Zacks Small-Cap Research

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Egalet Corp. (EGLT - NASDAQ)

Restructuring and Acquisition in the Near Term?

Based on our DCF model and a 25% discount rate, we generate a valuation of $1.40 per share. Our model assumes continued sales of Arymo, Oxaydo and Sprix and related royalties where applicable.

Current Price (9/19/2018)	$0.18
Valuation	**$1.40**

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.

Egalet faces significant financing risk, but is pursuing an acquisition and restructuring of debt to reach profitability. With current sales, topline growth and additional growth catalysts on the horizon, there remains upside for investors with risk tolerance. We believe that expansion of abuse deterrent technology as recommended by the FDA and supported by other government entities can provide additional upside.

SUMMARY DATA

52-Week High	**1.59**
52-Week Low	**0.18**
One-Year Return (%)	**-87.0**
Beta	**0.56**
Average Daily Volume (sh)	**861,968**
Shares Outstanding (mil)	**56.8**
Market Capitalization ($mil)	**9.8**
Short Interest Ratio (days)	**4.09**
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

Multiple Events Raise Risk Profile

Egalet Corporation (NASDAQ: EGLT) filed an 8-K on September 18, 2018 announcing several material events that raise the risk profile for the company, but also outline a path forward. On September 18, 2018, the NASDAQ notified Egalet that the company had not regained compliance with the listing requirements required by the exchange and the shares were delisted due to market capitalization and bid price minimums. The company pursued and was successful in having shares listed on the OTCQX bulletin board on September 19. As a result of the delisting, Egalet's 6.5% convertible notes became subject to redemption according to the original terms of the borrowing agreement. In anticipation of the NASDAQ action, Egalet negotiated a forbearance with noteholders to withhold from exercising their rights and remedies until October 14, 2018 and withdrew its previous tender offer for the 5.5% convertible senior notes.

Egalet has sought an acquisition for some time that is complementary to its offering in the pain space and that will also layer on top of its sales and marketing infrastructure. We believe that the company will pursue an asset that will improve its cash flow position and provide a longer runway for growth to achieve cash flow break even. As indicated in their 8-K filing, the company is pursuing an acquisition transaction and is highly incentivized to consummate this acquisition in conjunction with a restructuring of its debt to return to a sound financial footing. There is little detail regarding the asset being pursued, how far along negotiations have progressed or the likelihood of ultimate closure.

While we see value in Egalet with its portfolio of three approved products and growing sales, the uncertainty in the financing situation raises the risk profile of the company. If management is not able to restructure to the benefit of equity holders, investors could lose their investment. However, we do see the possibility of favorable government or payor action that will recognize the individual and societal benefits of abuse deterrent formulations (ADFs) and support their use. As of the second quarter, the company's ADFs make up only $2 million ($8 million on an annualized basis), in a market that could support hundreds of millions in ADF sales. While greater penetration is a possibility, we maintain our previous forecast of total company sales of $34 million in 2018 and $51 million in 2019. Below, we reiterate some of the factors that support these estimates in the "New Launches" and "Tentative Approval for Arymo" sections. We also recognize the higher risk faced by the company given the uncertainty in the availability of debt financing and increase our discount rate from 15% to 25%.

New Launches

Egalet announced an effort to improve Sprix in previous quarters. The new formulation is expected 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 September 18, 2018, Egalet was not in compliance with NASDAQ listing requirements and trading of shares was transferred to the OTCQX effective September 19, 2018. In early August, due to the shift from NASDAQ Global Markets to NASDAQ Capital Markets exchange, Egalet's 5.5% convertible note holders had the option to redeem their notes. Egalet provided a tender offer to these note holders to repurchase the $24.65 million outstanding balance. However, upon the delisting from the NASDAQ, 13% note holders also had the option to redeem, requiring a level of cash which could negatively impact operations. To provide flexibility, Egalet entered

into forbearance agreement with 94% of the company's 13% senior secured noteholders and withdrew the tender offer for the 5.5% notes. Currently the company is exploring options to restructure the notes in conjunction with the acquisition of a complementary asset.

Valuation

We maintain our prior revenue and cash flow estimates, but do change our target price due to the increased risk profile related to the uncertainty of the outcome of the notes restructuring and acquisition. We increase our discount rate from 15% to 25% used in our NPV model which reduces the valuation to approximately $1.40.

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. Despite the favorable factors, it is a heavy burden to maintain interest bearing debt under negative cash flow conditions. With the repurchase obligation related to the NASDAQ delisting, we reflect the increased financial risk by increasing our discount rate. This change reduces our target price $1.40 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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