Trinity Delta

Mereo BioPharma

Update

Focus shifts back to imminent data

8 May 2019

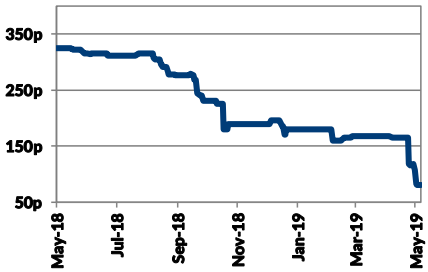
Mereo BioPharma has successfully completed the merger with OncoMed, and now the focus shifts firmly back to the pipeline. Initial data from the Phase II study in osteogenesis imperfecta (OI) with its leading rare disease asset, BPS-804, are due in the coming weeks, and top-line data for the full trial in Q419. The Phase II study with MPH-966 in alpha-1 anti-trypsin deficiency (AATD) is due to report top-line data around the year-end. At the same time, Mereo has strengthened the out-licensing packages of non-rare disease assets; notably the outline for a Phase III programme with BCT-197 has been agreed with the FDA, thereby raising the likelihood of BCT-197 being partnered by year-end. We value Mereo at 506p/share or $25.59/ADS.

Year-end: December 31	2017	2018	2019E	2020E
Sales (£m)	0.0	0.0	0.0	0.0
Adj. PBT (£m)	(43.3)	(35.0)	(41.9)	(29.2
Net Income (£m)	(38.8)	(32.0)	(38.6)	(28.2
Adj.EPS (p)	(51.9)	(42.2)	(41.2)	(27.3)
Cash (£m)	52.5	27.5	23.2	6.1*
EBITDA (£m)	(45.3)	(35.2)	(42.4)	(29.6)

Source: Trinity Delta Note: Adjusted numbers exclude share-based payments and exceptionals. *The cash position in FY20 assumes £25m is raised from equity, debt or partnering of assets.

- **Important year for data** Mereo is expected to report data from its two rare-disease assets, which it aims to self-commercialise, in the coming year. The first data from the Phase II study with BPS-804 (setrusumab) in OI should be reported in the coming weeks (results of open label arm) and data from the double-blinded arms with three doses due in Q419. Mereo initiated the Phase II study with MPH-966 in AATD in Q418 and top-line is expected to report around the end of the year.
- **Prospects of partnering improve** Mereo has four assets in its non-rare disease portfolio that management aims to partner to support the funding of its rare disease products. BCT-197 (acumapimod) is Phase III ready after Mereo agreed in principle the outline of a pivotal study programme for the treatment of acute exacerbations of COPD with the FDA in March; this should enable Mereo to partner the compound in 2019, as Phase II data suggest BCT-197 can effectively reduce severe exacerbations in COPD.
- **Strengthened balance sheet and expanded opportunities** The merger of Mereo with OncoMed has been completed. Mereo's cash position has increased by $51m (c. £39m), and has the possibility of raising additional funds from two clinical oncology assets; this could enable Mereo to start the pivotal Phase III paediatric study with BPS-804 in 2019. The deal also provides Mereo with a NASDAQ listing, which has already increased share liquidity, enhances access to capital, and, with the US infrastructure and expertise, raises its profile in the key US market.
- **rNPV valuation of 506p/share** We re-introduce our estimates and valuation of Mereo following the completion of the OncoMed transaction. We value Mereo using a rNPV methodology of its four leading assets at £541m ($704m), equivalent to 506p/share or $25.59/ADS (fully diluted). As indicated, there are multiple significant catalysts due in 2019, which could lead to major re-ratings of the shares.

Price (UK share)	80p
(US ADS)	$4.73
Market Cap	£76.8m
	$90.8m
Enterprise Value	£39.2m
	$41.9m
Shares in issue (shares)	96.0m
(ADS)	19.2m
12 month range	77.5p-325.0p
	$4.67-$8.48
Free float	68.9%
Exchanges	AIM London
	NASDAQ
Sector	Healthcare
Company codes	MPH.L
	MREO
Corporate client	Yes



Company description

Mereo BioPharma develops and commercialises innovative therapeutics addressing rare diseases. It also has specialty pharmaceutical products that it will partner. The assets are acquired or licensed in at clinical stages from large pharmaceutical companies. The portfolio consists of six compounds that are in clinical development.

Analysts

Mick Cooper PhD
mcooper@trinitydelta.org
+44 (0) 20 3637 5042

Lala Gregorek
lgregorek@trinitydelta.org
+44 (0) 20 3637 5043

Valuation and financials

Mereo valued at 506p/share or $25.59/ADS (fully diluted)

Pending the transaction, we suspended our valuation which was £510m, or 615p per share. Following the completion of the merger, we have updated our model, and now re-introduce our valuation and estimates. We value Mereo at £541m ($704m), equivalent to 506p/share or $25.59/ADS on a fully diluted basis.

We value the company using an rNPV model of the four late-stage clinical programmes, which are then netted out against the cost of running the business and net cash, as detailed in Exhibit 1. The rNPV of each individual clinical project is assessed and the success probabilities adjusted for the inherent clinical, commercial, and execution risks each carries. These are summed and netted against the costs of running the operation and net cash. We have not included the two oncology assets, navicixizumab and etigilimab, as they are early stage clinical assets and there are with CVRs associated with the potential partnering of the assets, although they could provide a useful source of funding.

Exhibit 1: Our rNPV-based valuation of Mereo BioPharma

	Total NPV ($m)	Total NPV (£m)	Likelihood of approval	rNPV ($m)	rNPV (£m)	rNPV/ ADS ($)	rNPV/ share (p)	Notes
BPS-804 (setrusumab)	918.1	706.2	50%	430.9	331.4	17.26	345.2	Peak sales: $735m (£566m) Launch year: 2023
MPH-966 (alvelestat)	418.8	322.2	25%	82.1	63.1	3.29	65.7	Peak sales: $420m (£323m) Launch year: 2024
*BCT-197 (acumapimod)	284.8	219.1	60%	121.5	93.4	4.87	97.3	Peak sales: $768m (£591m) Launch year: 2023
*BGS-649 (leflutrozole)	139.4	107.2	50%	28.3	21.7	1.13	22.6	Peak sales: $483m (£372m) Launch year: 2024
Operating costs	(7.7)	(5.9)		(7.7)	(5.9)	(0.31)	(6.1)	
Net cash	48.9	37.6		48.9	37.6	1.96	39.2	At Dec 2018 with cash from merger with Oncomed
Total	**1,802.3**	**1,386.4**		**703.9**	**541.4**	**28.19**	**563.9**	
Total (fully diluted)						**25.29**	**505.8**	Based on all options, warrants, bonus shares and convertible debt
Discount rate							12.5%	
Exchange rate ($/£)							1.30	
Taxation							10.0%	From 2026 with the benefit of UK Patent Box

Source: Trinity Delta; Note: *The rNPV of BGS-649 and BCT-197 includes a deal success factor of 50% and 70% respectively. For the purpose of the valuation, the launch year is the first year of material sales.

Our financial forecasts are summarised in Exhibit 2. We estimate investment in R&D will increase by 22.6% to £27.8m in FY19, with c. 80% of the spending on BPS-804 and MPH-966. Mereo's cash position following the completion of the merger was £53.9m ($70.1m), which should allow the company to operate to mid-2020, but could be extended significantly by the successful partnering of non-rare disease assets.

Exhibit 2: Summary of financials

Year-end: Dec 31	£'000s	2015	2016	2017	2018	2019E	2020E
INCOME STATEMENT							
Revenues		**0**	**0**	**0**	**0**	**0**	**0**
Cost of goods sold		0	0	0	0	0	0
Gross Profit		**0**	**0**	**0**	**0**	**0**	**0**
R&D expenses		(5,445)	(24,563)	(34,607)	(22,704)	(27,838)	(16,263)
G&A expenses		(4,734)	(5,123)	(7,045)	(10,316)	(12,364)	(11,131)
Underlying operating profit		**(10,179)**	**(29,685)**	**(41,652)**	**(33,019)**	**(40,202)**	**(27,394)**
Share-based payments		(2,982)	(6,494)	(3,652)	(2,189)	(2,233)	(2,278)
EBITDA		**(13,150)**	**(36,146)**	**(45,268)**	**(35,171)**	**(42,405)**	**(29,641)**
Operating Profit		**(13,161)**	**(36,179)**	**(45,304)**	**(35,208)**	**(42,435)**	**(29,672)**
Financing costs/income		26	2,458	(1,647)	(2,098)	(1,728)	(1,795)
Profit Before Taxes		**(13,136)**	**(33,722)**	**(46,951)**	**(37,306)**	**(44,164)**	**(31,466)**
Adj. PBT		**(10,153)**	**(27,228)**	**(43,299)**	**(35,117)**	**(41,931)**	**(29,189)**
Current tax income		947	5,331	8,152	5,277	5,568	3,253
Net Income		**(12,189)**	**(28,390)**	**(38,799)**	**(32,029)**	**(38,596)**	**(28,214)**
EPS (p)		**(101.5)**	**(63.4)**	**(56.2)**	**(44.8)**	**(43.4)**	**(29.4)**
Adj. EPS		**(78.5)**	**(51.0)**	**(51.9)**	**(42.2)**	**(41.2)**	**(27.3)**
DPS (p)		**0.0**	**0.0**	**0.0**	**0.0**	**0.0**	**0.0**
Average no. of shares (m)		12.0	44.8	69.0	71.4	88.9	96.0
BALANCE SHEET							
Current assets		**13,845**	**60,778**	**63,177**	**34,495**	**30,428**	**11,042**
Cash and cash equivalents		12,248	53,578	50,045	25,042	23,185	6,114
Short-term investments		0	0	2,500	2,500	0	0
Accounts receivable		396	767	509	609	609	609
Inventories		0	0	0	0	0	0
Other current assets		1,201	6,433	10,123	6,344	6,635	4,320
Non-current assets		**26,017**	**25,987**	**33,159**	**32,781**	**47,286**	**47,292**
Property, plant & equipment		205	174	153	149	154	160
Intangible assets		25,813	25,813	33,005	32,632	47,132	47,132
Current liabilities		**(3,978)**	**(3,209)**	**(9,618)**	**(16,178)**	**(27,612)**	**(13,143)**
Short-term debt		0	0	(1,940)	(6,838)	(17,510)	(5,121)
Accounts payable		(3,978)	(1,121)	(3,024)	(4,570)	(5,333)	(3,253)
Other current liabilities		0	(2,088)	(4,654)	(4,769)	(4,769)	(4,769)
Non-current liabilities		**(141)**	**(4,299)**	**(24,234)**	**(18,328)**	**(12,802)**	**(33,827)**
Long-term debt		0	(3,127)	(18,813)	(14,647)	(3,975)	(25,000)
Other non-current liabilities		(141)	(1,172)	(5,422)	(3,681)	(8,827)	(8,827)
Equity		**35,743**	**79,257**	**62,483**	**32,771**	**37,300**	**11,364**
CASH FLOW STATEMENTS							
Operating cash flow		**(6,673)**	**(29,287)**	**(31,423)**	**(22,852)**	**(35,861)**	**(25,670)**
Profit before tax		(13,136)	(33,722)	(46,951)	(37,306)	(44,164)	(31,466)
Non-cash adjustments		3,109	5,100	6,451	3,609	3,992	4,103
Change in working capital		3,328	(1,988)	3,021	2,408	762	(2,080)
Interest paid		26	375	724	285	(1,728)	(1,795)
Taxes paid		0	947	5,331	8,152	5,277	5,568
Investing cash flow		**(216)**	**(2)**	**(4,796)**	**(33)**	**34,003**	**(37)**
CAPEX on tangible assets		(216)	(2)	(2,296)	(33)	(35)	(37)
Acquisitions/disposals		0	0	0	0	31,538	0
Other investing cash flows		0	0	(2,500)	0	2,500	0
Financing cash flow		**19,137**	**68,357**	**34,070**	**(2,073)**	**0**	**8,636**
Proceeds from equity		20,005	67,889	15,000	(41)	0	0
Increase in loans		0	3,464	20,000	(2,110)	0	(16,364)
Other financing cash flow		(868)	(2,996)	(930)	78	0	25,000
Net increase in cash		**12,248**	**39,067**	**(2,149)**	**(24,959)**	**(1,857)**	**(17,071)**
Exchange rate effects		0	2,263	(1,384)	(44)	0	0
Cash at start of year		0	12,248	53,578	50,045	25,042	23,185
Cash at end of year		**12,248**	**53,578**	**50,045**	**25,042**	**23,185**	**6,114**
Net cash at end of year		**12,248**	**50,451**	**31,792**	**6,057**	**1,700**	**(24,007)**

Source: Company, Trinity Delta; Notes: Our estimates exclude the costs associated with the pivotal Phase III paediatric study with BPS-804, because the timing of the trial is yet to be decided. We include in FY20 long-term debt (other financing cash flow) of £25m, which is indicative of our estimate of the company's capital requirement; this could be achieved through an equity raise, debt of proceeds from partnering non-rare disease assets.

Mick Cooper PhD CFA mcooper@trinitydelta.org +44 (0) 20 3637 5042

Lala Gregorek lgregorek@trinitydelta.org +44 (0) 20 3637 5043

Franc Gregori fgregori@trinitydelta.org +44 (0) 20 3637 5041

Disclaimer

Trinity Delta Research Limited ("TDRL"; firm reference number: 725161), which trades as Trinity Delta, is an appointed representative of Equity Development Limited ("ED"). The contents of this report, which has been prepared by and is the sole responsibility of TDRL, have been reviewed, but not independently verified, by ED which is authorised and regulated by the FCA, and whose reference number is 185325.

ED is acting for TDRL and not for any other person and will not be responsible for providing the protections provided to clients of TDRL nor for advising any other person in connection with the contents of this report and, except to the extent required by applicable law, including the rules of the FCA, owes no duty of care to any other such person. No reliance may be placed on ED for advice or recommendations with respect to the contents of this report and, to the extent it may do so under applicable law, ED makes no representation or warranty to the persons reading this report with regards to the information contained in it.

In the preparation of this report TDRL has used publically available sources and taken reasonable efforts to ensure that the facts stated herein are clear, fair and not misleading, but make no guarantee or warranty as to the accuracy or completeness of the information or opinions contained herein, nor to provide updates should fresh information become available or opinions change.

Any person who is not a relevant person under section of Section 21(2) of the Financial Services & Markets Act 2000 of the United Kingdom should not act or rely on this document or any of its contents. Research on its client companies produced by TDRL is normally commissioned and paid for by those companies themselves ('issuer financed research') and as such is not deemed to be independent, as defined by the FCA, but is 'objective' in that the authors are stating their own opinions. The report should be considered a marketing communication for purposes of the FCA rules. It has not been prepared in accordance with legal requirements designed to promote the independence of investment research and it is not subject to any prohibition on dealing ahead of the dissemination of investment research. TDRL does not hold any positions in any of the companies mentioned in the report, although directors, employees or consultants of TDRL may hold positions in the companies mentioned. TDRL does impose restrictions on personal dealings. TDRL might also provide services to companies mentioned or solicit business from them.

This report is being provided to relevant persons to provide background information about the subject matter of the note. This document does not constitute, nor form part of, and should not be construed as, any offer for sale or purchase of (or solicitation of, or invitation to make any offer to buy or sell) any Securities (which may rise and fall in value). Nor shall it, or any part of it, form the basis of, or be relied on in connection with, any contract or commitment whatsoever. The information that we provide is not intended to be, and should not in any manner whatsoever be, construed as personalised advice. Self-certification by investors can be completed free of charge at www.fisma.org. TDRL, its affiliates, officers, directors and employees, and ED will not be liable for any loss or damage arising from any use of this document, to the maximum extent that the law permits.

More information is available on our website: www.trinitydelta.org