic growth. Selvita's new strategy includes substantial capacity increase in coming years. We have described and already included the first stage of the expansion in [our model](#). Selvita reported year-end cash at PLN36m and had PLN4.9m in debt. The disclosed end-March 2018 cash position was PLN159m, which includes proceeds of PLN134m gross from the share issue.

2018 backlog and estimate revision

In our last report we revised our estimates to reflect Selvita's new R&D strategy and assumed that the company would increase its R&D expenditure. 2017 revenues and operating costs were close to our estimates, but the latest contract backlog information provided by Selvita has prompted us to make some adjustments to our sales estimates:

- The reported backlog for the **Services** segment was PLN29.1m (excluding subsidies), up 48% y-o-y, while for **Bioinformatics** (excluding subsidies) it was PLN4.7m, flat y-o-y. The proportions of the backlogs compared to our estimated end-2018 sales in these two segments are similar to the proportions seen in 2017. As a result, we leave our Services and Bioinformatics sales estimates unchanged.
- However, the reported backlog for **Innovation** (excluding subsidies) was PLN6.9m compared to PLN38.2m a year ago. FY17 income was boosted by the Menarini Group deal and we do not expect such a large deal in 2018. Backlog for **subsidiaries**, on the other hand, was substantially higher at PLN27.8m compared to PLN17.5m a year ago. We have adjusted our FY18 Innovation revenues and total subsidies estimates to reflect similar proportions of backlog vs year-end sales seen last year. Given that the adjustments largely offset each other, our total top line estimate for 2018 is virtually unchanged.

Our current FY18 revenue estimate is PLN100.3m growing to PLN116.8m in FY19. We forecast total operating costs rising to PLN99.0m in FY18 due to increasing R&D activities and continued

increase in capacity in the Services segment. Notably, our financial forecasts do not include any subsequent milestone payments from Menarini Group.

Exhibit 1: Key changes to our financial forecasts and introduction of FY19 forecasts

PLN000s	FY16	FY17			FY18e			FY19e
	Act.	Est.	Act.	Change (%)	Old	New	Change (%)	New
Revenue	66,721	105,994	105,872	-0%	99,167	100,294	+1%	116,816
---Services	32,404	43,746	44,208	+1%	54,682	55,260	+1%	67,417
---Innovation	18,353	38,638	36,727	-5%	20,189	8,000	-60%	22,207
---Bioinformatics	3,431	6,855	6,885	+0%	7,541	7,574	+0%	8,331
---Subsides	12,067	16,290	17,591	+8%	16,290	29,000	+78%	18,400
Operating profit/loss (norm.)	4,646	13,212	13,222	+0%	1,067	1,324	+24%	3,420
Profit/loss before tax (norm.)	(1,283)	11,354	10,183	-10%	279	260	-7%	2,415
Profit/loss after tax (norm.)	8,545	11,031	7,315	-34%	265	247	-7%	2,246
EPS (norm.), PLN	0.64	0.81	0.51	-38%	0.02	0.02	-15%	0.14

Source: Selvita accounts, Edison Investment Research. Indicated lines normalised for costs associated with share-based incentive programme: PLN5.9m in 2016 and PLN583k in 2017.

Valuation

We have increased our Selvita valuation from PLN1.09bn or PLN79.1/share to PLN1.30bn or PLN81.7/share due to the higher cash position, rolling our model forward and a modest revision to our estimates. The valuation per share has increased proportionally less than our absolute valuation due to the higher number of shares after the issue. We maintain our valuation approach and assumptions as discussed in detail in our recent outlook report. We use DCF-based calculations with a discount rate of 10% to value the core drug discovery services business and research collaborations. Separately we use risk-adjusted NPV models with a discount rate of 12.5% for Selvita's R&D projects in various stages.

Exhibit 2: Sum-of-the-parts Selvita valuation

Product	Launch	Peak sales (\$m)	NPV (PLNm)	NPV/share (PLN)	Probability	rNPV (PLNm)	rNPV/share (PLN)
Innovation							
SEL24	2023	750	681.5	42.7	15.0%	135.0	8.5
SEL120	2025	1,500	1,431.5	89.6	10%	166.4	10.4
SMARCA2 inhibitor	2030	1,000	646.7	40.5	2%	102.4	6.4
A2A/A2B antagonist	2030	1,000	720.7	45.1	2%	99.5	6.2
SHMT2 inhibitor	2031	1,000	438.2	27.4	2%	69.0	4.3
Merck collaborations	2026	2,000	46.4	2.9	5%	7.6	0.5
Services (including Ardigen)							
Market				DCF (2018-2027)	100%	187.9	11.8
				Terminal value	100%	382.9	24.0
Net cash (at end March 2018)					100%	153.8	9.6
Valuation			3,965.1	248.3		1,304.4	81.7

Source: Edison Investment Research. Note: WACC = 12.5% for product valuations, WACC = 10% for Services segment.

Exhibit 3: Financial summary

	PLN'000s	2015	2016	2017	2018e	2019e
Year end 31 December		IFRS	IFRS	IFRS	IFRS	IFRS
PROFIT & LOSS						
Revenue		56,077	66,721	105,872	100,294	116,816
of which: Services (research outsourcing)		23,052	32,404	44,208	55,260	67,417
Innovation platform		15,416	18,353	36,727	8,000	22,207
Subsidiaries		14,700	12,067	17,591	29,000	18,400
Bioinformatics		2,561	3,431	6,885	7,574	8,331
EBITDA		10,235	8,264	18,462	6,564	9,891
Operating Profit (before amort. and except.)		6,802	4,646	13,222	1,324	3,420
Intangible Amortisation		0	0	0	0	0
Exceptionals/Other*		(4,729)	(5,860)	(583)	0	0
Operating Profit		2,073	(1,214)	12,639	1,324	3,420
Net Interest		748	947	(1,956)	18	78
Share in profit/(loss) of asocs. and JVs**		0	(1,016)	(1,082)	(1,082)	(1,082)
Other		0	0	0	0	0
Profit Before Tax (norm)		7,540	4,577	10,183	260	2,415
Profit Before Tax (reported)		2,821	(1,283)	9,600	260	2,415
Tax		(5)	0	(831)	(13)	(169)
Deferred tax		3,417	3,968	(2,037)	0	0
Profit After Tax (norm)		10,952	8,545	7,315	247	2,246
Profit After Tax (reported)		6,233	2,685	6,732	247	2,246
Average Number of Shares Outstanding (m)		13.1	13.4	13.8	14.9	16.0
EPS - normalised (PLN)		0.84	0.64	0.51	0.02	0.14
EPS - reported (PLN)		0.48	0.20	0.47	0.02	0.14
Dividend per share (PLN)		0.0	0.0	0.0	0.0	0.0
BALANCE SHEET						
Fixed Assets		16,718	41,451	43,701	77,034	109,326
Intangible Assets		2,274	6,640	2,638	2,638	2,638
Tangible Assets		8,597	21,833	31,377	64,711	97,002
Other		5,847	12,979	9,686	9,686	9,686
Current Assets		48,524	47,669	59,873	179,171	174,239
Stocks		1,174	1,403	1,591	1,569	1,548
Debtors		17,961	16,320	19,226	19,226	19,226
Cash		28,807	29,095	36,124	155,445	150,534
Other		582	851	2,932	2,932	2,932
Current Liabilities		(16,319)	(18,933)	(26,752)	(26,691)	(26,847)
Creditors		(3,927)	(7,883)	(10,873)	(10,873)	(10,873)
Provisions		(3,327)	(3,600)	(5,150)	(5,150)	(5,150)
Deferred revenues		(7,384)	(5,469)	(8,451)	(8,451)	(8,451)
Short term borrowings		(33)	(859)	(912)	(912)	(912)
Other		(1,648)	(1,122)	(1,366)	(1,304)	(1,460)
Long Term Liabilities		(2,043)	(14,477)	(12,826)	(37,826)	(62,826)
Long term borrowings		0	(4,792)	(3,982)	(28,982)	(53,982)
Deferred revenues		(1,513)	(6,382)	(4,233)	(4,233)	(4,233)
Other long term liabilities		(529)	(3,303)	(4,611)	(4,611)	(4,611)
Net Assets		46,880	55,710	63,996	191,689	193,892
CASH FLOW						
Operating Cash Flow		(16,430)	(6,280)	10,265	(23,521)	(9,535)
Net Interest		0	0	0	0	0
Tax		0	0	717	(74)	(13)
Capex		(5,190)	(21,210)	(21,558)	(38,574)	(38,763)
Acquisitions/disposals		0	0	10	0	0
Financing		27,314	303	715	127,490	0
Dividends		0	0	0	0	0
Other (incl. subsidies)		18,834	21,859	19,174	29,000	18,400
Net Cash Flow		24,529	(5,329)	9,323	94,320	(29,911)
Opening net debt/(cash)		(4,787)	(28,773)	(23,445)	(31,230)	(125,551)
HP finance leases initiated		0	0	0	0	0
Exchange rate movements		0	0	0	0	0
Other		(543)	0	(1,537)	0	0
Closing net debt/(cash)		(28,773)	(23,445)	(31,230)	(125,551)	(95,640)

Source: Company accounts, Edison Investment Research. Note: *Non-cash cost related to the employee stock options programme.

**Profit and loss from 2016 include share in Nodthera's earnings according to an equity method valuation. Please note that the share number changed in 2017 as a result of Nodthera's capital increase.

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