Zacks Small-Cap Research

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Aralez Pharmaceuticals Inc. (ARLZ-NASDAQ)

ARLZ: Promising Early Data Following Launch of Zontivity®; VIMOVO® Patents Upheld…

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 (07/10/17)	$1.35
Valuation	**$6.00**

OUTLOOK

Aralez Pharmaceuticals, Inc. (ARLZ) recently announced the U.S. commercial launch of Zontivity® with 75 sales representatives targeting 12,000 cardiologists, primary care physicians, and vascular surgeons. Early data following the launch is very encouraging, with weekly new prescription numbers exceeding the prior high set by Merck. We will continue to track these numbers to determine if this positive early trend continues.

On June 27, 2017, Aralez announced that the U.S. District Court upheld the validity of two patents covering VIMOVO® and that no generic versions of VIMOVO® may be launched until at least the expiration of one of those patents. The earliest patent expiry is February 2023, however other patents related to VIMOVO® may extend patent protection to 2031.

SUMMARY DATA

52-Week High	**$6.26**
52-Week Low	**$1.14**
One-Year Return (%)	**-62.60**
Beta	**1.37**
Average Daily Volume (sh)	**658,547**
Shares Outstanding (mil)	**66**
Market Capitalization ($mil)	**$89**
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	21.6 E	19.8 E	19.9 E	87.3 E
2018					100.0 E
2019					107.0 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	-$0.43 E	-$0.46 E	-$0.46 E	-$1.76 E
2018					-$1.41 E
2019					-$1.40 E

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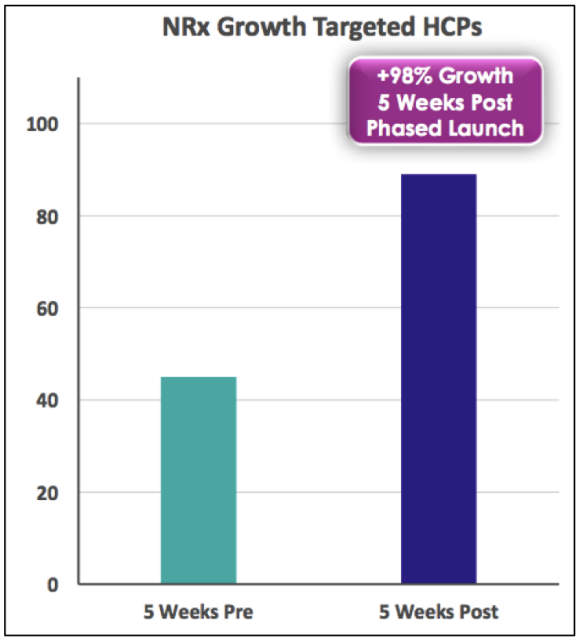
WHAT'S NEW

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. As the following figure shows, the phased launch was very successful with 98% growth in new prescriptions (NRx) after five weeks, compared to the five weeks preceding the phased launch.



Source: Aralez Pharmaceuticals, Inc.

The company's full sales force (approximately 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. According to management, for the week ending June 23, 2017, NRx hit an all-time high of 145 (Merck's previous high was 137), which was a 39% increase over the previous week and following multiple weeks of flat total prescriptions (TRx), that number increased 48% to 274.

The company is focused on continuing the momentum seen following the launch through the following strategic initiatives:

- Continuing to enhance managed care coverage, where Zontivity® is now covered by approximately 85% of Commercial Lives. The four largest pharmacy benefit managers (PBMs) are covering Zontivity®, with less than 15% of Commercial Lives requiring a prior authorization, which the company hopes to cut in half in the near term.

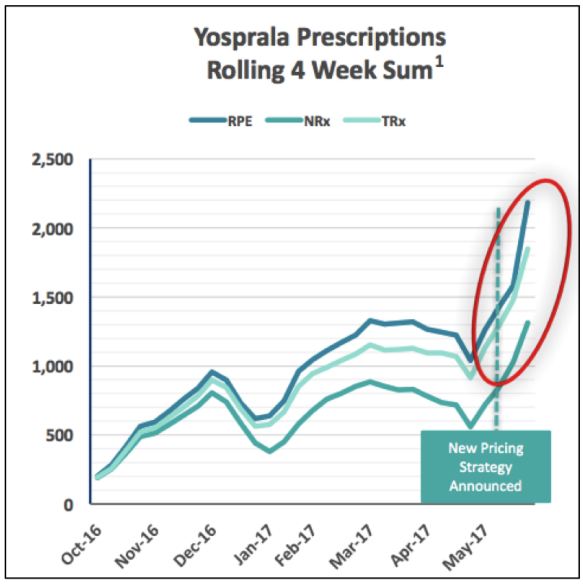
- Focusing on those patients with PAD and/or patients with a history of MI who also have diabetes and/or are smokers.

- Reducing patient co-pays to approximately $6/month through subsidy programs.

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. In addition, rejections have decreased from 60% to approximately 30%. We will continue to monitor these numbers closely to determine if this trend continues.



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 E	Q3 E	Q4 E	2017 E	2018 E	2019 E
Vimovo (royalty)	**$20.3**	**$3.7**	**$3.5**	**$3.5**	**$3.5**	**$14.2**	**$12.0**	**$11.0**
YOY Growth		-	-	-	-	*-29.9%*	*-15.5%*	*-8.3%*
Zontivity	**$0.6**	**$0.6**	**$0.6**	**$0.8**	**$0.9**	**$2.9**	**$3.5**	**$8.0**
YOY Growth	-	-	-	-	-	-	-	-
Toprol XL	**$8.0**	**$15.0**	**$11.0**	**$9.0**	**$9.0**	**$44.0**	**$55.0**	**$53.0**
YOY Growth	-	-	-	-	-	-	-	-
Product Revenues	**$25.4**	**$6.7**	**$6.5**	**$6.5**	**$6.5**	**$26.2**	**$29.5**	**$35.0**
Total Revenues	$54.3	$26.0	$21.6	$19.8	$19.9	$87.3	$100.0	$107.0
YOY Growth	-	-	-	-	-	*60.8%*	*14.6%*	*7.0%*
Cost of Goods Sold	$11.8	$2.8	$2.8	$2.8	$2.8	$11.2	$18.0	$20.0
Gross Income	$42.5					$76.1	$82.0	$87.0
Product Gross Margin	*78.3%*	*89.4%*	*87.0%*	*85.9%*	*85.9%*	*87.2%*	*82.0%*	*81.3%*
SG&A	$107.0	$28.0	$23.0	$23.0	$23.0	$97.0	$100.0	$105.0
% SG&A	*197.1%*	*107.8%*	*106.5%*	*116.2%*	*115.6%*	*111.2%*	*100.0%*	*98.1%*
SG&A Stock Based Compensation	$11.6	$2.8	$3.5	$4.0	$4.0	$14.3	$15.0	$15.0
R&D	$8.5	$0.1	$0.6	$0.8	$1.3	$2.8	$3.0	$3.0
% R&D	*15.7%*	*0.4%*	*2.8%*	*4.0%*	*6.5%*	*3.2%*	*3.0%*	*2.8%*
R&D Stock Based Compensation	$0.3	$0.0	$0.1	$0.1	$0.1	$0.2	$0.2	$0.3
EBITDA	($84.9)	($7.7)	($8.4)	($10.9)	($11.3)	($38.2)	($36.2)	($36.3)
Operating Margin	*-156.4%*	*-29.7%*	*-38.7%*	*-54.8%*	*-56.5%*	*-43.7%*	*-36.2%*	*-33.9%*
Interest, Income Net and Other	($5.5)	($6.2)	($6.9)	($6.9)	($6.9)	($26.9)	($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)	($4.0)	($4.0)	($4.0)	($16.4)	($16.0)	($16.0)
Pre-Tax Income	($103.0)	($26.9)	($27.8)	($30.3)	($30.7)	($115.6)	($97.1)	($97.2)
Taxes	($0.1)	$0.6	$0.8	$1.0	$1.0	$3.4	$3.0	$5.0
Net Income	($103.0)	($27.5)	($28.6)	($31.3)	($31.7)	($118.9)	($100.1)	($102.2)
YOY Growth	-	-	-	-	-	*15.5%*	*-15.8%*	*2.1%*
Net Margin	*-189.7%*	*-105.7%*	*-132.2%*	*-157.8%*	*-159.0%*	*-136.2%*	*-100.1%*	*-95.5%*
Reported EPS	($1.67)	($0.42)	($0.43)	($0.46)	($0.46)	($1.76)	($1.41)	($1.40)
Avg. Weighted Shares Outstanding	61.8	65.5	67.0	68.0	69.0	67.4	71.0	73.0

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

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