Zacks Small-Cap Research

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Egalet Corp. (EGLT - NASDAQ)

Costs Down, Revenues Up, Partnerships Expanding

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 $5.60 per share. Our model assumes continued sales of Arymo, Oxaydo and Sprix and related royalties where applicable.

Current Price (3/12/2018)	$0.88
Valuation	**$5.60**

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	**5.60**
52-Week Low	**0.67**
One-Year Return (%)	**-81.3**
Beta	**-0.11**
Average Daily Volume (sh)	**1,395,304**
Shares Outstanding (mil)	**45.9**
Market Capitalization ($mil)	**40.4**
Short Interest Ratio (days)	**10.6**
Institutional Ownership (%)	**61.1**
Insider Ownership (%)	**1.8**
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)
2016	$2.7 A	$3.5 A	$4.7 A	$6.1 A	$17.0 A
2017	$5.4 A	$6.3 A	$6.7 A	$7.8 A	$26.1 A
2018					$40.8 E
2019					$63.6 E

Earnings per Share

	Q1 (Mar)	Q2 (Jun)	Q3 (Sep)	Q4 (Dec)	Year (Dec)
2016	-$0.76 A	-$0.97 A	-$1.10 A	-$0.87 A	-$3.70 A
2017	-$1.02 A	-$1.04 A	-$0.46 A	-$0.29* A	-$2.47 A
2018					-$0.88 E
2019					-$0.48 E

*Adjusted EPS removes one-time items

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What's New

FY:17 Operational and Financial Results

Egalet Corporation (NASDAQ: EGLT) announced full-year 2017 results on March 12, 2018, posting revenues of $26.1 million and a net loss of ($2.05) per share. Revenues increased 54% on prescription growth of 120%. Full-year results compare with our estimates for revenues of $27 million and net loss of ($2.89) per share. The results were distinguished by higher year over year gross margins and expense reductions. Fourth quarter revenues were $7.8 million compared to our $8.8 million estimate and adjusted loss per share of ($0.31) was ahead of our ($0.37) estimate on lower expenses. Fourth quarter operational expenses of $16 million were less than our estimates of $20 million. The company continues to develop partnerships and achieve targeted expense reductions and maintains sufficient cash to support its development plan.

Total 2017 revenues of $26.1 million were comprised of Sprix sales of $19.9 million, Oxaydo sales of $5.6 million and Arymo sales of $0.6 million. Revenues rose 50% for Sprix and 70% for Oxaydo on a full year basis. For the fourth quarter, Sprix revenues increase 26% while Oxaydo rose 33%. Sprix posted prescription growth of 100% with 800 new prescribers added in 4Q:17. Oxaydo generated an 84% increase in prescription growth reaching almost 20,000 for the year. As Egalet enters into new agreements with partners such as Ascend or OraPharma, we anticipate continued growth in these numbers. Gross margins on an annual basis were 80.3%, up from the prior year's 78.3%. Fourth quarter gross margins were 80.7%, down 170 bps over 4Q:17.

Total annual expenses of $89.2 million, which include restructuring charges, were below our estimates of $92.9 million due to lower than expected expenses across the board. In the fourth quarter, expenses of $16.2 million declined from 4Q:17 levels of $23.7 million and were also below our estimates of $20.0 million as cost reductions were recognized. 4Q:17 general and administrative expenses of $6.3 million declined 21%, sales and marketing expenses fell 4% and research and development contracted 77% compared to the fourth quarter of 2016.

A gain of $13.2 million on extinguishment of debt was recognized in the fourth quarter representing the conversion of $12.5 million of convertible debt into new debt following as announced in late December 2017.

Egalet's cash balance stood at $91 million as of December 31, 2017. The increase over year end 2016 levels was attributable to the $30 million equity raise that was closed on July 11, 2017 and additional debt capital offset by operational cash burn. Long term debt listed on the balance sheet stands at $100 million, rising year over year, but declining sequentially from the third quarter due to debt restructuring.

Cash burn for the third quarter 2017 was ($23.1) million which was greater than our estimates and compares to cash burn of ($23.9) million in 3Q:16 and ($20.5) million in 2Q:17. For the nine months ending September 30, 2017, cash burn was ($64.2) million compared to ($66.2) in the same prior year period. A gain of $13.2 million on extinguishment of debt was a one-time item that helped Egalet achieve positive earnings on a GAAP basis. However, we removed this item from our core earnings calculation listed on page 1. Change in fair value of derivative liability and other gains also contributed to the positive bottom line result.

In the first quarter of 2018, Egalet will shift 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. This will have an anticipated $2.0 to $2.5 million impact on first quarter revenues, which will not be included in revenues, but rather an adjustment to retained earnings.

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 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 both provide improved usage profile for patients and additional 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.

Despite the hurdles faced by this nasal spray analgesic, Egalet continues to add partnerships most recently receiving preferred status at a large, but unidentified, northeast regional plan and late last year added Arymo ER to a large Medicare Part D formulary.

Potential generic competitor Apotex failed to notify Egalet that it planned to launch an authorized Sprix generic by November 25, 2017, which was the notification deadline for pursuing this competitive product. Failing to meet the deadline resulted in the loss of their right to launch an authorized generic version. Protection for Sprix will lapse in September 2018, at which time Apotex (and others) may potentially compete in the space following the issuance of an ANDA. At this time, Egalet has not received notice of any new ANDA filers.

Principal Amount of 5.5% Convertible Notes Reduced

On December 20, 2017 Egalet announced that it had refinanced $36.4 million of its $61.0 million face value 5.5% convertible notes for $23.9 million of new 6.5% convertible notes. The new notes add an additional three and a half years to maturity and reduce interest payments by about $450 thousand per year despite the 100 basis point higher interest rate.

The new convertible notes are due December 31, 2024 and are convertible into approximately 750 shares per $1,000 face value, equivalent to a conversion price of $1.33. Currently, Egalet does not have sufficient shares authorized to satisfy a full conversion of the new securities and has created 3.5 million warrants (exercisable at $0.01) as a temporary measure until additional shares are authorized. If the convertible bonds are exercised prior to authorization of new shares, the warrants will be issued to satisfy the conversion. Through the exchange, Egalet was able to lower the face value of the debt and lower its net interest expense by reducing the effective conversion price.

Egalet offered the exchange to all of the 5.5% convertible bondholders, however, only a portion took advantage of it. As the units move closer to maturity, we anticipate that Egalet will try to eliminate more of these units coming due in 2020 through exchange at a favorable time or paydown if sufficient cash is available at the time.

The exchange had an immediate benefit on cash flow by reducing cash interest payments from $13.8 million per year to $13.3 million. The extended maturity is another benefit which will lighten the pressure on the need to refinance in coming years and allow for revenue and cash flow improvement supportive of better future financing terms.

Tentative Approval for Arymo

In addition to the positive news regarding lower cash interest payments, Egalet also 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.

MorphaBond was initially approved in October 2015, however, the drug sponsors did not start marketing the drug until recently. No official date of launch was given, but Egalet has seen evidence of their salesforce discussing the benefits of MorphaBond in late 2017. Since penetration of ADFs is estimated to be in the low single digits, competitors in the market actively engaging with payors and providers is considered helpful to all ADF manufacturers. MorphaBond's salesforce is helping spread the message on the benefits of ADFs, making it easier to argue the case for using this class of pain relief. In the words of company management, a rising tide will lift all boats.

Valuation Update

Based on the announced removal of Sprix from CVS' formulary and slower ramp up of the portfolio as a whole, we are lowering our revenue estimates for 2018 and 2019. We forecast total revenues of $41 million in 2018 and $64 million in 2019 and $88 million in 2020. Our blended valuation methodology uses a 20x EPS multiple on 2021 earnings of $0.50 discounted back to present yielding a result of $5.70 and our DCF model, where the impact of lower revenues are offset by a lower tax rate in future years yields a result of $5.50. We equally weight these outputs to generate a target price of $5.60 per share.

Summary

Egalet experienced a very busy quarter with numerous moving parts in both the product sale and financing realm. New partners were added, competitive threats emerged and dissolved. The debt conversion and tentative approval will help improve cash flows and the marketing argument for Arymo respectively. The withdrawal of Sprix from CVS formulary combined with slower revenue growth were partially offset by the benefits of a lower future tax rate resulting in a reduction of our target price. We continue to believe the low level of ADF penetration and the compelling argument that ADFs can reduce diversion and prevent addiction combined with an education campaign by multiple companies are supportive of our growth estimates. Potentially favorable regulatory or government action requiring ADFs could have a potentially 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 $5.60 per share.

PROJECTED FINANCIALS

Egalet Corporation - Income Statement[1,2]

Egalet Corporation	2016 A	Q1 A	Q2 A	Q3 A	Q4 A	2017 A	2018 E	2019 E
Total Revenues	**$17.0**	**$5.4**	**$6.3**	**$6.7**	**$7.8**	**$26.1**	**$40.8**	**$63.6**
YOY Growth	*-26%*	*104%*	*81%*	*41%*	*27%*	*54%*	*56%*	*56%*
Cost of Sales	$3.7	$1.3	$1.1	$1.2	$1.5	$5.2	$7.2	$9.5
Product Gross Margin	*78.3%*	*75.6%*	*82.9%*	*81.2%*	*80.7%*	*80.3%*	*82.3%*	*85%*
Amortization of Product Rights	$2.0	$0.5	$0.5	$0.5	$0.5	$2.1	$2.0	$2.0
General and Administrative	$30.7	$8.5	$12.5	$6.8	$6.3	$34.1	$20.8	$22.0
Sales and Marketing	$27.9	$9.3	$9.3	$8.8	$8.1	$35.5	$30.0	$32.0
Research and Development	$33.8	$6.5	$4.6	$2.1	$1.6	$14.7	$8.0	$7.0
Restructuring Charges	$0.0	$0.0	$0.0	$3.0	($0.2)	$2.8	$0.0	$0.0
Income from operations	($81.0)	($20.7)	($21.7)	($15.8)	($10.0)	($68.2)	($27.2)	($8.9)
Operating Margin	*-478%*	*-381%*	*-348%*	*-238%*	*-128%*	*-261%*	*-67%*	*-14%*
Change in derivative liability	($0.6)	($0.0)	$0.0	($1.5)	($1.0)	($2.5)	$0.0	$0.0
Interest expense, net	$12.1	$4.5	$4.7	$4.7	$3.7	$17.7	$13.3	$13.3
Other	($0.8)	$0.2	($0.0)	($0.1)	($14.1)	($14.0)	$0.0	$0.0
Pre-Tax Income	($91.7)	($25.4)	($26.5)	($18.9)	$1.4	($69.4)	($40.5)	($22.2)
Provision for Income Tax	($1.1)	$0.0	$0.0	$0.0	$0.0	$0.0	$0.0	$0.0
Tax Rate	*1.2%*	*0.0%*	*0.0%*	*0.0%*	*0.0%*	*0.0%*	*0.0%*	*0.0%*
Net Income	**($90.6)**	**($25.4)**	**($26.5)**	**($18.9)**	**$1.4**	**($69.4)**	**($40.5)**	**($22.2)**
Net Margin	*-534%*	*-468%*	*-423%*	*-285%*	*18%*	*-265%*	*-99%*	*-35%*
Reported EPS	**($3.70)**	**($1.02)**	**($1.04)**	**($0.46)**	**$0.03**	**($2.05)**	**($0.88)**	**($0.48)**
YOY Growth	*26.0%*	*34.8%*	*6.7%*	*-58.0%*	*-103.8%*	*-44.4%*	*-57%*	*-46%*
Basic Shares Outstanding	24.51	24.77	25.54	41.15	43.44	33.76	43.50	46.73

Source: Company Filing // Zacks Investment Research, Inc. Estim

[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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