

Faron Pharmaceuticals

Company report

08/26/2022



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✓ Inderes corporate customer

This report is a summary translation of the report “Yllätyksetön raportti pitää ennusteet ennallaan” published on 08/26/2022 at 7:30 am.

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Unsurprising report keeps estimates unchanged

Faron's H1 report offered no surprises. The company didn't have any revenue as we expected, and the operating loss was in line with our forecasts. There was no significant new information on research or business progress, so we are not making any changes to the forecasts in our recently published extensive report. Our valuation relies heavily on a DCF calculation based on risk-adjusted estimates, which produces a present value of the stock that remains unchanged at EUR 2.8. In our view, peer analysis suggests a neutral valuation of the stock. We maintain our Buy recommendation for the share and keep the target price at EUR 2.8.

The figures were in line with our forecasts

As expected, Faron had no revenue in H1. The operating loss of EUR 13.4 million was in line with our forecasts and the financial reporting did not offer any other surprises. Faron's cash and cash equivalents at the end of H1 amounted to EUR 9.9 million and cash flow from operating activities to EUR -11.3 million. The company reiterated previous information on cash adequacy until Q1'23. Thus, we expect the company to make financial arrangements during H2. Possible arrangements could include a share issue or a commercialization agreement with a larger pharmaceutical company. Faron also signed a EUR 30 million debt agreement during the reporting period, of which the company has so far drawn down EUR 10 million. The remainder can be drawn down if the conditions of the debt agreement are met during this and next year.

A little extra light was shed on Traumakine plans

In terms of business development, new information was received about Traumakine drug candidate. In its H1 presentation, Faron announced plans to conduct a clinical trial starting in H1'23. The company said it plans the drug to be used for ischemia-reperfusion (i.e. the recovery of blocked blood flow) in organ damage. We await further details of the plans before modeling new uses in our estimates. In other respects, the company reported on the recently launched BEXMAB study (blood cancers) and the near-term plans for the MATINS study.

No significant changes in estimates and valuation

We are keeping our estimates virtually unchanged from the latest figures we presented in the extensive report. Our valuation is based on risk-weighted estimates that account for the risk of research failure. We discussed our estimate model in more detail in our recent [extensive report](#). In the absence of revenue and profitability, our view on the fair value of the stock is based on the DCF model and peer analysis. DCF indicates the share value of EUR 2.8. The median market value of the peers is EUR 81 million, below Faron's EUR 122 million. However, 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. In our assessment, Faron is neutrally valued relative to its peers. Faron is a high-risk investment. Therefore, we remind investors of the importance of diversification, as the failure of drug development can lead to the ultimate loss of invested capital. In our view, the share offers sufficient expected return to compensate for taking on high risk.

Recommendation

Accumulate

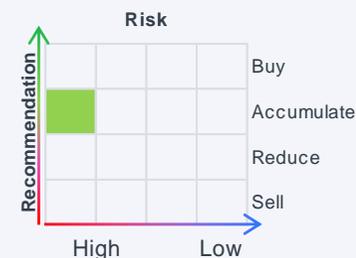
(previous Accumulate)

2.80 EUR

(previous EUR 2.80)

Share price:

2.22



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 medicines 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	2.22	2.22	2.22
Number of shares, millions	55.3	55.3	55.3
Market cap	123	123	123
EV	143	144	146
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

No surprises in the figures

Estimates vs. outcome H1'22

- As expected, the company had no revenue and other operating income was in line with our forecasts (0.5 MEUR).
- Operating loss of EUR 13.4 million was also in line with our estimates, due to costs being at expected level.
- Faron's cash and cash equivalents at the end of the period amounted to EUR 9.9 million, which the company says will be sufficient until Q1'23.
- Cash flow from operating activities was EUR -11.3 million.

Key business events H1'22

- Faron said its plans to refocus the Traumakine research program on the prevention of ischemia-reperfusion-related organ damage and is aiming to start a new study in H1'23.
- The first patient was recruited to the BEXMAB study, which focuses on blood cancers. The first results can be expected towards the end of the year.
- New recruitments strengthened R&D and investor relations capabilities, particularly in the US.
- The company agreed on a debt financing of EUR 30 million and arranged a small directed issue of EUR 5 million during the review period.

Estimates	H1'21	H1'22	H1'22e	2022e
MEUR / EUR	Comparison	Actualized	Inderes	Inderes
Revenue	0.0	0.0	0.0	0.0
EBIT	-10.4	-13.4	-13.4	-22.1
PTP	-10.6	-13.1	-13.5	-22.0
EPS (reported)	-0.20	-0.25	-0.24	-0.40

Source: Inderes

Estimates remained unchanged

Estimate changes

- The H1 report did not give rise to any change in the estimates we published in the recent extensive report.
- We don't expect revenue from the company in 2023-2024.
- Our operating profit estimates also remain unchanged as no new information was received on the cost levels that affect the estimates.

Estimate change drivers

- The results of published research may change our assessment of the probability of commercialization of drug candidates. Changes in probabilities are directly reflected in our estimates.
- The share issue we consider likely would affect our estimates through changes in the financial position and the number of shares
- Potential commercialization agreements would have an impact on the company's financial position and would likely act as a positive drive

Estimate revisions MEUR / EUR	2022e	2022e	Change	2023e	2023e	Change	2024e	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	-22.0	-1%	-1.0	-1.1	10%	-1.7	-2.0	18%
EPS (excl. NRIs)	-0.40	-0.40	-1%	-0.02	-0.02	10%	-0.03	-0.04	18%
DPS	0.00	0.00		0.00	0.00		0.00	0.00	

Source: Inderes

No material changes to the valuation

The valuation is based on risk-adjusted estimates

Our valuation is based on risk-adjusted estimates that take into account the binary risk of research failure. We 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.

Value of the discounted cash flow model remains unchanged at EUR 2.8

The R&D risk adjusted DCF gives the share a value of EUR 2.8, which is 26% above the market price of the share. Drugs have limited product protection, after which sales and profitability typically decline sharply. Therefore, our DCF model is exceptionally limited in time to 2038, when BEX's patents have expired and no cash flows that are significant to the current value are generated in our estimates. So, we do not make assumptions about terminal growth and profitability, as is typical for the DCF model.

We have used a weighted average cost of capital of 10.6% (WACC). The discount rate 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.

Investors should note that there are considerable uncertainties about the realization of estimated cash flows. The DCF model is also very sensitive to the assumptions used, especially when cash flows are far in the future. In the case of Faron, the estimated sales-based cash flows start in 2025 and reach their peak after the mid-2030s. We therefore encourage

investors to compare the assumptions used in the model with their own estimates and required return.

A majority of Faron's current share value (136%) is based on cash flows in 2027-2031. Years 2032-2038 are less important for the current value of cash flows. As future years are loss-making, 2022-2026 cash flows will have a negative impact on the current share value (-67%).

The valuation is in line with the peers

As peer companies, we use listed clinical stage drug development companies in the Nordic countries. We assess the companies' market cap relative to the clinical research stage of their leading drugs. The median market value of the peers is EUR 81 million, below Faron's EUR 122 million. However, 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. In our view, Faron is neutrally valued relative to its peers.

Recommendation remains the same

Our 12-month target price remains at EUR 2.8, as indicated by the DCF, and we maintain our Accumulate recommendation. Faron is a high-risk investment. Therefore, we remind investors of the importance of diversification, as the failure of drug development can lead to the ultimate loss of invested capital.

Valuation	2022e	2023e	2024e
Share price	2.22	2.22	2.22
Number of shares, millions	55.3	55.3	55.3
Market cap	123	123	123
EV	143	144	146
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

Valuation table

Valuation	2017	2018	2019	2020	2021	2022e	2023e	2024e	2025e
Share price			3.30	2.91	3.24	2.22	2.22	2.22	2.22
Number of shares, millions	28.4	31.0	43.3	46.9	53.2	55.3	55.3	55.3	55.3
Market cap			143	136	172	123	123	123	123
EV	-6.9	-1.9	138	135	169	143	144	146	167
P/E (adj.)	0.0	0.0	neg.	neg.	neg.	neg.	neg.	neg.	neg.
P/E	0.0	0.0	neg.	neg.	neg.	neg.	neg.	neg.	neg.
P/FCF	0.0	0.0	neg.	neg.	neg.	neg.	neg.	neg.	neg.
P/B	0.0	0.0	88.7	neg.	58.8	neg.	neg.	neg.	neg.
P/S		0.0	>100	>100	>100	>100	>100	>100	36.3
EV/Sales		neg.	>100	>100	>100	>100	>100	>100	49.5
EV/EBITDA	0.3	0.1	neg.	neg.	neg.	neg.	neg.	neg.	neg.
EV/EBIT (adj.)	0.3	0.1	neg.	neg.	neg.	neg.	neg.	neg.	neg.
Payout ratio (%)	0.0 %	0.0 %	0.0 %	0.0 %	0.0 %	0.0 %	0.0 %	0.0 %	0.0 %
Dividend yield-%			0.0 %	0.0 %	0.0 %	0.0 %	0.0 %	0.0 %	0.0 %

Source: Inderes

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	3.4
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	-20.2
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	-20.6
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	-20.6
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	-0.2	0.1	-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	-8.9	-22.0	-0.6	-0.6	-1.1	-2.0	-20.9
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	-8.9	-22.0	-0.6	-0.6	-1.1	-2.0	-20.9
EPS (adj.)	-0.16	-0.20	-0.36	-0.20	-0.20	-0.40	-0.24	-0.16	-0.40	-0.01	-0.01	-0.02	-0.04	-0.38
EPS (rep.)	-0.16	-0.20	-0.36	-0.20	-0.20	-0.40	-0.24	-0.16	-0.40	-0.01	-0.01	-0.02	-0.04	-0.38
Key figures	H1'20	H2'20	2020	H1'21	H2'21	2021	H1'22	H2'22e	2022e	H1'23e	H2'23e	2023e	2024e	2025e
Revenue growth-%			0.0 %			0.0 %			0.0 %			0.0 %	0.0 %	84401.9 %
Adjusted EBIT growth-%	12.6 %	40.7 %	27.1 %	45.9 %	12.4 %	26.7 %	28.2 %	-18.4 %	4.6 %	-97.0 %	-95.3 %	-96.3 %	106.0 %	1129.8 %
Net earnings-%			-423650%			-530225%			-549175%			-27793%	-49301%	-617.2 %

Source: Inderes

Balance sheet

Assets	2020	2021	2022e	2023e	2024e
Non-current assets	0.9	1.1	1.7	1.8	2.0
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
Current assets	7.4	12.1	0.0	0.0	0.0
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
Balance sheet total	8.4	13.2	1.7	1.8	2.0

Source: Inderes

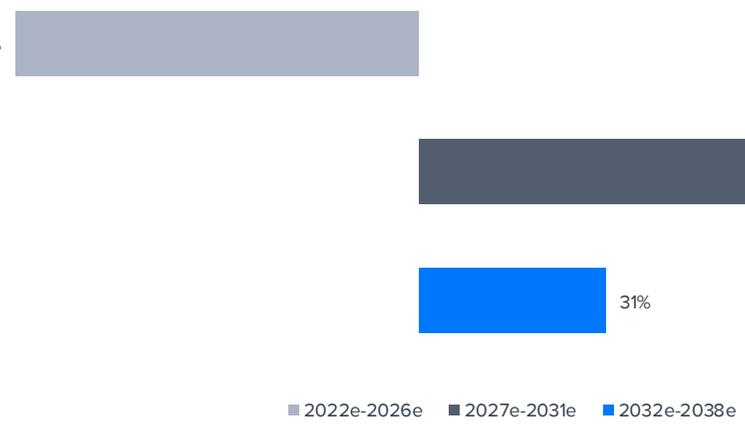
Liabilities & equity	2020	2021	2022e	2023e	2024e
Equity	-1.9	2.9	-19.1	-20.2	-22.1
Share capital	2.7	2.7	2.7	2.7	2.7
Retained earnings	-96.6	-116.3	-138.3	-139.4	-141.3
Hybrid bonds	0.0	0.0	0.0	0.0	0.0
Revaluation reserve	0.0	0.0	0.0	0.0	0.0
Other equity	92.0	117	117	117	117
Minorities	0.0	0.0	0.0	0.0	0.0
Non-current liabilities	3.7	3.1	0.5	0.5	0.5
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
Current liabilities	6.4	7.2	20.2	21.4	23.6
Short term debt	0.0	0.4	20.2	21.4	23.6
Payables	6.4	6.7	0.0	0.0	0.0
Other current liabilities	0.0	0.0	0.0	0.0	0.0
Balance sheet total	8.3	13.2	1.7	1.8	2.0

DCF calculation

DCF model	2021	2022e	2023e	2024e	2025e	2026e	2027e	2028e	2029e	2030e	2031e	2032e	2033e
EBIT (operating profit)	-21.1	-22.1	-0.8	-1.7	-20.6	-0.9	11.0	29.6	43.2	56.1	61.8	68.1	71.0
+ 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	-12.3	-13.6	-14.1
- 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	-0.6	-1.0	-0.7	-0.7	-0.3	-0.3	-0.2
Operating cash flow	-22.4	-23.7	-0.4	-1.3	-20.2	-1.4	10.9	29.1	42.9	56.0	49.7	54.7	57.2
+ 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
Free operating cash flow	-23.6	-23.8	-0.9	-1.8	-20.7	-2.0	10.3	28.5	42.3	55.3	49.0	54.0	56.5
+/- 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	-20.7	-2.0	10.3	28.5	42.3	55.3	49.0	54.0	56.5
Discounted FCFF		-23.0	-0.8	-1.5	-14.8	-1.3	6.0	15.1	20.3	23.9	19.2	19.1	18.1
Sum of FCFF present value		151	174	175	176	191	193	187	171	151	127	108	88.9
Enterprise value DCF		151											
- Interesting bearing debt		-3.3											
+ Cash and cash equivalents		6.9											
-Minorities		0.0											
-Dividend/capital return		0.0											
Equity value DCF		155											
Equity value DCF per share		2.8											

Wacc			
Tax-% (WACC)	20.0 %		
Target debt ratio (D/(D+E))	0.0 %	2027e-2031e	
Cost of debt	10.0 %		
Equity Beta	1.38		
Market risk premium	4.75%		
Liquidity premium	2.00%	2032e-2038e	31%
Risk free interest rate	2.0 %		
Cost of equity	10.6 %		
Weighted average cost of capital (WACC)	10.6 %		

Cash flow distribution



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	-0.40	-0.02
EBITDA	-12.9	-16.4	-20.8	-22.1	-0.4	EPS (adj.)	-0.31	-0.36	-0.40	-0.40	-0.02
EBIT	-13.1	-16.7	-21.1	-22.1	-0.8	OCF / share	-0.27	-0.36	-0.42	-0.43	-0.01
PTP	-13.3	-16.9	-21.2	-22.0	-1.1	FCF / share	-0.27	-0.35	-0.44	-0.43	-0.02
Net Income	-13.3	-16.9	-21.2	-22.0	-1.1	Book value / share	0.04	-0.04	0.06	-0.34	-0.37
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	-19.1	-20.2	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	20.2	21.4	EPS (adj.) growth-%	-53%	18%	10%	0%	-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 %	272.7 %	5.7 %
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 %	-1150.3 %	-1135.1 %
						Gearing	-287.8 %	73.9 %	-119.5 %	-106.1 %	-106.3 %
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
8/8/2022	Accumulate	2.80 €	2.44 €
8/26/2022	Accumulate	2.80 €	0.00 €



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