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Daily news on ASX-listed biotechnology companies

Dr Boreham's Crucible: Aroa Biosurgery

By TIM BOREHAM

ASX code: ARX

Share price: 63 cents

Shares on issue: 344,207,834

Market cap: $216.9 million

Founder and chief executive officer: Dr Brian Ward

Board: James (Jim) McLean (chair), Dr Ward, Darla Hutton, Phil McCaw, John Pinion, John Diddams, Dr Catherine Mohr

Financials (year to March 31, 2024): revenue $NZ69.1 million ($A62.1 million) (up 9%), reported net loss after tax $NZ10.6 million (previously $NZ396,000 loss), cash of $NZ11,522,000

(Three months to June 30, 2024): receipts $NZ17,834,000 (up 17.7%), cash burn $NZ3,645,000, cash $NZ23,889,000 ($NZ38,526,000 previously), 7.0 quarters cash.

Identifiable major holders: Dr Ward 9.7%, First Cape Group (Harbour Capital Management) 7.23%, Phil McCaw 5.75%, Acorn Capital 5%

While investor sentiment in the biotech sector continues to improve after valuations were hammered in the Great Post Pandemic Letdown of late 2021, some revenue-generating exponents are yet to feel the love.

Take the Auckland-based wound-care house Aroa Biosurgery, which the market values at a tad over $210 million compared with $355 million when we last visited the company in September 2021.

Since then, revenues have trebled to just under $NZ70 million, although profitability has proved elusive.

“I feel we are very undervalued at the moment but conditions have been tough for small caps generally,” says Aroa founder and CEO Dr Brian Ward.

Of course, every CEO says the same thing, but Dr Ward has a point given the nearest ASX peer Polynovo is valued at $1.7 billion, having reported first-half revenue of $48 million.

In the meantime, some pundits claim the company would be better off merging with its Nasdaq-listed US distribution partner, Tela Bio (see below).

About Aroa

Aroa develops and commercializes matrix-based wound healing products based on its proprietary ovine forestomach matrix (OFM) technology (a.k.a sheep guts).

The material promotes new tissue growth and blood supply and dissolves in the body after it has done its job.

“We get fast regrowth and very well revascularized tissue,” Dr Ward says. “We don’t seem to see the infection complications or adverse immune responses seen with other products.”

To date, Aroa’s products have been applied to more than six million wounds.

Aroa’s first product, Endoform, has been used for non-healing wounds such as diabetic and venous foot ulcers.

Other iterations include Myriad Matrix and Myriad Morcells (soft tissue reconstruction and complex wounds), Ovitex (reinforced scaffold for abdominal wall reconstruction) and Ovitex PRS (plastic and reconstructive surgery - such as breast reconstruction).

The Ovitex scaffolds work as a surgical mesh to reinforce and/or repair soft tissue where weaknesses exist.

Then there’s Symphony, a skin substitute for lower diabetic foot ulcers and venous leg ulcers.

The company claims its products are 20 percent to 60 percent cheaper than competing biologics-based products “while offering superior regenerative performance”.

Biologics-based scaffolds tend to be more expensive than the synthetic ones - and they both have their place in the surgery

“For the high-load bearing products such as hernia, you need additional strength and synthetics provides that,” Dr Ward says.

The story to date

With a keen interest in biologic materials and scaffolds for soft tissue regeneration, Kiwi veterinarian Dr Ward founded the company - then called Mesynthes - with $NZ1.5 million of seed capital in 2008.

Through his veterinary work he had found that the gut lining of ruminants was an ideal material, given its thick extracellular matrices and secondary ‘signalling’ molecules that promote cell growth.

Aroa listed on July 24, 2020, having raised $45 million at 75 cents apiece. The company raised a further $47 million at $1.165 a share in July 2021.

While Aroa’s devices are sold in 15 countries, the company is focused on the key US market which accounts for more than 90 percent of its sales.

In 2010, the US Food and Drug Administration (FDA) approved Endoform Natural for non-healing wounds. First sales flowed in 2013.

In July 2020, the US FDA green-lighted Symphony and in April 2021 it approved Myriad Morcells, having approved Myriad Matrix in June 2017.

The products are made at Aroa’s Auckland factory, which has been augmented with a new facility.

‘Telaroa’?

Aroa alliance with the Nasdaq-listed Tela Bio covers the Ovitex range and accounts for about half of Aroa’s revenue.

Under the compact, Aroa receives $27 for every $100 of product and Tela bears the cost of relevant clinical trials and selling costs.

However, Aroa shares some cost of development - usually equally - for product extensions.

In a recent report, broker Wilsons refers to long-standing speculation that Tela and Aroa will do the obvious thing and merge their operations.

Valued at around $US110 million, Tela last year made revenue of $US76 million and lost $US40.5 million.

“The current stage of the two companies and [the] position of both stocks make the idea of a merger more plausible than ever,” Wilsons opines.

Dr Ward says Aroa’s direct sales are becoming a bigger component relative to Tela - sourced revenue, which is nice because Aroa derives the full value of the products (despite bearing the full costs).

That said, the Tela alliance is also fruitful because the 27 percent cut pretty much goes straight to the bottom line.

Bravo to hernia management

In the case of hernias, a company-funded study - dubbed Bravo - produced “fantastic” results.

“In hernia procedures, recurrences are a big problem, especially with ventral and complex hernias,” Dr Ward says.

“Typical recurrence rates are in the 10 to 30 percent range, but with Bravo and Ovitex the recurrence was less than three percent.”

The company expects a number of studies to report this year, including a 130-patient prospective study of lower limb salvage.

The company is running a 120-patient Symphony trial for diabetic and venous leg ulcers. An interim report from the randomized, controlled effort is due by November 2024, with final analysis in March-April next year.

This year, the company also expects to report interim results from a 130-patient trial for lower limb salvage.

“We have some quite key studies coming through,” Dr Ward says. “Once again, the key themes are more rapid repair and lack of complications.”

What’s next?

Management is most excited about its novel device for tissue apposition in development, called Enivo.

Tissue apposition refers to bringing the tissue edges, or sides, of the wound next to each other for proper healing.

It’s also called ‘dead space’ management, which refers to closing infection-prone cavities post-surgery.

The Enivo device consists of an implant and a catheter and pump. A vacuum is delivered into dense soft tissue, enabling it to be held together while healing takes place.

“It will be used where surgeons have dissected tissue to access a surgical site, or have removed tissue in cancer surgery,” Dr Ward says.

In January, Aroa reported the results of a pilot study of patients who had undergone a unilateral mastectomy.

Six of the 10 patients had completed follow-up care with no “clinically relevant” seromas (fluid build-up) or other complications.

Initiated in Auckland in July last year, the study has been expanded to a site in picturesque Whangarei on the North Island.

Dr Ward says the company is also eyeing the prospect of using Myriad in combination with negative pressure wound therapy in trauma procedures.

“These products aren’t typically used in combination, but we think there’s a great opportunity to reduce time in hospital and complications,” Dr Ward says.

Eyeing the competition

Aroa does not have the market to itself, with the nature and ferocity of competition varying between product categories.

In the hernia market, Tela and Aroa are disrupting a virtual duopoly market competed by BD (Becton, Dickinson and Co) and Abbvie.

“With hernias, it tends to be the large established players with pretty old portfolios,” Dr Ward says.

“Ovitex is a new type of product, combining biologics and synthetics so it brings something new to the market.”

The breast is dominated by biologics products.

Dr Ward adds that breast reconstruction usually involves applying human acellular dermal matrices (the thick bit below the surface of the skin) which are not ideal because they stretch and big pieces are hard to find.

And there is competition in the soft tissue market primarily from Integra Life Sciences.

Finances and performance

Aroa reported revenue of $NZ69.1 million in the half year to March 2024, 12 percent higher than previously.

Sales were driven by the growth in Myriad sales, up 73 percent to $NZ23.3 million.

Ovitex revenues declined seven percent to $32.6 million, because of inventory issues since rectified in the second half.

Sales of Endoform - a mature product - were flat at just over $NZ10 million.

While Aroa made an underlying (Ebitda) loss of $NZ3.09 million, Dr Ward says the company would have been profitable, excluding Enivo development costs.

“We are now through a big part of the expenditure and this year we will transition to being profitable even with that investment,” he says.

Management has guided to revenue of $NZ80 million to $NZ87 million for the current financial year and Ebitda of $NZ2 million to $NZ6 million.

Dr Ward says the company’s new Auckland facility supports annual revenue of $NZ200 million, which means the company can more than double output without any more investment.

“Over the next two to three years we should get to the stage where we are using a good deal of that capacity.”

Over the last 12 months, Aroa shares have traded between 48 cents (mid-May this year) and 96 cents (late July last year). Since listing they have traded as high as $1.52 (mid-October 2020).

Dr Boreham’s diagnosis:

Management cites a total US addressable market of $US3 billion, including $US1 billion for Symphony and ulcers and $US730 million for Myriad. Plastic surgery is a $US700 million opportunity.

“So, we are only scratching the surface,” Aroa chair Jim McLean told Tuesday’s annual general meeting in Auckland.

He adds that because of the challenges faced by clinicians and hospitals in replacing existing products “the rate of uptake for our products is not easy to predict.”

Dr Ward says while the company plans product extensions in its existing portfolio, Enivo is the “stand-out opportunity” given the $US1 billion total addressable market.

Despite the sagging share price Aroa is happy to remain listed on the ASX, given the strong support from the top end of town that sees institutions account for 80 percent of the register.

While Dr Ward remains the biggest shareholder, instos on board include Harbour and Acorn.

Dr Ward is clearly unimpressed by the share valuation, it's a case of 'onwards and upwards'.

"We will just focus on delivering on the plan," he says.

Fortunately, the plan includes achieving consistent profitability - a key step to salving the share price wound.

Wilsons forecasts a $NZ6.7 million net profit in 2025-'26, rising to $NZ9.3 million in 2026-'27.

A merger with Tela could unlock value more quickly, but even the most 'obvious' unions have a habit of not happening for a range of reasons.

Dr Boreham is not a qualified medical practitioner and does not possess a doctorate of any sort. He remains laser-focused on delivering the plan.