Organon Organically Opens the Biosimilar Door

Price $34.56 | **Best Invest** | **September 01, 2021**

- Modest forward earnings and FCF multiples (5-6x) offer a margin of safety and opportunity for rerating.
- Competent management team with a clear strategy for capital allocation, debt reduction, and organic and acquisitive growth.
- Attractive dividend yield over 3%.
- A classic underwhelming spin-off that offers multiple catalysts to unlock fair value.

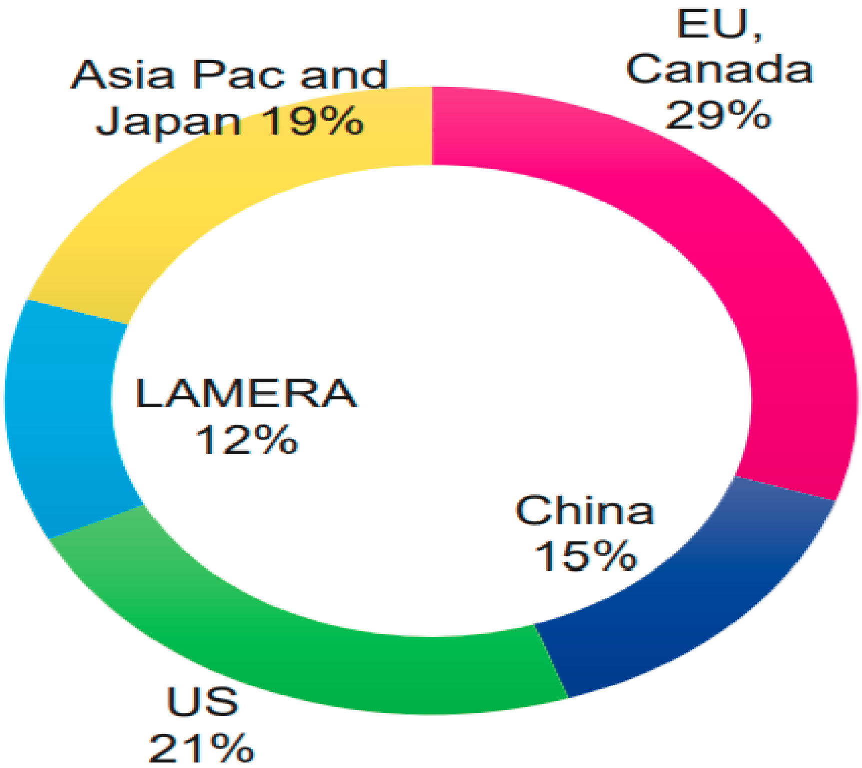
Investment Thesis

Organon (OGN) is a spin-off from Merck & Co. (MRK) (MSD, outside of the U.S.)'s women's health, legacy brands, off-patent brands, and biosimilars division. Organon has spun off with a competent management team with a clear strategy and capital allocation plan. In addition, it sees itself in a fruitful partnership with Samsung Bioepsis and the desire for more biosimilar partnerships. If management can execute its goals, the stock has handsome upside potential.

Spin-Off from Merck

Spin-offs are sometimes ignored and underwhelming. Their absence of trading history, the potential for forced selling by funds, unavailability of IPO hype, mediocre historical financial results (possibly due to underinvestment or lack of corporate focus), and a dearth of sell-side coverage tends to provide new spin-offs a modest start as new, independent public companies.

Spun-off from Merck, Organon brings a sizeable global distribution and sales platform, with sales numbers situated comfortably internationally. While the primary markets remain the United States, Canada, and Europe, Organon has an emerging share in Asia Pacific, Latin America, and China, acting as potential catalysts for growth.



Organon Q2 Presentation

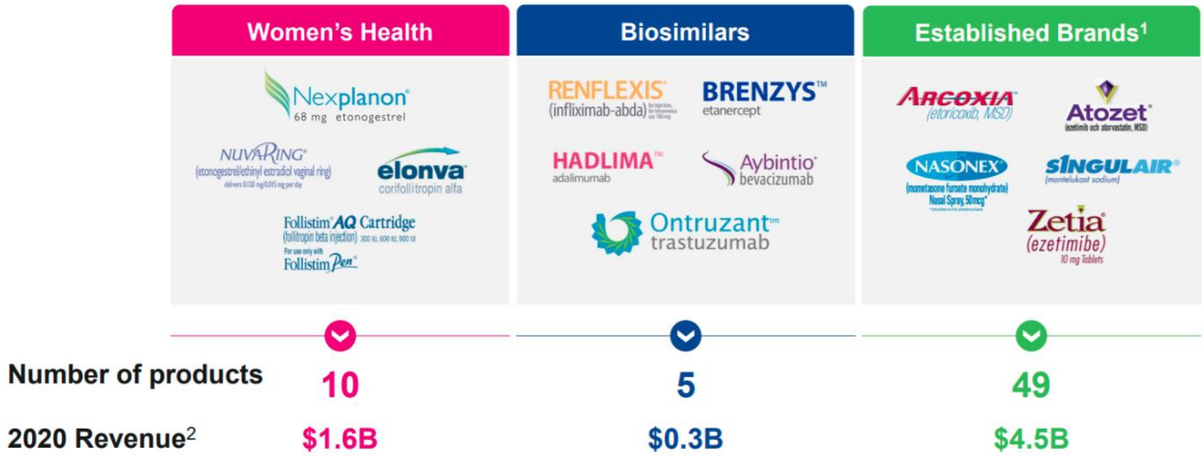
Biosimilar Strategy and R&D

OGN is in a partnership with Samsung Bioepis, the biopharmaceutical arm of Samsung, which focuses on increasing patient access to drugs through biosimilars. This relationship has existed since 2013 and is the most significant partnership that OGN is currently in. Samsung Bioepis has a robust product development and manufacturing arm, while Organon has a solid market strategy, a history of positive commercialization, and the potential to access advantageous pricing.

While Samsung Bioepis is the most significant partnership, OGN does not intend for this to remain exclusive; they have stated that they will continue to identify new partnership opportunities with other parallel biosimilar players.

OGN plans to launch a new product in its Biosimilars business every 1-2 years. Given that many market-driving exclusive drugs will be hitting a patent cliff in the 2020s, OGN will be poised to realize this as one of its key growth pillars.

Given OGN's experience in the sector, they have stated that they will focus on immunology and oncology for the time being but will consider opportunistic entries into other therapeutic areas.



2020 Merck Investor Day, OGN section.

Management

Management is guiding to low-to-mid-single-digit organic revenue growth off base 2021 results accompanied by EBITDA margin expansion. This is a significant turnaround as OGN's revenue has declined every year since 2016 due to loss of exclusivity (LOE) as products age and lose their patent protection.

Given the high visibility and predictability of patent expiries, the financial consequences can also be predicted reasonably over a multi-year horizon after the patent expires. Consequently, OGN feels reasonably confident the LOE impact on its current portfolio of products has declined to $300-$400 million in 2021 and is forecast to decrease to ~$300 million in lost revenue over 2022-2025 (total, not annually). Compare to an estimated ~$5-$6 billion lost to LOE between 2016 and 2020.

Risks

Major patent expiries come in 2025 and 2027 (Nexplanon Europe and the U.S., respectively).

Net leverage stands close to 4x EBITDA. Management desires to reduce net leverage to less than 3.5x EBITDA through debt reduction (over the next 18 months).

As with any international firm, foreign exchange is a risk to be watched closely. Despite being headquartered in the U.S., OGN's revenue is ~80% non-US.

As OGN is a newly independent company, there are not any long-standing legal issues. But, of course, the potential for unforeseen side effects, R&D misallocations, and other possibilities are all likely with any pharmaceutical company.

If management's first guidance as a stand-alone public company proves optimistic, it could weigh heavily on the shares for an extended period, over-inflating them. Additionally, the likelihood of using acquisitions to drive growth and patent acquisition runs the risk of overpayment.

Metrics

Attractive margins with opportunities to rise through optimization of SKUs.

OGN generates attractive free cash flow, which will be used to pay a dividend (20% payout target) and reduce net debt (to less than 3.5x). Currently, the dividend yield sits at over >3%. The prudent allocation of capital towards bolt-on acquisitions is critical and will provide further growth opportunities.

While 2021 saw declines in revenue, this is expected to turn in 2022 with low-to-mid-single-digit organic revenue growth.

Meager forward earnings and FCF multiples (5-6x) offer a margin of safety and attractive entry.

Disclaimer and Related Information

This article was written in collaboration with a member of our third-party research team. This third party generated the idea. At the time of this posting, Mr. Halliburton and Mr. Halliburton's family office do not currently own shares in Organon but are likely to take positions at a later date. Please read the remaining disclosures below.

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