Zacks Small-Cap Research

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Nuvo Research, Inc. (T.NRI - TSX)

T.NRI: Attractive Valuation Despite WF10 Clinical Failure…

Current Recommendation	**Buy**
Prior Recommendation	N/A
Date of Last Change	05/05/2014
Current Price (02/20/15)	$4.09
Target Price	**$6.50**

UPDATE

On January 30, 2015, Nuvo Research Inc. announced results of its Phase 2 allergic rhinitis study in Germany failed to demonstrate statistically significant separation of WF10 vs. placebo. We are disappointed with the results given the previous Phase 2 data with WF10 that had showed very nice separation between the WF10 and placebo group on both per protocol and intent-to-treat analysis. Although we are disappointed with the failure of WF10 in allergic rhinitis, the current valuation is supported entirely by the $58.3 million cash balance as of December 31, 2014. We think odds are high of success for the planned European Phase 3 trial with Pennsaid 2% and that the potential to partner the drug for Europe is significant once the data has been generated. Our target is $6.50 per share.

SUMMARY DATA

52-Week High	**10.36**
52-Week Low	**2.40**
One-Year Return (%)	**36**
Beta	**N/A**
Average Daily Volume (sh)	**79,507**
Shares Outstanding (mil)	**10.4**
Market Capitalization ($mil)	**57**
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**

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

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	$2.9 E	$2.5 E	$2.3 E	$2.0 E	$9.7 E
2016					$8.8 E
2017					$15.0 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	-$0.39 E	-$0.38 E	$0.45 E	-$0.50 E	$1.72 E
2016					-$1.88 E
2017					-$1.50 E

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WHAT'S NEW

Financial Update

On February 19, 2015, Nuvo Research, Inc. reported financial results for the fourth quarter and full year ending December 31, 2014. Revenue in the fourth quarter totaled $3.5 million, right in-line with our estimate. Revenue consists of product sales totaling $1.6 million, royalties totaling $1.2 million, license fees totaling $0.4 million, and revenue from research and other contracts totaling $0.2 million. Revenue for the full year ending 2014 totaled $13.1 million, a decrease of 29% when compared to the full year ending 2013. The decrease in revenue was attributable to lower royalty revenue primarily from Pennsaid and Pennsaid 2% net sales in the U.S. market. The decrease in royalty revenue was partially offset by an increase in product sales to Horizon to prepare for their launch of Pennsaid 2% in January 2015.

Net loss for the fourth quarter 2014 totaled $6.1 million, or $0.57 per share. Loss was driven primarily by $1.6 million in cost of goods, $2.8 million in R&D, and $4.3 million in G&A. For the full year 2014, the company reported a net gain of $38.6 million, or $3.76 per share. Gain in 2014 was primarily driven by $52.3 million litigation settlement (with Mallinckrodt) and licensing agreement (with Horizon) for Pennsaid 2% in the U.S.

Nuvo Research exited 2014 with $58.3 million in cash and short-term investments. Based on roughly 10.8 million shares outstanding as of today, this equates to $5.40 per share. The stock is currently trading at $4.09 per share, or a 24% discount to the cash on hand as of December 31, 2014. We believe operating burn at Nuvo is approximately $2.5 to $3.0 million per quarter. As such, cash and investments on hand as of March 31, 2015 should still be approximately $55 million, or in excess of $5.00 per share.

Even though U.S. rights to Pennsaid 2% are now with Horizon, Nuvo has retained the rights for Pennsaid / Pennsaid® 2% outside of the U.S., which includes royalties on commercial sales in Canada and the opportunity to gain approval in large markets like Europe. However, to gain approval in Europe the company must first complete a Phase 3 study. This is already in planning. The study will be conducted in Germany and will assess the efficacy of Pennsaid® 2% for the relief of pain associated with acute, localized muscle or joint injuries such as sprains, strains or sports injuries. The study is expected to begin in the second quarter of 2015 with results expected in the fourth quarter of 2015. In addition to supporting regulatory approval in locations outside the U.S., such as the European Union, the Phase 3 data will be integral to forging a partnership for marketing Pennsaid® 2% internationally. The total cost of the trial is estimated to be $1.5 million. We believe positive data will be a significant valuation inflection for the company. We plan to provide investors with a larger, more focused report on Pennsaid 2% and the Phase 3 trial in the second quarter after the trial starts.

Although we are clearly disappointed with the failure of the WF10 Phase 2 trial in January 2015, we believe Nuvo has done an excellent job in regards to extracting the full value from the Pennsaid® 2% franchise through both the litigation settlement and subsequent U.S. rights asset sale to Horizon Pharma. The current valuation is supported entirely by the $58.3 million cash balance as of December 31, 2014. We think odds are high of success for the planned European Phase 3 trial with Pennsaid 2% and that the potential to partner the drug for Europe is significant once the data has been generated. We expect continued progress extracting value from the topical franchises and Pennsaid out-licensing opportunities throughout 2015. We have adjusted our target to $6.50 per share, which includes an estimated $55+ million in cash as of March 31, 2015 and residual manufacturing and partnering opportunities for Pennsaid 2%. The biggest catalyst for the shares in the near-term will be the Pennsaid 2% European Phase 3 data late 2015.

PROJECTED FINANCIALS

Nuvo Research, Inc.
Income Statement

Nuvo Research, Inc.	2014 A	Q1 E	Q2 E	Q3 E	Q4 E	2015 E	2016 E
Revenue from Product Sales	**$6.5**	**$1.5**	**$1.4**	**$1.4**	**$1.3**	**$5.6**	**$5.5**
YOY Growth	*46.0%*	-	-	-	-	*-13.4%*	*-1.8%*
Royalties	**$5.5**	**$0.9**	**$0.7**	**$0.6**	**$0.4**	**$2.6**	**$1.8**
YOY Growth	*-10.5%*	-	-	-	-	*-52.4%*	*-30.8%*
Licensing Fees	**$0.6**	**$0.3**	**$0.3**	**$0.2**	**$0.2**	**$1.0**	**$1.0**
YOY Growth	*-91.8%*	-	-	-	-	*60.3%*	*0.0%*
Research and Contracts	**$0.5**	**$0.2**	**$0.1**	**$0.1**	**$0.1**	**$0.5**	**$0.5**
YOY Growth	*85.7%*	-	-	-	-	*-1.0%*	*0.0%*
Total Revenues	**$13.1**	**$2.9**	**$2.5**	**$2.3**	**$2.0**	**$9.7**	**$8.8**
YOY Growth	*-29.1%*	-	-	-	-	*-25.7%*	*-9.3%*
CoGS	$5.5	$1.2	$1.0	$0.9	$0.8	$4.0	$4.4
Gross Margin	*57.6%*	*58.0%*	*59.0%*	*60.0%*	*60.0%*	*59.1%*	*50.0%*
R&D	$8.1	$2.2	$2.0	$2.7	$3.1	$10.0	$12.5
% R&D	*61.7%*	*75.9%*	*80.0%*	*117.4%*	*155.0%*	*103.1%*	*142.0%*
SG&A	$13.0	$3.8	$3.7	$3.7	$3.8	$15.0	$15.0
% SG&A	*99.4%*	*131.0%*	*148.0%*	*160.9%*	*190.0%*	*154.6%*	*170.5%*
Other expenses	$0.5	$0.1	$0.1	$0.1	$0.1	$0.4	$0.5
% Payment	*3.9%*	*3.4%*	*4.0%*	*4.3%*	*5.0%*	*4.1%*	*5.7%*
Operating Income	($14.0)	($4.4)	($4.3)	($5.1)	($5.8)	($19.7)	($23.6)
Operating Margin	*-107.4%*	*-152.3%*	*-173.0%*	*-222.6%*	*-290.0%*	*-202.7%*	*-268.2%*
Total Other Income	$52.6	$0.2	$0.2	$0.2	$0.2	$0.8	$1.0
Pre-Tax Income	$38.6	($4.2)	($4.1)	($4.9)	($5.6)	($18.9)	($22.6)
Taxes & Other	$0.0	$0.0	$0.0	$0.0	$0.0	$0.0	$0.0
Tax Rate	*0%*	*0%*	*0%*	*0%*	*0%*	*0%*	*0%*
Net Income	$38.6	($4.2)	($4.1)	($4.9)	($5.6)	($18.9)	($22.6)
Net Margin	*295.6%*	*-145.4%*	*-165.0%*	*-213.9%*	*-280.0%*	*-194.5%*	*-256.8%*
Gain/Loss on trans. of foreign ops	$0.0	$0.0	$0.0	$0.0	$0.0	$0.0	$0.0
Comprehensive Income	$38.6	($4.2)	($4.1)	($4.9)	($5.6)	($18.9)	($22.6)
Reported EPS	**$3.76**	**($0.39)**	**($0.38)**	**($0.45)**	**($0.50)**	**($1.72)**	**($1.88)**
YOY Growth	*-420.1%*	-	-	-	-	*-145.7%*	*9.6%*
Shares Outstanding	10.3	10.8	10.9	11.0	11.2	11.0	12.0

Source: Zacks Investment Research, Inc. *Jason Napodano, CFA*

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HISTORICAL ZACKS RECOMMENDATIONS

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

Nuvo Research Inc. (NRI.TO)



Chart By: Yahoo!, Inc.

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