Zacks Small-Cap Research

December 21, 2016

Brian Marckx, CFA
bmarckx@zacks.com
Ph (312) 265-9474

scr.zacks.com

10 S. Riverside Plaza, Chicago, IL 60606

# Lombard Medical (EVAR-NASDAQ)

## EVAR: $15M Investment, Additional Positive Outcomes Data

We model 10-year revenue CAGR of 11%, gross margin widening from 45% to 56% over that period. We look for OpEx to eventually scale but now expect a more significant improvement in the front end but less leverage on the back end. The net result is our 10-year DCF model, which uses an 11% discount rate and 2% terminal growth rate, now values EVAR at approximately $2.25/share.

| | |
|---|---|
| Current Price (12/21/16) | $0.68 |
| **Valuation** | **$2.25** |

## OUTLOOK

Management threw a curve ball on the recent business update – noting that they are shedding U.S. operations in order to conserve capital and instead fully focus on overseas markets as they leverage early momentum from the recent launch of Altura and IntelliFlex. While a surprise, we think it may be a good move given the negative ROI in the domestic market as a result of lackluster of uptake of Aorfix and the capital-intensive nature of the direct sales force.

More recently Lombard announced that they entered into an agreement with MicroPort Scientific Corporation, a Shanghai, China-based medical device company, whereby MicroPort invested a total of $15M in EVAR through a combination of common equity and convertible debt. Two MicroPort representatives will join EVAR's board of directors. The deal brings EVAR not only financing on what we think are very reasonable terms, but also what could be relatively seamless commercial entry of Aorfix and Altura into the large Chinese and Brazilian markets.

## SUMMARY DATA

| | |
|---|---|
| **52-Week High** | **$1.83** |
| **52-Week Low** | **$0.55** |
| **One-Year Return (%)** | **-48.49** |
| **Beta** | **1.43** |
| **Average Daily Volume (sh)** | **83,179** |
| **Shares Outstanding (mil)** | **20** |
| **Market Capitalization ($mil)** | **$14** |
| **Short Interest Ratio (days)** | **N/A** |
| **Institutional Ownership (%)** | **59** |
| **Insider Ownership (%)** | **N/A** |
| **Annual Cash Dividend** | **$0.00** |
| **Dividend Yield (%)** | **0.00** |
| **5-Yr. Historical Growth Rates** | |
| **Sales (%)** | **24.1** |
| **Earnings Per Share (%)** | **N/A** |
| **Dividend (%)** | **N/A** |
| **P/E using TTM EPS** | **N/A** |
| **P/E using 2016 Estimate** | **N/A** |
| **P/E using 2017 Estimate** | **N/A** |
| **Zacks Rank** | **N/A** |

| | |
|---|---|
| **Risk Level** | **High,** |
| **Type of Stock** | **Small-Value** |
| **Industry** | **Med Instruments** |

## ZACKS ESTIMATES

**Revenue**
(in 000s of $)

| | Q1 (Mar) | Q2 (Jun) | Q3 (Sep) | Q4 (Dec) | Year (Dec) |
|---|---|---|---|---|---|
| 2015 | 3.4 A | 4.5 A | 4.2 A | 2.9 A | 15.1 A |
| 2016 | 2.9 A | 3.8 A | 3.0 A | 3.3 E | 13.0 E |
| 2017 | | | | | 15.0 E |
| 2018 | | | | | 17.9 E |

**Earnings per Share**

| | Q1 (Mar) | Q2 (Jun) | Q3 (Sep) | Q4 (Dec) | Year (Dec) |
|---|---|---|---|---|---|
| 2015 | -$0.59 A | -$0.51 A | -$0.45 A | -$0.58 A | -$2.13 A |
| 2016 | -$0.38 A | -$0.42 A | -$0.37 A | -$0.31 E | -$1.48 E |
| 2017 | | | | | -$0.61 E |
| 2018 | | | | | -$0.37 E |

Zacks Projected EPS Growth Rate - Next 5 Years % **N/A**

© Copyright 2016, Zacks Investment Research. All Rights Reserved.

### $15M Investment From MicroPort:

Lombard announced that they entered into an agreement with MicroPort Scientific Corporation, a Shanghai, China-based medical device company, whereby MicroPort invested a total of $15M in EVAR through a combination of common equity and convertible debt. Two MicroPort representatives will join EVAR's board of directors. The deal brings EVAR not only financing on what we think are very reasonable terms, but also what could be relatively seamless commercial entry of Aorfix and Altura into the large Chinese and Brazilian markets.

The financing includes $5M in equity, consisting of 8.06M common shares @ $0.62/share (no warrants), and $10M of unsecured notes which are convertible at any time at $0.90/share with initial maturity 12/18/2021 (i.e. 5 years but which can be extended). Interest on the notes is payment-in-kind (PIK) and calculated as six-month LIBOR (currently 1.30%) plus 4%. The PIK interest, which is capitalized and added to the principal, reduces cash outflows.

Following the financing, MicroPort owns approximately 29% of EVAR's outstanding shares. The agreement stipulates that MicroPort cannot own more than 49% of the voting power of EVAR. As such, in the event a conversion would result in MicroPort owning more than 49%, EVAR will pay in cash an amount equal to the number of shares that MicroPort is entitled to above a 49% interest.

Pro forma for the financing, EVAR had approximately $24M of cash as of the end of Q3 (9/30/16). Cash used in operating activities was $4.9M ($6.0M ex-changes in working capital) and $22.4M ($18.7M ex-changes in working capital) in the three and nine months ending September 30th. As such, at the current burn rate, the pro forma Q3 cash balance represents approximately 12 months of operating funds.

We note that the increase in share count resulting from this transaction has no effect on our valuation of EVAR as our model had assumed a near-term capital raise in the form of either straight equity or convertible debt.

***Offers Seamless Entry Into China, Brazil and Manufacturing Efficiencies…***

Other potential benefits that this agreement brings is the potential for relatively seamless entry of Aorfix and Altura into the large medical device territories of China and Brazil. MicroPort has substantial presence throughout much of the world, employs 3k people and has a portfolio consisting of more than 2k products which they note have been used in over 5k hospitals across the globe. Their products cover ten major medical disciplines which includes a rapidly growing endovascular business, which currently generates an annual run-rate of approximately $20M in revenue.

Microport's website notes that they currently sell a handful of AAA and thoracic stent grafts. While Microport's Minos (14f – 16f) AAA stent graft is currently undergoing clinical trials, noteworthy is that their endovascular portfolio currently does not include an ultra-low profile AAA stent graft (such as Altura) or a AAA stent graft approved for high neck angles (such as Aorfix). This agreement comes on the heels of additional positive outcomes data related to both Aorfix and Altura which were presented at VEITH in November (see below).

The duo are also expected to enter into a component supply manufacturing agreement, whereby MicroPort will manufacture certain components of Aorfix and Altura in their (relatively low-cost) manufacturing facility in Shanghai, which could benefit gross margins.

And while details of the China/Brazil distribution agreement, including responsibility for regulatory approval activities in each country, as well as the component manufacturing agreement are still being worked out, we view the transaction as a significantly positive event for Lombard. At the very least, the company secured financing at what we think are very reasonable terms (i.e. equity at a slight discount to current market, no warrants, PIK interest on the notes and conversion price well out-of-the-money). And the distribution and manufacturing agreement offers a potential low-risk upside-kicker in the form of additional revenue contribution as well as lower-cost manufacturing. We expect to hear additional updates on the progress of discussions regarding the distribution and manufacturing agreement in the future.

### Data Continues To Show Positive Outcomes of Patients Treated With Both Aorfix and Altura

Lombard presented additional data related to both Aorfix and Altura at the 43rd annual VEITHsymposium in NYC in mid-November.

- **Aorfix Long-term PYTHAGORAS data**: as a reminder, PYTHAGORAS was a controlled, prospective, non-randomized clinical study conducted at 41 sites in the U.S., three in Canada and one in Poland. Results of the

study were the main support for Lombard's U.S. premarket approval (PMA) filing and what FDA based their approval decision upon. 218 patients were enrolled in the investigational arm and 210 ultimately treated. Of the 210 treated with Aorfix, 67 had neck angles less than 60 degrees, 109 with 60 degrees to 90 degrees, and 42 greater than 90 degrees. The Aorfix-treated group was compared to an open surgical group which consisted of 76 patients. The high neck-angle cohort also had other risk factors that have been associated with poor outcomes.

**The data presented at VEITH in November relates to five-year follow-up** which continues to demonstrate Aorfix's high performance in both normal and tortuous anatomies. Five-year data showed no type I or III endoleaks and migration in just 3.3% of cases. In addition, 95% of patients with neck angles greater than 60 degrees and 99% of patients with neck angles less than 60 degrees were free from aneurysm-related mortality. The data has been accepted for publication by the Journal of Vascular Surgery.

- **Altura** was featured in a presentation titled "Advantages and Limitations of Lombard's Altura Endograft Device to Simplify EVAR Procedures: A Multicenter Study". Data relates to 24 patients with average of 75 which were treated with Altura over a six month period. Results highlighted the advertised benefits of Altura – specifically the relative ease of placing the device, short procedure times, ultra low profile and high performance. Specific highlights were a short deployment time, which ranged from just 19 – 45 minutes, low contrast dose, and very high success rate with 100% of patients free from type I and III endoleaks and no sign of migration. In addition, it was noted that 18 of the 24 patients were discharged within 24 hours and no deaths had occurred at 90-day follow-up.

## FINANCIAL MODEL

**Lombard Medical, Inc.**

| | 2015 A | Q1A | Q2A | Q3A | Q4E | 2016 E | 2017 E | 2018 E | 2019 E |
|---|---|---|---|---|---|---|---|---|---|
| Total Revenues | $15,114.0 | $2,922.0 | $3,803.0 | $3,044.0 | $3,266.0 | $13,035.0 | $15,039.1 | $16,940.2 | $19,889.8 |
| *YOY Growth* | *13.8%* | *-14.3%* | *-16.1%* | *-28.0%* | *11.0%* | *-13.8%* | *15.4%* | *12.6%* | *17.4%* |
| Cost of Goods Sold | $8,296.0 | $1,938.0 | $3,388.0 | $2,694.0 | $2,906.7 | $10,926.7 | $11,429.7 | $11,011.2 | $11,536.1 |
| Gross Income | $6,818.0 | $984.0 | $415.0 | $350.0 | $359.3 | $2,108.3 | $3,609.4 | $5,929.1 | $8,353.7 |
| *Gross Margin* | *45.1%* | *33.7%* | *10.9%* | *11.5%* | *11.0%* | *16.2%* | *24.0%* | *35.0%* | *42.0%* |
| Sell, Mktg & Dist | $23,125.0 | $4,110.0 | $3,487.0 | $3,600.0 | $3,007.0 | $14,204.0 | $12,761.0 | $13,111.0 | $14,121.8 |
| *% SM&D* | *153.0%* | *140.7%* | *91.7%* | *118.3%* | *92.1%* | *109.0%* | *84.9%* | *77.4%* | *71.0%* |
| R&D | $11,279.0 | $2,306.0 | $2,291.0 | $1,739.0 | $1,715.0 | $8,051.0 | $7,010.0 | $7,115.0 | $7,250.0 |
| *% R&D* | *74.6%* | *78.9%* | *60.2%* | *57.1%* | *52.5%* | *61.8%* | *46.6%* | *42.0%* | *28.2%* |
| Admin | $11,707.0 | $1,888.0 | $1,930.0 | $1,776.0 | $1,740.0 | $7,334.0 | $7,020.0 | $7,210.0 | $7,515.0 |
| *% Admin* | *77.5%* | *64.6%* | *50.7%* | *58.3%* | *53.3%* | *56.3%* | *46.7%* | *42.6%* | *37.8%* |
| Operating Income | ($39,293.0) | ($7,320.0) | ($7,293.0) | ($6,765.0) | ($6,102.7) | ($27,480.7) | ($23,181.6) | ($21,506.9) | ($20,533.0) |
| *Operating Margin* | *-260.0%* | *-250.5%* | *-191.8%* | *-222.2%* | *-186.9%* | *-210.8%* | *-154.1%* | *-127.0%* | *-103.2%* |
| Total Other Income (Expense) | ($726.0) | ($491.0) | ($1,232.0) | ($818.0) | ($599.0) | ($3,140.0) | ($1,914.3) | ($1,702.5) | ($760.2) |
| Pre-Tax Income | ($40,019.0) | ($7,811.0) | ($8,525.0) | ($7,583.0) | ($6,701.7) | ($30,620.7) | ($25,095.9) | ($23,209.5) | ($21,293.3) |
| Tax expense (benefit) | ($2,215.0) | ($205.0) | ($210.0) | ($161.0) | ($147.4) | ($723.4) | ($501.9) | ($464.2) | ($425.9) |
| *Tax Rate* | *5.5%* | *2.6%* | *2.5%* | *2.1%* | *2.2%* | *2.4%* | *2.0%* | *2.0%* | *2.0%* |
| Net Income | ($37,804.0) | ($7,606.0) | ($8,315.0) | ($7,422.0) | ($6,554.3) | ($29,897.3) | ($24,594.0) | ($22,745.3) | ($20,867.4) |
| *YOY Growth* | *8.8%* | *-23.6%* | *1.4%* | *-8.9%* | *-13.4%* | *-20.9%* | *-17.7%* | *-7.5%* | *-8.3%* |
| *Net Margin* | *-250.1%* | *-260.3%* | *-218.6%* | *-243.8%* | *-200.7%* | *-229.4%* | *-163.5%* | *-134.3%* | *-104.9%* |
| EPS | ($2.13) | ($0.38) | ($0.42) | ($0.37) | ($0.31) | ($1.48) | ($0.61) | ($0.37) | ($0.30) |
| *YOY Growth* | *-10.8%* | *-40.9%* | *-19.5%* | *-13.5%* | *-12.8%* | *-30.5%* | *-58.5%* | *-40.3%* | *-18.7%* |
| Diluted Shares O/S | 17,745 | 19,886 | 19,886 | 19,886 | 21,117 | 20,194 | 40,000 | 62,000 | 70,000 |

*Brian Marckx, CFA*

© Copyright 2016, Zacks Investment Research. All Rights Reserved.

## HISTORICAL ZACKS RECOMMENDATIONS




© Copyright 2016, 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, Brian Marckx, 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.

INVESTMENT BANKING AND FEES FOR SERVICES

Zacks SCR does not provide investment banking services nor has it received compensation for investment banking services from the issuers of the securities covered in this report or article.
Zacks SCR has received compensation from the issuer directly or from an investor relations consulting firm engaged by the issuer for providing non-investment banking services to this issuer and expects to receive additional compensation for such non-investment banking services provided to this issuer. The non-investment banking services provided to the issuer includes the preparation of this report, investor relations services, investment software, financial database analysis, organization of 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 and types of services contracted. Fees typically range between ten thousand and fifty thousand dollars per annum. Details of fees paid by this issuer are available upon request.

POLICY DISCLOSURES

This report provides an objective valuation of the issuer today and expected valuations of the issuer at various future dates based on applying standard investment valuation methodologies to the revenue and EPS forecasts made by the SCR Analyst of the issuer's business.
SCR Analysts are restricted from holding or trading securities in the issuers that they cover. ZIR and Zacks SCR do not make a market in any security followed by SCR nor do they act as dealers in these securities. Each Zacks SCR Analyst has full discretion over the valuation of the issuer included in this report based on his or her own due diligence. SCR Analysts are paid based on the number of companies they cover. SCR Analyst compensation is not, was not, nor will be, directly or indirectly, related to the specific valuations or views expressed in any report or article.

ADDITIONAL INFORMATION

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