Zacks Small-Cap Research

August 27, 2015
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Nuvo Research, Inc. (T.NRI - TSX)

T.NRI: *Product sales continue to grow, Valuation Very Attractive---Buy*

Current Recommendation	**Buy**
Prior Recommendation	N/A
Date of Last Change	05/05/2014
Current Price (08/26/15)	$5.49
Target Price	**$7.00**

OUTLOOK

On March 5, 2015, Nuvo Research, Inc. (NRI.TO) provided investors with a business update that offered some visibility on the future direction of the cash-rich company. In short, management is splitting the company into two distinct divisions: an Immunology Group and a Topical Products and Technology (TPT) Group. Based on the success of the company's planned Phase II study with WF10, we believe management plans to spin-off the Immunology Group to shareholders. Below we outline the key drivers for each group and what to expect in terms of news over the next few quarters. We conclude with a valuation of the entire company, with some thoughts on what the upside might look like if WF10 succeeds. Our target is $7 per share.

SUMMARY DATA

52-Week High	**10.36**
52-Week Low	**2.50**
One-Year Return (%)	**86.30**
Beta	**N/A**
Average Daily Volume (sh)	**33,678**
Shares Outstanding (mil)	**10.9**
Market Capitalization ($mil)	**53.9**
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 2015 Estimate	**N/A**
P/E using 2016 Estimate	**N/A**
52-Week High	**10.36**
52-Week Low	**2.50**

Risk Level	**Above Average**
Type of Stock	**Small-Growth**
Industry	**Med-Biomed/Gene**
Risk Level	**Above Average**

ZACKS ESTIMATES

Revenue
(in millions of $)

	Q1 (Mar)	Q2 (Jun)	Q3 (Sep)	Q4 (Dec)	Year (Dec)
2014	$2.8 A	$3.9 A	$3.0 A	$3.5 A	$13.1 A
2015	$4.5 A	$3.2 A	$3.8 E	$4.7 E	$16.3 E
2016					$20.0 E
2017					$27.7 E

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

	Q1 (Mar)	Q2 (Jun)	Q3 (Sep)	Q4 (Dec)	Year (Dec)
2014	-$0.31 A	-$0.23 A	$4.80 A	-$0.57 A	$3.76 A
2015	-$0.02 A	-$0.55 A	$0.40 E	-$0.38 E	-$1.35 E
2016					-$1.09 E
2017					-$0.49 E

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WHAT'S NEW

Update on Second Quarter 2015 Financials

In early August, Nuvo reported financial results for the second quarter ended June 30, 2015.

Product sales in 2Q15 were $2.9 million, compared to $2.2 million for the three months ended June 30, 2014, an increase of 32%. The company has four marketed products which include Pennsaid 2%, Pennsaid, WF10 and HLT bulk, which are marketed by its licensees and distributors.

The increase in product sales was primarily related to higher product sales of Pennsaid 2% to Horizon, and slightly offset by lower Pennsaid product sales. Product sales of Pennsaid 2% to Horizon were $2.1 million in 2Q15, compared to only $0.4 million in 2Q14 to Nuvo's previous US marketing partner.

According to IMS Health, U.S. prescriptions of Pennsaid 2% increased from approximately 31,000 in 1Q15 to 76,000 in 2Q15, an impressive 145% increase. Under the terms of an exclusive manufacturing agreement with Horizon, the Company earns revenue from U.S. product sales of Pennsaid 2% to Horizon, which acquired the U.S. Pennsaid 2% rights from the Company in 4Q14. Since its launch by Horizon on January 1, 2015, U.S. prescriptions for Pennsaid 2% have increased significantly from 18,000 prescriptions in the fourth quarter of 2014.

($ mm)	2Q14	2Q15
Pennsaid Sales	$1.7	$0.6
Pennsaid 2% Sales	$0.4	$2.1
Synera/HLT Sales	$0.0	$0.0
WF10 / Oxoferin Sales	$0.1	$0.2
Total Product Sales	**$2.2**	**$2.9**

Other revenue, consisting of royalties, license fee revenue and research and other contract revenue for 2Q15 was $0.3 million, compared to $1.7 million for the three months ended June 30, 2014. The decrease in other revenue was primarily related to a decrease in royalty revenues as the Company no longer receives a royalty on Pennsaid 2% net sales in the U.S.

COGS for 2Q15 was $1.9 million, compared to $1.5 million for the three months ended June 30, 2014. The increase in COGS in 2Q15 was associated with increased Pennsaid 2% product sales.

The increase in product sales improved the gross margin to $1.0 million or 35% for the three months ended June 30, 2015 compared to a gross margin of $0.7 million or 32% for the three months ended June 30, 2014.

R&D expenses in 2Q15 were $4.3 million, compared to $1.5 million for the three months ended June 30, 2014. The increase was primarily related to the costs incurred for the Phase II trial using WF10 for the treatment of allergic rhinitis and the Pennsaid 2% Phase III trial for the treatment of acute pain.

SG&A expenses in 2Q15 were $3.1 million, compared to $2.9 million for the three months ended June 30, 2014.

Total operating expenses for 2Q15 were $9.2 million versus $6.0 million for the three months ended June 30, 2014. The increase was primarily related to higher cost of goods sold (COGS) due to an increase in product sales and higher research and development expenses (R&D) due to costs incurred on the Company's clinical studies.

Net loss in 2Q15 was $6.0 million ($0.55 per share), compared to $2.3 million ($0.23 per share) for the three months ended June 3, 2014.

Strong Balance Sheet

As of June 30, 2015, cash and short-term investments were $51.8 million and no debt was sitting on the balance sheet.

The company's balance sheet is quite strong in our view, especially when we consider the company is going to divest its immunology business and focus on its profitable topical products and technology (TPT) group.

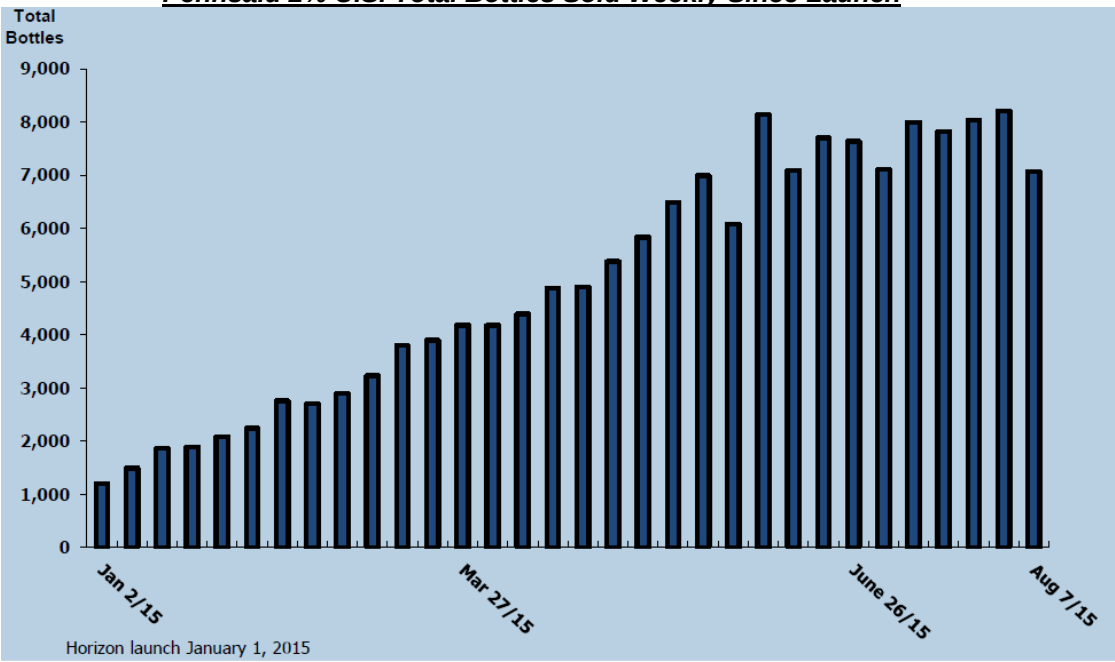
Cash burn for 1H15 was $6.5 million. Management believes that the cash burn in the second half of the year will be consistent to that experienced in the first half of 2015. Current cash balance can fund the company's operations into fiscal 2018, in which the company will become profitable with positive cash flow.

Update on International Licensing of Pennsaid® 2%

As a reminder, Pennsaid 2% was approved by the FDA on January 16, 2014. In October 2014, the Company sold the U.S. rights to Pennsaid 2% to Horizon Pharma plc for a cash payment of US$45 million. Effective January 1, 2015, Horizon began U.S. commercialization of PENNSAID 2% from Nuvo's former U.S. marketing licensee. Nuvo will supply PENNSAID 2% to Horizon for the U.S. market from its Varennes, Québec manufacturing facility pursuant to an exclusive long-term manufacturing agreement.

Nuvo earns revenue from U.S. product sales of Pennsaid 2% to Horizon. Since its launch by Horizon on January 1, 2015, U.S. prescriptions for Pennsaid 2% have increased more than fivefold compared to the number of prescriptions being generated by Nuvo's previous U.S. licensee.

Pennsaid 2% U.S. Total Bottles Sold Weekly Since Launch



Nuvo retains all rights to PENNSAID and PENNSAID 2% outside of the U.S. and will be seeking a marketing partner or partners for international territories

The Company has licensed Pennsaid 2% marketing rights to Paladin Labs Inc. for Canada, to NovaMedica LLC for Russia and some of the Community of Independent States and to Vianex S.A. for Greece. Pennsaid 2% is available for out-licensing in all other territories.

In June, Nuvo received approval from the German Federal Institute for Drugs and Medical Devices (BfArM) to conduct a **Phase III** clinical trial in Germany of Pennsaid 2% for the treatment of acute pain to support regulatory approval applications for Pennsaid 2% in the E.U., Canada and certain other international territories. The 124-patient trial commenced in July 2015 and topline results are expected in 4Q15 or 1Q16.

Nuvo also retained PricewaterhouseCoopers Corporate Finance Inc. (PwC) to assist it in securing international license agreements for Pennsaid 2%. PwC will assist Nuvo in identifying, contacting and qualifying potential licensees for available territories using its international offices and contacts.

Going forward, Pennsaid 2% will become a significant contributor to the company's top line growth both from US product sales and royalties from other countries.

Business Update

On March 5, 2015, Nuvo Research provided investors with a business update that offered some visibility on the future direction of the cash-rich company. In short, management is splitting the company into two distinct divisions: **an Immunology Group** and a Topical Products and Technology **(TPT) Group**.

Based on the success of the company's planned Phase II study with WF10, we believe management plans to spin-off the Immunology Group to shareholders. Below we outline the key drivers for each group and what to expect in terms of news over the next few quarters. We conclude with a valuation of the entire company, with some thoughts on what the upside might look like if WF10 succeeds.

The TPT Group

Nuvo's Topical Products and Technology (TPT) Group consists of several approved and revenue-generating products, including Pennsaid®, Pennsaid® 2%, Pliaglis®, and HLT Patch® (heated lidocaine / tetracaine), and Oxoferin™. Nuvo receives sales and royalties on these products on a region-by-region basis.

Commercial Products

Brand	Therapeutic Area	Licensee or Distributor	Licensed Territories	Intellectual Property
Pennsaid 2%	Osteoarthritis of the knee	Horizon Pharma plc[1]	United States	Eight granted U.S. patents listed in the FDA's Orange Book with latest expiry in 2030.
Pennsaid	Osteoarthritis of the knee	Paladin Labs Inc.	Canada	-
		Vianex S.A.	Greece	-
		Italchimici S.p.A.	Italy	-
		Movianto UK Limited	U.K.	-
Synera[2]	Local Dermal Analgesia (Patch)	Galen US Incorporated	United States	Nine granted U.S. patents of which seven have been listed in the FDA's Orange Book with latest expiry in 2020.
Rapydan[2]		Eurocept B.V.	Europe	Two granted European patents validated in 10 countries with latest expiry in 2019.
Synera/ Rapydan			United States / Europe	Method of manufacturing patents that expire 2019 (U.S.) and 2020 (Europe).
Pliaglis	Local Dermal Analgesia (Peelable Cream)	Galderma Pharma S.A.[3]	United States	Two granted U.S. patents listed in the FDA's Orange Book with latest expiry in 2019.
			Europe	Two granted European patents validated in 18 countries with latest expiry in 2020.
			Worldwide[4]	Four patents granted worldwide[4] with latest expiry in 2020.

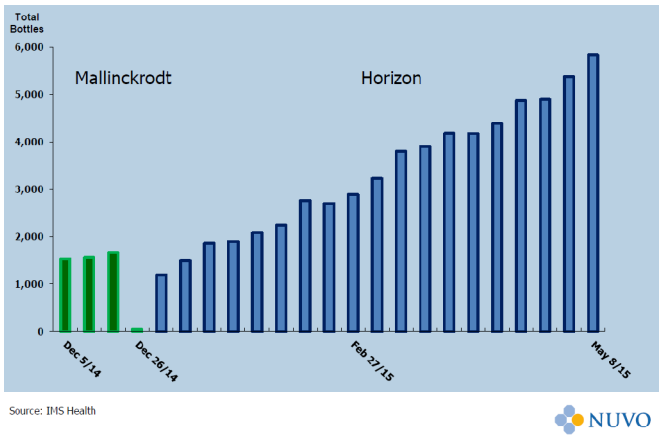
Licensed Products

Brand	Therapeutic Area	Licensee or Distributor	Licensed Territories	Intellectual Property
Pennsaid 2%	Osteoarthritis of the knee	Paladin Labs Inc.	Canada	Patent application allowed in Canada. Anticipated expiry date is 2027.
		NovaMedica LLC	Russia; some Community of Independent States	One patent granted in Russia expiring in 2027.
Pennsaid	Osteoarthritis of the knee	NovaMedica LLC	Russia; some Community of Independent States	-
Rapydan[2]	Local Dermal Analgesia (Patch)	Eurocept B.V.	Russia, Turkey, Israel and People's Republic of China	Seven patents granted worldwide[1] with latest expiry in 2019.
Heated Lidocaine/ Tetracaine Patch		Paladin Labs Inc.	Canada	

The primary driver of the TPT Group is Pennsaid 2%. Pennsaid 2% is FDA approved (since January 2014), and is currently being sold in the U.S. by **Horizon Pharma** plc (HZNP). Horizon took over promotion for Pennsaid 2% in October 2014 after Nuvo regained the rights from previous development and commercialization partner, **Mallinckrodt plc (MNK).** For whatever reason, Mallinckrodt was doing a rather poor job promoting Pennsaid 2% in the U.S., and Nuvo filed a lawsuit against the company claiming a breach of contract with respect to development and promotion of the product. The lawsuit was settled in September 2014, with Nuvo regaining the U.S. rights to the product, plus $10 million in cash. When we include the $45 million Nuvo received from Horizon Pharma, all-told the company walked away with $55 million in cash for Pennsaid 2%. This greatly boosted the company's balance sheet in a non-dilutive way.

However, besides the cash, which is clearly nice and will enable Nuvo to conduct a Phase III trial with the drug for regulatory approval outside the U.S., Nuvo is also receiving a generous manufacturing mark-up on transfer of product to Horizon Pharma. Horizon is doing an outstanding job in promoting Pennsaid 2%. Sales in the first quarter totaled $18.2 million, about equal to what Mallinckrodt did in all of 2014. Sales increased to $29.4 million in 2Q15, an increase of 62% compared to the sales of $18.2 million in 1Q15.

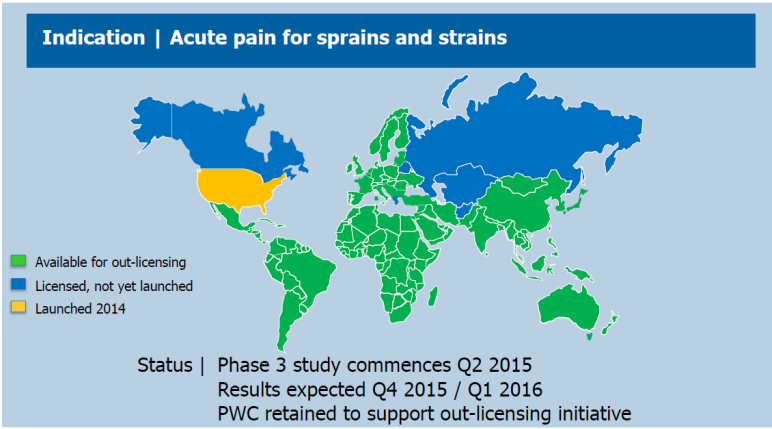
The trajectory looks fantastic, with Horizon management thinking Pennsaid 2% will do over $100 million in 2015. The product is patent protected to 2027.



Nuvo's goal is to continue to help Horizon by providing product as the ramp gains steam throughout 2015 and beyond.

Expand Pennsaid 2%

Beyond Pennsaid 2% in the U.S., Nuvo is also shipping Pennsaid to partners such as NovaMedica for distribution in Russia and some other countries, and partners like Paladin for sale in Canada, Vianex S.A. for sales in Greece, Italchimici SpA for sale in Italy, and Movianto Ltd for sale in the UK. The primary driver of upside to the current TPT Group business is expanding the approval of Pennsaid 2% outside the U.S. As a reminder, this is a product that is already approved in the U.S., with a successful registration trial conducted in 2011. The picture below shows the regions for which Pennsaid 2% is available for out-licensing and future potential sale.



To gain approval for Pennsaid 2% outside of the U.S., Nuvo initiated a 124-patient **Phase III** clinical trial in July in Germany of Pennsaid 2% for the treatment of acute pain to support regulatory approval applications for Pennsaid 2% in the E.U., Canada and certain other international territories. Topline results are expected in 4Q15 or 1Q16.

It is important to note that the U.S. label is for pain of osteoarthritis of the knee. The new Phase III program will be a randomized, double-blind, placebo-controlled study evaluating the efficacy of Pennsaid 2% for the relief of pain associated with acute, localized muscle or joint injuries such as sprains, strains or sports-related injuries. This is a wider label indication than in the U.S., which has its pros and cons in our view. Nevertheless, this is similar to the label for Voltaren Gel, another topical diclofenac product, currently on the market and doing sales in the $100-150 million range in Europe alone.

We estimate the cost of this Phase III study will be approximately $1.5 million. The primary endpoint will be change in pain on movement (POM) from day 1 to day 5. It will also measure other secondary endpoints.

We believe a cost of $1.5 million to fund a Phase III study is extremely cheap, and could allow for the approval of Pennsaid 2%, a potential $100 million product outside the U.S. Based on the strong uptake for the drug in the U.S., we expect that Nuvo will be successful in signing new licensing and distribution deals for Pennsaid 2% for key areas such as South America, Asia, and Europe in 2015 and 2016. We believe this will allow the TPT Group to generate even more cash flow.

We expect management to use existing and new cash to bring in more products to develop, license, and manufacture. We note that manufacturing capacity seems adequate, with plenty of room to expand, and thus management's strategy makes excellent sense.

Immunology Group

The Immunology Group, based in Leipzig, Germany, is focused on developing drug products that modulate chronic inflammation processes resulting in a therapeutic benefit.

The lead candidate in the Immunology Group is **WF10**, which is an immune system modulating drug containing chlorite and/or chlorate ions including its derivative formulations and dosage forms as formulated or developed by the Company.

It is believed that WF10 focuses on supporting the immune system by targeting the macrophage to regulate normal immune function. Based on the concept that WF10 may rebalance improperly functioning immune systems, the Company's scientists have hypothesized that it may be effective for the treatment of conditions such as allergic rhinitis, where the body's immune system inappropriately responds to the presence of foreign allergens and rheumatoid arthritis, where autoimmunity plays a pivotal role in the progression of cartilage destruction in the joints.

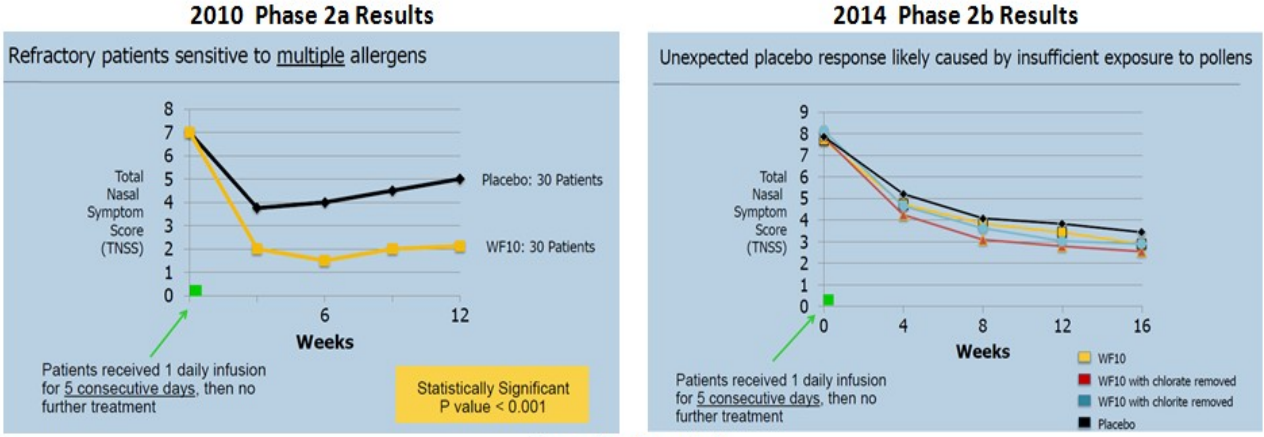
WF10 is approved in Thailand under the name Immunokine as an adjunct in the treatment of cancer to relieve post radiation therapy syndromes and as adjunctive therapy for diabetic foot ulcers.

On January 30, 2015, Nuvo announced results of its **Phase IIb** allergic rhinitis study that was conducted in Germany. The study failed to demonstrate statistically significant separation of WF10 vs. placebo. We were disappointed with these results given that the previous Phase IIa data of WF10 that had showed very nice separation between the WF10 and placebo group on both per protocol and intent-to-treat analyses.

As a reminder, the Phase 2b trial examined the safety and efficacy of WF10 for the treatment of refractory allergic rhinitis in 184 patients (179 completed). The trial commenced in March 2014 at 15 sites entirely in Germany. This was a 16-week, randomized, double-blind, placebo-controlled study to assess the efficacy, safety and tolerability of a regimen of five infusions of either WF10 or its main constituents (sodium chlorite and sodium chlorate) relative to saline control (sodium chloride) in patients who suffer from refractory allergic rhinitis with positive skin test to at least one allergen. Endpoints included assessment of total nasal symptom score (TNSS), total ocular symptom score (TOSS), and other secondary endpoints.

Topline findings from the study showed that the WF10 arm demonstrated a reduction in TNSS over the course of the observation period similar to the reduction in TNSS demonstrated in the WF10 arm in the company's previous 2010 Phase 2a proof-of-concept study. We remind investors that in this study, the baseline TNSS score was around 7 (entry criteria ≥ 6) and pooled patient data showed a reduction to ~2 at 3, 6, and 12 weeks. However, in the recent Phase 2b study, the placebo arm demonstrated a reduction in TNSS over the course of the observation period that was significantly greater than demonstrated in the placebo arm of the company's 2010 Phase 2a study. In the 2010

study, the placebo group saw a meaningful decline by week 3, but patients got worse as time went on, exiting the 12th week with a TNSS score at around 5. This was not the case for the recent Phase 2b. The baseline TNSS score for the most recent Phase 2b study was around 8 according to the conference call held back in January 2015.



Source: Nuvo Research, Inc.

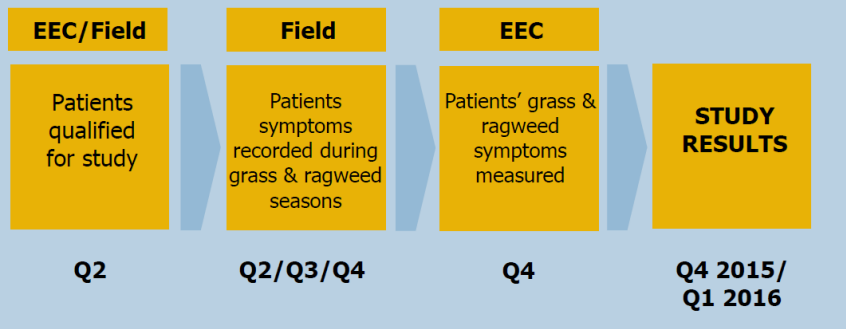
Management's contention is that the 2010 trial more accurately illustrates the efficacy of WF10 in the treatment of allergic rhinitis. They believe that the placebo group in the 2014 trial did not record as high TNSS and TOSS scores compared to the 2010 trial due to a longer enrollment period that started later in the allergy season, varying environmental conditions (a wetter spring and summer in Germany leading to lower allergic response by patients), and other factors that resulted in some patients in the 2014 trial not being exposed to a high enough concentration of the allergens that they were allergic to throughout the trial period.

According to the National Centers for Environmental Information (NOAA), in 2014, Germany recorded its warmest year on record, with average temperatures 1.4°C above the 1981-2010 average. This would seem to suggest higher pollen counts. However, total rainfall in Germany was also above normal, with the month of July 2014, right in the middle of the Nuvo Phase 2b study, reporting up to a 150% increase in rainfall from the 1981-2010 NOAA average (source: NOAA). The months of June, July, and August reported a 140% increase in precipitation compared to the 1981-2010 average. Generally speaking, increased rain means lower pollen count. As such, this would seem to suggest that Nuvo's claim of "a mild allergy season in Germany impacting results" holds some validity.

However, investors should keep in mind, the 2010 Phase IIa study that management thinks is more representative of the true efficacy of WF10 was a 60-patient, single center study. The failed 2014 Phase 2b study was a 184-patient, 15 center study. Historically speaking, results from multi-center studies are more representative of future outcomes for registration of pivotal trials, and we would be remiss to not caution investors, regardless of the weather, that it is very possible that WF10 simply may not an effective drug.

Strategy Update on WF10

During the months of January to March 2015, Nuvo management went back and analyzed the data from the 2014 Phase IIb study. In April 2015, the company announced a strategy update noting its intension to conduct another Phase II study with WF10 to truly determine if the product has utility for the treatment of allergic rhinitis. The new Phase II trial will be a randomized, double-blind, placebo-controlled, single-center trial to assess the efficacy, safety and tolerability of a regimen of five WF10 infusions. The trial will enroll patients who have a moderate to severe allergy to grass and ragweed pollen. Patients' symptoms will be recorded prior to commencement of the grass allergy season in an Environmental Exposure Chamber (EEC), in the field throughout the grass and ragweed allergy seasons and again in the EEC after completion of the ragweed season. We note the trial will be conducted in southern Ontario, Canada by Inflamax Research Inc., a full service, specialty Contract Research Organization (CRO) that specializes in allergy, respiratory and EEC studies. The 2015 WF10 Trial is expected to enroll approximately 146 patients and to be completed with top line results available in late 2015 or early 2016. Nuvo's external costs of conducting the trial will be approximately $4.5 million (CND$5.0 million). Below is a timeline of the expected trial.



If the 2015 WF10 Trial is successful, the company plans to continue WF10 development in an independently financed entity that will include the participation of Nuvo shareholders. While Nuvo's management is optimistic that the 2015 WF10 Trial will generate positive results, should the trial be unsuccessful, the company plans to discontinue WF10 development. Management has taken steps to curtail spending on a number of WF10 projects and studies planned for 2015 until results of the 2015 WF10 Trial are available.

Valuation & Recommendation

We maintain our Buy rating on Nuvo shares and reiterate our 12-month price target of $7.00 per share.

We continue to believe Nuvo will dramatically grow both its top line and bottom line in the coming years when management executes on its long term growth strategy.

For 2015, we model revenues will grow to $16.3 million, driven primarily by increasing product sales and manufacturing transfer of Pennsaid 2% to Horizon Pharma. We also see the potential for Nuvo to sign licensing and distribution agreements for Pennsaid 2% outside the U.S., and begin shipping product to areas that would piggy-back off of the U.S. approval. In the long-run, success of the Phase III Pennsaid 2% study in Germany creates enormous value by allowing commercialization deals in Europe.

According to our financial model, product sales will grow from $13.9 million in 2015 to $33.3 million in 2020, an impressive compound annual growth rate (CAGR) of 139.7%. Accordingly, total revenue will grow from $16.3 million in 2015 to $53.4 million in 2020, an even higher CAGR of 228.3%. Nuvo will become profitable in 2018 with an EPS of $0.22 based on total revenue of $37.2 million. EPS will grow to $1.17 in 2020 based on total revenue of $53.4 million.

The company exited the second quarter with $51.8 million in cash and short-term investments and no debt was sitting on the balance sheet.

Based on roughly 10.9 million shares outstanding as of today, this equates to $4.75 per share. The stock is currently trading at $5.49 per share. This is a huge discount compared to its peers in the specialty pharma industry.

We think it makes sense to value the TPT group as a specialty pharma company. The TPT Group has commercial products and is developing drugs for a variety of therapeutic areas with a focus on delivering drugs topically into and through the skin directly to the desired site.

Currently specialty pharma industry trades at 15x P/E multiples. If we apply this P/E ratio, multiplied by EPS of $1.17 in 2020, discounted at 20% for 5 years, we come up with a fair value of $7.00 per share, which values the company at $763 million in market cap. This is our valuation for the TPT Group based on the above industry comps, along with expected growth from Pennsaid 2% piggy-backing on a growth from Horizon in the U.S. and a successful Phase III study in Germany. We believe that this will allow for expansion of the distribution footprint outside the U.S.

Upside Comes From WF10

Nuvo Research plans to spend around $4.5 million (CND$5.0 million) to conduct the 2015 WF10 Phase II study. In our opinion, this is not an unreasonable amount of money to conclude if WF10 truly works or not. As noted above, the company believes the 2010 Phase IIa study is more representative of the true efficacy of the product, and thinks the 2014 Phase IIb study failed due to a rather mild spring and summer allergy season in Germany. The belief is that this did not allow for separation between WF10 and the placebo group. As such, the next Phase II study will be exposing patients to "environmentally relevant" allergens in an Environmental Exposure Chamber (EEC). The

company should have a definitive answer by early 2016. If WF10 works, Nuvo Research will package up the asset and spin-out the Immunology Group to shareholders. If it fails, the company will discontinue it and focus solely on the TPT Group.

We know what the Phase II trial will cost – roughly $4.5 million. However, if it succeeds, we think the asset is worth between $40 and $50 million pre-Phase III. We arrive at this number by doing some probability-adjusted NPV modeling on WF10 sales once approved. Firstly, according to the American College of Allergy, Asthma & Immunology, in 2014, approximately 17 million American adults and 6.7 million children had seasonal allergies. In 2014, more than 13.4 million visits to physician offices, hospital outpatient departments and emergency departments were due to allergic rhinitis.

This second statistic would seem to suggest, that despite the availability of OTC medications like diphenhydramine (Benadryl®), loratadine (Claritin®), and certirizine (Zyrtec®), a significant percent of Americans are still suffering from seasonal or perennial allergic rhinitis, and might be interested in a new and effective treatment option like WF10. We assume this to be 25%. We also assume that a product like WF10 will cost roughly $1,000 per year, which is expensive compared to OTC medications, but still very cheap in comparison to other branded pharmaceutical products. We assume approximately $25 million in funds required to gain approval of WF10 in 2019, with 5% market penetration, and a 20% discount rate on the future cash flows. If we apply a 15% probability of success of the pending Phase II trial, which we believe the company might argue is very low, our NPV analysis pegs the valuation of WF10 at $36 million today.

But we have not added this to our $7 price target. We believe it represents 100% upside to the Nuvo Research story. As such, we think $5 million to conduct the trial is a prudent investment, because if the trial succeeds, we think the shares could easily double.

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INCOME STATEMENT

Nuvo Research, Inc. ($ mm)	2014 A	Q1 A	Q2 A	Q3 E	Q4 E	2015 E	2016 E	2017 E	2018 E	2019 E	2020 E
Pennsaid Sales	$3.4	$1.5	$0.6	$0.4	$0.2	$2.6	$1.5	$0.5	$0.3	$0.3	$0.3
Pennsaid 2% Sales	$2.3	$2.2	$2.1	$2.6	$3.5	$10.4	$15.0	$20.0	$24.0	$28.0	$32.0
Synera/HLT Sales	$0.1	$0.0	$0.0	$0.1	$0.1	$0.2	$0.2	$0.2	$0.3	$0.4	$0.5
WF10 / Oxoferin Sales	$0.6	$0.2	$0.2	$0.2	$0.1	$0.6	$0.4	$0.4	$0.5	$0.5	$0.5
Revenue from Product Sales	**$6.5**	**$3.9**	**$2.9**	**$3.2**	**$3.9**	**$13.9**	**$17.1**	**$21.1**	**$25.1**	**$29.2**	**$33.3**
YOY Growth	*46.0%*	*237.6%*	*32.2%*	*115.0%*	*139.3%*	*114.7%*	*23.1%*	*23.4%*	*19.0%*	*16.3%*	*14.0%*
Pennsaid Royalties	$2.0	$0.4	$0.3	$0.2	$0.1	$1.0	$0.5	$0.1	$0.1	$0.1	$0.1
Pennsaid 2% Royalties	$3.0	$0	$0	$0	$0	$0	$1	$4.0	$8.5	$12.0	$15.0
Other Royalties	$0.5	$0.1	$0.1	$0.1	$0.1	$0.4	$0.4	$0.5	$0.5	$0.5	$0.5
Royalties	**$5.5**	**$0.5**	**$0.2**	**$0.3**	**$0.2**	**$1.3**	**$1.4**	**$4.6**	**$9.1**	**$12.6**	**$15.6**
YOY Growth	*-10.5%*	-	-	-	-	*-76.8%*	*10.7%*	*228.6%*	*97.8%*	*38.5%*	*23.8%*
Licensing Fees	**$0.6**	**$0**	**$0**	**$0.2**	**$0.5**	**$0.7**	**$1.0**	**$1.2**	**$2.0**	**$2.5**	**$3.0**
YOY Growth	*-91.8%*	-	-	-	-	*12.2%*	*42.9%*	*20.0%*	*66.7%*	*25.0%*	*20.0%*
Research and Contracts	**$0.5**	**$0.1**	**$0.1**	**$0.1**	**$0.1**	**$0.4**	**$0.5**	**$0.8**	**$1.0**	**$1.2**	**$1.5**
YOY Growth	*85.7%*	-	-	-	-	*-18.6%*	*21.7%*	*50.0%*	*33.3%*	*20.0%*	*25.0%*
Total Revenues	**$13.1**	**$4.5**	**$3.2**	**$3.8**	**$4.7**	**$16.3**	**$20.0**	**$27.7**	**$37.2**	**$45.5**	**$53.4**
YOY Growth	*-29.1%*	*64.9%*	*-16.0%*	*27.1%*	*34.8%*	*24.6%*	*22.9%*	*38.3%*	*34.5%*	*22.3%*	*17.4%*
CoGS	$5.5	$2.6	$1.9	$2.4	$2.4	$9.3	$10.5	$12.5	$15.5	$17.5	$20.0
Gross Income	$7.5	$2.0	$1.4	$1.4	$2.3	$7.0	$9.5	$15.2	$21.7	$28.0	$33.4
Product Gross Margin	*14.4%*	*34.4%*	*34.9%*	*25.6%*	*37.7%*	*33.4%*	*38.6%*	*40.8%*	*38.2%*	*40.1%*	*39.9%*
R&D	$8.1	$2.0	$4.3	$2.7	$3.1	$12.1	$10.0	$8.0	$5.0	$2.0	$1.0
SG&A	$13.0	$0.7	$3.1	$3.2	$3.5	$10.4	$12.5	$13.5	$14.5	$15.5	$16.5
Other expenses	$0.5	($0.1)	($0.1)	$0.1	$0.1	$0.1	$0.5	$0.5	$0.5	$0.5	$0.5
Operating Income	($14.0)	($0.5)	($5.9)	($4.6)	($4.5)	($15.5)	($13.5)	($6.9)	$1.7	$10.0	$15.4
Operating Margin	*-107.4%*	*-11.8%*	*-183.1%*	*-119.6%*	*-95.7%*	*-95.3%*	*-67.5%*	*-24.8%*	*4.6%*	*22.0%*	*28.8%*
Total Other Income	$52.6	$0.3	$0.0	$0.2	$0.2	$0.7	$1.0	$1.0	$1.0	$1.0	$1.0
Pre-Tax Income	$38.6	($0.3)	($5.9)	($4.4)	($4.3)	($14.8)	($12.5)	($5.9)	$2.7	$11.0	$16.4
Taxes & Other	$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%*
Net Income	$38.6	($0.3)	($5.9)	($4.4)	($4.3)	($14.8)	($12.5)	($5.9)	$2.7	$11.0	$16.4
Net Margin	*295.6%*	*-5.9%*	*-183.1%*	*-114.4%*	*-91.4%*	*-91.2%*	*-62.5%*	*-21.2%*	*7.3%*	*24.2%*	*30.7%*
Gain/Loss on trans. of foreign ops	$0.0	($0.1)	$0.0	($0.1)	($0.1)	($0.3)	($0.5)	($0.5)	($0.5)	($0.5)	($0.5)
Comprehensive Income	$38.6	($0.4)	($5.9)	($4.5)	($4.4)	($15.1)	($13.0)	($6.4)	$2.2	$10.5	$15.9
Reported EPS	**$3.76**	**($0.02)**	**($0.55)**	**($0.40)**	**($0.38)**	**($1.35)**	**($1.09)**	**($0.49)**	**$0.22**	**$0.85**	**$1.17**
YOY Growth	*#VALUE!*	-	-	-	-	*-135.9%*	*-19.5%*	*-55.2%*	*-144.3%*	*291.7%*	*38.4%*
Shares Outstanding	10.3	10.8	10.9	11.0	11.2	11.0	11.5	12.0	12.5	13.0	14.0

Company filings and Zacks Estimates

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HISTORICAL ZACKS RECOMMENDATIONS

Initiations of Coverage – May 5, 2014 @ $3.26 per share



Chart By: Yahoo!, Inc.

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