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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: Strong Revenue Growth Forecast 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 (03/19/18)	$1.83
Valuation	**$7.50**

OUTLOOK

On March 13, 2018, Aralez Pharmacueticals, Inc. (ARLZ) announced financial results for the fourth quarter and full year 2017. The company reported $105.9 million in 2017 revenue and had positive adjusted EBIDTA of $2.1 million. For 2018, we are projecting total revenue of $150.0 million and adjusted EBITDA of $41.3 million.

During the fourth quarter of 2017, new prescriptions for Zontivity® increased 22% compared to the third quarter of 2017. The company is guiding for a 3-fold growth in total prescriptions in 2018 to 45,000-55,000.

SUMMARY DATA

52-Week High	**$2.61**
52-Week Low	**$0.98**
One-Year Return (%)	**-18.67**
Beta	**1.41**
Average Daily Volume (sh)	**734,252**
Shares Outstanding (mil)	**67**
Market Capitalization ($mil)	**$123**
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	33.8 E	35.9 E	39.2 E	41.1 E	150.0 E
2019					165.0 E
2020					180.0 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	-$0.25 E	-$0.22 E	-$0.12 E	-$0.11 E	-$0.70 E
2019					-$0.66 E
2020					-$0.60 E

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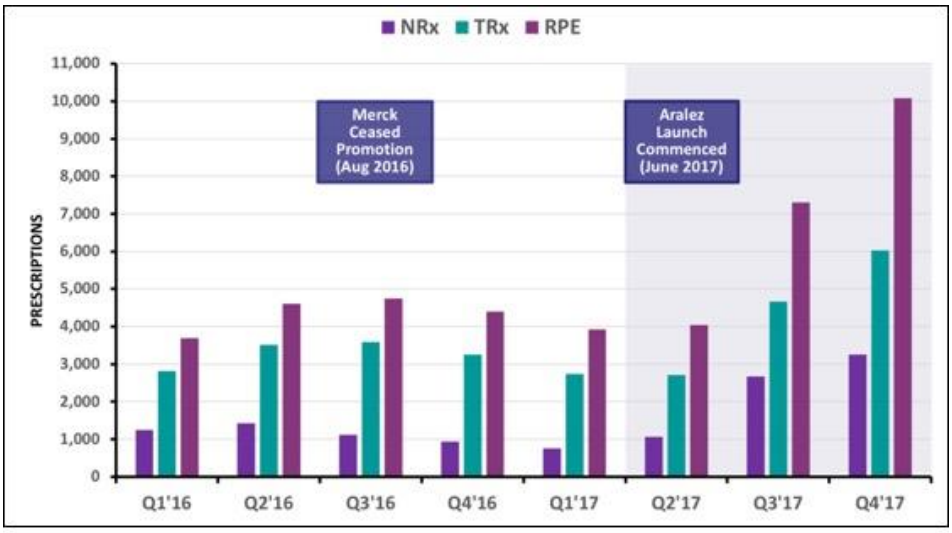
WHAT'S NEW

Business Update

Continued Growth in Zontivity®

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 fourth quarter of 2017, Aralez saw a 22% increase in new prescriptions compared to the third quarter of 2017 along with a 32% increase in total prescriptions and a 39% increase in retail prescription equivalents (RPEs). The company uses the RPE metric, which is defined as the total pill count divided by 30, to better reflect the fact that many Zontivity® prescriptions are for more than a 30-day supply. The current average prescription for Zontivity® is 48 pills. The following chart shows the growth in prescriptions over the past year.



Source: Aralez Pharmaceuticals Inc.

Of the Zontivity® prescriptions being generated, 65% 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 90% of Medicare Part D lives leading to approximately 80% of prescription claims being approved weekly.

In 2017, Aralez reported a total of approximately 8,000 new prescriptions, approximately 16,000 total prescriptions, and approximately 25,000 RPEs for Zontivity® (while only being promoted for seven months out of the year). The total number of prescription writers increased 52%, which led to increases of 119%, 146%, and 178% in new prescriptions, total prescriptions, and RPEs, respectively.

For 2018, Aralez is forecasting to grow total Zontivity® prescriptions three-fold to a range of 45,000 to 55,000 and RPEs threefold to a range of 75,000 to 90,000. In addition, the company is looking to increase total market share from 0.3% in 2017 to 0.9% in 2018. We estimate that a 6% total market share would correspond to approximately $100 million in sales, thus based on attaining a 0.9% market share we are forecasting 2018 Zontivity® revenues of approximately $15 million.

Toprol-XL® Continues to Perform Well

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 has recently initiated a targeted promotion strategy in a P2 position behind Zontivity® in order to drive sales of the branded product. A new generic version of Toprol-XL® was approved by the FDA in February 2018, however assuming that no additional generic versions are

approved this year we anticipate an increase in revenue in 2018 compared to 2017 driven by improved volume and margins, 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 mid-2019, however no milestone payments are due in 2018. As a reminder, starting in the first quarter of 2018, Aralez will record 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.

Canadian Business Update

Total revenues from the Canadian business were $26.7 million in 2017 compared to $24.2 million in 2016. In addition to solid revenue growth, the Canadian business is continuing to generate positive adjusted EBIDTA. In its first year of promotion, Blexten® achieved a 4.4% market share out of an estimated prescription antihistamine market in Canada of approximately $37 million. The growth in the Canadian business was driven mostly by Blexten® and Cambia®, which offset generic erosion of brands such as Fiorinal® and Bezalip® SR during 2017.

Yosprala® Discontinued

Along with the fourth quarter financial update, Aralez also announced the discontinuation of Yosprala® in the U.S. We are not entirely surprised by this announcement, since despite significant investments in commercialization the drug was never able to gain the market share that was originally forecast, most likely due to increased pricing pressures in the specialty pharmaceutical business. The company will continue to evaluate ways in which it can maximize the value of Yosprala® both in the U.S. and overseas.

Financial Update

On March 13, 2017, Aralez announced financial results for the fourth quarter and full year 2017. Total revenues for the fourth quarter of 2017 were $28.0 million, compared to $20.0 million for the fourth quarter of 2016. The $28.0 million of revenue consisted of $17.0 million in U.S. core business revenue, which consists of net revenues from Toprol-XL® and net product sales from Yosprala®, Fibricor®, and Zontivity®, $7.0 million in Canadian products, and royalty revenues of $4.0 million, which were derived from the sale of VIMOVO®.

SG&A expenses were $28.8 million for the fourth quarter of 2017, compared to $32.9 million for the fourth quarter of 2016. The decrease was primarily due to reduced costs from the cost savings initiatives announced in April 2017 partially offset by increased marketing costs for Zontivity®.

Net loss for the fourth quarter of 2017 was $45.8 million, or $0.68 per share, compared to a net loss of $31.1 million, or $0.48 per share, in the fourth quarter of 2016. The company reported adjusted EBIDTA of $2.1 million in the fourth quarter of 2017 compared to adjusted EBIDTA of ($11.9) million in the fourth quarter of 2016.

For 2017, Aralez reported total revenues of $105.9 million, compared to $54.3 million in 2016. The $105.9 million in revenue consisted of $59.9 million in U.S. Core Business revenue, $26.7 million in Canadian products, and $19.3 million in royalties and milestones.

SG&A expenses in 2017 were $116.6 million compared to $118.5 million in 2016. The decrease was mostly due to lower transaction costs during 2017, which totaled $19.7 million in 2016. The decrease in transaction costs were offset by increased costs associated with the U.S. sales force, increased promotional costs for Zontivity®, increased facility and infrastructure costs, and increased professional fees.

Net loss in 2017 was $125.2 million, or $1.89 per share, compared to a net loss of $103.0 million, or $1.74 per share, in 2016. Adjusted EBIDTA for 2017 was ($4.5) million compared to ($46.7) million in 2016.

For 2018 we are forecasting revenues of $150.0 million and adjusted EBIDTA of $41.8 million. The company has provided guidance for 2018 of revenues between $140-$160 million and adjusted EBIDTA in the range of $35-$55 million. As a reminder, in 2018 Aralez will be reporting Toprol-XL® net revenues and cost of revenues separately. For comparison, revenues in 2017 would have been approximately $138 million if Toprol-XL® revenues were recorded using 2018 accounting treatment.

As of December 31, 2017, Aralez had cash and cash equivalents totaling $28.9 million. We believe that based on increasing revenues for 2018 and the cost savings plan that has been implemented the company has sufficient capital to fund operations through 2018.

Conclusion

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 goal for 2018. 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 share price is not likely to last.

PROJECTED FINANCIALS

Aralez Pharmaceuticals, Inc.	2017 A	Q1 E	Q2 E	Q3 E	Q4 E	2018 E	2019 E	2020 E
Royalties and License Fees	**$19.3**	**$3.8**	**$3.8**	**$3.8**	**$3.8**	**$15.2**	**$14.0**	**$12.0**
YOY Growth	*-4.8%*					*-21.2%*	*-7.9%*	*-14.3%*
U.S. Core Products	**$59.9**	**$23.0**	**$24.9**	**$28.0**	**$29.8**	**$105.7**	**$120.0**	**$135.0**
YOY Growth	-						-	-
Canadian Products	**$26.7**	**$7.0**	**$7.2**	**$7.4**	**$7.5**	**$29.1**	**$31.0**	**$33.0**
Total Revenues	$105.9	$33.8	$35.9	$39.2	$41.1	$150.0	$165.0	$180.0
YOY Growth	*95.2%*	-	-	-	-	*41.6%*	*10.0%*	*9.1%*
Cost of Goods Sold	$13.5	$8.7	$9.2	$10.0	$10.5	$38.4	$45.0	$50.0
Gross Income	$92.4					$111.6	$120.0	$130.0
Product Gross Margin	*87.3%*	*74.3%*	*74.4%*	*74.5%*	*74.5%*	*74.4%*	*72.7%*	*72.2%*
SG&A	$105.2	$20.2	$19.0	$14.9	$15.4	$69.5	$71.0	$75.0
% SG&A	*99.3%*	*59.8%*	*52.9%*	*38.0%*	*37.5%*	*46.3%*	*43.0%*	*41.7%*
SG&A Stock Based Compensation	$11.3	$2.8	$3.0	$3.1	$3.1	$12.0	$12.0	$13.0
R&D	$2.3	$0.5	$0.5	$0.5	$0.5	$2.0	$4.0	$4.5
% R&D	*2.2%*	*1.5%*	*1.4%*	*1.3%*	*1.2%*	*1.3%*	*2.4%*	*2.5%*
R&D Stock Based Compensation	$0.0	$0.0	$0.0	$0.0	$0.0	$0.0	$0.0	$0.0
EBITDA	($26.5)	$1.6	$4.2	$10.7	$11.6	$28.1	$33.0	$37.5
Adjusted EBITDA	($4.5)	$4.7	$7.5	$14.1	$15.0	$41.3	$46.5	$52.0
Operating Margin	*-25.0%*	*4.7%*	*11.7%*	*27.3%*	*28.2%*	*18.7%*	*20.0%*	*20.8%*
Interest, Income Net and Other	($26.3)	($6.5)	($6.5)	($6.5)	($6.5)	($26.0)	($26.0)	($26.0)
Amortization Expense	($34.3)	($8.6)	($8.7)	($8.7)	($8.8)	($34.8)	($34.0)	($34.0)
Change in Fair Value of Contingent Consideration	($35.7)	($3.0)	($3.2)	($3.4)	($3.4)	($13.0)	($13.0)	($13.0)
Pre-Tax Income	($122.8)	($16.5)	($14.2)	($7.9)	($7.1)	($45.7)	($40.0)	($35.5)
Taxes	$2.4	$0.3	$0.3	$0.4	$0.5	$1.5	$5.0	$5.0
Net Income	($125.2)	($16.8)	($14.5)	($8.3)	($7.6)	($47.2)	($45.0)	($40.5)
YOY Growth	*21.6%*	-	-	-	-	*-62.3%*	*-4.6%*	*-10.0%*
Net Margin	*-118.2%*	*-49.7%*	*-40.4%*	*-21.1%*	*-18.5%*	*-31.5%*	*-27.3%*	*-22.5%*
Reported EPS	($1.89)	($0.25)	($0.22)	($0.12)	($0.11)	($0.70)	($0.66)	($0.60)
Avg. Weighted Shares Outstanding	66.3	66.9	67.0	67.0	67.0	67.0	68.0	68.0

Source: Zacks Investment Research, Inc.

David Bautz, PhD

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