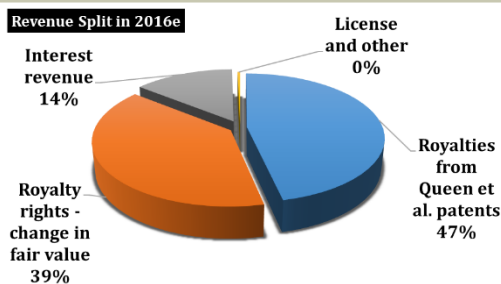


PDL BIOPHARMA: (4% DUE FEB. 2018)

Sector: Pharma & Biotech
(Small-Cap)

Current Price (07-11-16): 94.50 cents
Principle Amount (\$): 300m
YTM: 8.86%
Domicile: U.S.A
Rule 144A: No



Company Description

In layman's terms, PDL BioPharma, Inc., is a healthcare venture capitalist from the time when few knew what venture capitalism was; 1986. It earns money with royalty agreements, patents, license agreements and provides credit financing to a range of healthcare startup or early growth niche operating small companies with favorably high interest rates. PDL has committed over \$1 billion and funded approximately \$937 million in these investments to date. Company has \$300m, 4% coupon outstanding convertible notes that have a high certainty of being paid back in early 2018.

SWOT

Strength	Weaknesses
<ul style="list-style-type: none"> - Niche healthcare operations. Extensive royalty operations knowledge. - Healthcare cigar-butt "investing company". - Provide capital on highly favorable interest rates with extensive collateral cover. - 10 full time employees managing almost all of the business. 	<ul style="list-style-type: none"> - Provide credit financing to many unknown/developing biotech's. - Queen et al patent revenues (82% of 2015 full rev.) are zero in 2HY 2016. - Serious credit risk exposure for portfolio. (Wellstat D. ~\$40m/7% of rev. = impaired) - Genentech accounted for 70%, 71%, and 81% of revenues 2015, 14 & 13.
Opportunities	Threats
<ul style="list-style-type: none"> - Healthcare world never short of patent expires, always an opportunity available. - Valeant and others may dispose-off assets, PDL may buy. 	<ul style="list-style-type: none"> - Serious competition in the business model space. - Inflation expectations plus interest rates on the rise. - Low free cashflow in future is a surety.

Poor Man's Valuation

	Bond Principle or Equity Market Cap. (\$m)	Aprx. Discounted FFCF 3 Years (\$m)	Probable Upside/Safety to Investment	Certainty
Bond	246	288	17%	High
Equity	530	288	-46%	Low

Investment Summary

The nature of this business is that royalties of patents will eventually have to be passed as new patents will be filed whereas old ones will expire; the intellectual property will always be around and firms like PDL pharma will be able to get small niche deals from the sector. I am not convinced with the equity since many things (credit to startups, litigation) can go wrong, but the bonds make sense. Due early 2018, the company is properly capitalized, the notes can be converted to cash under certain conditions and the rule of certainty favors ~8% price return plus 4% coupons from the fixed asset side than seemingly hypothetical limitless equity upside. Going forward, I do believe they will refinance the current issues with more issuance as free cash flow will not be sufficient to cover entire principle. While this will depress the liquidity profile as visible from the forecasted ratios, I have conviction bonds will mature with full payment. Positive free cashflow, liquidity and interest coverage ratios will result in a respectable return over the remaining life of the notes, thus my preference of notes over equity.

CHEAP

Last Price (\$ cents)	94.50
Amount Outstanding (\$m)	246,4
Coupon	4%
Coupon Type	Fixed
Par Value	1000
Coupon Frequency	Semi-Annually
Maturity Date	2/1/2018

SPREADS

Benchmark Treasury (\$)	US Treasury 3-5 Year Yield
Yield Spread	7.35 %
Treasury Yield	1.51 %

FINANCIALS

	2014	2015	Sep-16	2017e
Current Ratio	1,89	7,69	2,91	1,14
Quick Ratio	1,87	7,59	2,89	1,14
Debt/Equity	0,60	0,33	0,31	0,31
Debt/EBITDA	0,84	0,46	0,66	1,52
FCF/Debt	0,47	0,73	0,84	0,36

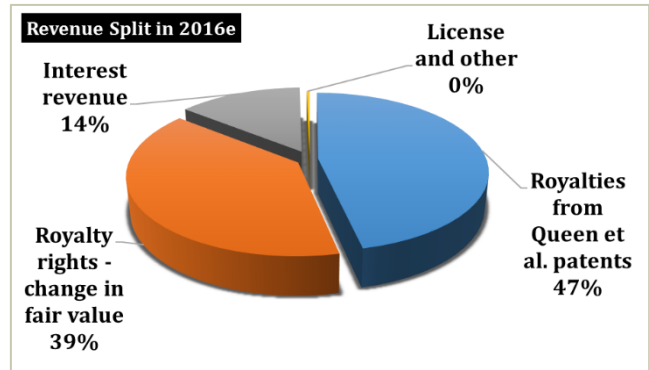
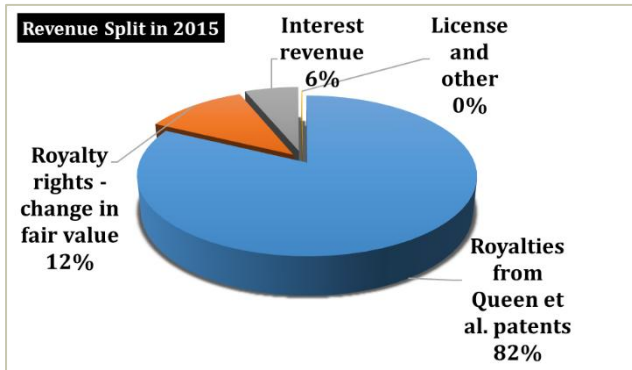
VALUATION

Growth Rate	1%
Wacc	11%
Forecast Period FCF (m)	427
Terminal value	675
PV terminal value	445
Total Equity value	872
Plus Debt	235
Minus Cash	190
EV	917
Shares Outstanding (m)	165,54
Fair Value Share Price	\$ 5
Current Price (03-11-16)	\$ 3,20

"Arpadutch is a small step in the world filled with experts. I eat the cookie I make and sell, every long investment case or research that is being bought will be immediately invested through my broker."

No conflict of interest."

Revenue Evolution due to Royalty Expiry.



Credit History: Obligation Side

Series 2012 Notes	Exchanged \$169.0 million aggregate principal of new Series 2012 Notes for an identical principal amount of the February 2015 Notes, plus a cash payment of \$5.00 for each \$1,000 principal amount, totaling approximately \$845,000. Also, PDL did a private replacement of \$10m of 2012 notes for 2015. Remaining \$131.7 m and later \$48m payment settled through cash and equity offering.	In our case, I believe the same formula follows but the only difference is that revenues will be highly depressed, so will be the cashflows therefore (equity which is already depressed) may not be an option. They will try retiring the major chunk faster this time with the cash in hand causing price to rally.
May 2015 Notes	Issued \$155.3 million in aggregate principal amount, at par, for net proceeds of \$149.7 million. At 3.75% interest rate, notes were retired at stated maturity plus 5.2 million shares of its common stock for the excess conversion value.	
February 2018 Notes	In 2014, company issued \$300.0 million in aggregate principal amount for net proceeds of \$290.2 million. At 4% interest rate, the proceeds were used to redeem some previous outstanding notes. In November 2015, company initiated purchase of \$53.6million for \$43.7 million.	

Credit History: Investments Side

The company provides credit to aspiring companies for various sources of revenues including royalties & high interest.

Wellstat Diagnostics	In 2012, company executed \$7.5 million at 10% interest two-year senior secured note with equity holders at Wellstat. PDL is still legally owed \$94 million and the transaction was one of the major failures.	While some of the credit has been successfully retired at very high interest rate, quite significant investments have gone under water. Primary reason being that credit is extended to new enterprising healthcare startups that on a larger scale don't stand the test of time. This again adds to my conviction that the equity part of the company is a horse too rough to ride.
LENSAR	In 2013, LENSAR was provided upto \$60 million for its laser system. Interest rate charged was 15.5% and currently the company is going through restructuring, therefore PPDL is salvaging all it can.	
Durata	In 2013, Durata was given upto \$70 million at around 14% interest rate with repayment made in full by 2014.	
Direct Flow Medical	PDL provided upto \$ 50 million to Direct Flow at 15.5% interest rate secured by all assets of Direct Flow. Loan is now impaired.	
Paradigm Spine	Upto \$75 million at 13% was provided in 2014 and is secured by all of Paradigm's assets.	

Model & Assumptions

	2013	2014	2015	2016e	2017e	2018e	2019e	2020e
Revenue Split								
Royalties from Queen et al. patents	430,3	486,9	485,2	121,3	0,0	0,0	0,0	0,0
Growth %		13,2%	-0,4%	25,0%	0,0%	0,0%	0,0%	0,0%
Royalty rights - change in fair value	5,6	45,7	68,4	102,2	127,5	143,2	152,1	156,8
Growth %		722,0%	49,5%	49%	25%	12%	6%	3%
Interest revenue	19,0	48,0	36,2	36,2	36,2	36,2	36,2	36,2
Growth %		153,1%	-24,6%	0%	0%	0%	0%	0%
License and other	1,5	0,6	0,7	0,9	1,1	1,4	1,8	2,3
Growth %		-61,7%	25,7%	26%	26%	26%	26%	26%
Total	456,3	581,2	590,4	260,6	164,8	180,9	190,1	195,2
Growth %		27,4%	1,6%	-55,9%	-36,8%	9,7%	5,1%	2,7%

	2013	2014	2015	2016e	2017e	2018e	2019e	2020e
Key Financials								
EBIT = EBITDA	427,0	540,0	557,0	244,3	154,2	169,2	177,9	183,0
% growth		26%	3%	-56%	-37%	10%	5%	3%
FCF	29,0	211,0	186,0	135,4	85,4	93,8	98,6	101,4
% growth		628%	-12%	-27%	-37%	10%	5%	3%
Net Profit	265,0	322,0	333,0	147,1	93,0	102,1	107,3	110,2
% growth		22%	3%	-56%	-37%	10%	5%	3%
Total LT Debt	395	452	254	235	235*	235*	235*	235*
% growth		14%	-44%	-7%	0%	0%	0%	0%

* assuming debt issuance to retire 2018 notes

Explanation

- Very conservatively modeled. Royalties are modeled at 25% in 2016 since only the first quarter is revenue generating.
- Interest revenue is kept constant in line with recent failures.
- Royalty rights change in fair value growth with decreasing rate.

Reporting Quality

Language in 10K	Standard
Auditor's Opinion	PwC: Pass
ESG & Sustainability reporting	None
ESG Materiality Matrix Reported & Assessed	✗
Quantitative Identification of all key ESG metrics	✗
Usefulness of ESG metrics in current scenario?	Helps identifying the worthiness of credit investments the company takes. Quite significant of those have been failures therefore PDL would do better by incorporating an ESG assessment into extending credit to new enterprising healthcare startups.