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May 10, 2018
David Bautz, PhD
312-265-9471
dbautz@zacks.com

scr.zacks.com
10 S. Riverside Plaza, Chicago, IL 60606

Aralez Pharmaceuticals Inc. (ARLZ-NASDAQ)

ARLZ: Shift in Strategy to Focus on Canadian Business…

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 $1.50/share. Additional upside to this valuation is possible from increased sales of the company's products and/or divesting rights to Zontivity®, Yosprala®, Fibricor®, and/or Bezalip® SR.

Current Price (05/10/18)	$0.41
Valuation	**$1.50**

OUTLOOK

On May 8, 2018, Aralez Pharmaceuticals Inc. (ARLZ) announced financial results for the first quarter of 2018 and provided a business update. The company announced a new strategic direction that will focus on the Canadian business, which will be supported by the Toprol-XL® franchise and Vimovo® royalties, while the U.S. commercial operations will be stopped immediately. The company will explore strategic alternatives for the rights to Zontivity®, Yosprala®, Fibricor®, and Bezalip® SR. In addition, the company has noted increased generic competition for Toprol-XL® that has resulted in the withdrawal of previous financial guidance for 2018, with revised guidance coming after further assessment of the company's new strategy.

SUMMARY DATA

52-Week High	**$2.61**
52-Week Low	**$0.41**
One-Year Return (%)	**-69.30**
Beta	**1.61**
Average Daily Volume (sh)	**1,797,590**
Shares Outstanding (mil)	**67**
Market Capitalization ($mil)	**$27**
Short Interest Ratio (days)	**1**
Institutional Ownership (%)	**18**
Insider Ownership (%)	**7**
Annual Cash Dividend	**$0.00**
Dividend Yield (%)	**0.00**
5-Yr. Historical Growth Rates	
Sales (%)	**75.9**
Earnings Per Share (%)	**N/A**
Dividend (%)	**N/A**
P/E using TTM EPS	**N/A**
P/E using 2018 Estimate	**-7.5**
P/E using 2019 Estimate	**-5.7**

Risk Level	**Above Avg.**
Type of Stock	**Small-Blend**
Industry	**Med-Drugs**

ZACKS ESTIMATES

Revenue
(in millions of $)

	Q1 (Mar)	Q2 (Jun)	Q3 (Sep)	Q4 (Dec)	Year (Dec)
2017	26.0 A	27.6 A	24.3 A	28.0 A	105.9 A
2018	38.1 A	32.6 E	32.7 E	32.8 E	136.2 E
2019					127.5 E
2020					121.0 E

Earnings per Share

	Q1 (Mar)	Q2 (Jun)	Q3 (Sep)	Q4 (Dec)	Year (Dec)
2017	-$0.42 A	-$0.42 A	-$0.37 A	-$0.68 A	-$1.89 A
2018	-$0.29 A	-$0.24 E	-$0.12 E	-$0.07 E	-$0.73 E
2019					-$0.61 E
2020					-$0.76 E

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WHAT'S NEW

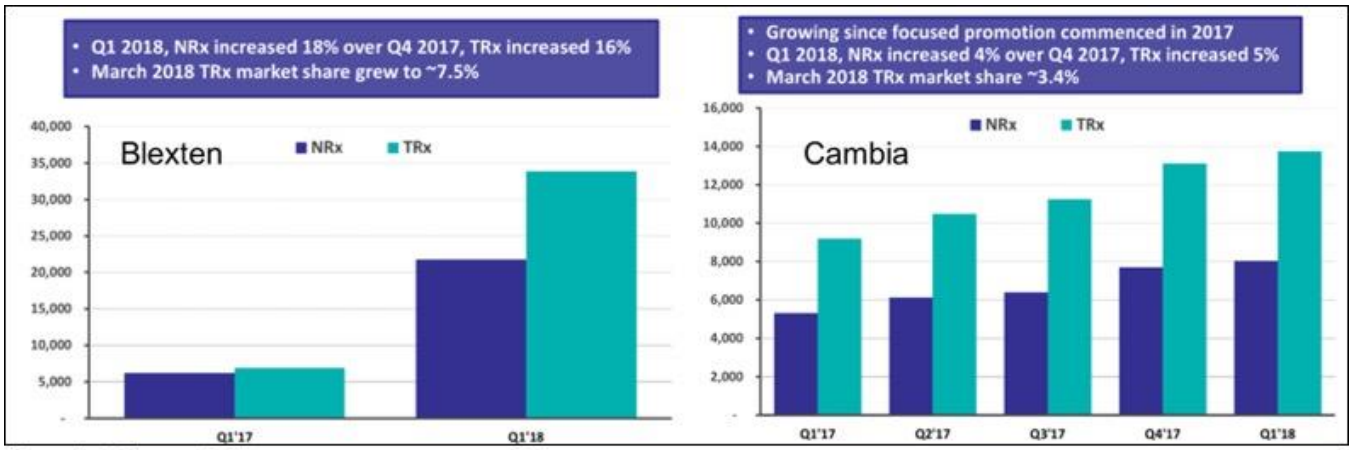
Business Update

New Strategic Focus

On May 8, 2018, Aralez Pharmaceuticals Inc. (ARLZ) announced a new strategic direction for the company that will focus on the Canadian business with support from the Toprol-XL® franchise and Vimovo® royalties. Included in this new strategic focus is a decision by the company to cease all U.S. operations.

While the Zontivity® launch has been somewhat successful, the company decided that it was not enough to fund the U.S. commercial infrastructure. The unsuccessful launch of Yosprala® and the subsequent discontinuation of its promotion also contributed to the inability to adequately fund U.S. operations.

The Canadian business has been steadily growing since the formation of Aralez and it continues to generate positive adjusted EBITDA. The main drivers for the Canadian business are Blexten®, which is a histamine H_1-receptor inhibitor that is indicated for the relief of seasonal allergies, and Cambia®, which is a nonsteroidal anti-inflammatory drug indicated for the acute treatment of migraines. The following graphs show the prescription growth trends for Blexten® (left) and Cambia® (right) since the first quarter of 2017. As of March 2018, market share for Blexten® was approximately 7.5% while for Cambia® it was approximately 3.4%.



Source: Aralez Pharmaceuticals Inc.

New Challenge for Toprol-XL®

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. The company recently announced the arrival of a new generic version of Toprol-XL® that may have a negative impact on future revenues. At this point it is too early to tell what, if any, impact there will be, however we will continue to watch the situation closely as the year progresses. As a reminder, Aralez will see improved margins in 2018 due in part to switching from Endo Par to Lannett as the Toprol-XL® authorized generic distributor.

Due to the fact that Aralez met certain milestones for Toprol-XL®, eight quarterly installments of $5.6 million will be payable to AstraZeneca beginning in the second quarter of 2019, however no milestone payments are due in 2018. Starting in the first quarter of 2018, Aralez recorded Toprol-XL® net product revenues on a gross basis as the transition service agreement with AstraZeneca came to an end at the end of 2017.

Financial Update

On May 8, 2017, Aralez announced financial results for the first quarter of 2018. Total revenues for the first quarter of 2018 were $38.1 million, compared to $26.0 million in the first quarter of 2017. The $38.1 million of revenue consisted of $27.5 million of U.S. core business revenue, which consists of net product sales from Toprol-XL® Fibricor®, and Zontivity®, $6.7 million in Canadian products, and royalty revenues of $3.9 million, which were derived from the sale of Vimovo®.

SG&A expenses were $26.5 million for the first quarter of 2018 compared to $30.8 million for the first quarter of 2017. The decrease in 2018 was primarily due to the impact of cost savings initiatives announced in April 2017 partially offset by increased costs associated with the discontinuation of Yosprala®.

Net loss for the first quarter of 2018 was $19.7 million, or $0.29 per share, compared to a net loss of $27.5 million, or $0.42 per share, in the first quarter of 2017. The company reported adjusted EBITDA of $4.9 million in the first quarter of 2018 compared to adjusted EBITDA of ($3.7) million in the first quarter of 2017. This marks the fourth consecutive quarter of increased adjusted EBITDA.

As previously mentioned, the company has withdrawn financial guidance for 2018 due to the discontinuation of U.S. operations and the unknown impact of new generic competition for Toprol XL®. We have decreased our revenue forecast for 2018 to $136 million from $150 million, but note that this number is subject to change pending further guidance from the company.

As of March 31, 2018, Aralez had cash and cash equivalents totaling $43.9 million, which is increased from the $28.9 million as of Dec. 31, 2017. However, this change was simply due to the accounting changes associated with how revenues and costs for Toprol-XL® are treated now that the transition services agreement with AstraZeneca has ended.

Conclusion

While we had thought Aralez was in the midst of a turnaround it appears that is not the case, and at this point the company is just figuring out a way to survive. Thankfully, the Canadian business has been and will likely to continue generating positive adjusted EBITDA and Toprol-XL® will likely bring in much needed revenue, although we will closely monitor the effect of the new generic competition. The greatest risk right now is the debt. The company owes approximately $26.9 million in interest per year on the $275 million in debt it currently has, with the principal being due in 2022. In addition, Aralez will owe AstraZeneca eight quarterly payments of $5.6 million ($44.8 million) beginning in the second quarter of 2019. We are hopeful that the company will be able to divest the rights to Zontivity®, Yosprala®, Fibricor®, and Bezalip® SR to generate some much needed cash to mitigate the debt risk.

We have adjusted our model to account for the company's new strategic direction and discontinuation of U.S. operations. We now forecast for revenues of $117 million in 2022 and using an EV/revenue ratio of 4.5 based on 2022 sales and a 10% discount rate yields a net present value of approximately $1.50 per share.

PROJECTED FINANCIALS

Aralez Pharmaceuticals, Inc.	2017 A	Q1 A	Q2 E	Q3 E	Q4 E	2018 E	2019 E	2020 E
Royalties and License Fees	**$19.3**	**$3.9**	**$3.8**	**$3.8**	**$3.8**	**$15.3**	**$14.0**	**$12.0**
YOY Growth	*-4.8%*					*-20.7%*	*-8.5%*	*-14.3%*
U.S. Core Products	**$59.9**	**$27.5**	**$22.0**	**$22.0**	**$22.0**	**$93.5**	**$85.0**	**$80.0**
YOY Growth	-						-	-
Canadian Products	**$26.7**	**$6.7**	**$6.8**	**$6.9**	**$7.0**	**$27.4**	**$28.5**	**$29.0**
Total Revenues	$105.9	$38.1	$32.6	$32.7	$32.8	$136.2	$127.5	$121.0
YOY Growth	*95.2%*	-	-	-	-	*28.6%*	*-6.4%*	*-5.1%*
Cost of Goods Sold	$13.5	$11.5	$9.8	$9.9	$10.0	$41.2	$40.0	$38.0
Gross Income	$92.4					$95.0	$87.5	$83.0
Product Gross Margin	*87.3%*	*69.8%*	*69.9%*	*69.7%*	*69.5%*	*69.8%*	*68.6%*	*68.6%*
SG&A	$105.2	$24.7	$18.0	$10.0	$6.0	$58.7	$42.0	$48.0
% SG&A	*99.3%*	*64.8%*	*55.2%*	*30.6%*	*18.3%*	*43.1%*	*32.9%*	*39.7%*
SG&A Stock Based Compensation	$11.3	$1.8	$1.8	$1.8	$1.8	$7.2	$8.0	$8.0
R&D	$2.3	$0.1	$0.1	$0.1	$0.1	$0.4	$1.0	$1.0
% R&D	*2.2%*	*0.3%*	*0.3%*	*0.3%*	*0.3%*	*0.3%*	*0.8%*	*0.8%*
R&D Stock Based Compensation	$0.0	$0.0	$0.0	$0.0	$0.0	$0.0	$0.0	$0.0
EBITDA	($26.5)	$0.0	$2.9	$10.9	$14.9	$28.7	$36.5	$26.0
Adjusted EBITDA	($4.5)	$4.9	$5.0	$13.0	$17.0	$39.9	$46.0	$35.5
Operating Margin	*-25.0%*	*0.0%*	*8.9%*	*33.3%*	*45.4%*	*21.1%*	*28.6%*	*21.5%*
Interest, Income Net and Other	($26.3)	($6.8)	($6.8)	($6.8)	($6.8)	($27.2)	($26.0)	($26.0)
Amortization Expense	($34.3)	($9.0)	($8.7)	($8.7)	($8.8)	($35.2)	($34.0)	($34.0)
Change in Fair Value of Contingent Consideration	($35.7)	($5.1)	($3.2)	($3.4)	($3.4)	($15.1)	($13.0)	($13.0)
Pre-Tax Income	($122.8)	($20.9)	($15.8)	($8.0)	($4.1)	($48.8)	($36.5)	($47.0)
Taxes	$2.4	($1.2)	$0.3	$0.4	$0.5	$0.0	$5.0	$5.0
Net Income	($125.2)	($19.7)	($16.1)	($8.4)	($4.6)	($48.8)	($41.5)	($52.0)
YOY Growth	*21.6%*	-	-	-	-	*-61.0%*	*-14.9%*	*25.3%*
Net Margin	*-118.2%*	*-51.7%*	*-49.4%*	*-25.6%*	*-14.0%*	*-35.8%*	*-32.5%*	*-43.0%*
Reported EPS	($1.89)	($0.29)	($0.24)	($0.12)	($0.07)	($0.73)	($0.61)	($0.76)
Avg. Weighted Shares Outstanding	66.3	67.0	67.0	67.0	67.0	67.0	68.0	68.0

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

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