

Merus

Takeaways from our dinner with MRUS

Reiterate Rating: BUY | PO: 44.00 USD | Price: 38.06 USD

Ph 3 trial in 2L+ HNSCC expected to initiate in mid-24

We hosted Bill Lundberg, CEO of Merus to discuss expectations for the company in 2024. Our conversation focused on the development plans for petosemtamab in HNSCC. On 2L+, mgmt highlighted positive ph 1/2 data showing 37% ORR and fast onset of responses. The company noted high unmet need in the 2L+ setting where ORR are in the ~5-19% range and highlighted the potential for a highly competitive profile in this setting. They noted peto's differentiated mechanism of action targeting EGFR and LGR5 as well as strong ADCC induction. Mgmt reiterated they have plans to initiate a ph 3 trial in 2L+ HNSCC evaluating peto' monotherapy vs investigator's choice of single agent chemotherapy or cetuximab in mid-24. The company noted a dose finding trial evaluating 1,100mg and 1,500mg doses in ~40 patients is ongoing and will inform the ph 3 dose selection. Based on FDA feedback, they expect an early endpoint such as ORR could be used to support accelerated approval with later OS data serving as the confirmatory endpoint. We continue to be encouraged by peto' differentiated profile in 2L+ HNSCC given the large unmet need and supporting potential competitive efficacy in 1L. We reiterate our Buy rating with new \$44 PO (prev. \$38).

Ph 1/2 for peto'+pembro in 1L HNSCC in 1H24

On 1L in HNSCC, the company reiterated they expect to present initial ph 1/2 data for peto' in combination with pembrolizumab in 1H24 at a medical conference. The company noted that initial data in 2L+ gives them confidence about a competitive profile in 1L, where they expect a higher ORR than 2L+ based on prior trials. We think the recent data from Bicara Therapeutics for BCA101 (EGFR/TGF- β bispecific) in combination with pembro' in 1L HNSCC showing 46% ORR in the overall population could be used as a benchmark for efficacy. Mgmt reiterated their view that based on FDA feedback, there is potential to pursue accelerated approval in 1L. The company thinks these initial results could support initiating ph 3 trial, where they would study peto'+pembro' against pembro' monotherapy. We think positive results in 1L could be a significant driver of upside, as we see this as the larger commercial opportunity. We currently model risk-adjusted peak sales in 1L of \$703mn contributing \$7/sh to our PO.

Differentiated efficacy in 2L+ could drive higher uptake

In our DCF-based model, we increase our peak penetration estimates for peto' in 2L+ HNSCC to 20%/12% in US/EU (prev. 15%/10%) as we see potential for higher uptake given the differentiated efficacy over current treatment options seen so far. We now model risk-adj peak sales in 2L+ of \$947mn (\$23/sh) resulting in our new \$44 PO. We also roll the quarter and adjust our near-term op ex.

Estimates (Dec) (US\$)	2021A	2022A	2023E	2024E	2025E
EPS	(1.73)	(2.92)	(2.39)	(2.78)	(3.01)
EPS Change (YoY)	NA	-68.8%	18.2%	-16.3%	-8.3%
Consensus EPS (Bloomberg)			(2.67)	(3.07)	(3.31)
DPS	0	0	0	0	0
Valuation (Dec)					
Free Cash Flow Yield*	-2.8%	-7.2%	-5.4%	-7.4%	-8.6%

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

08 February 2024

Equity

Key Changes

(US\$)	Previous	Current
Price Obj.	38.00	44.00
2023E EPS	-2.30	-2.39
2024E EPS	-2.91	-2.78
2025E EPS	-3.34	-3.01

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Stock Data

Price	38.06 USD
Price Objective	44.00 USD
Date Established	8-Feb-2024
Investment Opinion	C-1-9
52-Week Range	15.93 USD - 38.07 USD
Mrkt Val (mn) / Shares Out (mn)	2,197 USD / 57.7
Free Float	92.5%
Average Daily Value (mn)	18.70 USD
BofA Ticker / Exchange	MRUS / NAS
Bloomberg / Reuters	MRUS US / MRUS.OQ
ROE (2023E)	-45.2%
Net Dbt to Eqty (Dec-2022A)	-55.0%

See inside for abbreviations

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Timestamp: 08 February 2024 05:31AM EST

iQprofileSM Merus

iQmethodSM – Bus Performance*

(US\$ Millions)	2021A	2022A	2023E	2024E	2025E
Return on Capital Employed	NA	-41.5%	-39.2%	-53.4%	-71.9%
Return on Equity	-42.3%	-46.6%	-45.2%	-63.5%	-88.1%
Operating Margin	-183.2%	-384.8%	-323.0%	-426.1%	-473.8%
Free Cash Flow	(60)	(158)	(119)	(163)	(189)

iQmethodSM – Quality of Earnings*

(US\$ Millions)	2021A	2022A	2023E	2024E	2025E
Cash Realization Ratio	NM	NM	NM	NM	NM
Asset Replacement Ratio	0.7x	7.8x	2.1x	2.4x	2.8x
Tax Rate	0.4%	0.7%	2.6%	2.5%	2.2%
Net Debt-to-Equity Ratio	-75.6%	-55.0%	-87.7%	-103.3%	-116.8%
Interest Cover	NM	NA	NA	NA	NA

Income Statement Data (Dec)

(US\$ Millions)	2021A	2022A	2023E	2024E	2025E
Sales	49	42	48	49	50
% Change	NA	-15.3%	15.0%	2.0%	2.0%
Gross Profit	49	42	48	49	50
% Change	NA	-15.3%	15.0%	2.0%	2.0%
EBITDA	(89)	(159)	(154)	(207)	(235)
% Change	NA	-79.3%	3.4%	-34.8%	-13.5%
Net Interest & Other Income	23	30	34	40	41
Net Income (Adjusted)	(67)	(131)	(123)	(172)	(199)
% Change	NA	-96.4%	6.0%	-39.4%	-15.8%

Free Cash Flow Data (Dec)

(US\$ Millions)	2021A	2022A	2023E	2024E	2025E
Net Income from Cont Operations (GAAP)	(66)	(129)	(117)	(164)	(190)
Depreciation & Amortization	1	1	1	1	1
Change in Working Capital	16	(19)	4	7	7
Deferred Taxation Charge	0	(2)	0	0	0
Other Adjustments, Net	(10)	(1)	(5)	(6)	(5)
Capital Expenditure	(1)	(8)	(2)	(1)	(1)
Free Cash Flow	-60	-158	-119	-163	-189
% Change	NA	-160.4%	24.7%	-37.6%	-15.5%
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)	2021A	2022A	2023E	2024E	2025E
Cash & Equivalents	241	148	275	263	259
Trade Receivables	6	4	4	4	5
Other Current Assets	176	155	99	57	29
Property, Plant & Equipment	6	14	15	16	16
Other Non-Current Assets	27	56	31	24	22
Total Assets	457	377	424	365	331
Short-Term Debt	NA	NA	NA	NA	NA
Other Current Liabilities	72	79	77	78	79
Long-Term Debt	2	12	12	13	14
Other Non-Current Liabilities	66	39	35	31	28
Total Liabilities	140	129	124	122	121
Total Equity	316	247	299	242	210
Total Equity & Liabilities	457	377	424	365	331

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

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 491,412

Quarterly Earnings Estimates

	2022	2023
Q1	-0.41A	-0.86A
Q2	-0.12A	-0.66A
Q3	-0.53A	-0.43A
Q4	-1.76A	-0.49E

Abbreviations

1L/2L+: first/second line

ADCC: Antibody-dependent cell-mediated cytotoxicity

EGFR: epidermal growth factor receptor

FDA: Food and Drug administration

HNSCC: Head and neck squamous cell carcinoma

LGR5: leucine-rich repeat-containing G protein-coupled receptor 5

mgmt: management

ORR: Objective response rate

OS: Overall survival

TGF-beta: transforming growth factor beta

Price objective basis & risk

Merus (MRUS)

Our \$44 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 (\$7/sh) and cash (\$7/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

I, Tazeen Ahmad, hereby certify that the views expressed in this research report accurately reflect my personal views about the subject securities and issuers. I also certify that no part of my compensation was, is, or will be, directly or indirectly, related to the specific recommendations or view expressed in this research report.

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
	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

iQmethodSM Measures Definitions

Business Performance

Return On Capital Employed

Return On Equity

Operating Margin

Earnings Growth

Free Cash Flow

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

Denominator

Total Assets – Current Liabilities + ST Debt + Accumulated Goodwill

Amortization

Shareholders' Equity

Sales

N/A

N/A

Quality of Earnings

Cash Realization Ratio

Asset Replacement Ratio

Tax Rate

Net Debt-To-Equity Ratio

Interest Cover

Numerator

Cash Flow From Operations

Capex

Tax Charge

Net Debt = Total Debt – Cash & Equivalents

EBIT

Denominator

Net Income

Depreciation

Pre-Tax Income

Total Equity

Interest Expense

Valuation Toolkit

Price / Earnings Ratio

Price / Book Value

Dividend Yield

Free Cash Flow Yield

Enterprise Value / Sales

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

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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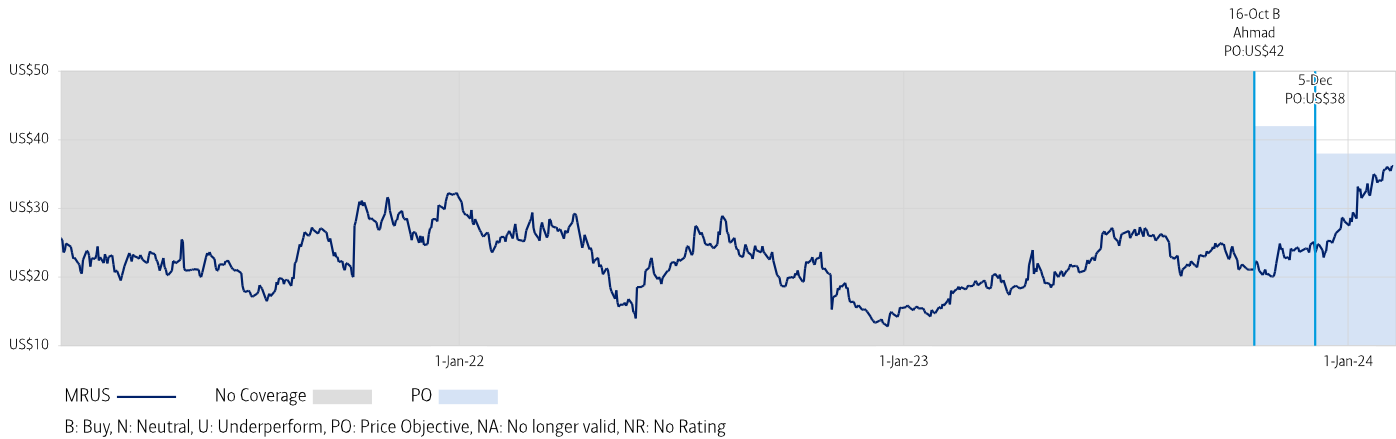
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Merus (MRUS) Price Chart



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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)

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Buy	1895	53.62%	Buy	1083	57.15%
Hold	832	23.54%	Hold	454	54.57%
Sell	807	22.84%	Sell	383	47.46%

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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%

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