Zacks Small-Cap Research

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Aralez Pharmaceuticals Inc. (ARLZ-NASDAQ)

ARLZ: Looking to Capitalize on Successful Launch of Zontivity®…

Based on our financial model that uses a EV/revenue multiple of 5.0x based on projected 2021 revenues, with a 15% discount rate, ARLZ is valued at $6/share. Additional upside to this valuation is possible from increased sales of YOSPRALA® and/or accretive deals.

Current Price (08/10/17)	$1.12
Valuation	**$6.00**

OUTLOOK

On August 9, 2017, Aralez Pharmaceuticals Inc. (ARLZ) announced financial results for the second quarter of 2017. The company reported revenues of $27.6 million and a net loss of $27.5 million, or $0.42 per share. On an adjusted EBITDA, which excludes certain non-cash charges and one-time payments, the company reported a net loss of $3.3 million.

The company has had a successful launch for Zontivity®, with both new prescription and total prescription weekly numbers already exceeding the highs previously set by Merck. We will continue to monitor prescription growth and believe the early results are a clear positive sign for the company.

SUMMARY DATA

52-Week High	**$6.26**
52-Week Low	**$1.12**
One-Year Return (%)	**-74.01**
Beta	**1.35**
Average Daily Volume (sh)	**783,452**
Shares Outstanding (mil)	**67**
Market Capitalization ($mil)	**$75**
Short Interest Ratio (days)	**1**
Institutional Ownership (%)	**36**
Insider Ownership (%)	**7**
Annual Cash Dividend	**$0.00**
Dividend Yield (%)	**0.00**
5-Yr. Historical Growth Rates	
Sales (%)	**-3.2**
Earnings Per Share (%)	**N/A**
Dividend (%)	**N/A**
P/E using TTM EPS	**N/A**
P/E using 2017 Estimate	**-1.9**
P/E using 2018 Estimate	**-2.1**

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

ZACKS ESTIMATES

Revenue
(In millions of $)

	Q1 (Mar)	Q2 (Jun)	Q3 (Sep)	Q4 (Dec)	Year (Dec)
2016	8.1 A	12.6 A	13.6 A	20.0 A	54.3 A
2017	26.0 A	27.6 A	23.5 E	24.8 E	101.9 E
2018					102.0 E
2019					111.0 E

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

	Q1 (Mar)	Q2 (Jun)	Q3 (Sep)	Q4 (Dec)	Year (Dec)
2016	-$0.65 A	-$0.27 A	-$0.32 A	-$0.55 A	-$1.67 A
2017	-$0.42 A	-$0.42 A	-$0.38 E	-$0.35 E	-$1.57 E
2018					-$1.30 E
2019					-$1.25 E

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WHAT'S NEW

Financial Update

On August 9, 2017, Aralez Pharmaceuticals Inc. (ARLZ) announced financial results for the second quarter of 2017 and provided a business update. Total revenues for the second quarter of 2017 were $27.6 million, compared to $12.6 million for the second quarter of 2016. The $27.6 million of revenue consisted of $8.8 million in net product revenue, which is derived from the product portfolio acquired from the acquisition of Tribute along with net product revenues for YOSPRALA®, Fibricor®, and Zontivity®, and other revenues of $18.9 million, which were comprised of $3.9 million in royalties from the sale of VIMOVO®, a $4.0 million one time license fee that was recorded in the second quarter in connection with a license agreement signed in May 2017, and net revenues from the Toprol-XL® franchise of $11.0 million.

Cost of product revenues were $2.9 million for the second quarter of 2017, compared to $3.4 million for the second quarter of 2016. The decrease was primarily related to $0.8 million in inventory step-up costs related to the Tribute merger that were expensed in the second quarter of 2016 partially offset by an increase in production costs related to the increased product sales in the second quarter of 2017.

SG&A expenses were $32.2 million for the second quarter of 2017, compared to $22.7 million for the second quarter of 2016. The increase was primarily due to an increase in the company's U.S. sales force and increased promotional expenses associated with the commercialization of YOSPRALA® and the relaunch of Zontivity®.

Interest expense was $6.7 million for the second quarter of 2017 compared to $0.6 million in the second quarter of 2016. The increase was due to the borrowing of $200 million under the credit facility with Deerfield. Amortization of intangible assets was $8.5 million in the second quarter of 2017, related to the acquisition of Tribute, Zontivity®, and Toprol-XL®, compared to $2.1 million in the second quarter of 2016, which was related solely to the acquisition of Tribute. The change in fair value of contingent consideration was $3.6 million, which is related to accretion of the Toprol-XL® and Zontivity® franchises, while there was no expense related to the fair value in contingent consideration for the second quarter of 2016.

Net loss for the second quarter of 2017 was $27.5 million, or $0.42 per share, while adjusted EBITDA showed a loss of $3.3 million. The company is continuing to guide for full year 2017 revenues of $80 to $100 million, although during the second quarter conference call management indicated this is likely to come in at the high end of that range. In addition, the company is continuing to guide for adjusted EBITDA to be in the range of ($5) million to $5 million.

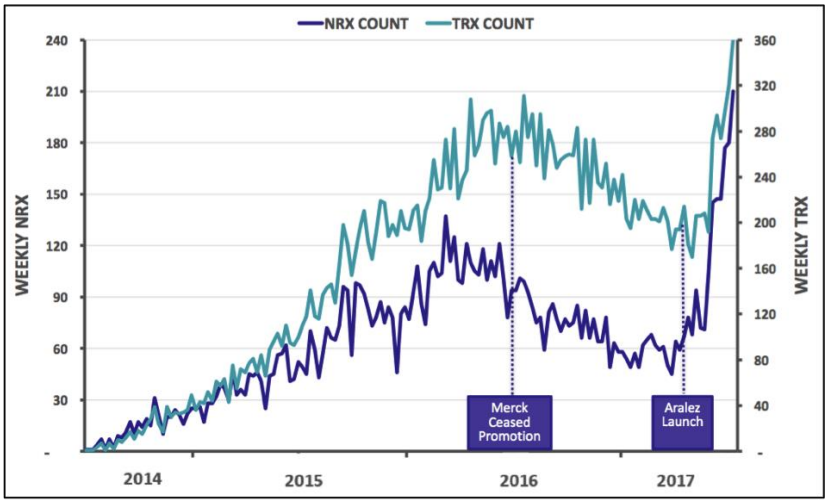
Aralez had $55.8 million in cash and cash equivalents as of June 30, 2017 and we believe that the company has sufficient capital to fund operations for at least the next 12 months.

Business Update

Promising Early Data Following Zontivity® Launch

On June 7, 2017, Aralez announced the national commercial launch of Zontivity® in the U.S. The company had previously commenced a phased launch of Zontivity® in late April 2017 with 15 sales representatives targeting high volume physicians who treat post-myocardial infarction and peripheral artery disease (PAD) patients.

The company's full sales force (75 representatives) is now promoting Zontivity® to approximately 12,000 cardiologists, primary care physicians, and vascular surgeons. The early numbers following the launch look quite promising. The following chart shows that both new prescriptions (NRx) and total prescriptions (TRx) have recently hit new all time highs and are exceeding the previous highs set by Merck in 2016 before it ceased promotion.



Source: Aralez Pharmaceuticals Inc.

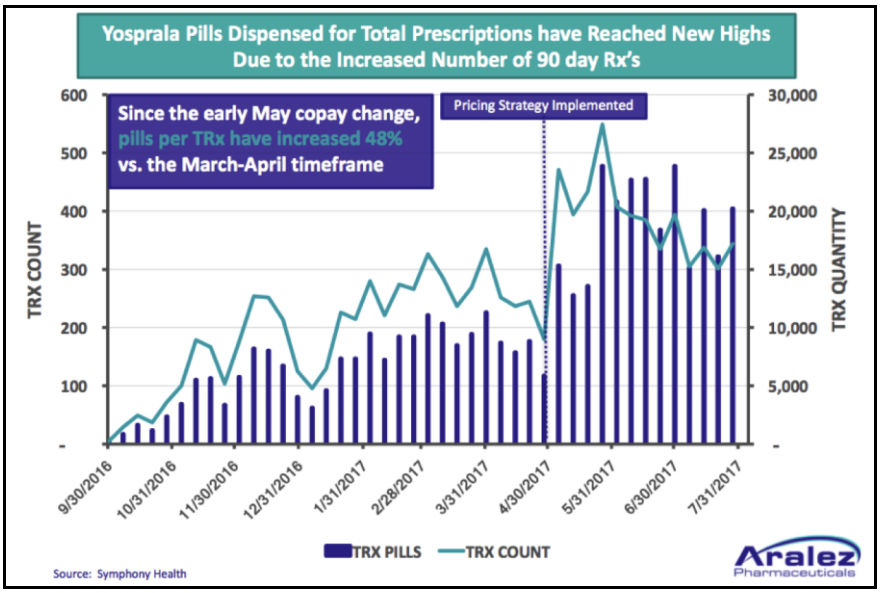
Helping to contribute to the rise in prescriptions is the increase in managed care coverage for Zontivity® since April 1, 2017. Since that time, Aralez has increased covered lives from approximately 70 million to 170 million. The four largest pharmacy benefit managers (PBMs) cover Zontivity® and less than 15% of covered lives require a prior authorization. Since July 1st, Zontivity® was added to the two largest Medicare Part D formularies and is now covered on over 70% of state Medicaid formularies.

We are encouraged by the early data following the launch of Zontivity® and we will continue to monitor prescribing data closely over the next few quarters to determine whether this trend continues.

YOSPRALA® Numbers Improving Following Price Change

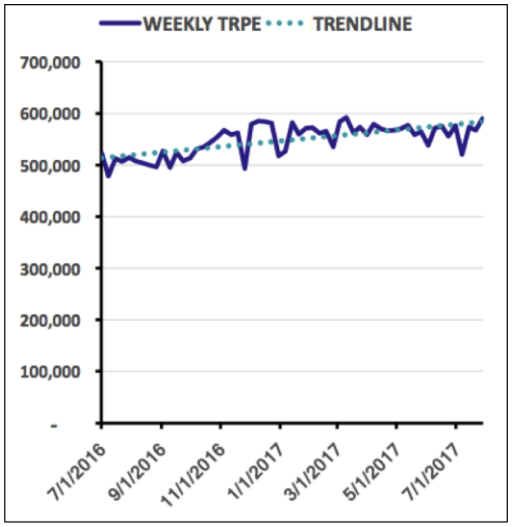
Following a lackluster launch, Aralez has initiated a number of changes regarding YOSPRALA®. The first change was a 32% reduction in the U.S. sales force, which was disclosed in April 2017. The other major change was a new pricing strategy for YOSPRALA®. The new pricing program is aimed at allowing all patients access to YOSPRALA® for only $10 per month, regardless of whether a patient has insurance or not or what the copay is if insured. This compares to a $20 target copay that was instituted at launch.

The following graph shows a sizeable increase in prescriptions for YOSPRALA® following implementation of the price change. Also, there appears to be a shift to more 90-day supply prescriptions, as shown by an increase in the total number of pills per prescription. In addition, rejections have decreased from 60% to approximately 30% and patient abandonment has dropped to 10%. We will continue to monitor these numbers closely to determine if this trend continues.



Toprol-XL® Providing Steady Source of Revenues

During the second quarter conference call, management indicated that Toprol-XL® is continuing to perform in-line with the company's expectations. The following chart shows that prescription volume continues to be strong and is trending in a positive direction. The company reported $11.0 million in revenues for Toprol-XL® in the second quarter of 2017.



Source: Aralez Pharmaceuticals Inc.

VIMOVO® Patents Upheld

On June 27, 2017, Aralez announced that the U.S. District Court for the District of New Jersey upheld the validity of two patents that cover VIMOVO®. A subsidiary of Aralez filed patent infringement lawsuits against Dr. Reddy's Laboratories Inc., Lupin Pharmaceuticals Inc., and Mylan Pharmaceuticals, Inc. in April 2011, July 2011, and June 2013, respectively, related to Abbreviated New Drug Applications (ANDAs) filed with the U.S. FDA for generic versions of VIMOVO®. The lawsuit alleged infringement of U.S. Patents 8,557,285 and 6,926,907, and the court's decision will prevent any generic versions of VIMOVO® in the U.S. until at least the expiry of the '907 patent (Feb. 2023), although VIMOVO® may have protection due to other patents until 2031. Perhaps most importantly, the prevention of generic competitors to VIMOVO® protects Aralez's guaranteed minimum royalty from Horizon Pharma of $7.5 million per year based on the licensing agreement between the two firms. Lastly, this could lend support to the company in their patent fight with Teva Pharmaceuticals, which is attempting to bring a generic version of YOSPRALA® to market. The '907 patent is one of the patents being challenged by Teva, however that case is likely years away from a verdict.

Conclusion and Valuation

Following a very rough first half of 2017 for Aralez, it appears as though the company has at least stabilized, and may be in the process of heading in the right direction. The early numbers for Zontivity® look promising, and the company's focus on high-risk PAD patients may end up paying dividends. While YOSPRALA® is unlikely to ever live up to its original billing, its nice to see patients and prescribers responding favorably to the new pricing strategy. We will continue with updates on sales for Zontivity® and YOSPRALA® throughout the year, and are cautiously optimistic this may be the beginning of a turn around for the company. Our valuation remains $6.00, and now may be a good time for those with a high-risk tolerance to consider an investment in Aralez.

PROJECTED FINANCIALS

Aralez Pharmaceuticals Inc.
Income Statement

Aralez Pharmaceuticals, Inc.	2016 A	Q1 A	Q2 A	Q3 E	Q4 E	2017 E	2018 E	2019 E
Royalties and License Fees	**$20.3**	**$3.7**	**$7.9**	**$3.5**	**$3.5**	**$18.6**	**$12.0**	**$11.0**
YOY Growth		-	-	-	-	*-8.2%*	*-35.5%*	*-8.3%*
U.S. Core Products	**$8.6**	**$15.6**	**$12.8**	**$13.0**	**$14.0**	**$55.4**	**$60.0**	**$65.0**
YOY Growth	-	-	-	-	-	-	-	-
Canadian Products	**$25.4**	**$6.7**	**$6.9**	**$7.0**	**$7.3**	**$27.9**	**$30.0**	**$35.0**
Total Revenues	$54.3	$26.0	$27.6	$23.5	$24.8	$101.9	$102.0	$111.0
YOY Growth	-	-	-	-	-	*87.8%*	*0.1%*	*8.8%*
Cost of Goods Sold	$11.8	$2.8	$2.9	$2.8	$2.8	$11.3	$12.0	$13.0
Gross Income	$42.5					$90.6	$90.0	$98.0
Product Gross Margin	*78.3%*	*89.4%*	*89.3%*	*88.1%*	*88.7%*	*88.9%*	*88.2%*	*88.3%*
SG&A	$107.0	$28.0	$29.3	$23.0	$23.0	$103.3	$100.0	$105.0
% SG&A	*197.1%*	*107.8%*	*106.0%*	*97.9%*	*92.7%*	*101.4%*	*98.0%*	*94.6%*
SG&A Stock Based Compensation	$11.6	$2.8	$2.9	$2.9	$3.0	$11.7	$15.0	$15.0
R&D	$8.5	$0.1	$0.7	$0.6	$0.5	$1.9	$3.0	$3.0
% R&D	*15.7%*	*0.4%*	*2.6%*	*2.6%*	*2.0%*	*1.9%*	*2.9%*	*2.7%*
R&D Stock Based Compensation	$0.3	$0.0	$0.0	$0.0	$0.0	$0.0	$0.2	$0.3
EBITDA	($84.9)	($7.7)	($8.3)	($5.8)	($4.5)	($26.3)	($28.2)	($25.3)
Operating Margin	*-156.4%*	*-29.7%*	*-30.0%*	*-24.7%*	*-18.2%*	*-25.8%*	*-27.6%*	*-22.8%*
Interest, Income Net and Other	($5.5)	($6.2)	($6.6)	($6.8)	($6.8)	($26.5)	($26.9)	($26.9)
Amortization Expense	($12.6)	($8.5)	($8.5)	($8.5)	($8.5)	($34.0)	($34.0)	($34.0)
Change in Fair Value of Contingent Consideration	$0.0	($4.4)	($3.6)	($4.0)	($4.0)	($16.0)	($16.0)	($16.0)
Pre-Tax Income	($103.0)	($26.9)	($27.0)	($25.1)	($23.8)	($102.9)	($89.1)	($86.2)
Taxes	($0.1)	$0.6	$0.5	$0.5	$0.5	$2.0	$3.0	$5.0
Net Income	($103.0)	($27.5)	($27.5)	($25.6)	($24.3)	($104.9)	($92.1)	($91.2)
YOY Growth	-	-	-	-	-	*1.9%*	*-12.2%*	*-1.0%*
Net Margin	*-189.7%*	*-105.7%*	*-99.6%*	*-109.0%*	*-98.0%*	*-102.9%*	*-90.3%*	*-82.2%*
Reported EPS	($1.67)	($0.42)	($0.42)	($0.38)	($0.35)	($1.57)	($1.30)	($1.25)
Avg. Weighted Shares Outstanding	61.8	65.5	66.1	67.5	68.5	66.9	71.0	73.0

Source: Zacks Investment Research, Inc. *David Bautz, PhD*

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Adjusted EBITDA

	1Q17 A	2Q17 A	3Q17 E	4Q17 E	2017 E
Net Loss	($27.5)	($27.5)	($25.6)	($24.3)	($104.9)
Share based comp	$2.8	$3.0	$2.9	$3.0	$11.7
Retention/Severence	$0.1	$0.9	$0.1	$0.0	$1.1
D&A	$8.9	$8.9	$8.9	$8.9	$35.6
Interest	$6.6	$6.6	$6.8	$6.8	$26.8
Change in FV contingent consideration	$4.4	$3.6	$4.0	$4.0	$16.0
Transaction related expenses	$0.8	$0.8	$0.8	$0.8	$3.2
Taxes	$0.6	$0.5	$0.5	$0.5	$2.0
Other	($0.3)	($0.1)	($0.2)	($0.2)	($0.8)
Adjusted EBITDA	($3.6)	($3.3)	($1.8)	($0.5)	($9.2)

Source: Zacks Investment Research, Inc. *David Bautz, PhD*

HISTORICAL STOCK PRICE



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