Zacks Small-Cap Research

July 2, 2014
Jason Napodano, CFA
312-265-9421
jnapodano@zacks.com

scr.zacks.com
111 North Canal Street, Chicago, IL 60606

POZEN, Inc. (POZN-NASDAQ)

POZN: Pozen Resubmits PA NDA…

UPDATE

We believe Pozen represents a compelling valuation and catalyst play at this level. Despite the minor CRL issued by the FDA in April, the application is now back under review and we continue to believe PA is approved in 2014. Once PA is approved, we think Pozen becomes cash flow positive on an operating basis through a combination of growing royalties on both PA and Vimovo. Pozen is also sitting on enough cash that the company may look to do another cash-distribution to shareholders in 2015. We see the shares fairly-valued at $12.50.

Current Recommendation	**Outperform**
Prior Recommendation	Neutral
Date of Last Change	03/07/2007
Current Price (07/02/14)	$8.56
Target Price	**$12.50**

SUMMARY DATA

52-Week High	**$9.77**
52-Week Low	**$5.00**
One-Year Return (%)	**67.51**
Beta	**1.95**
Average Daily Volume (sh)	**331,408**
Shares Outstanding (mil)	**31**
Market Capitalization ($mil)	**$264**
Short Interest Ratio (days)	**9.63**
Institutional Ownership (%)	**63**
Insider Ownership (%)	**18**
Annual Cash Dividend	**$0.00**
Dividend Yield (%)	**0.00**
5-Yr. Historical Growth Rates	
Sales (%)	**N/M**
Earnings Per Share (%)	**N/A**
Dividend (%)	**N/A**
P/E using TTM EPS	**N/A**
P/E using 2014 Estimate	**13.5**
P/E using 2015 Estimate	**10.0**

Risk Level	**Average**
Type of Stock	**Small-Growth**
Industry	**Med-Drugs**

ZACKS ESTIMATES

Revenue
(In millions of $)

	Q1 (Mar)	Q2 (Jun)	Q3 (Sep)	Q4 (Dec)	Year (Dec)
2013	1.4 A	1.7 A	2.6 A	4.7 A	10.3 A
2014	7.5 A	6.3 E	6.7 E	16.1 E	36.6 E
2015					41.5 E
2016					54.0 E

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

	Q1 (Mar)	Q2 (Jun)	Q3 (Sep)	Q4 (Dec)	Year (Dec)
2013	-$0.19 A	-$0.13 A	-$0.16 A	-$0.07 A	-$0.55 A
2014	$0.09 A	$0.05 E	$0.08 E	$0.39 E	$0.62 E
2015					$0.81 E
2016					$1.19 E

© Copyright 2014, Zacks Investment Research. All Rights Reserved.

WHAT'S NEW

Pozen Resubmits PA NDA

On July 1, 2014, Pozen Inc (POZN) announced it had resubmitted the New Drug Application (NDA) for PA81/40 and PA325/40 to the U.S. FDA. Pozen noted that the FDA is expected to notify the company within 14 days of receipt of the NDA whether or not the submission will be accepted, and if accepted, what the new PDUFA date will be. More specifically, we will find out in two weeks if the FDA will take two months or six months to review the application.

We remind investors that on April 25, 2014, Pozen announced receipt of a complete response letter (CRL) for PA8140/PA32540. In the CRL, the FDA noted that, "*During an inspection of the manufacturing facility of an active ingredient supplier that concluded earlier in the week, inspection deficiencies were found*." We note that these deficiencies were found at the manufacturing facility of a third-party supplier of the active ingredient for PA. On Pozen's first quarter conference call held on May 8, 2014, CEO John Plachetka noted that the third-party supplier was already addressing these deficiencies and planned to respond to the FDA by the end of that week. As it turns out, the third party manufacturer did respond to the FDA on May 9, 2014.

Last month, Pozen conducted its own onsite audit of the facility. Pozen learned that the third party manufacturer recently submitted supplement to its May 9th initial response. Pozen believes that based upon the available information there are actions in place that address the deficiencies noted in the FDA's inspection report. With a two-month (Class-1) turnaround, we could be looking at a new PDUFA date for PA in early September 2014. We note that Pozen has stated in both their press release that no other deficiencies, including clinical or safety issues, were noted in the CRL. Pozen also noted that draft labeling for the product is still pending, but the initial proposal was in-line with expectations.

…Optimistic on PA…

Despite the minor delay, we continue to believe that Sanofi will be in position to launch PA in early 2015. We model peak sales of PA in the U.S. at around $300 million. Pozen management expects Sanofi U.S. to put forth a first class effort with PA, piggy-backing off the success in this area by the company with mega-blockbuster Plavix®. We remind investors that besides the $20 million in pre-commercialization milestones, Pozen is entitled to sales milestones and royalties from Sanofi U.S. ranged between 12.5% and 22.5% on sales. We think the opportunity for PA outside the U.S. is around $150 to $200 million. We suspect that Sanofi-Aventis (SNY) is the ideal EU commercialization partner for PA, but chose to model the path to market conservatively. Thus, a commercialization deal for Europe represents nice upside to our financial model in terms of bringing in new upfront and sales cash milestones.

24 Million American's with history of CV disease (secondary prevention)
- Approximately 90% on medication
- Approximately 60-80% take Apspirin
- Pozen's Market Research shows 30-40% physician acceptance
- Pozen's Market Research shows 36% patients willing to pay $1/day
- Payors coverage PA at Tier-2 (cost-neutral) at $1/day
- Assume 40% market penetration on above metrics

This equates to 800,000 patients @ $365/year ~ $300 Million Peak Sales

Assume sales outside the U.S. is around half that, or around $150 Million.
Thus, we model Peak WW sales of $450 Million for our vaulation model.

Cash And Future Plans

Pozen exited March 31, 2014 with $27.1 million in cash on the books. The company also showed an Accounts Receivable line on the balance sheet of $4.549 million, equal exactly to the royalty line recorded on the income statement. We expect that this cash was paid to Pozen in April 2014 from Vimovo commercialization partners AstraZeneca (AZN) and Horizon (HZNP). We remind investors that back in December 2013, Pozen paid a special cash distribution of $1.75 per share to all stockholders of record as of the close of business on December 30, 2013.

On its first quarter conference call, Pozen noted that has been working to reduce operating expenses to maximize profitability and reduce cash burn ahead of PA approval. The company made the strategic decision not to start new development programs that are not fully funded by a partner. The press release states, "*Our board of directors and management team continue to explore potential ways to return value to our stockholders, including future cash distributions when we accumulate surplus cash as a result of receiving milestones and royalties from our commercial partners*."

Pozen is basically telling us – once PA gets approved, expect more cash distributions (or dividends if distributed in a year with positive net income). The approval of PA hit a minor hiccup, but we believe the issue was minor and with the application now back under review launch expectations by Sanofi remain the same. Therefore, we still expect PA approval in 2014; this entitles Pozen to $20 million in combined pre-launch milestones from Sanofi U.S. that would further strengthen the cash position. The first $10 million is for approval (which we model in the third quarter 2014) and the second $10 million is for "commercial-readiness" (which we model in the first quarter 2015).

If all goes well, Pozen could exit 2014 with over $40 million on the books, and another $10 million coming early 2015. Pozen was very near cash flow positive in the first quarter 2014 based on Vimovo alone. We think by the end of 2014, Pozen will be cash flow positive based on Horizon ramping sales of Vimovo. Add in PA in 2015 and we see the company generating significant positive cash flow in the coming years. Therefore, we think Pozen can potentially look to distribute more cash to shareholders in 2015.

For example, based on our current financial projections, Pozen could generate $25 million in positive cash flow from operating activities in 2015, along with having $50+ million in cash on the books. If the company wanted to have a payout ratio of 50%, this would equate to a cash dividend of around $12.5 million, or a yield on the stock of around 4.7%. However, if Pozen will truly have $50+ million in cash in 2015, we suspect that they will pay out – at least – 50% of this figure. This puts the total dividend payout more like $32.5 million, or $1.00 per share, or a yield on the current stock price of 11.5%.

Valuation

We've done some initial modeling on what Pozen will look like with PA on the market and a reinvigorated Vimovo selling at Horizon (see below). We think Pozen could generate as much as $60+ million in free cash flow starting a few years. Based on the current share count, with equates to over $2.00 in potential free cash flow per share earmarked for future cash distributions.

	Vimovo		PA		Licsening	Cash				Free Cash
	WW Sales	Royalty	WW Sales	Royalty	Payments	Revenues	Op. Exps	Taxes	Cash Adjs	Flow
2013	$91	$6.4	$0	$0	$15	$21	($27)	$0	$2	($4)
2014	$200	$17.0	$0	$0.0	$10	$27	($18)	$0	$2	$11
2015	$300	$26.0	$50	$8.8	$10	$45	($17)	$0	$2	$30
2016	$350	$35.0	$100	$20.0	$5	$60	($16)	$0	$2	$46
2017	$200	$20.0	$250	$50.0	$0	$70	($16)	$0	$2	$56
2018	$150	$15.0	$350	$78.8	$10	$104	($16)	($18)	$2	$72
2019	$150	$15.0	$400	$90.0	$0	$105	($16)	($27)	$2	$64
2020	$140	$14.0	$450	$101.3	$10	$125	($16)	($33)	$2	$78
2021	$130	$13.0	$450	$101.3	$0	$114	($16)	($29)	$2	$71
2022	$120	$12.0	$450	$101.3	$10	$123	($16)	($32)	$2	$77
2023	$110	$11.0	$400	$80.0	$0	$91	($16)	($23)	$2	$55

TGR:	1%	Net Present Value of Cash Flows	$247
Discont Rate:	15%	Term Value	$96
		Cash Projection As of Year-End 2014	$42.5
Jason Napodano, CFA - Zacks/SCR		**Firm Value**	$385
		Shares Outstanding	30.7
		Target Price	**$12.55**

At the current stock price, these dividends would equate to a 23% yield, and that includes no payment of surplus cash currently on the books. You can't find that kind of "high-income yield" anywhere in the market! Pozen's stock should be trading at $12+ per share based on the future projected cash flows and return of capital to shareholders. On a price to earnings ratio, Pozen is currently trading at 13.5x our 2014 estimate. For 2015, assuming PA approval, Pozen is trading at 10.0x earnings.

Now we understand there is risk based on the fact that PA has yet to be approved, but we think this is a low hurdle to overcome. We also note that our modeling above has Pozen paying taxes starting in 2017. Our assumptions could be increased by 1/3rd if Pozen decides to sell to a tax advantaged organization, similar to what the company did when it monetized the Treximet royalty to Canada's CPPIB Credit Investments in November 2011. That sales price of Treximet royalty for $75 million was around 35% higher than we factored in our DCF model due to tax implications.

PROJECTED INCOME STATEMENT

INCOME STATEMENT

Pozen, Inc.	2012 A	2013 A	Q1 A	Q2 E	Q3 E	Q4 E	2014 E	2015 E	2016 E
Vimovo (royalty)	**$4.8**	**$6.3**	**$4.5**	**$3.3**	**$3.7**	**$4.1**	**$15.6**	**$24.0**	**$31.5**
YOY Growth	*66.5%*	*30.4%*	*221.5%*	*99.9%*	*132.2%*	*142.1%*	*146.3%*	*54.1%*	*31.3%*
PA-Franchise (royalty)	**$0**	**$0**	**$0**	**$0**	**$0**	**$0**	**$0**	**$7.5**	**$17.5**
YOY Growth	-	-	-	-	-	-	-	-	*133.3%*
Licensing / Development	**$0.5**	**$4.0**	**$3.0**	**$3.0**	**$3.0**	**$12.0**	**$21.0**	**$10.0**	**$5.0**
Total Revenues	$5.3	$10.3	$7.5	$6.3	$6.7	$16.1	$36.6	$41.5	$54.0
YOY Growth	*-93.8%*	*93.0%*	*703.1%*	*366.0%*	*24.8%*	*1034.3%*	*254.3%*	*13.5%*	*30.1%*
Cost of Goods Sold	$0	$0	$0	$0	$0	$0	$0	$0	$0
Product Gross Margin	*100.0%*	*100.0%*	-	-	-	-	*100.0%*	*100.0%*	*100.0%*
SG&A	$19.0	$17.2	$2.8	$2.8	$2.6	$2.5	$10.7	$10.0	$10.0
% SG&A	*355.7%*	*166.3%*	*37.4%*	*44.4%*	*39.0%*	*15.6%*	*29.3%*	*24.1%*	*18.5%*
R&D	$11.9	$9.9	$1.8	$2.0	$1.7	$1.5	$7.0	$6.5	$6.0
% R&D	*221.8%*	*96.3%*	*24.2%*	*31.7%*	*25.5%*	*9.3%*	*19.2%*	*15.7%*	*11.1%*
Operating Income	($25.5)	($16.8)	$2.9	$1.5	$2.4	$12.1	$18.8	$25.0	$38.0
Operating Margin	*-477.5%*	*-162.6%*	*38.4%*	*23.8%*	*35.6%*	*75.1%*	*51.5%*	*60.2%*	*70.4%*
Interest Income / Net	$0.3	$0.1	$0.0	$0.0	$0.0	$0.0	$0.1	$0.1	$0.1
Pre-Tax Income	($25.3)	($16.7)	$2.9	$1.5	$2.4	$12.1	$18.9	$25.1	$38.1
Taxes	$0	$0	$0	$0	$0	$0	$0	$0	$0
Tax Rate	*0%*	*0%*	*0%*	*0%*	*0%*	*0%*	*0%*	*0%*	*0%*
Net Income	($25.3)	($16.7)	$2.9	$1.5	$2.4	$12.1	$18.9	$25.1	$38.1
YOY Growth	*-159.7%*	*-33.9%*	-	-	-	-	*-213.1%*	*32.9%*	*51.8%*
Net Margin	*-472.7%*	*-161.9%*	-	*24.1%*	*35.9%*	*75.2%*	*51.6%*	*60.5%*	*70.6%*
Reported EPS	($0.84)	($0.55)	$0.09	$0.05	$0.08	$0.39	$0.62	$0.81	$1.19
Fully Diluted Shares	30.1	30.4	30.7	30.6	30.7	30.8	30.7	31.0	32.0

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

© Copyright 2014, Zacks Investment Research. All Rights Reserved.

HISTORICAL ZACKS RECOMMENDATIONS



© Copyright 2014, Zacks Investment Research. All Rights Reserved.

DISCLOSURES

The following disclosures relate to relationships between Zacks Small-Cap Research ("Zacks SCR"), a division of Zacks Investment Research ("ZIR"), and the issuers covered by the Zacks SCR Analysts in the Small-Cap Universe.

ANALYST DISCLOSURES

I, Jason Napodano, CFA, CFA, hereby certify that the view expressed in this research report accurately reflect my personal views about the subject securities and issuers. I also certify that no part of my compensation was, is, or will be, directly or indirectly, related to the recommendations or views expressed in this research report. I believe the information used for the creation of this report has been obtained from sources I considered to be reliable, but I can neither guarantee nor represent the completeness or accuracy of the information herewith. Such information and the opinions expressed are subject to change without notice.

INVESMENT BANKING, REFERRALS, AND FEES FOR SERVICE

Zacks SCR does not provide nor has received compensation for investment banking services on the securities covered in this report. Zacks SCR does not expect to receive compensation for investment banking services on the Small-Cap Universe. Zacks SCR may seek to provide referrals for a fee to investment banks. Zacks & Co., a separate legal entity from ZIR, is, among others, one of these investment banks. Referrals may include securities and issuers noted in this report. Zacks & Co. may have paid referral fees to Zacks SCR related to some of the securities and issuers noted in this report. From time to time, Zacks SCR pays investment banks, including Zacks & Co., a referral fee for research coverage.

Zacks SCR has received compensation for non-investment banking services on the Small-Cap Universe, and expects to receive additional compensation for non-investment banking services on the Small-Cap Universe, paid by issuers of securities covered by Zacks SCR Analysts. Non-investment banking services include investor relations services and software, financial database analysis, advertising services, brokerage services, advisory services, equity research, investment management, non-deal road shows, and attendance fees for conferences sponsored or co-sponsored by Zacks SCR. The fees for these services vary on a per client basis and are subject to the number of services contracted. Fees typically range between ten thousand and fifty thousand USD per annum.

POLICY DISCLOSURES

Zacks SCR Analysts are restricted from holding or trading securities placed on the ZIR, SCR, or Zacks & Co. restricted list, which may include issuers in the Small-Cap Universe. ZIR and Zacks SCR do not make a market in any security nor do they act as dealers in securities. Each Zacks SCR Analyst has full discretion on the rating and price target based on his or her own due diligence. Analysts are paid in part based on the overall profitability of Zacks SCR. Such profitability is derived from a variety of sources and includes payments received from issuers of securities covered by Zacks SCR for services described above. No part of analyst compensation was, is or will be, directly or indirectly, related to the specific recommendations or views expressed in any report or article.

ADDITIONAL INFORMATION

Additional information is available upon request. Zacks SCR reports are based on data obtained from sources we believe to be reliable, but are not guaranteed as to be accurate nor do we purport to be complete. Because of individual objectives, this report should not be construed as advice designed to meet the particular investment needs of any investor. Any opinions expressed by Zacks SCR Analysts are subject to change without notice. Reports are not to be construed as an offer or solicitation of an offer to buy or sell the securities herein mentioned.

ZACKS RATING & RECOMMENDATION

ZIR uses the following rating system for the 1094 companies whose securities it covers, including securities covered by Zacks SCR:
Buy/Outperform: The analyst expects that the subject company will outperform the broader U.S. equity market over the next one to two quarters.
Hold/Neutral: The analyst expects that the company will perform in line with the broader U.S. equity market over the next one to two quarters.
Sell/Underperform: The analyst expects the company will underperform the broader U.S. Equity market over the next one to two quarters.

The current distribution is as follows: Buy/Outperform- 16.5%, Hold/Neutral- 76.2%, Sell/Underperform – 6.4%. Data is as of midnight on the business day immediately prior to this publication.