May 11, 2018
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Egalet Corp. (EGLT - NASDAQ)

Partnerships and Formulary Adds Impressive; Waiting for Revenue Catch-up

Based on our DCF model and a 15% discount rate and our 20x multiple of 2021 earnings discounted to present, we generate a valuation of approximately $5.00 per share. Our model assumes continued sales of Arymo, Oxaydo and Sprix and related royalties where applicable.

Current Price (5/10/2018)	$0.65
Valuation	**$5.00**

OUTLOOK

Egalet is an integrated specialty pharmaceutical company focused on pain therapies. The company has developed its abuse deterrent Guardian Technology that can be applied to many classes of controlled substances. The company currently has three marketed products: Arymo ER, an abuse deterrent morphine tablet, Oxaydo, an oral oxycodone for acute and chronic pain and Sprix, a nasal spray for pain.

EGLT differentiates its products by improving their method of delivery or their resistance to manipulation obtaining approval through the 505(b)(2) pathway.

At the current price, we view Egalet shares as undervalued, with substantial upside given the growth expected in commercialized products. We believe that expansion of abuse deterrent technology as recommended by the FDA and supported by other government entities can provide upside to our valuation.

SUMMARY DATA

52-Week High	**3.47**
52-Week Low	**0.55**
One-Year Return (%)	**-78.3**
Beta	**-0.06**
Average Daily Volume (sh)	**822,744**
Shares Outstanding (mil)	**52.9**
Market Capitalization ($mil)	**34.4**
Short Interest Ratio (days)	**10.6**
Institutional Ownership (%)	**58.9**
Insider Ownership (%)	**1.5**
Annual Cash Dividend	**$0.00**
Dividend Yield (%)	**0.00**
5-Yr. Historical Growth Rates	
Sales (%)	**N/A**
Earnings Per Share (%)	**N/A**
Dividend (%)	**N/A**
P/E using TTM EPS	**N/A**
P/E using 2017 Estimate	**N/A**
P/E using 2018 Estimate	**N/A**
Zacks Rank	**N/A**

Risk Level	**Above Average**
Type of Stock	**Small-Growth**
Industry	**Med-Biomed/Gene**

ZACKS ESTIMATES

Revenue

(In millions of US$)

	Q1 (Mar)	Q2 (Jun)	Q3 (Sep)	Q4 (Dec)	Year (Dec)
2017	$5.4 A	$6.3 A	$6.7 A	$7.8 A	$26.1 A
2018	$6.3 A	$8.5 E	$9.0 E	$11.5 E	$35.3 E
2019					$53.0 E
2020					$75.9 E

Earnings per Share

	Q1 (Mar)	Q2 (Jun)	Q3 (Sep)	Q4 (Dec)	Year (Dec)
2017	-$1.02 A	-$1.04 A	-$0.46 A	-$0.29* A	-$2.47 A
2018	-$0.26 A	-$0.16 E	-$0.27 E	-$0.11 E	-$0.80 E
2019					-$0.49 E
2020					-$0.04 E

*Adjusted EPS removes one-time items

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What's New

1Q:18 Operational and Financial Results

Egalet Corporation (NASDAQ: EGLT) released first quarter 2018 results on May 8 and form 10-Q on May 10 posting revenues of $6.3 million and a net loss of ($0.26) per share. Revenues increased 15% on prescription growth of 115%. First quarter results compare with our estimates for revenues of $9 million and net loss of ($0.31) per share. The results were distinguished by a marked decline in expenses, particularly R&D costs as the company streamlines its structure to emphasize profitability. First quarter operational expenses were down 28% to $17.4 million. The company continues to develop partnerships and add products to preferred formulary positions. Egalet is also re-aligning its sales force to allow the full complement of reps in the field to offer all products in the portfolio.

First quarter revenues of $6.3 million were comprised of Sprix sales of $4.8 million, Oxaydo sales of $1.3 million and Arymo sales of $0.2 million. Revenues rose 17% for Sprix and were flat for Oxaydo. Sprix posted prescription growth of 86% with ~700 new prescribers added in 1Q:18. Oxaydo generated a 47% increase in prescription units exceeding 6,000 for the quarter. While prescription unit growth has been impressive, incentives, couponing and price reductions have pressured pricing over the last several quarters. In many cases, these incentives are needed to gain patients and rapidly obtain formulary inclusion. We anticipate that Egalet's new focus on providers serving populations with favorable drug coverage will reverse this trend. Gross margins fell to 64.6% in the quarter down from 75.6% in the prior year period, due to an increase in gross to net spreads and minimum volume requirements for Arymo.

Total first quarter operating expenses of $17.4 million were ahead of our estimates; however, the higher than expected level was attributable to seasonality. The company has maintained its operating expense guidance of $55 to $60 million for the year.

Egalet's cash balance stood at $74 million as of March 31, 2018 while long term debt listed on the balance sheet was $100 million. Interest expense totaled $3.6 million in the quarter, which includes a non-cash component of $0.4 million.

Cash burn for the first quarter of 2018 was ($20.7) million which was greater than our estimates due to a sharp increase in accounts receivable and was essentially even with 1Q:17 levels.

In the first quarter of 2018, Egalet shifted its revenue recognition methodology from sell-in (when products are delivered to distributors) to a sell-through (when products are re-sold to end users) as mandated by the SEC and FASB. In the first quarter, $2.2 million of channel inventory was not recognized in either 4Q:17 or 1Q:18, and was allocated to retained earnings.

Sales Force Realignment

Egalet announced a realignment of its sales force which occurred as of April 1st. Prior to this date, sales representatives were either focused on Sprix or the duo of Arymo and Oxaydo. However, the company saw an opportunity to expand the reach of the sales representatives by marketing the entire portfolio through each of them. Initial results show several new prescribers entering the mix. Direct benefits from the change are smaller territories, shorter travel time and the ability for representatives to offer the most appropriate product. The group is targeting 10,500 health care providers in a variety of specialties including pain, physical medicine, rehabilitation, primary care, nurse practitioners, orthopedic surgeons and neurology.

The company further seeks to leverage the salesforce by adding new products that match with current call points. While we do not see anything immediately pending, we anticipate this will be in the pain or CNS space and also believe that the incremental commercialization cost of this strategy would be very low, providing a very attractive margin to Egalet.

Product Updates

On February 23rd, 2018, Egalet filed an 8-K announcing that it had received notice from Teva Pharmaceuticals that Teva had submitted an Abbreviated New Drug Application (ANDA) seeking approval of a generic version of Arymo ER. Current patents protecting Arymo ER extend until 2033 and we believe that Teva's strategy is to broadly seek approval for branded drugs in order to obtain first to file exclusivity rather than any weakness in Egalet's patents. In

response to the filing, Egalet filed a patent infringement lawsuit against Teva in April which will trigger a 30 month stay on Teva's assertion, or until a district court decides the case.

In December, Egalet filed an 8-K noting that partner CVS would remove Sprix from its formulary as of January 1, 2018. The company believes this could impact up to 20% of Sprix prescriptions after this date. Management is in discussions with CVS making a case for Sprix, highlighting the benefits of the drug and the opioid-like efficacy but with the lower risk profile of an NSAID.

Egalet expects to continue to pursue other partners to distribute Sprix, including urologists and hospitals. Additionally, the company is developing a new formulation of the drug that can improve the usage profile for patients and add intellectual property protections. We expect to hear an update on progress in this effort in mid-2018. Egalet is also seeking complementary product acquisitions. The company is considering both new and seasoned pain therapies with similar call points to the current portfolio and limited incremental cost to commercialize.

Tentative Approval for Arymo

Egalet received tentative approval from the FDA regarding the addition of an intranasal abuse-deterrent claim to the label for Arymo. This will allow the company to update the label after October 2, 2018 and will help generate sales to organizations that require the official label to match their product requirements. Egalet was required to wait until the expiration of exclusivity for Daiichi Sankyo's MorphaBond. However, the FDA did allow Egalet to share the results of abuse deterrent studies that provided evidence of efficacy for intra-nasal abuse deterrence with payors and providers.

Opioid Crisis

Due to the benefits of ADFs accruing more to society and those not directly under a payor's coverage, government guidance is needed to substantially increase the use of this class of pain product. Some advancements were made on this front recently. Over the last 15 months, FDA commissioner Scott Gottlieb has been vocally supportive of using ADFs and has issued generic ADF guidance and called for the transition of the market to ADFs. In April, Representative Earl Carter of Georgia introduced House Resolution 5582, called the Abuse Deterrent Access Act of 2018. The bill requires the CMS to report to Congress on the adequacy of access to ADFs for individuals with chronic pain enrolled in a prescription drug plan under Medicare plans. The DEA also proposed changes in April that would reduce a company's quota of the drug class if it is determined diversion has occurred. This shift makes ADFs a relatively more attractive and reliable source of pain relief.

Partnerships

- OraPharma to promote Sprix to the dental space – January 2018
  - 2-year agreement
- Large regional health plan formulary addition – February 2018
  - Arymo and Sprix placed in preferred formulary positions
- Two Large Northeast Regional Health Plan formulary additions – April 2018
  - Arymo receives preferred coverage
  - Almost 1 million lives covered
- National Pharmacy Benefit Manager to cover Sprix and Arymo – May 2018
  - Sprix in Tier 2 preferred position
  - Arymo in Tier 3 unrestricted position
  - Covers 3.5 million member lives

Summary

Egalet has continued to add new partners to its distribution channel and show impressive prescription growth; however, unit prices have fallen sharply as co-pay assistance and rebates have pressured gross to net realizations. Some of this effort is justified in the short term to obtain formulary inclusion and can be sorted out later as market penetration is achieved. Improvements on pricing metrics are critical to our valuation. Egalet is refining its sales focus by offering its full portfolio of products through each sales representative and is targeting regions with favorable insurance coverage in an effort to improve price realizations. We reduce our revenue estimates to reflect a slower growth rate than earlier anticipated. We also reduce our expense estimates as we believe management will have to be more aggressive on cost cutting to turn towards profitability. The net of our changes reduces our target price to $5.00. We continue to believe the low level of ADF penetration and the compelling argument that ADFs can reduce diversion and prevent addiction can yield attractive growth rates. Favorable regulatory or government action requiring ADFs could also have a transformative effect on Egalet and represent an unrecognized option if they emerge. We reduce our target price to reflect the updates noted above to generate a value of $5.00 per share.

PROJECTED FINANCIALS

Egalet Corporation - Income Statement[1,2]

Egalet Corporation	2017 A	Q1 A	Q2 E	Q3 E	Q4 E	2018 E	2019 E	2020 E
Total Revenues	**$26.1**	**$6.3**	**$8.5**	**$9.0**	**$11.5**	**$35.3**	**$53.0**	**$75.9**
YOY Growth	*54%*	*15%*	*36%*	*35%*	*47%*	*35%*	*50%*	*43%*
Cost of Sales	$5.2	$2.2	$1.4	$1.4	$2.1	$7.2	$7.9	$11.39
Product Gross Margin	*80.3%*	*64.6%*	*83%*	*84%*	*82%*	*79.7%*	*85%*	*85%*
Amortization of Product Rights	$2.1	$0.5	$0.5	$0.5	$0.5	$2.0	$2.0	$1.1
General and Administrative	$34.1	$7.1	$5.0	$5.0	$5.0	$22.1	$20.0	$20.0
Sales and Marketing	$35.5	$9.1	$7.0	$7.0	$7.0	$30.1	$28.8	$29.0
Research and Development	$14.7	$1.3	$1.3	$1.3	$1.3	$5.2	$4.0	$3.0
Income from operations	($68.2)	($13.9)	($6.7)	($6.2)	($4.4)	($31.3)	($9.8)	$11.5
Operating Margin	*-261%*	*-222%*	*-79%*	*-69%*	*-38%*	*-89%*	*-18%*	*15%*
Change in derivative liability	($2.5)	($5.1)	$0.0	$0.0	$0.0	($5.1)	$0.0	$0.0
Interest expense, net	$17.7	$3.6	$0.7	$6.0	$0.7	$10.9	$13.3	$13.3
Other	($14.0)	$0.0	$0.0	$0.0	$0.0	$0.0	$0.0	$0.0
Pre-Tax Income	($69.4)	($12.4)	($7.4)	($12.2)	($5.0)	($37.0)	($23.1)	($1.8)
Provision for Income Tax	$0.0	$0.0	$0.0	$0.0	$0.0	$0.0	$0.0	$0.0
Tax Rate	*0.0%*	*0.0%*	*0.0%*	*0.0%*	*0.0%*	*0.0%*	*0.0%*	*0.0%*
Net Income	**($69.4)**	**($12.4)**	**($7.4)**	**($12.2)**	**($5.0)**	**($37.0)**	**($23.1)**	**($1.8)**
Net Margin	*-265%*	*-197%*	*-87%*	*-136%*	*-44%*	*-105%*	*-44%*	*-2%*
Reported EPS	**($2.05)**	**($0.26)**	**($0.16)**	**($0.27)**	**($0.11)**	**($0.80)**	**($0.49)**	**($0.04)**
YOY Growth	*-44.4%*	*-74.5%*	*-84.4%*	*-42.4%*	*-427.9%*	*-61%*	*-38%*	*-92%*
Basic Shares Outstanding	33.76	47.30	45.80	46.10	46.40	43.50	46.73	48.50

Source: Company Filing // Zacks Investment R

[1] Egalet estimates do not include non-cash interest amortization of approximately $1.0 to $1.5 million per quarter.
[2] Our 4Q:17 actuals on page 1 exclude the $13.2 million gain on extinguishment of debt; however, we provide GAAP earnings above for full disclosure.

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HISTORICAL STOCK PRICE

Egalet Corporation – Share Price Chart



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