Zacks Small-Cap Research

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Aralez Pharmaceuticals Inc. (ARLZ-NASDAQ)

ARLZ: Zontivity to be Officially Launched in June 2017…

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 (05/15/17)	$1.56
Valuation	**$6.00**

OUTLOOK

On May 9, 2017, Aralez Pharmaceuticals Inc. (ARLZ) announced financial results for the first quarter of 2017 and provided a business update. The company reported $26.0 million in revenue and a net loss of $27.5 million, or $0.42 per share. Adjusted EBITDA was ($3.6) million, compared to Adjusted EBITDA of ($11.1) million for the three months ended March 31, 2016.

Aralez has implemented a new pricing program that will allow all patients access to YOSPRALA® for $10 per month, regardless of coverage or copay level set by the insurer. In addition, the company has identified cost saving initiatives totaling approximately $23 million that will allow added flexibility while getting through the current challenging business environment.

SUMMARY DATA

52-Week High	**$6.26**
52-Week Low	**$1.21**
One-Year Return (%)	**-55.81**
Beta	**1.12**
Average Daily Volume (sh)	**1,017,817**
Shares Outstanding (mil)	**66**
Market Capitalization ($mil)	**$103**
Short Interest Ratio (days)	**1**
Institutional Ownership (%)	**44**
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

Financial Update

On May 8, 2017, Aralez Pharmaceuticals Inc. (ARLZ) announced financial results for the first quarter of 2017 and provided a business update. Total revenues for the first quarter of 2017 were $26.0 million, compared to $8.1 million for the first quarter of 2016. The $26.0 million of revenue consisted of $6.7 million in net product revenues, which are derived from the product portfolio acquired from the acquisition of Tribute along with net product revenues from YOSPRALA® and Fibricor®. Other revenues of $19.3 million were comprised of $15.6 million in revenues from the acquisitions of Toprol-XL® and Zontivity® and Vimovo® royalties of $3.7 million. Aralez is guaranteed a minimum annual royalty of $7.5 million from Horizon Pharma for Vimovo®, which is reflected in the Vimovo® royalty number.

Cost of product revenues were $2.8 million compared to $2.5 million for the first quarter of 2016. The increase was primarily related to a full quarter of product costs, compared to 2016 that only included results from Feb. 5, 2016, the date of the merger with Tribute.

SG&A expenses were $30.8 million for the first quarter of 2017, compared to $37.5 million for the first quarter of 2016. The decrease was due to a lack of merger related costs that were incurred in 2016 partially offset by an increased sales force and promotional expenses during the first quarter of 2017.

Interest expense was $6.7 million for the first quarter of 2017 compared to $0.3 million in the first 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 first quarter of 2017, related to the acquisition of Tribute, Zontivity, and Toprol-XL, compared to $1.2 million in the first quarter of 2016, which was related solely to the acquisition of Tribute. The change in fair value of contingent consideration was $4.4 million 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 first quarter of 2016.

Net loss for the first quarter of 2017 was $27.5 million, or $0.42 per share, while adjusted EBITDA was ($3.6). Aralez had $73.7 million in cash and cash equivalents as of March 31, 2017. Subsequent to the end of the quarter, Aralez's subsidiary Pozen Inc. granted a non-exclusive license to a Japanese patent to a multi-national company for an upfront payment of $4.0 million plus potential milestone payments and royalties.

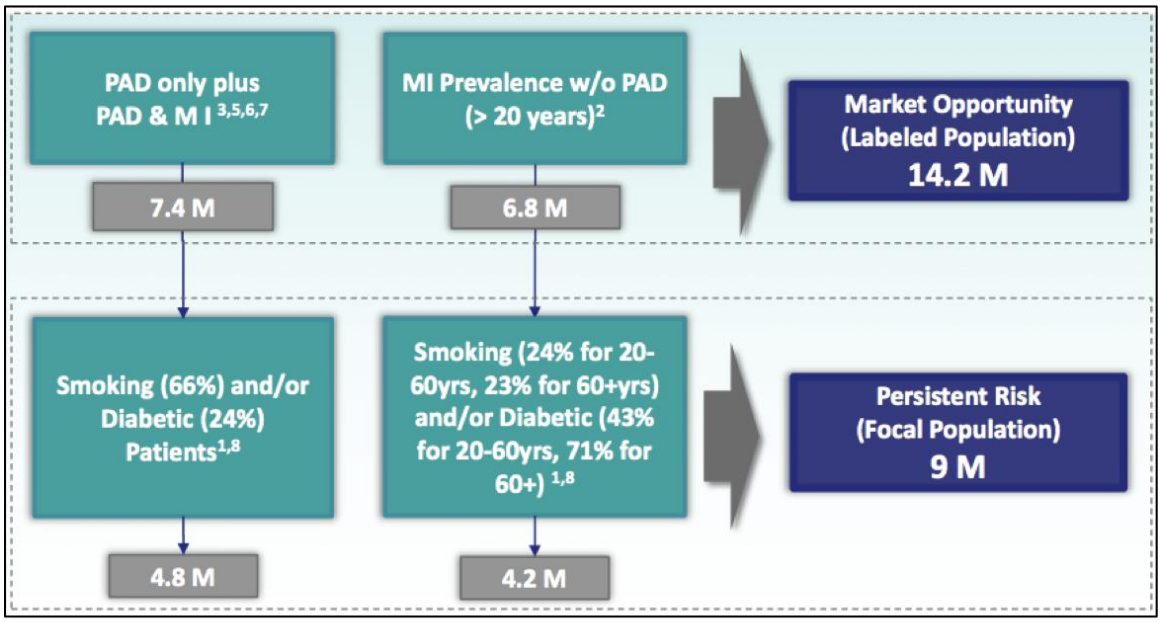
Aralez provided updated financial guidance for 2017 that included a description of the cost savings initiative that began in April 2017. The total expected operating expense reduction in 2017 is $23.0 million and includes the previously announced 32% reduction in the U.S. sales force (savings of $5.5 million), a decrease of approximately $9.0 million in 2017 commercial spending (related to non-direct marketing spend on YOSPRALA®), and additional business expenses across all departments of approximately $8.5 million. The company is continuing to guide for total revenues of $80 to $100 million and has updated adjusted EBIDTA to be in the range of ($5) million to $5 million.

Zontivity® Update

Aralez began Phase 1 of the Zontivity® launch on April 24th, 2017 with 15 sales representatives deployed to high volume targets who treat both post-myocardial infarction (MI) and peripheral arterial disease (PAD) patients. The 2nd Phase of the launch will initiate in June 2017 with 75 sales representatives targeting approximately 12,000 cardiologists, primary care physicians, and vascular surgeons. The company estimates that approximately 76% of formulary lives will be covered at launch.

Potential Market Opportunity

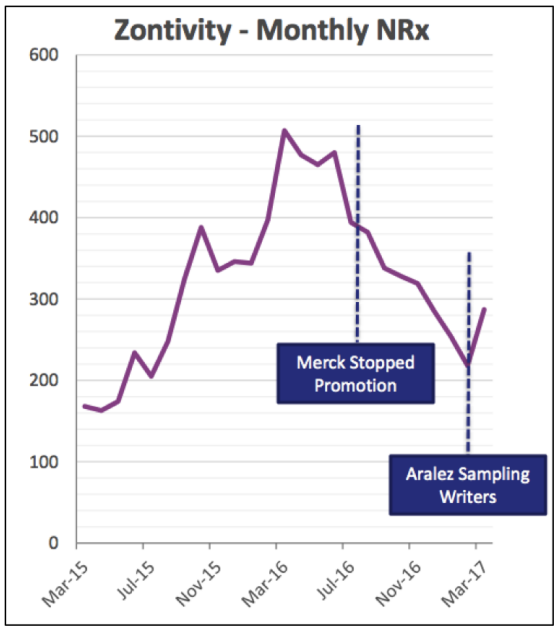
Zontivity® is indicated for the reduction of thrombotic cardiovascular events in patients with a history of MI or with PAD without a history of stroke or transient ischemic attack (TIA). Aralez is positioning Zontivity® for patients with PAD and/or MI and persistent risk (smoking and/or diabetes). The following graph shows the potential number of on-label patients is over 14 million, with approximately 9 million having persistent risk.



Source: Aralez Pharmaceuticals Inc.

Succeeding Where Merck Failed…

Merck was completely unsuccessful promoting Zontivity®, however Aralez believes they have identified a number of things that can be done differently to make Zontivity® a commercial success. Zontivity's® approval came ahead of schedule, thus Merck did not have adequate preparation in regards to meeting with key opinion leaders and getting the proper messaging for the product in place. Aralez has deliberately taken the time to meet with key opinion leaders to determine the correct patient population to target. In addition, Merck's sales force promoting Zontivity® was sub-optimal, and Aralez has taken the time to properly train its sales representatives for a successful launch. As the following graph shows, when Merck stopped promoting Zontivity® last summer sales dropped off. However, just since Aralez began sampling in February 2017, prescriptions have picked up.



Source: Aralez Pharmaceuticals Inc.

YOSPRALA® Update

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 is 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. YOSPRALA® currently has a patient abandonment rate that is triple that of other branded cardiovascular drugs. The company has identified pricing as the key driver behind the lackluster sales of YOSPRALA® thus far, and based on patient feedback, a $10 copay appears to offer a compelling value.

Conclusion and Valuation

We're glad to see that Aralez has instituted a number of measures in an attempt to address the current challenges facing the company. At this point, YOSPRALA® does not appear to have as much potential as originally thought, however it remains to be seen whether the new pricing strategy will help to increase sales, and it is something we will closely monitor in the coming quarters.

Zontivity® could end up being a true "diamond in the rough", as there appears to be a large patient population that would derive meaningful benefit from it. Aralez has attempted to identify the reasons that Merck was unsuccessful in promoting the drug, and we are confident that with a different strategy Zontivity® could be a solid product.

Our valuation for Aralez is based on an enterprise value (EV)/revenues multiple of 5.0x on projected 2021 revenues of $199 million using a 15% discount rate. The company currently has $275 million in debt and approximately $74 million in cash at the end of the first quarter of 2017. This leads to a valuation of approximately $6 per share.

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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