

## Royalty Pharma

# Vanza data likely avoids worst case scenario, but some CF switch risk remains

Maintain Rating: BUY | PO: 40.00 USD | Price: 27.71 USD

## Uncertainty on deuterated ivacaftor royalty remains

Today, after market close, Vertex reported results from the pivotal trials of vanzaaftor/tezacaftor/deutivacaftor ("vanza triple") for cystic fibrosis (CF). Importantly, in both SKYLINE 102 and SKYLINE 103, the vanza triple was non-inferior to treatment with Trikafta on the primary endpoint, absolute change from baseline in percent predicted forced expiratory volume in 1 second (ppFEV1) through week 24. While royalty rates to Vertex's vanza triple remain debatable, we're of the view that given comparable efficacy on FEV-1, it is likely that only a subset of CF patients (perhaps 25%) stable on Trikafta could initially switch to the vanza triple treatment. We don't think that the superiority of the vanza triple over Trikafta on sweat chloride will be a major catalyst for dramatic switching away from Trikafta (which carries a higher royalty rate) as sweat chloride isn't used in clinical treatment decisions in CF. That said, the ~6,000 eligible CF patients not on Trikafta could try vanza which could be potentially additive to Royalty's CF economics, albeit at a likely lower royalty rate.

We maintain our current estimate of a blended royalty rate ~8% (down from current 9% for Trikafta) and \$924M adjusted cash receipts in 2030 (vs. consensus' \$985M) for the CF business. Overall, we are of the view that the SKYLINE 102 / 103 data avoided a negative scenario for Royalty (by showing vanza non-inferiority on FEV-1) and from a sentiment perspective, having vanza phase 3 data finally out, investors can work through the potential royalty scenarios over the long-term with more precision. Royalty Pharma is scheduled to report 4Q23 results on February 15th before market open (8am ET), where we expect management to further discuss the potential CF business risk given the data Vertex reported. We maintain our Buy rating and \$40 PO.

## Assumptions on CF risk and read-through to our forecast

Our base case assumes deuterated ivacaftor is royalty-bearing and uptake of the vanza triple is on the lower end (50% vs 75%), leading to a blended royalty rate of ~8%. Assuming deuterated ivacaftor is not royalty-bearing with 50% uptake would suggest a blended royalty rate of ~7%. Put differently, the potential range of adjusted cash receipts in 2030 based on Royalty Pharma's scenario analyses suggests a low-end range of \$600M (4% blended royalty) and high-end range of \$950M (9% blended royalty) on franchise sales of \$13B, and Vertex's data today supports a range of \$700-900M. That said, we could see upside to cash flow forecasts if conversion rates to the new vanza triple are more limited (e.g., <50%). Overall, while we think worst case scenario for Royalty's CF business is unlikely (blended royalty of ~4% and \$600M adjusted cash receipts by 2030), we don't think the overhang from the CF business risk has been completely lifted as royalty rights on deuterated ivacaftor and switch rates remain to be seen. Indeed, we could see an additional >\$200M as at-risk if deuterated ivacaftor isn't royalty bearing or if switch rights are higher than expected.

05 February 2024

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### Stock Data

Price	27.71 USD
Price Objective	40.00 USD
Date Established	8-Aug-2023
Investment Opinion	B-1-7
52-Week Range	25.92 USD - 39.10 USD
Mkt Val (mn) / Shares Out (mn)	12,328 USD / 444.9
Free Float	85.5%
Average Daily Value (mn)	56.47 USD
BofA Ticker / Exchange	RPRX / NAS
Bloomberg / Reuters	RPRX US / RPRX.OQ
ROE (2023E)	38.4%
Net Dbt to Eqty (Dec-2022A)	56.7%
ESGMeter™	Medium

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Timestamp: 05 February 2024 07:29PM EST

## Price objective basis & risk

### Royalty Pharma (RPRX)

Our \$40/share price objective is based on a probability-adjusted SOTP NPV analysis which includes current growth products (\$32/sh, 79% of our valuation), and projected revenues from future investments (\$13/sh, 33%). We project out revenues through 2038, apply a WACC of 5% (mature products) to 8% (future growth products), and use terminal growth rates ranging from -5% (current growth products) to 5% (future growth products), in-line with other mature biopharma companies. We calculate net cash as - \$5/sh (-11% of our valuation).

Downside risks: 1) current portfolio royalties do not reach current assumed levels, 2) new investments fail to replicate historical returns, 3) new corporate structure and shareholder base adversely impacts historically low tax rate, 4) competition in the royalty investing space makes it harder to attain new value accretive investments, 5) patent/royalty expiries are not replaced by new royalty streams.

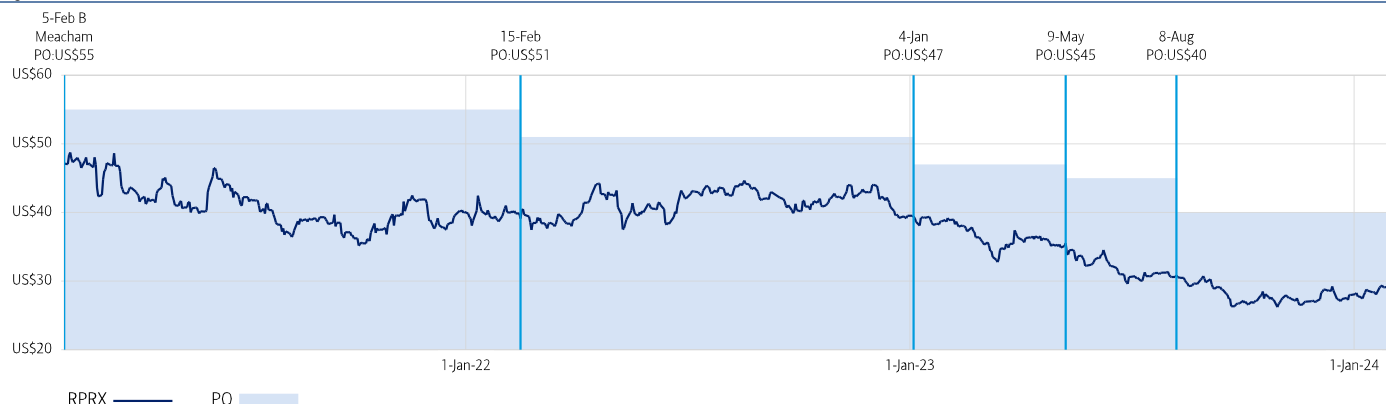
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### Royalty Pharma (RPRX) Price Chart



B: Buy, N: Neutral, U: Underperform, PO: Price Objective, NA: No longer valid, NR: No Rating

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Coverage Universe	Count	Percent	Inv. Banking Relationships <sup>R1</sup>	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%

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Coverage Universe	Count	Percent	Inv. Banking Relationships <sup>R1</sup>	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%

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Neutral	≥ 0%	≤ 30%
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