

Merus

GILD collaboration is another important investment in pipeline

Reiterate Rating: BUY | PO: 52.00 USD | Price: 47.04 USD

Collaboration to focus on trispecific T-cell engagers

Merus (MRUS) announced a new collaboration with Gilead (GILD; covered by Geoff Meacham) for the discovery and development of novel trispecific antibodies. MRUS' proprietary Multiclonics platform allows for the development of novel multispecific antibodies including bispecific and trispecific antibodies. So far, the platform has shown encouraging results from the two bispecific lead assets, petosemtamab in head and neck squamous cell carcinoma and zenocutuzumab in NRG1+ solid tumors. MRUS highlighted they aim to develop T-cell engager trispecific antibodies, which we think could help drive stronger responses by targeting two tumor-associated antigens. We think the partnership with a large biopharmaceutical company reflects confidence in the potential for the platform to expand to trispecific antibodies and further advance the early-stage pipeline and could help MRUS leverage GILD's commercial and development expertise in oncology. We reiterate our Buy rating with new \$52 PO (prev. \$44).

Deal includes up to \$1.5bn in milestones + royalties

MRUS will lead the development of 2 programs with an option for a third program and GILD will have the right to license these programs after initial early-stage research activities. GILD will be responsible for additional research, development and commercialization of any licensed programs, and MRUS is entitled to mid-single to low-double digit tiered royalties as well as up to \$1.5bn in milestones. MRUS will receive an upfront payment of \$56mn for initial targets and a \$25mn equity investment from GILD.

Peto'+pembro data in 1L HNSCC expected at ASCO

We remain focused on the upcoming update for peto' in 1L HNSCC in combination with pembrolizumab in 2Q, which we view as a key catalyst for the company in 2024. We expect the update to happen at the upcoming ASCO meeting (May 31-June 4). Recall, management has noted that they are confident in showing a competitive profile in 1L based on encouraging efficacy in 2L+ as monotherapy (see our [Feb 8 note](#)). We think ~46% ORR (using Bicara as a benchmark) is the benchmark for efficacy based on prior trials in 1L HNSCC. In our view, a positive result could be a significant driver of upside given the large commercial opportunity in 1L. The company also plans to initiate a phase 3 trial in 2L+ HNSCC in mid-24 and report data from the dose finding trial in 2H.

Model changes

In our DCF-based model, we update for FY23 results, cash and share count and the collaboration deal with GILD. We also increase our pipeline value to \$1.2bn (prev. \$800mn) based on the GILD collaboration. These changes result in our new \$52 PO.

Estimates (Dec) (US\$)	2022A	2023A	2024E	2025E	2026E
EPS	(2.92)	(3.00)	(3.27)	(3.49)	(3.87)
EPS Change (YoY)	-68.8%	-2.7%	-9.0%	-6.7%	-10.9%
Consensus EPS (Bloomberg)			(3.35)	(3.53)	(2.92)
DPS	0	0	0	0	0
Valuation (Dec)					
Free Cash Flow Yield*	-5.8%	-5.4%	-5.8%	-6.6%	-7.5%

* For full definitions of *IQmethod*SM measures, see page 4.

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07 March 2024

Equity

Key Changes

(US\$)	Previous	Current
Price Obj.	44.00	52.00
2024E EPS	-2.78	-3.27
2025E EPS	-3.01	-3.49
2026E EPS	-3.40	-3.87

Tazeen Ahmad
Research Analyst
BofAS
+1 646 855 4236
tazeen.ahmad@bofa.com

Daniel Giraldo
Research Analyst
BofAS
daniel.giraldo@bofa.com

Jeremiah Lorentz
Research Analyst
BofAS
jeremiah.lorentz@bofa.com

Stock Data

Price	47.04 USD
Price Objective	52.00 USD
Date Established	7-Mar-2024
Investment Opinion	C-1-9
52-Week Range	17.15 USD - 52.04 USD
Mrkt Val (mn) / Shares Out (mn)	2,723 USD / 57.9
Free Float	92.5%
Average Daily Value (mn)	27.66 USD
BofA Ticker / Exchange	MRUS / NAS
Bloomberg / Reuters	MRUS US / MRUS.OQ
ROE (2024E)	-60.4%
Net Dbt to Eqty (Dec-2023A)	-54.4%

Abbreviations

ASCO: American Society of Clinical Oncology

HNSCC: Head and neck squamous cell carcinoma

NRG1: Neuregulin 1

ORR: Objective response rate

iQprofileSM Merus

iQmethodSM – Bus Performance*

(US\$ Millions)	2022A	2023A	2024E	2025E	2026E
Return on Capital Employed	-41.5%	-37.4%	-46.4%	-59.1%	-101.7%
Return on Equity	-46.6%	-51.4%	-60.4%	-76.7%	-137.0%
Operating Margin	-384.8%	-356.2%	-422.3%	-469.5%	-518.8%
Free Cash Flow	(158)	(146)	(158)	(180)	(205)

iQmethodSM – Quality of Earnings*

(US\$ Millions)	2022A	2023A	2024E	2025E	2026E
Cash Realization Ratio	NM	NM	NM	NM	NM
Asset Replacement Ratio	7.8x	1.7x	1.4x	1.5x	1.7x
Tax Rate	0.7%	2.1%	2.2%	2.0%	1.9%
Net Debt-to-Equity Ratio	-55.0%	-54.4%	-83.0%	-103.3%	-129.5%
Interest Cover	NA	NA	NA	NA	NA

Income Statement Data (Dec)

(US\$ Millions)	2022A	2023A	2024E	2025E	2026E
Sales	42	44	49	50	51
% Change	-15.3%	5.7%	11.0%	2.0%	2.0%
Gross Profit	42	44	49	50	51
% Change	-15.3%	5.7%	11.0%	2.0%	2.0%
EBITDA	(159)	(154)	(204)	(232)	(262)
% Change	-79.3%	3.0%	-32.4%	-13.7%	-12.9%
Net Interest & Other Income	30	5	10	11	12
Net Income (Adjusted)	(131)	(155)	(200)	(227)	(256)
% Change	-96.4%	-18.1%	-29.2%	-13.4%	-12.7%

Free Cash Flow Data (Dec)

(US\$ Millions)	2022A	2023A	2024E	2025E	2026E
Net Income from Cont Operations (GAAP)	(129)	(149)	(192)	(218)	(246)
Depreciation & Amortization	1	2	2	1	1
Change in Working Capital	(19)	(26)	4	6	6
Deferred Taxation Charge	(2)	1	0	0	0
Other Adjustments, Net	(1)	29	30	33	36
Capital Expenditure	(8)	(4)	(3)	(2)	(2)
Free Cash Flow	-158	-146	-158	-180	-205
% Change	-160.4%	7.2%	-8.4%	-13.6%	-13.9%
Share / Issue Repurchase	NA	NA	NA	NA	NA
Cost of Dividends Paid	0	0	0	0	0
Change in Debt	0	0	0	0	0

Balance Sheet Data (Dec)

(US\$ Millions)	2022A	2023A	2024E	2025E	2026E
Cash & Equivalents	148	204	266	306	127
Trade Receivables	4	2	3	3	3
Other Current Assets	155	162	88	37	23
Property, Plant & Equipment	14	14	15	15	16
Other Non-Current Assets	56	73	33	22	19
Total Assets	377	455	405	383	188
Short-Term Debt	NA	NA	NA	NA	NA
Other Current Liabilities	79	69	69	71	73
Long-Term Debt	12	10	11	12	12
Other Non-Current Liabilities	39	20	18	16	14
Total Liabilities	129	99	98	98	99
Total Equity	247	356	307	285	89
Total Equity & Liabilities	377	455	405	383	188

* For full definitions of iQmethodSM measures, see page 4.

Company Sector

Biotechnology

Company Description

Merus (MRUS) is clinical-stage biotechnology company focusing on developing multispecific antibodies using their proprietary technology. Its lead assets are petosemtamab in head and neck squamous cell cancer and zenocutuzumab in NRG1+ cancers. Additional assets include MCLA-129 in EGFR+ non-small cell lung cancer and other early stage assets including partnerships with Incyte, Eli Lilly and Ono.

Investment Rationale

We rate MRUS at Buy. We view the multispecific antibody platform as having several shots on goal in oncology. We think petosemtamab represents an attractive opportunity based on promising clinical data in HSNCC with potential for accelerated approval. Zenocutuzumab has also shown efficacy in an area of unmet need with potential for commercial partnerships. However, we await further clinical validation from the pipeline and color on path forward for lead programs.

Stock Data

Average Daily Volume 588,018

Quarterly Earnings Estimates

	2023	2024
Q1	-0.86A	-0.81E
Q2	-0.66A	-0.83E
Q3	-0.43A	-0.85E
Q4	-0.53A	-0.94E

Price objective basis & risk

Merus (MRUS)

Our \$52 PO is based on a probability adjusted net present value analysis. Our valuation consists of \$23/sh for petosemtamab in 2L+ head and neck squamous cell cancer (HNSCC) and \$7/sh for peto' in 1L HNSCC. The remainder of our valuation comes from pipeline (\$14/sh) and cash (\$8/sh). Our discounted cash flow (DCF)-based model goes out to 2040. We assume 11% WACC for peto in 2L+, 13% in 1L and 14% for pipeline expenses, and assume no terminal value

Upside risks to our PO are 1) positive clinical data for lead programs, 2) potential for accelerated approval in 2L+ HNSCC and potentially 1L, 3) successful partnership for commercialization of zenocutuzumab, and 4) better-than-expected market penetration.

Downside risks to our PO are 1) negative results from upcoming clinical data readouts, 2) unexpected safety signals from lead assets, 3) failure to obtain accelerated approval in HNSCC, 4) failure to partner zenocutuzumab, and 5) lower than expected commercial uptake.

Analyst Certification

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US - Biotechnology Coverage Cluster

Investment rating	Company	BofA Ticker	Bloomberg symbol	Analyst
BUY				
	4D Molecular Therapeutics, Inc.	FDMT	FDMT US	Tazeen Ahmad
	Alnylam Pharmaceuticals	ALNY	ALNY US	Tazeen Ahmad
	Amicus Therapeutics	FOLD	FOLD US	Tazeen Ahmad
	Annexon Biosciences	ANNX	ANNX US	Tazeen Ahmad
	Apellis Pharmaceuticals	APLS	APLS US	Tazeen Ahmad
	Argenx SE	ARGX	ARGX US	Tazeen Ahmad
	Arvinas	ARVN	ARVN US	Tazeen Ahmad
	Ascendis Pharma	ASND	ASND US	Tazeen Ahmad
	Biocryst Pharmaceuticals Inc	BCRX	BCRX US	Tazeen Ahmad
	BioNTech	BNTX	BNTX US	Tazeen Ahmad
	Denali Therapeutics	DNLI	DNLI US	Tazeen Ahmad
	Inozyme Pharma, Inc.	INZY	INZY US	Tazeen Ahmad
	Merus	MRUS	MRUS US	Tazeen Ahmad
	Neurocrine Biosciences	NBIX	NBIX US	Tazeen Ahmad
	Ocular Therapeutix	OCUL	OCUL US	Tazeen Ahmad
	PepGen Inc	PEPG	PEPG US	Tazeen Ahmad
	Rhythm Pharmaceuticals	RYTM	RYTM US	Tazeen Ahmad
	Sarepta Therapeutics	SRPT	SRPT US	Tazeen Ahmad
	Ultragenyx Pharmaceuticals	RARE	RARE US	Tazeen Ahmad
NEUTRAL				
	Acadia Pharmaceuticals	ACAD	ACAD US	Tazeen Ahmad
	Incyte Corporation	INCY	INCY US	Tazeen Ahmad
	Prothena Corporation	PRTA	PRTA US	Tazeen Ahmad
	SAGE Therapeutics	SAGE	SAGE US	Tazeen Ahmad
UNDERPERFORM				
	Achilles Therapeutics	ACHL	ACHL US	Tazeen Ahmad
	Fate Therapeutics	FATE	FATE US	Tazeen Ahmad
	Fulcrum Therapeutics	FULC	FULC US	Tazeen Ahmad
	Pharvaris	PHVS	PHVS US	Tazeen Ahmad
	PTC Therapeutics	PTCT	PTCT US	Tazeen Ahmad



US - Biotechnology Coverage Cluster

Investment rating	Company	BofA Ticker	Bloomberg symbol	Analyst
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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

NOPAT = (EBIT + Interest Income) × (1 – Tax Rate) + 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
EV = Current Share Price × Current Shares + Minority Equity + Net Debt + Other LT Liabilities
Enterprise Value

Denominator

Total Assets – Current Liabilities + ST Debt + 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
Market Cap = Current Share Price × Current Basic Shares
Sales

Basic EBIT + Depreciation + Amortization

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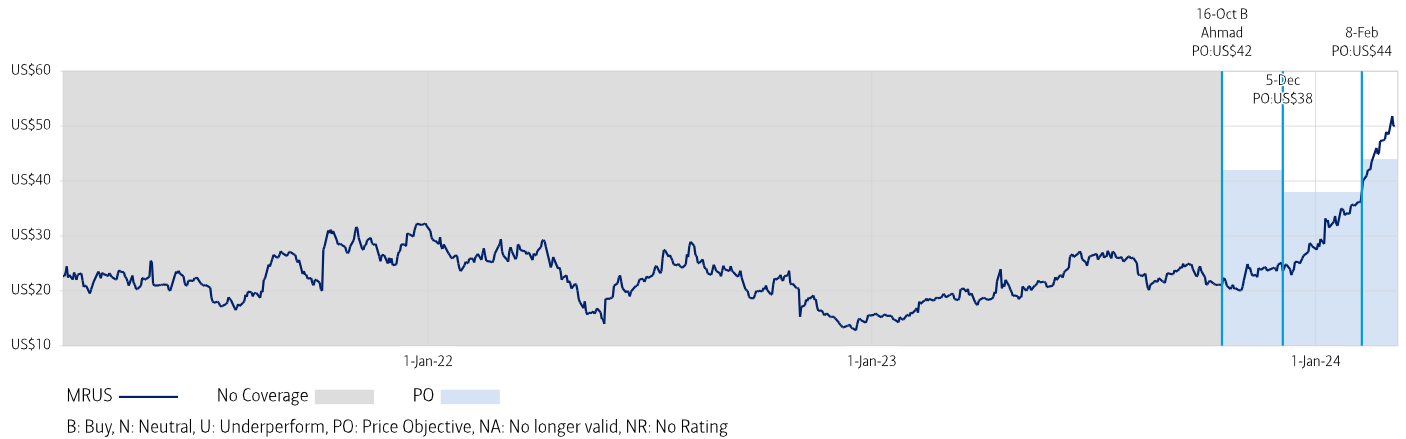
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Merus (MRUS) Price Chart



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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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