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Toll-Free: 561-391-5555 ♦ www.DawsonJames.com ♦ 101 North Federal Highway - Suite 600 ♦ Boca Raton, FL 33432

**Mesoblast (NASDAQ/MESO, ASX/MSB)**

December 18, 2020

**BUY: COVID ARDS Study is Snafued by Improved SOC**

The good news is we are getting better at treating COVID with a range of improved therapeutics. The bad news is that as the Standard of Care has improved, it makes it tougher for Mesoblast's cell therapy, remestemcel, to show efficacy in these patients. The DSMB has advised the company that the trial is not likely to reach its endpoint. 223 patients have been treated and that data will be analyzed to see what effects the therapy has in its totality on treated patients. Recall that Mesoblast had announced a deal with Novartis (NVS-Not Rated) to develop remestemcel for ARDS, but our understanding is that deal is predicated on a successful outcome of this trial. We never factored COVID/ARDS and the Novartis deal into our model (long shot, in our view), and as such, this does not change our valuation math.

**Jason Kolbert**  
 Healthcare Research  
 jkolbert@dawsonjames.com

**Investment Highlights:**

Mesoblast provided an update on the randomized controlled trial of remestemcel-L in ventilator-dependent patients with moderate to severe acute respiratory distress syndrome (ARDS) due to COVID-19 infection after the Data Safety Monitoring Board performed a third interim analysis on the trial's first 180 patients.

**Background:** The trial was powered to achieve a primary endpoint of 43% reduction in mortality at 30 days for treatment with remestemcel-L on top of maximal care in a trial of 300 patients. The trial was designed based on results of a 60-patient "pilot" trial observed during the initial stages of the pandemic when control mortality rates were exceedingly high and prior to new evolving treatment regimens that have reduced disease mortality in ventilated patients.

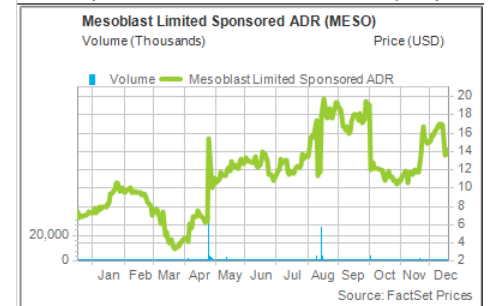
**Conclusion:** The DSMB reported that the trial is not likely to meet the 30-day mortality reduction endpoint at the planned 300-patient enrollment. The DSMB recommended that the trial complete with the currently enrolled 223 patients and that all be followed-up as planned.

**Trial Design.** The trial is a randomized, double-blinded, controlled trial enrolling up to 300 ventilator-dependent patients with moderate to severe ARDS and aims to confirm findings from a pilot study at New York's Mount Sinai Hospital in March-April this year. In that study, nine of 12 ventilator-dependent patients (75%) were successfully discharged from hospital a median of 10 days after receiving two intravenous doses of remestemcel-L within five days.

**Valuation (see next page).**

**Risk to our thesis, include the following:** (1) clinical and regulatory; (2) commercial; (3) employee; (4) financial; (5) legal and intellectual property; and (6) partnership. We review these and other risks in the risk section of this report.

Current Price	\$13.67		
Price Target	\$20.00		
Estimates	F2019A	F2020E	F2021E
Expenses (\$000s)	\$ 97	\$ 92	\$ 136
1Q March	\$ 28	\$ 28	\$ 31
2Q June	\$ 27	\$ 22	\$ 33
3Q September	\$ 23	\$ 23	\$ 34
4Q December	\$ 19	\$ 19	\$ 38
	F2019A	F2020E	F2021E
EPS (diluted)	\$ (0.72)	\$ (0.63)	\$ (0.62)
1Q March	\$ (0.19)	\$ (0.14)	\$ (0.14)
2Q June	\$ (0.05)	\$ (0.17)	\$ (0.15)
3Q September	\$ (0.20)	\$ (0.18)	\$ (0.15)
4Q December	\$ (0.28)	\$ (0.14)	\$ (0.17)
EBITDA/Share	(\$0.90)	(\$0.53)	(\$0.61)
EV/EBITDA (x)	-15.5	-21.9	-18.9
Stock Data			
52-Week Range	\$3.12	-	\$21.28
Shares Outstanding (mil.)	117.5		
Market Capitalization (mil.)	\$1,607		
Enterprise Value (mil.)	\$1,636		
Debt to Capital	5%		
Book Value/Share	\$6.02		
Price/Book	2.4		
Average Three Months Trading Volume (K)	390		
Insider Ownership	14.6%		
Institutional Ownership	28.6%		
Short interest (mil.)	2.7%		
Dividend / Yield	\$0.00/0.0%		



Please find Important Disclosures beginning on Page 4.

**Valuation:** Our valuation methodology begins with our projected revenues from our product models. We apply assumptions for the timing of approval, launch dates, and product attributes to estimate revenues. These estimates feed into our income statement through the year 2030. The result of these projections is then fed into our income statement projections. Our price target is derived from an equal-weighted average of free cash flow to the firm (FCFF), discounted EPS (EPS), and sum-of-the-parts (SOP) models. A 30% discount is then applied and rounded to the nearest whole number to derive our price target. A higher risk rate of 30% is applied (vs. 15% or 10%) since Mesoblast is a microcap company with drug candidates in clinical trials that have yet to gain FDA approval.

### Exhibit 1. Free Cash Flow Model

Average	\$	20
Price Target	\$	20
Year		2020

DCF Valuation Using FCF (mln):													
Units (millions - \$)	2018A	2019A	2020E	2021E	2022E	2023E	2024E	2025E	2026E	2027E	2028E	2029E	2030E
EBIT	(66)	(105)	(75)	(87)	(31)	151	634	1,280	2,980	4,261	5,446	5,481	5,515
Tax Rate	0%	0%	3%	0%	0%	15%	25%	30%	35%	36%	36%	36%	36%
EBIT(1-t)	(66)	(105)	(73)	(87)	(31)	128	475	896	1,937	2,727	3,485	3,508	3,530
CapEx													
Depreciation													
Change in NWC													
FCF	(66)	(105)	(73)	(87)	(31)	128	475	896	1,937	2,727	3,485	3,508	3,530
PV of FCF	(111)	(137)	(73)	(87)	(18)	58	166	241	401	435	427	331	256
Discount Rate													
Long Term Growth Rate													
Free Cash Flow		12,294											
Terminal Value YE 2030		892											
NPV		3,050											
NPV/Debt		84											
Shares out (M)			146	2030E									
NPV Per Share	\$		20										

Source: Dawson James estimates, company reports

### Exhibit 2. Discounted-EPS Model

Year of EPS	2020
Year of EPS	2030
Earnings Multiple	10
Discount Factor	30%
Selected Year EPS	\$ 24.20
NPV	\$ 18

Discount Rate and Earnings Multiple Varies, Year is Constant							
2030 EPS							
Earnings Multiple		Discount Rate					
		10%	15%	20%	25%	30%	35%
1		\$7.49	\$4.80	\$3.14	\$2.09	\$1.41	\$ 0.97
5		\$37.46	\$24.02	\$15.69	\$10.43	\$7.05	\$ 4.83
10		\$74.92	\$48.03	\$31.38	\$20.87	\$14.10	\$ 9.66
15		\$112.38	\$72.05	\$47.08	\$31.30	\$21.14	\$ 14.50
20		\$149.84	\$96.07	\$62.77	\$41.73	\$28.19	\$ 19.33
25		\$187.30	\$120.08	\$78.46	\$52.16	\$35.24	\$ 24.16
30		\$224.76	\$144.10	\$94.15	\$62.60	\$42.29	\$ 28.99
35		\$262.22	\$168.12	\$109.84	\$73.03	\$49.33	\$ 33.83

Source: Dawson James estimates

### Exhibit 3. Sum-of-the-Parts Model

Mesoblast Sum of the Parts	LT Gr	Discount Rate	Yrs. to Mkt	% Success	Peak Sales MMs	NPV
Revascor - CHF (Class II - III) U.S.	1%	30%	4	25%	\$5,152	\$17,766
NPV						\$5.33
Revascor - CHF - LVAD: Class IV	1%	30%	2	25%	\$361	\$1,246
NPV						\$0.63
Revascor - CHF (Class II - III) EU	1%	30%	5	25%	\$3,895	\$13,431
NPV						\$3.10
Acute Pediatric GvHD - U.S.	1%	30%	0	100%	\$142	\$490
NPV						\$1.68
Acute Adult GvHD U.S.	1%	30%	1	100%	\$319	\$1,101
NPV						\$2.90
Acute Pediatric GvHD - E.U.	1%	30%	1	100%	\$108	\$372
NPV						\$0.98
Acute Adult GvHD E.U.	1%	30%	1	100%	\$383	\$1,322
NPV						\$3.48
CLBD-DDD U.S.	1%	30%	2	30%	\$984	\$3,392
NPV						\$2.06
TEMCELL	1%	10%	0	75%	\$20	\$222
NPV						\$0.57
Other Indications	1%	30%	5	30%	\$0	\$0
NPV						\$0.00
Net Margin						50%
MM Shrs OS					2030E	146
Total						\$21

Source: Dawson James estimates

**Exhibit 4. Income Statement**

Mesoblast, Inc. Income Statement (M)	Sept.	Dec.	March	June												
Mesoblast: YE June 30	2019A	1Q20A	2Q20	3Q20	4Q20	2020E	2021E	2022E	2023E	2024E	2025E	2026E	2027E	2028E	2029E	2030E
Milestone / Partnership Revenues	14	12														
% Sequential Growth																
Revasco in CHF U.S.	-	-	-	-	-	-	-	-	-	255	638	1,280	1,926	2,576	2,584	2,592
% Sequential Growth																
Revascor in CHF; EU	-	-	-	-	-	-	-	-	-	-	-	830	1,387	1,948	1,953	1,959
% Sequential Growth																
Disogenic Disc Chronic Lower Back (U.S.)	-	-	-	-	-	-	-	-	139	279	421	566	627	689	693	698
% Sequential Growth																
Remestemcel-L GvHD - USA - Pediatric	1	-	-	-	-	-	43	87	132	145	141	137	139	142	145	148
% Sequential Growth																
Remestemcel-L GvHD - USA - Acute Adult	-	-	-	-	-	-	-	-	-	102	198	288	313	319	326	332
% Sequential Growth																
Remestemcel-L GvHD - EU Pediatric	-	-	-	-	-	-	-	27	67	110	107	104	106	108	110	110
% Sequential Growth																
Remestemcel-L GvHD - EU Acute Adult	-	-	-	-	-	-	-	-	-	-	119	230	352	383	391	399
% Sequential Growth																
<b>Product Revenues</b>	<b>15</b>	<b>12</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>12</b>	<b>43</b>	<b>114</b>	<b>338</b>	<b>891</b>	<b>1,624</b>	<b>3,434</b>	<b>4,850</b>	<b>6,164</b>	<b>6,202</b>	<b>6,238</b>
TemCell GvHD - Japan Adult & Pediatric	1	2	2	2	2	7	7	9	11	12	13	14	16	17	18	19
<b>Product &amp; Royalty Revenues</b>	<b>17</b>	<b>17</b>	<b>2</b>	<b>2</b>	<b>2</b>	<b>22</b>	<b>50</b>	<b>123</b>	<b>349</b>	<b>903</b>	<b>1,638</b>	<b>3,448</b>	<b>4,866</b>	<b>6,181</b>	<b>6,220</b>	<b>6,257</b>
<b>Expenses</b>																
MesoBlast COGS	-	-	-	-	-	-	13	23	68	134	227	343	485	616	620	624
COGS % Sales	0%	0%	0%	0%	0%	0%	30%	-20%	-20%	-15%	-14%	-10%	-10%	-10%	-10%	-10%
R&D	60	14	15	16	18	63	66	69	73	76	73	69	65	66	67	67
Manufacturing & Commercialization	15	8	4	4	1	16	32	26	21	20	19	18	18	17	16	16
Management & Administration	22	6	3	3	1	13	25	36	37	39	38	38	37	36	35	35
<b>Total expenses</b>	<b>97</b>	<b>28</b>	<b>22</b>	<b>23</b>	<b>19</b>	<b>92</b>	<b>136</b>	<b>153</b>	<b>198</b>	<b>269</b>	<b>357</b>	<b>468</b>	<b>605</b>	<b>736</b>	<b>739</b>	<b>741</b>
<b>Oper. Inc. (Loss)</b>	<b>(80)</b>	<b>(11)</b>	<b>(20)</b>	<b>(21)</b>	<b>(17)</b>	<b>(70)</b>	<b>(87)</b>	<b>(31)</b>	<b>151</b>	<b>634</b>	<b>1,280</b>	<b>2,980</b>	<b>4,261</b>	<b>5,446</b>	<b>5,481</b>	<b>5,515</b>
<b>Oper Margin</b>																
Fair Value Remeasurement (contingent consideration)	(6)	2														
Finance Cost/Interest Expense		3														
Changes in the fair value of available-for-sale financial assets																
Exchange differences on translation of foreign operations	(1)															
Interest Payments	(11)	(0)	-	-	-	(0)	-	-	-	-	-	-	-	-	-	-
Other comprehensive loss/income for the period, net of tax	(20)	5	-	-	-	5	-	-	-	-	-	-	-	-	-	-
<b>Pre-tax income</b>	<b>(105)</b>	<b>(16)</b>	<b>(20)</b>	<b>(21)</b>	<b>(17)</b>	<b>(75)</b>	<b>(87)</b>	<b>(31)</b>	<b>151</b>	<b>634</b>	<b>1,280</b>	<b>2,980</b>	<b>4,261</b>	<b>5,446</b>	<b>5,481</b>	<b>5,515</b>
<b>Pretax Margin</b>																
Tax benefit (or expense)	9	2	-	-	-	2	-	-	(23)	(158)	(384)	(1,043)	(1,534)	(1,960)	(1,973)	(1,986)
Tax Rate		0%	0%	0%	0%	3%	0%	0%	15%	25%	30%	35%	36%	36%	36%	36%
<b>Net income</b>	<b>(97)</b>	<b>(15)</b>	<b>(20)</b>	<b>(21)</b>	<b>(17)</b>	<b>(73)</b>	<b>(87)</b>	<b>(31)</b>	<b>128</b>	<b>475</b>	<b>896</b>	<b>1,937</b>	<b>2,727</b>	<b>3,485</b>	<b>3,508</b>	<b>3,530</b>
<b>Net Margin</b>																
<b>EPS</b>	<b>\$ (0.72)</b>	<b>\$ (0.14)</b>	<b>\$ (0.17)</b>	<b>\$ (0.18)</b>	<b>\$ (0.14)</b>	<b>\$ (0.63)</b>	<b>\$ (0.62)</b>	<b>\$ (0.22)</b>	<b>\$ 0.90</b>	<b>\$ 3.34</b>	<b>\$ 6.27</b>	<b>\$ 13.49</b>	<b>\$ 18.92</b>	<b>\$ 24.08</b>	<b>\$ 24.14</b>	<b>\$ 24.20</b>
Non GAAP EPS (dil)																
Wgtd Avg Shrs (Bas) - '000s	106	108	120	120	120	117	141	141	142	142	143	144	144	145	145	146
Wgtd Avg Shrs (Dil) - '000s	106	108	120	120	120	117	141	141	142	142	143	144	144	145	145	146

Source: Dawson James estimates, company reports

**Risk Analysis**

In addition to the typical risks associated with development stage specialty pharmaceutical companies, potential risks specific to Mesoblast are as follows:

**Clinical and regulatory risk.** Lead products must start and complete clinical trials. Trials may not produce results sufficient for regulatory approval.

**Commercial risk.** There are no assurances that the company will be able to secure favorable pricing, commercially launch products, and achieve significant market share to become profitable.

**Employee risk.** Mesoblast has an experienced and dedicated management team, many of whom have been with the company since its founding. The company plans to bring its proposed products to market in the next two years, and as such, transitioning from a clinical to a commercial team will be a critical success factor. The success of the business may depend on the experience, abilities, and continued services of its senior officers, sales staff, and key scientific personnel.

**Financial risk.** The company may need to raise capital in the marketplace in order to support operations. There are no assurances that the company will be able to successfully raise capital and or do so on favorable terms.

**Legal and intellectual property risk.** The company may have to defend its patents and technical know-how, and there can be no assurances that the patents will not be infringed or will be held as valid if challenged, and or that the company may infringe on third parties' patents.

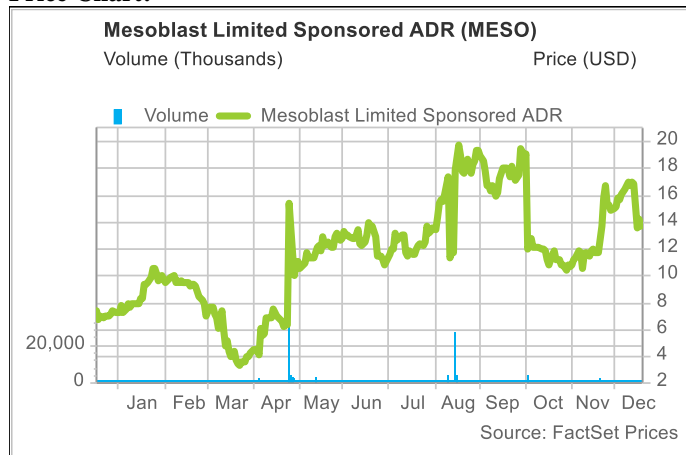
**Partnership risk.** Mesoblast may seek partnerships for clinical development support and commercialization. We have no specific knowledge of any discussions with possible partners today, and there can be no assurances that the company will be able to secure a favorable partnership.

**Important Disclosures:**

**Companies that May Be Mentioned in this report which Mesoblast has worked with or which may be relative to Mesoblast include the list below. None of these companies are rated.**

- BlueBird
- Cephalon
- Grunenthal
- JCR Pharma
- Juno
- Kite
- Lonza
- Novartis
- Osiris
- Takeda (which acquired Tigenix)
- Teva
- Tasly

**Price Chart:**



Price target and rating changes over the past three years:

Initiated – Buy – December 19, 2019 – Price Target \$14.00  
Update – Buy – January 16, 2020 – Price Target \$14.00  
Update – Buy – January 28, 2020 – Price Target \$15.00  
Update – Buy – February 3, 2020 – Price Target \$15.00  
Update – Buy – February 28, 2020 – Price Target \$15.00  
Update – Buy – March 10, 2020 – Price Target \$15.00  
Update – Buy – April 1, 2020 – Price Target \$15.00  
Update – Buy – April 6, 2020 – Price Target \$15.00  
Update – Buy – April 17, 2020 – Price Target \$15.00  
Update – Buy – April 24, 2020 – Price Target \$15.00  
Update – Buy – May 1, 2020 – Price Target \$15.00  
Update – Buy – May 6, 2020 – Price Target \$15.00  
Update – Buy – May 26, 2020 – Price Target \$15.00  
Update – Buy – May 28, 2020 – Price Target \$15.00  
Update – Buy – July 30, 2020 – Price Target \$15.00  
Price Target Change – Buy – August 24, 2020 – Price Target Increased to \$20.00 from \$15.00  
Update – Buy – September 2, 2020 – Price Target \$20.00  
Update – Buy – October 2, 2020 – Price Target \$20.00  
Update – Buy – October 13, 2020 – Price Target \$20.00  
Update – Buy – November 20, 2020 – Price Target \$20.00  
Update – Buy – December 8, 2020 – Price Target \$20.00  
Update – Buy – December 15, 2020 – Price Target \$20.00  
Update – Buy – December 18, 2020 – Price Target \$20.00

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- 1) **Buy:** The analyst believes the price of the stock will appreciate and produce a total return of at least 20% over the next 12-18 months;
- 2) **Neutral:** The analyst believes the price of the stock is fairly valued for the next 12-18 months;
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Ratings Distribution	Company Coverage		Investment Banking	
	# of Companies	% of Total	# of Companies	% of Totals
Market Outperform (Buy)	21	78%	5	24%
Market Perform (Neutral)	6	22%	1	17%
Market Underperform (Sell)	0	0%	0	0%
Total	27	100%	6	22%

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