

Arrowhead Pharmaceuticals

F1Q24 EPS: fine-tuning cardiometabolic strategy; Maintain Buy

Reiterate Rating: BUY | PO: 51.00 USD | Price: 33.20 USD

F1Q24 R&D focus and color on leadership change

Yesterday after market close, Arrowhead (ARWR) reported fiscal year 1Q24 quarterly results that included pro forma cash of \$649m and identification of some cost sparing R&D measures which should extend the company's cash runway. Importantly, the company will not result in termination of any program that we had ascribed discrete value and the intention is to keep the cardiometabolic and pulmonary verticals under the ARWR roof. On the call, the company did offer some nuanced updates around its cardiometabolic program and flagged two candidates for CTA filings in 2024 (ARO-INHBE for obesity + undisclosed adipose gene target). The fiscal 1Q update mostly resulted in lessening of cash burn but no other substantive model changes, thus no PO change. We reiterate Buy on attractive risk/reward on key '24-'25 pipeline readouts.

Cardiometabolic to remain in-house vertical

The most notable updates were around Ph3 development plans for plogasiran in the SHTG indication, which remain on track to start two pivotal trials by 2Q, while enrollment is expected to be expedited [~6-9mo faster] by not enriching for patients with pre-defined higher AP events. Our estimated time to market (~2027) is based on a 2.5-year timeline from trial start to topline utilizing competitor Ionis' Ph3s as an analog (though note mgmt has not provided guidance on planned enrollment time). Effectively, ARWR believes it can conduct a Ph4 post-market study [SHASTA-5] in a population of subjects with high AP events to drive important outcome data/label claim differentiation vs. Ionis' olezarsen. Otherwise, management's messaging around zodasiran (ANG3) as front-runner for CVOT outcomes trial that could enable a larger mixed dyslipidemia indication remains unchanged with confirmation of that decision sometime in 2Q24.

RAGE FeNO data sets up key 3Q catalyst

On the call, no updates were provided around ARO-RAGE impact on FeNo in mild/moderate FeNo patients with management noting tiny number of patients with high FeNo thus decision not to present uninterpretable data. The company remains on track to provide a 3Q update from 38 subjects (drug or pbo) with a FeNo cutoff > 35 ppb and the company believes it could be in a position to advance one pulmonary siRNA program to Ph2 in 2025. As with prior calls, management did not refine bogey beyond goal to show 30% FeNo reduction. We view the 3Q ARO-RAGE update as arguably the most important 2024 pipeline update offering clinical validation to an asset that appears safe and capable of achieving high level of target engagement.

See page 3 for model changes.

| Estimates (Sep) (US\$) | 2022A | 2023A | 2024E | 2025E | 2026E |
|---------------------------|--------|--------|--------|--------|--------|
| EPS | (1.67) | (1.92) | (2.43) | (3.64) | (2.26) |
| EPS Change (YoY) | -15.2% | -15.0% | -26.6% | -49.8% | 37.9% |
| Consensus EPS (Bloomberg) | | | (3.01) | (3.42) | (2.61) |
| DPS | 0 | 0 | 0 | 0 | 0 |
| Valuation (Sep) | | | | | |
| Free Cash Flow Yield* | -4.6% | -4.3% | -5.5% | -7.3% | -3.7% |

* For full definitions of *IQmethod*SM measures, see page 5.

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12656191

Timestamp: 07 February 2024 05:00AM EST

07 February 2024

Equity

Key Changes

| (US\$) | Previous | Current |
|---------------|----------|---------|
| 2024E Rev (m) | 0 | 53.6 |
| 2024E EPS | -3.93 | -2.43 |
| 2025E EPS | -4.03 | -3.64 |
| 2026E EPS | -2.59 | -2.26 |

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Stock Data

| | |
|--------------------------------|-----------------------|
| Price | 33.20 USD |
| Price Objective | 51.00 USD |
| Date Established | 9-Jan-2024 |
| Investment Opinion | C-1-9 |
| 52-Week Range | 20.67 USD - 42.48 USD |
| Mkt Val (mn) / Shares Out (mn) | 4,113 USD / 123.9 |
| Free Float | 95.5% |
| Average Daily Value (mn) | 52.96 USD |
| BofA Ticker / Exchange | ARWR / NAS |
| Bloomberg / Reuters | ARWR US / ARWR.OQ |
| ROE (2024E) | -32.7% |
| Net Dbt to Eqty (Sep-2023A) | -36.7% |
| ESGMeter™ | Low |

ESGMeter is not indicative of a company's future stock price performance and is not an investment recommendation or rating. ESGMeter is independent of BofA Global Research's equity investment rating, volatility risk rating, income rating, and price objective for that company. For full details, refer to "BofA ESGMeter Methodology".

iQprofileSM Arrowhead Pharmaceuticals

iQmethodSM – Bus Performance*

| (US\$ Millions) | 2022A | 2023A | 2024E | 2025E | 2026E |
|----------------------------|--------|--------|---------|--------|---------|
| Return on Capital Employed | -28.0% | -25.3% | -20.4% | -22.6% | -12.8% |
| Return on Equity | -42.6% | -47.8% | -32.8% | -32.5% | -17.7% |
| Operating Margin | -73.4% | -85.2% | -516.2% | NA | -135.9% |
| Free Cash Flow | (188) | (177) | (224) | (302) | (154) |

iQmethodSM – Quality of Earnings*

| (US\$ Millions) | 2022A | 2023A | 2024E | 2025E | 2026E |
|--------------------------|--------|--------|--------|--------|--------|
| Cash Realization Ratio | NM | NM | NM | NM | NM |
| Asset Replacement Ratio | 5.1x | 4.8x | 3.4x | 0.6x | 0x |
| Tax Rate | 2.2% | 1.3% | NM | NM | NM |
| Net Debt-to-Equity Ratio | -25.8% | -36.7% | -51.2% | -38.5% | -35.8% |
| Interest Cover | NA | -11.2x | NA | NA | NA |

Income Statement Data (Sep)

| (US\$ Millions) | 2022A | 2023A | 2024E | 2025E | 2026E |
|------------------------------|---------------|---------------|---------------|---------------|--------------|
| Sales | 243 | 241 | 54 | 0 | 195 |
| % Change | 89.6% | -1.0% | -77.8% | -100.0% | NA |
| Gross Profit | 243 | 241 | 54 | 0 | 194 |
| % Change | 89.6% | -1.0% | -77.8% | NM | NA |
| EBITDA | (168) | (195) | (264) | (396) | (252) |
| % Change | -11.5% | -16.1% | -35.2% | -49.9% | 36.2% |
| Net Interest & Other Income | 6 | (1) | 15 | 15 | 15 |
| Net Income (Adjusted) | (176) | (205) | (261) | (395) | (248) |
| % Change | -16.7% | -16.6% | -27.2% | -51.1% | 37.2% |

Free Cash Flow Data (Sep)

| (US\$ Millions) | 2022A | 2023A | 2024E | 2025E | 2026E |
|--|-------------|-------------|---------------|---------------|--------------|
| Net Income from Cont Operations (GAAP) | (169) | (204) | (261) | (395) | (253) |
| Depreciation & Amortization | 10 | 10 | 13 | 14 | 13 |
| Change in Working Capital | (98) | (37) | (31) | (5) | (7) |
| Deferred Taxation Charge | NA | NA | NA | NA | NA |
| Other Adjustments, Net | 121 | 101 | 97 | 92 | 92 |
| Capital Expenditure | (53) | (47) | (42) | (8) | 0 |
| Free Cash Flow | -188 | -177 | -224 | -302 | -154 |
| % Change | NM | 6.0% | -26.8% | -34.5% | 48.9% |
| Share / Issue Repurchase | 0 | 0 | 423 | 0 | 0 |
| Cost of Dividends Paid | 0 | 0 | 0 | 0 | 0 |
| Change in Debt | 0 | 0 | 0 | 0 | 0 |

Balance Sheet Data (Sep)

| (US\$ Millions) | 2022A | 2023A | 2024E | 2025E | 2026E |
|---------------------------------------|------------|------------|--------------|--------------|--------------|
| Cash & Equivalents | 108 | 161 | 590 | 493 | 544 |
| Trade Receivables | 1 | 1 | 1 | 0 | 2 |
| Other Current Assets | 296 | 514 | 734 | 937 | 1,144 |
| Property, Plant & Equipment | 110 | 148 | 178 | 172 | 158 |
| Other Non-Current Assets | 176 | 69 | 62 | 60 | 59 |
| Total Assets | 692 | 894 | 1,564 | 1,662 | 1,907 |
| Short-Term Debt | 0 | 0 | 0 | 0 | 0 |
| Other Current Liabilities | 139 | 98 | 55 | 27 | 31 |
| Long-Term Debt | 0 | 0 | 0 | 0 | 0 |
| Other Non-Current Liabilities | 135 | 356 | 356 | 356 | 356 |
| Total Liabilities | 274 | 454 | 411 | 383 | 387 |
| Total Equity | 418 | 440 | 1,153 | 1,279 | 1,521 |
| Total Equity & Liabilities | 692 | 894 | 1,564 | 1,662 | 1,907 |

* For full definitions of iQmethodSM measures, see page 5.

Company Sector

Biotechnology

Company Description

Arrowhead Pharmaceuticals is a biotechnology company that develops RNAi-based therapeutics to treat diseases by silencing causative genes. The company's drug platform is called Targeted RNAi Molecule (TRiM) which aims to modify/reduce the production of disease-causing proteins by destroying RNA. ARWR has two (wholly owned) drugs in Ph3 trials and >10 drugs in early to late-stage development with the aim of having 20 drugs in clinical development or on the market in 2025.

Investment Rationale

We rate ARWR a Buy. We expect ARWR to deliver P&L leverage driven by the rollout of new products that are either wholly owned or partnered (future royalty streams). Our thesis is based on favorable risk/reward in front of several key 2024 catalysts including 1) topline data from Ph3 ARO-APOC3 in FCS in 2Q24 - data could facilitate an NDA leading to ARWR's first approved product, 2) Ph1/2 biomarker data from respiratory assets.

Stock Data

Average Daily Volume 1,595,104

Quarterly Earnings Estimates

| | 2023 | 2024 |
|----|--------|--------|
| Q1 | -0.60A | -1.24E |
| Q2 | 0.45A | -0.31E |
| Q3 | -0.98A | -0.68E |
| Q4 | -0.80A | -0.32E |

Acronyms:

ANG3, INHBE, RAGE: drug targets
AP: acute pancreatitis
CTA: clinical trial application
CVOT: cardiovascular outcomes trial
FeNO: exhaled nitric oxide
OpEx: operating expenses
Pbo: placebo
Ph: phase
Ppb: parts per billion
R&D: research and development
sHTG: severe hypertriglyceridemia
siRNA: small interfering ribonucleic acid

Model updates

We update our ARWR model for F1Q24 financials and pro-forma cash and share count to reflect recent financing. Other model updates include modeling \$50m milestone payment in anticipation of Ph3 Lp(a) enrollment in 1H24, decreasing OpEx in '24 to reflect updated cash runway guidance (est. ~\$330/year cash burn vs prior ~\$435m/yr) and smooth out '25-'26 OpEx to reflect R&D expense shift.

Price objective basis & risk

Arrowhead Pharmaceuticals (ARWR)

Our \$51 price objective (PO) is based on a risk-adjusted DCF analysis which assumes 1) risk-adjustment to pipeline programs based on abundance and strength of clinical data with <30% POS assigned to early-stage programs vs >50% POS for mid-to-late stage assets, 2) the biggest value drivers in our DCF valuation are ARO-APOC3 for FCS and SHTG (30%), ARO-AAT (16%), and pipeline programs (60%), 3) we assume 10% discount rate.

Downside risks to our PO: 1) failure of wholly-owned late stage clinical trials, 2) competitor clinical data outperform vs our expectation, 3) failure to partner programs for financing requirements.

Upside potential to our PO: 1) delay to regulatory approval of competitors products, 2) failure of competitors' clinical trials, 3) better-than-expected performance of wholly-owned and/or pipeline assets.

Analyst Certification

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US - Specialty Pharma & Biotechnology Coverage Cluster

| Investment rating | Company | BofA Ticker | Bloomberg symbol | Analyst |
|---------------------|---------------------------|-------------|------------------|-------------------|
| BUY | | | | |
| | Arcellx, Inc. | ACLX | ACLX US | Jason M. Gerberry |
| | Arrowhead Pharmaceuticals | ARWR | ARWR US | Jason M. Gerberry |
| | bluebird bio | BLUE | BLUE US | Jason M. Gerberry |
| | Exelixis | EXEL | EXEL US | Jason M. Gerberry |
| | Immunovant, Inc. | IMVT | IMVT US | Jason M. Gerberry |
| | Intra-Cellular Therapies | ITCI | ITCI US | Jason M. Gerberry |
| | Ionis | IONS | IONS US | Jason M. Gerberry |
| | Jazz Pharmaceuticals | JAZZ | JAZZ US | Jason M. Gerberry |
| | Lyra Therapeutics | LYRA | LYRA US | Jason M. Gerberry |
| | Oculis Holding AG | OCS | OCS US | Jason M. Gerberry |
| | Relay Therapeutics | RLAY | RLAY US | Jason M. Gerberry |
| | Tarsus Pharmaceuticals | TARS | TARS US | Jason M. Gerberry |
| | Teva Pharmaceuticals | TEVA | TEVA US | Jason M. Gerberry |
| | Vaxcyte Inc | PCVX | PCVX US | Jason M. Gerberry |
| | Xenon Pharmaceuticals | XENE | XENE US | Jason M. Gerberry |
| NEUTRAL | | | | |
| | Alkermes | ALKS | ALKS US | Jason M. Gerberry |
| | Amphastar Pharmaceuticals | AMPH | AMPH US | Jason M. Gerberry |
| | Axsome Therapeutics | AXSM | AXSM US | Jason M. Gerberry |
| | Galapagos | GLPG | GLPG US | Jason M. Gerberry |
| | ProKidney Corp | PROK | PROK US | Jason M. Gerberry |
| | Roivant | ROIV | ROIV US | Chi M. Fong |
| UNDERPERFORM | | | | |
| | Bausch Health Cos Inc | BHC | BHC US | Jason M. Gerberry |
| | FibroGen Inc. | FGEN | FGEN US | Jason M. Gerberry |
| | Harmony Biosciences | HRMY | HRMY US | Jason M. Gerberry |
| | Organon | OGN | OGN US | Jason M. Gerberry |
| | Viartis Inc. | VTRS | VTRS US | Jason M. Gerberry |

iQmethodSM Measures Definitions

Business Performance

Return On Capital Employed

Return On Equity

Operating Margin

Earnings Growth

Free Cash Flow

Quality of Earnings

Cash Realization Ratio

Asset Replacement Ratio

Tax Rate

Net Debt-To-Equity Ratio

Interest Cover

Valuation Toolkit

Price / Earnings Ratio

Price / Book Value

Dividend Yield

Free Cash Flow Yield

Enterprise Value / Sales

EV / EBITDA

Numerator

$\text{NOPAT} = (\text{EBIT} + \text{Interest Income}) \times (1 - \text{Tax Rate}) + \text{Goodwill Amortization}$

Net Income

Operating Profit

Expected 5 Year CAGR From Latest Actual

Cash Flow From Operations – Total Capex

Numerator

Cash Flow From Operations

Capex

Tax Charge

Net Debt = Total Debt – Cash & Equivalents

EBIT

Numerator

Current Share Price

Current Share Price

Annualised Declared Cash Dividend

Cash Flow From Operations – Total Capex

$\text{EV} = \text{Current Share Price} \times \text{Current Shares} + \text{Minority Equity} + \text{Net Debt} +$

Other LT Liabilities

Enterprise Value

Denominator

$\text{Total Assets} - \text{Current Liabilities} + \text{ST Debt} + \text{Accumulated Goodwill}$

Amortization

Shareholders' Equity

Sales

N/A

N/A

Denominator

Net Income

Depreciation

Pre-Tax Income

Total Equity

Interest Expense

Denominator

Diluted Earnings Per Share (Basis As Specified)

Shareholders' Equity / Current Basic Shares

Current Share Price

$\text{Market Cap} = \text{Current Share Price} \times \text{Current Basic Shares}$

Sales

Basic EBIT + Depreciation + Amortization

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Important Disclosures

Arrowhead (ARWR) Price Chart



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Equity Investment Rating Distribution: Health Care Group (as of 31 Dec 2023)

| Coverage Universe | Count | Percent | Inv. Banking Relationships ^{R1} | Count | Percent |
|-------------------|-------|---------|--|-------|---------|
| Buy | 234 | 60.94% | Buy | 115 | 49.15% |
| Hold | 80 | 20.83% | Hold | 36 | 45.00% |
| Sell | 70 | 18.23% | Sell | 29 | 41.43% |

Equity Investment Rating Distribution: Global Group (as of 31 Dec 2023)

| Coverage Universe | Count | Percent | Inv. Banking Relationships ^{R1} | Count | Percent |
|-------------------|-------|---------|--|-------|---------|
| Buy | 1895 | 53.62% | Buy | 1083 | 57.15% |
| Hold | 832 | 23.54% | Hold | 454 | 54.57% |
| Sell | 807 | 22.84% | Sell | 383 | 47.46% |

^{R1} Issuers that were investment banking clients of BofA Securities or one of its affiliates within the past 12 months. For purposes of this Investment Rating Distribution, the coverage universe includes only stocks. A stock rated Neutral is included as a Hold, and a stock rated Underperform is included as a Sell.

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| Investment rating | Total return expectation (within 12-month period of date of initial rating) | Ratings dispersion guidelines for coverage cluster ^{R2} |
|-------------------|---|--|
| Buy | ≥ 10% | ≤ 70% |
| Neutral | ≥ 0% | ≤ 30% |
| Underperform | N/A | ≥ 20% |

^{R2} Ratings dispersions may vary from time to time where BofA Global Research believes it better reflects the investment prospects of stocks in a Coverage Cluster.

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