

Exelixis's TKI-based products spark a purchase for CUSP managers

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CUSP Fund managers added Exelixis Incorporated (EXEL) to the Healthcare sector of the CUSP in March of 2023. Exelixis is a small biotech firm specializing in oncology products and research. The firm's products, Cometriq and Cabomeytx, are primarily used to treat kidney, liver and thyroid cancer. The products are built from the firm's drug compound Cabozantinib. Both products are based on tyrosine kinase inhibitor (TKI) technology. TKI drugs are targeted therapies that work to prevent the growth of cancer cells by blocking key mechanisms of division (National Cancer Institute). TKI's are medications in pill form and require little support from the manufacturer. Exelixis's marquee product, Cabomeytx, is estimated to control roughly 43% of the TKI kidney cancer market (2022 Q4 Earnings Presentation).

In November of 2022, CUSP managers voted to sell Horizon Therapeutics (HZNP) due to a significant jump in price on rumors of a takeover. Both EXEL and HZNP are classified as a biotech and pharma firms within the healthcare sector. The CUSP managers weighed the added risk biotech presents relative to other types of firms in the sector, ultimately deciding that EXEL presented a reasonable risk/return option for the sector within the portfolio. The CUSP managers simultaneously voted to add McKesson Corporation, a stable healthcare investment, as an additional way to diversify the risk within the Fund's holdings in the sector.

COVID-19 created substantial profit potential for firms with existing applicable treatments, or the means to quickly adapt existing research. The post-COVID-19 pharmaceutical environment separated the stronger biotech firms from the weaker. Well positioned firms have large cash balances, strong existing products and well-developed drug pipelines. Our research suggests Exelixis is one of those firms.

Exelixis has a very strong balance sheet with a 100% equity capital structure and significant liquidity with a meaningful cash balance. On the operating side, the CUSP managers are optimistic about the growth potential of Cabomeytx. There are 400,000 new cases of kidney cancer each year globally, with 80,000 new cases in the U.S. (National Library of Medicine). 20-40% of those cases qualify for Cabomeytx treatment, and the potential patient population will only continue to grow. The firm's drug pipeline is particularly strong due to the success of Cabozantinib. Exelixis is actively pursuing eight phase three trials involving Cabozantinib and over 15 phase one and phase two trials. The firm's other TKI-based drugs in development, such as Zanzalintinib, are additional reasons for excitement. Moreover, the firm prefers to allocate 50% of revenue to R&D, which serves as a competitive advantage over its peers which allocate 25% of revenue to R&D.

The CUSP managers viewed the firm as attractively priced with a P/E of 30 and an EV/EBITDA of 20.06. Both were below the median in its 14-company large peer set. Exelixis also traded at a substantially lower P/S of 3.44 and had a PEG ratio of 0.65. One concern is that the firm may be undervalued due to earnings volatility. Our analysis suggests the volatility was due to

fluctuations in R&D expenses and that the firm has otherwise been consistently growing earnings. We expect earnings will continue stabilizing this year and in the near future. We also noted that sales have doubled in the past three years without any meaningful change in stock price. Overall, we came to the same conclusion as professional analysts that Exclixis is reasonably valued and that the recent stock price is a good entry point for investment.