Zacks Small-Cap Research

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Egalet Corp. (EGLT - NASDAQ)

Egalet 2Q:18 Results

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 $3.00 per share. Our model assumes continued sales of Arymo, Oxaydo and Sprix and related royalties where applicable.

Current Price (8/21/2018)	$0.29
Valuation	**$3.00**

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	**1.59**
52-Week Low	**0.26**
One-Year Return (%)	**-73.4**
Beta	**0.13**
Average Daily Volume (sh)	**679,907**
Shares Outstanding (mil)	**56.8**
Market Capitalization ($mil)	**34.4**
Short Interest Ratio (days)	**10.0**
Institutional Ownership (%)	**44.1**
Insider Ownership (%)	**3.1**
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	$7.4 A	$9.0 E	$11.5 E	$34.2 E
2019					$50.9 E
2020					$72.6 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	-$0.22 A	-$0.21 E	-$0.09 E	-$0.79 E
2019					-$0.40 E
2020					-$0.07 E

*Adjusted EPS removes one-time items

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What's New

2Q:18 Operational and Financial Results

Egalet Corporation (NASDAQ: EGLT) released second quarter 2018 results on August 8 and filed form 10-Q on August 9 posting revenues of $7.4 million and a net loss of ($0.22) per share. Revenues increased 19% on prescription growth of 67%. Second quarter results compare with our estimates for revenues of $8.5 million and net loss of ($0.16) per share. Higher than expected G&A expenses partially offset by lower R&D costs characterized the second quarter; however, operational expenses were down 37% to $16.7 million. The company continues to develop partnerships and add products to preferred formulary positions adding several new PBMs and plans to its portfolio.

Second quarter revenues of $7.4 million were comprised of Sprix sales of $5.4 million, Oxaydo sales of $1.7 million and Arymo sales of $0.4 million. Revenues rose 10% for Sprix and were up 30% for Oxaydo. Egalet is now lapping its first full quarter of Arymo sales and saw a 250% increase for this product, albeit off of a small base. We are hopeful that Egalet's new focus on providers serving populations with favorable drug coverage will accelerate topline increases. Gross margins fell to 70.0% in the quarter down from 82.9% in the prior year period but were up sequentially by over 15 percentage points. Efforts made to target appropriate patients and physician's offices and a focus on providing assistance for prior authorizations have strengthened gross to nets from trends earlier in the year.

Total first quarter operating expenses of $16.7 million contracted from the $26.4 million expended in 2Q:17 as the cost cutting efforts continue to take place. Research and development costs were down sharply on lower expenditures for EGLT-002. General and administrative spend contracted 46% as prior-year Arymo post-marketing study fees did not recur and the company experienced lower compensation costs.

Egalet's cash balance stood at $70 million as of June 30, 2018 while long term debt listed on the balance sheet was $101 million. Interest expense totaled $3.8 million in the quarter, which includes a non-cash component of $0.7 million. However, the company has submitted a tender to holders of the 5.5% convertible senior notes that have a principal amount of $24.65 million. We expect this debt to be extinguished, resulting in a reduction in cash balance.

Cash burn for the second quarter of 2018 was ($5.4) million which compares to ($20.5) million in 2Q:17 with the difference attributable to a larger net loss in 2017.

New Launches

Egalet announced an effort to improve Sprix in previous quarters. Their objective with a new formulation is to improve tolerability and absorption as well as provide additional intellectual property protection. The company plans to have a final formulation ready to announce in mid-2019. We expect to hear an update on progress in this effort in coming quarters. 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 right away.

Listing Changes and Tender Offer

As of June 30, 2018, Egalet was not in compliance with NASDAQ Global Markets listing requirements and trading of shares was transferred to the NASDAQ Capital Markets effective July 11, 2018. A market capitalization below $35 million was cited for the transition. As a result of the change in market listing, the company's 5.5% convertible note holders have to option to redeem their notes at the principal amount of $1,000. As of July 30, 2018, there were $24.65 million of principal notes outstanding. Note holders can choose for the company to repurchase their shares

until September 18, 2018. On August 10th Egalet filed form SC TO-I/A informing note holders of their options. Egalet held $70 million in cash on their balance sheet as of June 30, 2018 which is sufficient to satisfy a full exercise of the noteholders option. Egalet's 6.5% convertible notes is also subject to a redemption if Egalet's shares are delisted from the NASDAQ Capital Markets. Currently the company is exploring options to remedy the delisting including a secondary offering which could also reduce the debt balance in addition to improving the market capitalization of the company.

Partnerships

- OraPharma to promote Sprix to the dental space – January 2018
  - 2-year agreement
  - 70% prescription growth in 2Q:18 to ~2,000 scripts
- 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
- Large Southeast regional plan – May 2018
  - Sprix on tier 3 covered position

Summary

Egalet has continued to add new partners to its distribution channel and post impressive prescription growth; however, revenue expansion has not been as rapid as we had hoped. While there has been verbal support from the FDA for ADFs, we believe that a coordinated effort by multiple stakeholders including regulatory agencies, state and federal government, payors, providers and others is necessary to drive stronger growth for abuse deterrent formulations. There is evidence for the utility of ADFs to prevent opioid addiction and reduce overall proliferation of opioid pain relievers. However, the effort to educate stakeholders on the benefits is an extended process that is still underway. Sprix has favorable characteristics that can also address many of the concerns related to the opioid crisis and the company's new targeted strategy has shown economic improvement especially for gross margins. There are a few positive catalysts on the horizon, including the improved label for Arymo in October and new formulations of Sprix which we expect will increase adoption and extend sales growth respectively.

We decrease our revenue estimates to reflect a slower growth rate than earlier anticipated and also update the share balance to reflect current levels. 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 as evidenced by attractive prescription growth. Favorable regulatory or government action requiring ADFs could also have a transformative effect on Egalet and represent an unrecognized option if they emerge. The net result of changes reduces our target price $3.00 per share.

PROJECTED FINANCIALS

Egalet Corporation - Income Statement[1]

Egalet Corporation	2017 A	Q1 A	Q2 A	Q3 E	Q4 E	2018 E	2019 E	2020 E
Total Revenues	**$26.1**	**$6.3**	**$7.4**	**$9.0**	**$11.5**	**$34.2**	**$50.9**	**$72.6**
YOY Growth	*54%*	*15%*	*19%*	*35%*	*47%*	*31%*	*49%*	*43%*
Cost of Sales	$5.2	$2.2	$1.6	$1.4	$2.1	$7.3	$7.6	$10.89
Product Gross Margin	*80.3%*	*64.6%*	*79.0%*	*84%*	*82%*	*78.7%*	*85%*	*85%*
Amortization of Product Rights	$2.1	$0.5	$0.5	$0.5	$0.5	$2.1	$2.0	$1.1
General and Administrative	$34.1	$7.1	$6.7	$5.0	$5.0	$23.8	$20.0	$20.0
Sales and Marketing	$35.5	$9.1	$9.0	$7.0	$7.0	$32.1	$28.8	$29.0
Research and Development	$14.7	$1.3	$1.0	$1.3	$1.3	$4.9	$4.0	$3.0
Income from operations	($68.2)	($13.9)	($11.4)	($6.2)	($4.4)	($35.9)	($11.5)	$8.6
Operating Margin	*-261%*	*-222%*	*-153%*	*-69%*	*-38%*	*-105%*	*-23%*	*12%*
Change in derivative liability	($2.5)	($5.1)	($3.2)	$0.0	$0.0	($8.3)	$0.0	$0.0
Interest expense, net	$17.7	$3.6	$3.8	$6.0	$0.7	$14.0	$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)	($12.0)	($12.2)	($5.0)	($41.6)	($24.8)	($4.7)
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)**	**($12.0)**	**($12.2)**	**($5.0)**	**($41.6)**	**($24.8)**	**($4.7)**
Net Margin	*-265%*	*-197%*	*-161%*	*-136%*	*-44%*	*-122%*	*-49%*	*-6%*
Reported EPS	**($2.05)**	**($0.26)**	**($0.22)**	**($0.21)**	**($0.09)**	**($0.79)**	**($0.40)**	**($0.07)**
YOY Growth	*-44.4%*	*-74.5%*	*-78.3%*	*-53.5%*	*-362.3%*	*-62%*	*-49%*	*-81%*
Basic Shares Outstanding	33.76	47.30	53.30	57.00	58.00	53.90	62.00	63.00

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.

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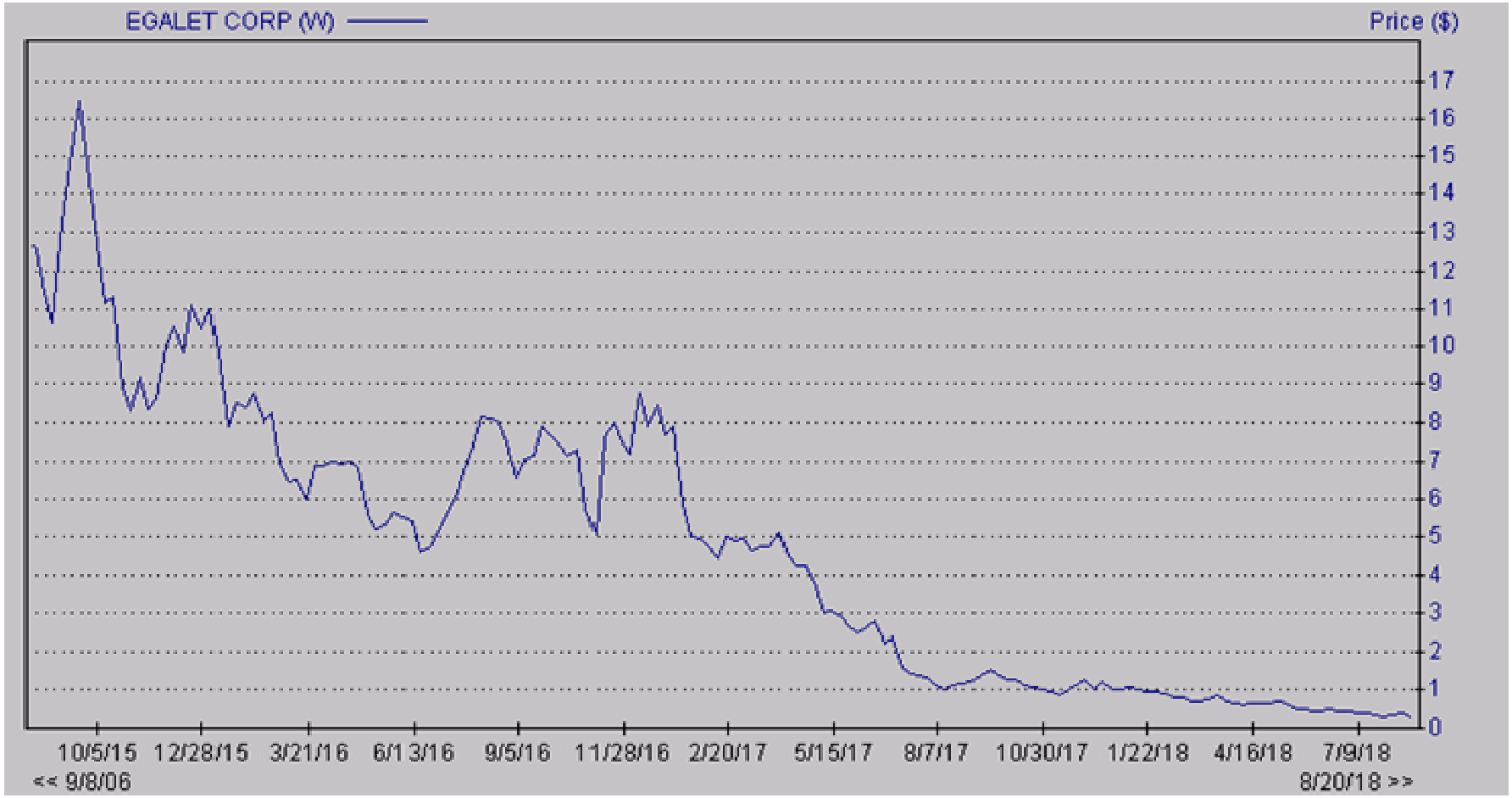
HISTORICAL STOCK PRICE

Egalet Corporation – Share Price Chart



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