Zacks Small-Cap Research

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Aralez Pharmaceuticals Inc. (ARLZ-NASDAQ)

ARLZ: Increasing Revenue Projections for 2018…

Based on our financial model that uses a EV/revenue multiple of 4.5x based on projected 2022 revenues, with a 10% discount rate, ARLZ is valued at $7.50/share. Additional upside to this valuation is possible from increased sales of the company's products and/or accretive deals.

Current Price (11/13/17)	$1.68
Valuation	**$7.50**

OUTLOOK

On November 9, 2017, Aralez Pharmaceuticals, Inc. (ARLZ) announced financial results for the third quarter of 2017 and provided a business update. The company reported total revenues of $24.3 million as well as the first quarter of positive adjusted EBITDA of $0.4 million. Toprol-XL has shown surprising strength in 2017, with new prescription growth of 15% compared to 2016.

Aralez announced further financial improvements that are designed to help deliver profitability and extend the company's cash runway through 2018. In support of this, Aralez provided guidance for SG&A costs in 2018 of $79-$83 million, which is an approximately $32 million decrease from estimated SG&A costs in 2017. Based on increasing our revenue forecast we have adjusted our model, with a new valuation of $7.50 per share.

SUMMARY DATA

52-Week High	**$5.28**
52-Week Low	**$0.98**
One-Year Return (%)	**-65.31**
Beta	**1.37**
Average Daily Volume (sh)	**774,103**
Shares Outstanding (mil)	**67**
Market Capitalization ($mil)	**$114**
Short Interest Ratio (days)	**1**
Institutional Ownership (%)	**24**
Insider Ownership (%)	**7**
Annual Cash Dividend	**$0.00**
Dividend Yield (%)	**0.00**
5-Yr. Historical Growth Rates	
Sales (%)	**28.0**
Earnings Per Share (%)	**N/A**
Dividend (%)	**N/A**
P/E using TTM EPS	**N/A**
P/E using 2017 Estimate	**-0.6**
P/E using 2018 Estimate	**-0.8**

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	24.3 A	25.0 E	102.9 E
2018					143.0 E
2019					169.0 E

Earnings per Share

	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	-$0.37 A	-$0.35 E	-$1.55 E
2018					-$0.69 E
2019					-$0.44 E

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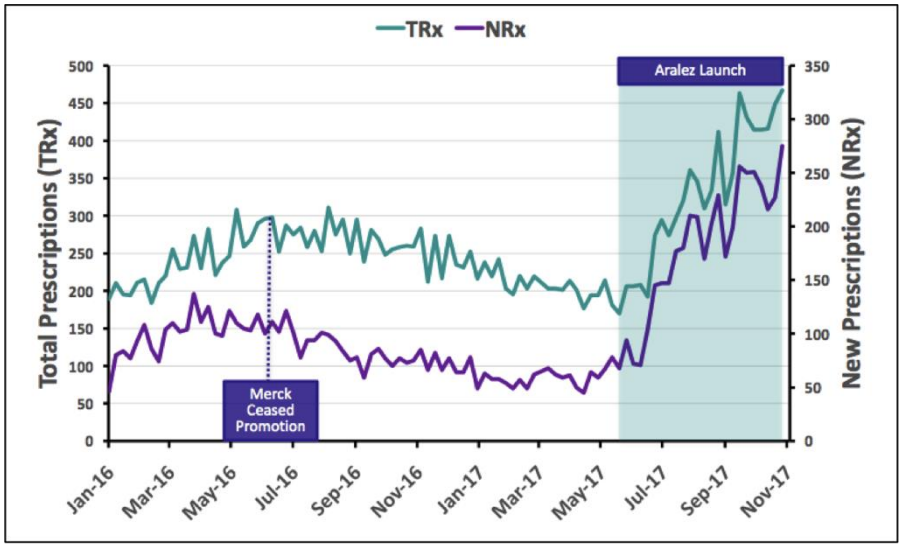
Business Update

Zontivity® Launch Progressing Nicely

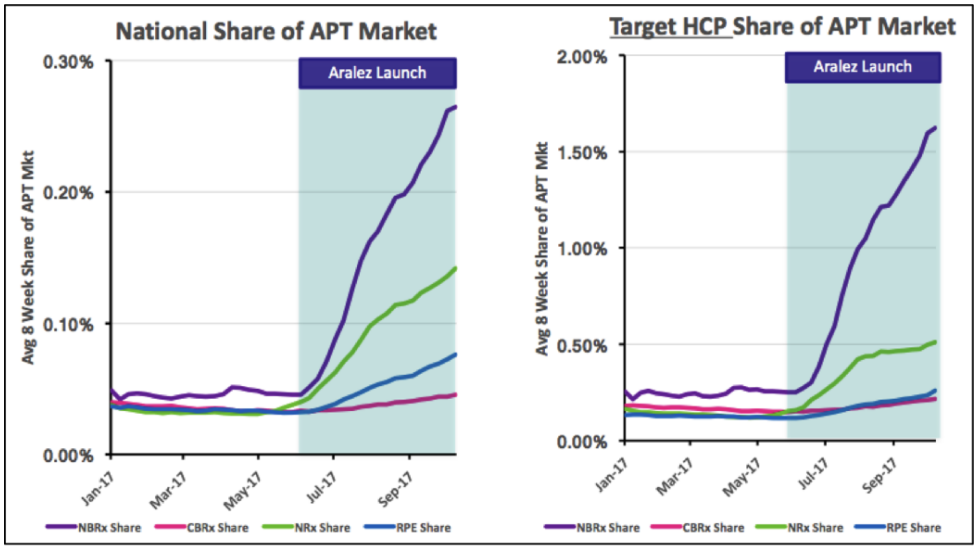
Aralez launched Zontivity® in June 2017 and is now promoting the drug with the company's 75 person sales force to approximately 12,000 cardiologists, primary care physicians, and vascular surgeons. During the third quarter of 2017 Aralez reported all-time highs in both new prescriptions (NRx) and total prescriptions (TRx), as they increased 151% and 82%, respectively. As the following chart shows, Zontivity® has shown strong weekly prescription growth since being launched by Aralez.



Source: Aralez Pharmaceuticals, Inc.

Refills increased 21% from the second quarter to the third quarter of 2017. Thus far, 65% of Zontivity® prescriptions are written by cardiologists, 24% from primary care physicians, and 4% from vascular surgeons. Approximately 90% of commercial lives are now covered (excluding Medicaid) along with approximately 65% of Medicare Part D lives.

Zontivity® is experiencing strong growth in the anti-platelet therapy (APT) market, particularly in the new to brand metric. The new to brand metric quantifies the patients that are new to prescription therapy in the APT market over the past 12 months. As the following graphs show, since it was launched Zontivity's® new to brand (NBRx) market share has been growing steadily and has reached 1.6% within the target health care practitioner audience.

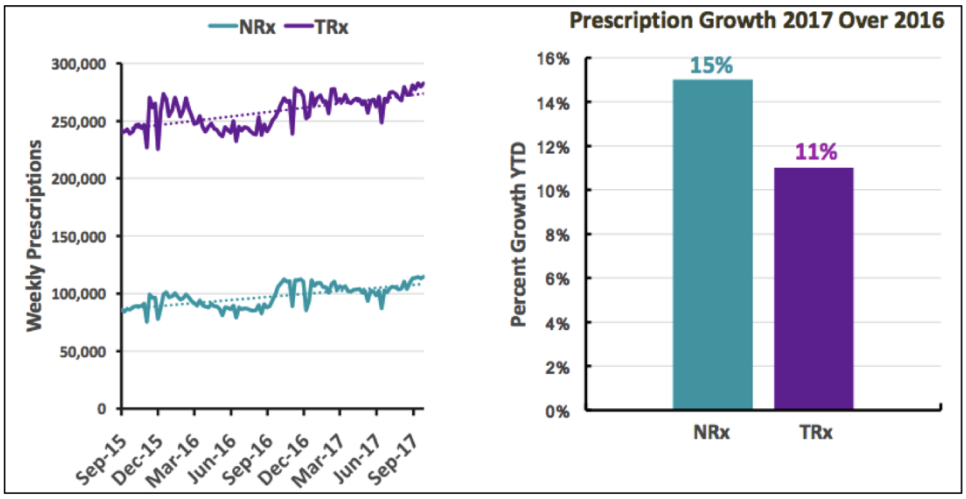


Source: Aralez Pharmaceuticals, Inc.

While still in the early stages of the launch, we are encouraged by the steadily increasing prescription numbers and encouraging feedback that the company is receiving from both prescribers and patients. During the recent conference call, management provided an example that peak market share for Zontivity® of 6-8% in the target APT market would correspond to approximately $100 million in sales. While the company did not give that as an official estimate for Zontivity's® potential, CEO Adrian Adams pointed out that he hoped the example was conservative. We believe that Zontivity® has great potential and we forecast for potential peak sales of approximately $150 million.

Continued Strength From Toprol-XL® Franchise

Aralez acquired Toprol-XL® and its authorized generic in October 2016 from AstraZeneca with the strategy being it would help to diversify the company's product offerings, revenue streams, and provide immediate cash flow. Toprol-XL® has proven to be a highly dependable revenue source. Prescription growth continues to be steady and predictable, as shown by the following graph on the left. The following graph on the right quantifies the growth of the Toprol-XL® franchise, which is a pleasant surprise for a drug that has been on the market for 20 years. The company is forecasting improved net product sales for the Toprol-XL® franchise in 2018 due to improved volume and margins as a result of renegotiated distribution and other fees with some of their partners.



Source: Aralez Pharmaceuticals, Inc.

Starting in the first quarter of 2018, Aralez will record Toprol-XL® net product revenues as the transition service agreement with AstraZeneca is coming to an end at the end of 2017. The following table shows that total net product revenues for the Toprol-XL® franchise are $60 million year-to-date, with cost of product revenues and transition fees of $23 to yield total net revenues to Aralez of $37 million. Aralez estimates approximately $80 million in total net product sales for the Toprol-XL® franchise in 2017, and with the improved volume and margins we anticipate this number will increase in 2018.

Toprol-XL Franchise Revenues Consist of:	2017 YTD	2017 Annualized
Total Net Revenues*	$37M	~$49M
Cost of Product Revenues and Transition Fees	$23M	~$31M
Total Net Product Sales	$60M	~$80M

Source: Aralez Pharmaceuticals, Inc.

Financial Update

On November 9, 2017, Aralez announced financial results for the third quarter of 2017. Total revenues for the third quarter of 2017 were $24.3 million, compared to $13.6 million for the third quarter of 2016. The $24.3 million of revenue consisted of $9.5 million in net product revenue, which is derived from the product portfolio acquired from the Tribute merger along with net product revenues for Yosprala®, Fibricor®, and Zontivity®, and other revenues of $14.9 million, which were comprised of $3.7 million in royalties from the sale of VIMOVO® and net revenues from

the Toprol-XL® franchise of $11.2 million.

Cost of product revenues were $3.1 million for the third quarter of 2017, compared to $3.4 million for the third quarter of 2016. The decrease was primarily related to a decrease in overall revenues from the product portfolio acquired from the Tribute merger partially offset by an increase in cost of product revenues for Zontivity®, Yosprala®, and Blexten®, which generated no corresponding product revenues in the third quarter of 2016.

SG&A expenses were $24.7 million for the third quarter of 2017, compared to $25.4 million for the third quarter of 2016. The decrease was primarily due to reduced costs for Yosprala® marketing and sales efforts partially offset by increase costs related to the U.S. sales force.

Interest expense was $6.8 million for the third quarter of 2017 compared to $0.5 million in the third quarter of 2016. The increase was due to the borrowing of $200 million under the credit facility with Deerfield. Amortization of intangible assets was $8.7 million in the third quarter of 2017, related to the acquisition of Tribute, Zontivity®, and Toprol-XL®, compared to $2.4 million in the third quarter of 2016, which was related solely to the acquisition of Tribute. The change in fair value of contingent consideration was $4.6 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 third quarter of 2016.

Net loss for the second quarter of 2017 was $24.4 million, or $0.37 per share. The company reported the first quarter of positive adjusted EBITDA of $0.4 million. We forecast revenues of $102.9 million for the full year (the company is guiding for $95-$105 million) and adjusted EBITDA of ($4.5). Aralez has provided guidance for 2018 of $140-$160 million in revenues and adjusted EBITDA of $35-$55 million. As a reminder, in 2018 Aralez will be reporting Toprol-XL® net revenues and cost of revenues separately. For comparison, company guidance for 2017 would have been $125-$135 million if Toprol-XL® revenues were recorded using 2018 accounting treatment.

Aralez had $40.7 million in cash and cash equivalents as of September 30, 2017 and we believe that the company has sufficient capital to fund operations at least through 2018.

Conclusion and Valuation

Aralez is continuing its turnaround, which we believe will occur with Zontivity® as the main revenue driver over the long term. While still early in the launch phase, we continue to be encouraged by the steady growth in prescriptions for Zontivity® and believe that this will continue for the foreseeable future. In addition, Toprol-XL® is supplying the company with a steady revenue stream, which we believe will continue to grow at a modest rate for at least the next few years.

We have updated our model to account for both an increase in projected peak sales of Zontivity®, continued strength from the Toprol-XL® franchise, and decreased operating expenses over the next few years. We forecast for Zontivity® to have peak sales of approximately $150 million. Our model calls for the company to produce $111 million in adjusted EBITDA in 2022 on revenues of $250 million. As the company's adjusted EBITDA continues to improve, we believe a refinancing of the debt to a more reasonable rate will occur, something the company has stressed as a near term goal. Using an EV/EBITDA ratio of 4.5 based on 2022 sales and a 10% discount rate yields a net present value of approximately $7.50 per share. We feel that Aralez's best days are ahead of it and that the disparity between our valuation and the company's current market cap is not likely to last.

PROJECTED FINANCIALS

Aralez Pharmaceuticals Inc.
Income Statement

Aralez Pharmaceuticals, Inc.	2016 A	Q1 A	Q2 A	Q3 A	Q4 E	2017 E	2018 E	2019 E
Royalties and License Fees	**$20.3**	**$3.7**	**$7.9**	**$3.7**	**$3.5**	**$18.8**	**$13.0**	**$12.0**
YOY Growth		-	-	-	-	*-7.2%*	*-30.9%*	*-7.7%*
U.S. Core Products	**$8.6**	**$15.6**	**$12.8**	**$13.5**	**$14.2**	**$56.1**	**$100.0**	**$125.0**
YOY Growth	-	-	-	-	-	-	-	-
Canadian Products	**$25.4**	**$6.7**	**$6.9**	**$7.1**	**$7.3**	**$28.0**	**$30.0**	**$32.0**
Total Revenues	$54.3	$26.0	$27.6	$24.3	$25.0	$102.9	$143.0	$169.0
YOY Growth	-	-	-	-	-	*89.7%*	*38.9%*	*18.2%*
Cost of Goods Sold	$11.8	$2.8	$2.9	$3.1	$3.1	$11.9	$38.0	$42.0
Gross Income	$42.5					$91.1	$105.0	$127.0
Product Gross Margin	*78.3%*	*89.4%*	*89.3%*	*87.5%*	*87.6%*	*88.5%*	*73.4%*	*75.1%*
SG&A	$107.0	$28.0	$29.3	$21.7	$21.0	$100.0	$69.0	$71.0
% SG&A	*197.1%*	*107.8%*	*106.0%*	*89.3%*	*84.0%*	*97.2%*	*48.3%*	*42.0%*
SG&A Stock Based Compensation	$11.6	$2.8	$2.9	$3.0	$3.5	$12.2	$12.0	$13.0
R&D	$8.5	$0.1	$0.7	$0.7	$0.5	$2.1	$2.0	$2.0
% R&D	*15.7%*	*0.4%*	*2.6%*	*3.0%*	*2.0%*	*2.0%*	*1.4%*	*1.2%*
R&D Stock Based Compensation	$0.3	$0.0	$0.0	$0.0	$0.0	$0.0	$0.0	$0.0
EBITDA	($84.9)	($7.7)	($8.3)	($4.1)	($3.1)	($23.2)	$22.0	$41.0
Adjusted EBITDA	($46.7)	($3.6)	($3.3)	$0.4	$1.8	($4.7)	$35.5	$55.5
Operating Margin	*-156.4%*	*-29.7%*	*-30.0%*	*-17.0%*	*-12.4%*	*-22.6%*	*15.4%*	*24.3%*
Interest, Income Net and Other	($5.5)	($6.2)	($6.6)	($6.7)	($6.8)	($26.4)	($26.9)	($17.9)
Amortization Expense	($12.6)	($8.5)	($8.5)	($8.7)	($8.6)	($34.3)	($34.0)	($34.0)
Change in Fair Value of Contingent Consideration	$0.0	($4.4)	($3.6)	($4.6)	($4.3)	($17.0)	($13.5)	($13.0)
Pre-Tax Income	($103.0)	($26.9)	($27.0)	($24.2)	($22.8)	($100.9)	($52.4)	($23.9)
Taxes	($0.1)	$0.6	$0.5	$0.3	$0.5	$1.8	$2.0	$5.0
Net Income	($103.0)	($27.5)	($27.5)	($24.4)	($23.3)	($102.7)	($54.4)	($28.9)
YOY Growth	-	-	-	-	-	*-0.2%*	*-47.0%*	*-46.9%*
Net Margin	*-189.7%*	*-105.7%*	*-99.6%*	*-100.4%*	*-93.2%*	*-99.8%*	*-38.0%*	*-17.1%*
Reported EPS	($1.67)	($0.42)	($0.42)	($0.37)	($0.35)	($1.55)	($0.77)	($0.40)
Avg. Weighted Shares Outstanding	61.8	65.5	66.1	66.8	67.0	66.4	71.0	73.0

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

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Adjusted EBITDA

	1Q17 A	2Q17 A	3Q17 A	4Q17 E	2017 E
Net Loss	($27.5)	($27.5)	($24.4)	($22.8)	($102.7)
Share based comp	$2.8	$2.9	$3.0	$3.5	$12.2
Retention/Severance/Restructuring	$0.1	$0.9	$0.4	$0.4	$1.8
D&A	$8.9	$8.9	$9.0	$9.0	$35.8
Interest	$6.6	$6.6	$6.8	$6.9	$26.9
Change in FV contingent consideration	$4.4	$3.6	$4.6	$4.3	$17.0
Transaction related expenses	$0.8	$0.8	$0.8	$0.6	$3.0
Taxes	$0.6	$0.5	$0.3	$0.5	$1.8
Other	($0.3)	($0.1)	($0.1)	($0.1)	($0.5)
Adjusted EBITDA	($3.6)	($3.3)	$0.4	$1.8	($4.7)

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

HISTORICAL STOCK PRICE



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