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Arrowhead Pharm (ARWR-NASDAQ)

ARWR: Strategic shift to subQ and extra-hepatic programs; Two Phase I programs initiated; Collaborations with Amgen announced; Balance sheet remains strong,

Relative valuation metrics indicates a fair value at $15/share.

Current Price (05/10/18)	$9.12
Valuation	**$15.00**

OUTLOOK

After discontinuation of three DPCiv programs, Arrowhead shifted its focus on subcutaneous and extra-hepatic therapeutics.

The company has begun dosing patients in two Phase I clinical programs.

New financing will extend its cash runway into 2019.

We remain optimistic about Arrowhead's prospect.

SUMMARY DATA

52-Week High	**$9.00**
52-Week Low	**$1.44**
One-Year Return (%)	**429.41**
Beta	**2.41**
Average Daily Volume (sh)	**1,150,319**
Shares Outstanding (mil)	**88**
Market Capitalization ($mil)	**$788**
Short Interest Ratio (days)	**N/A**
Institutional Ownership (%)	**N/A**
Insider Ownership (%)	**N/A**
Annual Cash Dividend	**$0.00**
Dividend Yield (%)	**0.00**
5-Yr. Historical Growth Rates	
Sales (%)	**N/A**
Earnings Per Share (%)	**N/A**
Dividend (%)	**N/A**
P/E using TTM EPS	**N/A**
P/E using 2013 Estimate	**N/A**
P/E using 2014 Estimate	**N/A**
Zacks Rank	**N/A**

Risk Level	**High,**
Type of Stock	**Small-Growth**
Industry	**Biotechnology**
Zacks Rank in Industry	**N/A**

ZACKS ESTIMATES

Revenue
(in millions of $)

	Q1 (Dec)	Q2 (Mar)	Q3 (Jun)	Q4 (Sep)	Year (Sep)
2016	0.04 A	0.04 A	0.04 A	0.03 A	0.16 A
2017	4.37 A	8.99 A	9.34 A	8.71 A	31.4 A
2018	3.50 A	0.65 A	0.50 E	0.50 E	5.16 E
2019					5.00 E

Earnings per Share
(EPS is operating earnings before non-recurring items)

	Q1 (Dec)	Q2 (Mar)	Q3 (Jun)	Q4 (Sep)	Year (Sep)
2016	-$0.32 A	-$0.35 A	-$0.32 A	-$0.34 A	-$1.34 A
2017	-$0.21 A	-$0.08 A	-$0.08 A	-$0.14 A	-$0.50 A
2018	-$0.18 A	-$0.18 A	-$0.21 E	-$0.22 E	-$0.79 E
2019					-$0.84 E

Zacks Projected EPS Growth Rate - Next 5 Years % **N/A**

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WHAT'S NEW

Update on Financials for Fiscal Second Quarter Ended March 31, 2018

Total revenue was $0.65 million and $9.00 million for the three months ended March 31, 2018 and 2017, respectively. Revenue for the fiscal second quarter of 2018 was primarily related to the upfront payments received from Amgen in 2016 that was recognized as revenue as performance is completed for the ARO-LPA (AMG-890) and ARO-AMG1 Agreements. The decrease during the three months ended March 31, 2018 was driven by a reduction in the amount of revenue recognized associated with the $30 million upfront payment received from Amgen associated with the ARO-LPA (AMG-890) Agreement.

R&D expenses for the fiscal second quarter of 2018 was $12 million.

G&A expenses for the fiscal second quarter of 2018 was $3.7 million.

Net loss for the second quarter ended March 31, 2018 was $15 million ($0.18 per share).

As of March 31, 2018, the Company had cash and investments of $91.5 million.

In January 2018, Arrowhead closed an underwritten public offering of 11,500,000 shares of its common stock, which included shares issued upon the exercise in full by the underwriters of their option to purchase 1,500,000 additional shares.

The offering was priced at $5.25 per share, and the company received gross proceeds of approximately $60.4 million.

Current financial resources are sufficient to fund its operations for next two years according to our financial model.

Update on Phase I Study of ARO-AAT for Treatment of Alpha-1 Liver Disease

In February, Arrowhead received approval from the New Zealand Medicines and Medical Devices Safety Authority (MEDSAFE) and from the local Ethics Committee to proceed with a first-in-human **Phase I** study of **ARO-AAT** for the treatment of **alpha-1 antitrypsin deficiency (AATD)**.

The company has begun **dosing** patients in March 2018.

The study, which is designated as **AROAAT1001** (NCT03362242), is a Phase I single- and multiple-ascending dose study to evaluate the safety, tolerability, pharmacokinetics, and effect of ARO-AAT on serum alpha-1 antitrypsin levels in healthy adult volunteers. The study is designed to include up to 5 cohorts of 8 subjects per cohort who will receive placebo or ARO-AAT at doses of 35, 100, 200, 300, or 400 mg.

AATD is a rare genetic disorder associated with liver disease in children and adults and pulmonary disease in adults. AAT is primarily synthesized and secreted by liver hepatocytes. Its function is to inhibit enzymes that can break down normal connective tissue.

The most common disease variant, the Z mutant, has a single amino acid substitution that results in improper folding of the protein. The mutant protein cannot be effectively secreted and accumulates in globules inside the hepatocytes. This triggers continuous hepatocyte injury, leading to fibrosis, cirrhosis, and increased risk of hepatocellular carcinoma.

ARO-AAT is designed to knock down the hepatic production of the mutant alpha-1 antitrypsin (Z-AAT) protein. Reducing production of the inflammatory Z-AAT protein is expected to halt the progression of liver disease and potentially allow it to regenerate and repair.

The US FDA has granted **orphan drug designation** to ARO-AAT.

Update on Phase I/II Study of ARO-HBV for Treatment of Hepatitis B

In February 2018, Arrowhead also received approval from the New Zealand Medicines and Medical Devices Safety Authority (MEDSAFE) and from the local Ethics Committee to proceed with a **Phase I/II** first-in-human study of **ARO-HBV** for the treatment of chronic hepatitis B virus **(HBV)** infection.

Dosing began in late March.

The study, **AROHBV1001** (NCT03365947), is a Phase I/II study to evaluate the safety, tolerability, and pharmacokinetic effects of single-ascending doses (SAD) of ARO-HBV in healthy adult volunteers, and to evaluate the safety, tolerability, and pharmacodynamic effects of multiple-ascending doses (MAD) of ARO-HBV in patients with chronic HBV.

The SAD portion is designed to include up to 5 cohorts of 6 subjects per cohort. Each SAD subject will receive a single-dose administration of either placebo or ARO-HBV at up to 5 dose levels (35, 100, 200, 300, 400 mg). The MAD portion is designed to include up to 8 cohorts of 4 HBV patients per cohort. Each MAD patient will receive 3 doses of ARO-HBV at up to 4 dose levels (100, 200, 300, 400 mg).

Preclinical Data on ARO-HBV

At the HEP DART meeting held in December 2017, Arrowhead presented select **preclinical data** on **ARO-HBV**. Three doses of ARO-HBV in wild type pHBV mice led to reductions in HBV DNA of 3.44 log10 and both HBsAg and HBeAg dropped below the lower limit of quantitation (reductions of greater than 3.0 log10 and greater than 2.2 log10, respectively).

In addition, in a mutated pHBV mouse model that eliminates the HBx trigger site to simulate HBV patients with high levels of integrated HBV DNA relative to cccDNA, a single dose of ARO-HBV led to a reduction in HBsAg of 2.95 log10. The duration of effect was long, with a HBsAg reduction of approximately 2.0 log10 still observed 8 weeks after the dose.

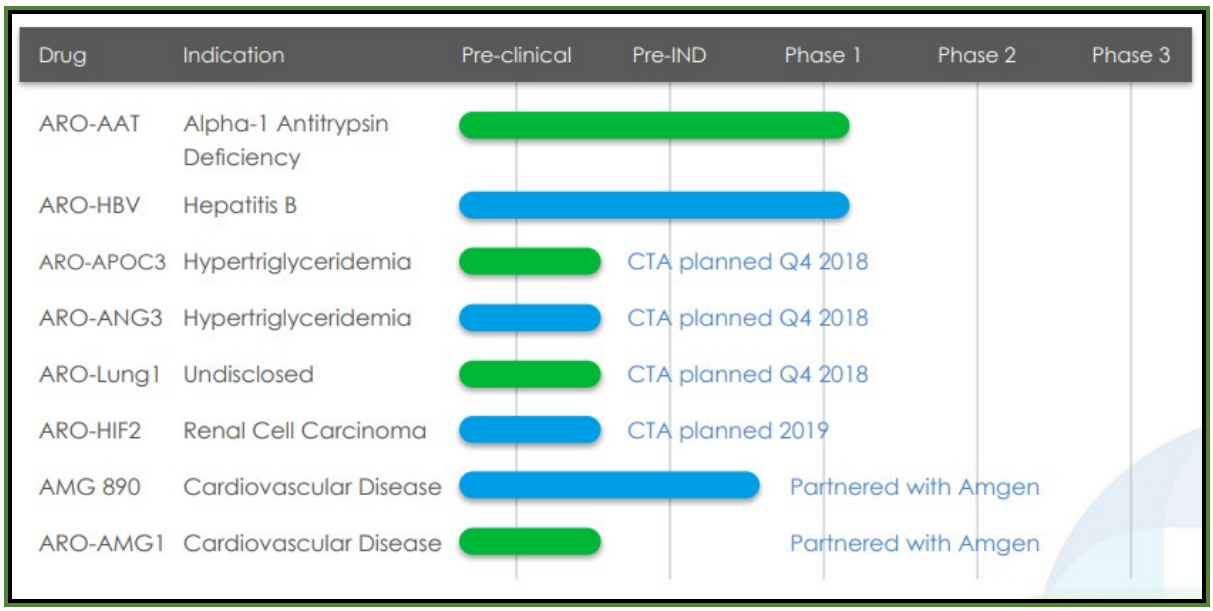
Both clinical programs of ARO-AAT and ARO-HBV are based on the company's RNAi programs that utilize the company's new proprietary subcutaneous **(subQ**) delivery system.

Other Pipeline Update

In addition to **HBV**, and **AAT,** Arrowhead has expanded its cardiometabolic pipeline, which now includes **ARO-APOC3**, targeting apolipoprotein C-III, and **ARO-ANG3**, targeting angiopoietin-like protein 3 (ANGPTL3); with CTA filings planned around the end of 2018.

Arrowhead has also achieved continued progress with the company's **extra-hepatic platform** and pipeline, including:

- ARO-Lung1, Arrowhead's first candidate against an undisclosed gene target in the lung, which achieved nearly 90% target knockdown following inhaled administration in rodents;
- ARO-HIF2, the Company's candidate targeting renal cell carcinoma, which achieved 85% target gene knockdown in a rodent tumor model.



Collaborations with Amgen for Two Cardiovascular Programs

On Sept. 29, 2016, Arrowhead announced two license and collaboration agreements with Amgen to develop and commercialize two cardiovascular programs based on Arrowhead's RNAi platform.

These programs will utilize Arrowhead's proprietary **subcutaneous RNAi delivery technology**.

Pursuant to one agreement, Amgen receives a worldwide, exclusive license to Arrowhead's novel, RNAi **ARC-LPA program**, which is designed to reduce production of apolipoprotein A, a key component of lipoprotein(a), which has been genetically linked with increased risk of cardiovascular diseases, independent of cholesterol and LDL levels. ARC-LPA is Arrowhead's first drug candidate to use a subcutaneously administered delivery construct. Elevated lipoprotein(a), or Lp(a), is widely viewed as a key risk factor for cardiovascular diseases, including coronary artery disease, atherosclerosis, thrombosis and stroke.

Under the second agreement, Amgen receives an option to a worldwide, exclusive license for a RNAi therapy for an **undisclosed genetically validated cardiovascular target**.

In both agreements, Amgen will be wholly responsible for clinical development and commercialization.

In connection with the two collaborations, Arrowhead will receive $35 million in upfront payments; $21.5 million in the form of an equity investment by Amgen in Arrowhead common stock (about 3 million shares); and up to $617 million in option payments, and development, regulatory and sales milestone payments. Arrowhead is further eligible to receive single digit royalties for sales of products against the undisclosed target and up to low double-digit royalties for sales of products under the ARC-LPA agreement.



Our Takeaways from the Deal

We welcome this deal and think it's positive to Arrowhead in the following aspects:

First, the collaborations immediately boost the company's balance sheet with the $56.5 million upfront payment. In the long run, milestone payment and royalty will further enhance the company's cash position in a non-dilutive way.

Second, the deal with Amgen further validates Arrowhead's RNAi technology and its clinical application.

Third, with a great partner Amgen, this deal could serve as a signal of renewed interest in RNAi technology and similar deal could be signed in the future for Arrowhead.

We will provide further updates on this deal for investors when they are available.

Update on ARO-HIF2 for Kidney Cancer

In September 2015, Arrowhead nominated **ARO-HIF2** as its first therapeutic candidate delivered using a new Dynamic Polyconjugate™ (DPC™) designed to target tissues outside of the liver. Arrowhead believes that ARO-HIF2, which uses RNA interference to silence transcription factor hypoxia-inducible factor 2α (HIF-2α), is a promising new candidate for the treatment of clear cell renal cell carcinoma **(ccRCC).**

ARO-HIF2 is designed to inhibit the production of HIF-2α, which has been linked to tumor progression and metastasis in ccRCC. Using ARC-HIF2 in a preclinical ccRCC tumor model, mice treated with weekly injections led to greater than 80% knockdown of HIF-2α mRNA in tumors. Furthermore, tumors from treated mice exhibited statistically significant reductions in size and weight, extensive tumor cell death, reduction in the tumor-expressed VEGF-A biomarker, and destruction of the blood vessels feeding the tumors.

The company presented positive **preclinical data** at the European Cancer Congress 2015 (ECC2015) in Vienna on September 27, 2015 in a poster titled "HIF-2α targeting with a novel RNAi delivery platform as therapy for renal cell carcinoma," (abstract #353).

The company further presented positive preclinical data on ARO-HIF2 at AACR2016.

The poster presentation described data from various stages of development of ARO-HIF2, including RNAi trigger selection, HIF2-α target validation, delivery and targeting ligand validation, and multiple RCC tumor models. These data show that important advancements are being made in this program and for Arrowhead's Dynamic Polyconjugate™ (DPCTM) delivery platform generally, including the following key findings:

- Proof-of-concept ligand dependent, functional delivery was demonstrated using the DPC targeted delivery platform
- Silencing HIF2-α expression by RNA interference resulted in reduction of HIF-2α regulated genes
- In two different RCC tumor bearing mouse models, ARO-HIF2 inhibited tumor growth and promoted tumor cell death and structural degeneration

The company is in the process of manufacturing scale up to allow for initiation of IND-enabling studies. Timing for anticipated regulatory submission will be announced in the future.

We Remain Optimistic about the Prospect of Arrowhead

We continue to be optimistic about the prospect of Arrowhead and maintain our fair valuation at $15 per share based on the recent development within the company.

We believe management decision to focus on the subQ and extra-hepatic programs is prudent.

The discontinuation of the DPCiv programs is not based on the safety or efficacy of the three candidates. Instead, the safety profile of ARC-520, ARC-521, and ARC-AAT in human clinical trials appeared to be favorable, and supported advancing the programs, with a small minority (6%) of infusions being associated with infusion reactions. In addition, across the ARC-520, ARC-521, and ARC-AAT clinical programs, laboratory values have not been deemed indicative of drug induced organ toxicity.

In addition, each candidate was highly active against its respective target. For example, ARC-AAT achieved 90% knockdown of serum AAT, which is believed to be near full suppression of liver production of the protein, in a **Phase I** clinical study. For ARC-520, it was previously reported that reductions in surface antigen (HBsAg) of almost 99%, or 2 logs, were achieved after a single dose. In subsequent multiple dose studies, for which data have not yet been reported, reductions of almost 3 logs were observed, with several patients being tracked that appear poised to possibly seroclear HBsAg, representing potential function cures.

The major reason for discontinuing the DPCiv programs is that it may takes more than 18 months to obtain actionable results to lift the clinical hold on the DPCiv programs. Even after this long delay, the possibility remains that the study could be inconclusive or fall short of satisfying the regulators in some way.

Therefore, management decided to focus entirely on its SubQ and extra-hepatic programs.

We believe it is a natural transition because the company’s SubQ platform is capable of achieving similar results as the EX1 delivery vehicle, with the added benefit of a more convenient mode of administration and expected improved safety margins.

Our price target $15 per share values the company at about $1.3 billion in market capitalization, which we think is appropriate at this time. As long as management remains committed, value will be generated for shareholders in the future.

PROJECTED INCOME STATEMENT

	2017 (Sept)					2018 (Sept)					2019 (Sept)
$ in millions except per share data	Q1	Q2	Q3	Q4	FY	Q1	Q2	Q3	Q4	FYE	FYE
Revenue	$4.37	$8.99	$9.34	$8.71	$31.41	$3.51	$0.65	$0.50	$0.50	$5.16	$5.00
YOY Growth	-	-	-	-	*19736.5%*	*-19.6%*	*-92.8%*	*-94.6%*	*-94.3%*	*-83.6%*	*-3.1%*
Total Revenues	**$4.37**	**$8.99**	**$9.34**	**$8.71**	**$31.41**	**$3.51**	**$0.65**	**$0.50**	**$0.50**	**$5.16**	**$5.00**
YOY Growth	*9878.3%*	*20439.3%*	*23502.3%*	*27784.1%*	*19736.5%*	*-19.6%*	*-92.8%*	*-94.6%*	*-94.3%*	*-83.6%*	*-3.1%*
Cost of Revenue	$0.0	$0.0	$0.0	$0.0	$0.0	$0.0	$0.0	$0.0	$0.0	$0.0	$0.0
Gross Income	**$4.4**	**$9.0**	**$9.3**	**$8.7**	**$31.4**	**$3.5**	**$0.7**	**$0.5**	**$0.5**	**$5.2**	**$5.0**
Gross Margin	*100.0%*	*100.0%*	*100.0%*	*100.0%*	*100.0%*	*100.0%*	*100.0%*	*100.0%*	*100.0%*	*100.0%*	*100.0%*
R&D	$9.5	$7.0	$6.9	$8.3	$31.7	$8.4	$12.0	$14.0	$15.0	$49.4	$55.0
% R&D	*218.2%*	*77.6%*	*73.9%*	*95.0%*	*100.9%*	*240.2%*	*1846.2%*	*2800.0%*	*3000.0%*	*958.0%*	*1100.0%*
Salary and G&A	$6.1	$5.2	$5.3	$7.5	$24.1	$5.7	$3.7	$4.5	$5.0	$18.8	$25.0
% SG&A	*140.4%*	*57.9%*	*56.5%*	*86.3%*	*76.8%*	*161.2%*	*566.3%*	*900.0%*	*1000.0%*	*365.1%*	*500.0%*
Other expenses	$3.6	$2.9	$2.9	$3.2	$12.6	$3.2	$0.0	$0.0	$0.0	$3.2	$0.0
% Other	*82.7%*	*32.6%*	*30.8%*	*36.3%*	*40.1%*	*92.1%*	*0.0%*	*0.0%*	*0.0%*	*62.7%*	*0.0%*
Operating Income	**($14.9)**	**($6.1)**	**($5.7)**	**($10.3)**	**($37.0)**	**($13.8)**	**($15.0)**	**($18.0)**	**($19.5)**	**($66.3)**	**($75.0)**
Operating Margin	-	-	-	-	-	-	-	-	-	-	-
Other Income (Net)	$2.8	$0.1	$0.2	($0.5)	$2.6	$0.6	$0.1	$0.0	$0.0	$0.8	($0.5)
Pre-Tax Income	**($12.1)**	**($6.0)**	**($5.5)**	**($10.7)**	**($34.4)**	**($13.2)**	**($14.9)**	**($18.0)**	**($19.5)**	**($65.6)**	**($75.5)**
Net Taxes (benefit)	$0.0	$0.0	$0.0	$0.0	$0.0	$0.0	$0.0	$0.0	$0.0	$0.0	$0.0
Tax Rate	*0.0%*	*0.0%*	*0.0%*	*0.0%*	*0.0%*	*0.0%*	*0.0%*	*0.0%*	*0.0%*	*0.0%*	*0.0%*
Reported Net Income	**($12.1)**	**($6.0)**	**($5.5)**	**($10.7)**	**($34.4)**	**($13.2)**	**($14.9)**	**($18.0)**	**($19.5)**	**($65.6)**	**($75.5)**
YOY Growth	-	-	-	-	-	-	-	-	-	-	-
Net Margin	-	-	-	-	-	-	-	-	-	-	-
Weighted avg. Shares Out	*71.4*	*74.6*	*74.8*	*74.7*	*73.9*	*74.8*	*84.1*	*87.6*	*88.0*	*83.6*	*90.0*
Reported EPS	**($0.17)**	**($0.08)**	**($0.07)**	**($0.14)**	**($0.47)**	**($0.18)**	**($0.18)**	**($0.21)**	**($0.22)**	**($0.78)**	**($0.84)**
YOY Growth	-	-	-	-	-	-	-	-	-	-	-
One-time charge	($2.82)	($0.09)	($0.19)	$0.48	($2.62)	($0.61)	($0.15)	$0.00	$0.00	($0.76)	$0.00
Non GAAP Net Income	**($14.9)**	**($6.1)**	**($5.7)**	**($10.3)**	**($37.0)**	**($13.8)**	**($15.0)**	**($18.0)**	**($19.5)**	**($66.3)**	**($75.5)**
Non GAAP EPS	**($0.21)**	**($0.08)**	**($0.08)**	**($0.14)**	**($0.50)**	**($0.18)**	**($0.18)**	**($0.21)**	**($0.22)**	**($0.79)**	**($0.84)**

Source: Company filing and Zacks estimates

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Sell/Underperform: The analyst expects the company will underperform the broader U.S. Equity market over the next one to two quarters.

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