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Zacks Small-Cap Research

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Innovus Pharma (INNVD-OTC)

INNVD: A subtle, but important strategic change

Our $3.44 per share valuation target is based on a 10-year DCF with a WACC of 13%. Our WACC is reduced from 15% to 13% to reflect our confidence in the Company's move to focus on profitable growth.

Innovus's 4Q results showed progress towards the Company's commitment to profitable growth based on solid metrics. Investments over the past nine-months towards gathering and tracking returns on marketing and other spending appear to be informing and improving decision making across the organization – making for more consistent results.

Current Price (04/08/19)	$3.13
Valuation	**$3.44**

OUTLOOK

SUMMARY DATA

52-Week High	**$19.38**
52-Week Low	**$1.50**
One-Year Return (%)	**-74.22**
Beta	**2.89**
Average Daily Volume (sh)	**14,290**
Shares Outstanding (mil)	**2**
Market Capitalization ($mil)	**$9**
Short Interest Ratio (days)	**N/A**
Institutional Ownership (%)	**10**
Insider Ownership (%)	**16**
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 2019 Estimate	**N/A**
P/E using 2020 Estimate	**N/A**
Zacks Rank	**N/A**

Risk Level	**N/A,**
Type of Stock	**Small-Growth**
Industry	**Med-Drugs**
Zacks Rank in Industry	**N/A**

ZACKS ESTIMATES

Revenue
(millions of $)

	Q1 (Mar)	Q2 (Jun)	Q3 (Sep)	Q4 (Dec)	Year (Dec)
2018	4.5 A	7.3 A	7.7 A	4.7 A	24.0 A
2019	7.1 E	7.7 E	7.3 E	7.9 E	30.7 E
2020					37.9 E
2021					47.4 E

Earnings per share

	Q1 (Mar)	Q2 (Jun)	Q3 (Sep)	Q4 (Dec)	Year (Dec)
2018	-$0.98 A	-$0.90 A	-$1.14 A	-$0.99 A	-$4.16 A
2019	-$0.54 E	-$0.42 E	-$0.31 E	-$0.42 E	-$1.81 E
2020					$0.40 E
2021					$2.38 E

Zacks Projected EPS Growth Rate - Next 5 Years % **N/A**

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INVESTMENT UPDATE – A subtle but important shift in priorities

Innovus Pharma announced 4Q18 and full year results on April 1, 2019. To us, results signaled a change in corporate priorities, with the Company focused on informed, profitable growth, rather than aiming for the fastest top-line growth possible. As we mention in our initiation report (10/02/18), in 2018 the Company moved out of an advanced start-up phase to full commercial operations. In the past year, the Company took important steps to fill its team with financial and marketing/operating expertise while building out internal controls and executive information systems.

Throughout 2018, INNV noted that it was aiming for profitability in 4Q18. We noted, It might be possible for the Company to post positive operating income, however, we would rather see consistent improvement in operating metrics (sales, marketing expense, operating cash flow) than a quarter that "manages" to positive operating income in order to create a positive headline. In fact, management seems to have heeded our feedback. The Company showed improvement along four financial metrics: subscriptions, gross margins. marketing expense, and cash flow from operations.

Revenues for the year totaled $24.0 million, in line with Company guidance. Quarterly revenues were up to $4.8 million, roughly double the $2.4 million posted in the year-earlier period. On a sequential basis, sales fell by $2.5 million; however, the Company scaled back its marketing spend by 500bp in what is a seasonally weak quarter for nutraceuticals.

Much of INNV's path to profitability relies on increasing its subscriptions as a percent of revenues. Subscriptions create recurring revenue allowing the Company to focus its marketing dollars on new customer acquisition. Subscriptions increased for the third consecutive quarter, rising 22% sequentially in the December quarter to $1.1 million (25% of product revenues) compared with $0.9 million (11.6% of product revenues) in 3Q and 8.7% in 2Q.

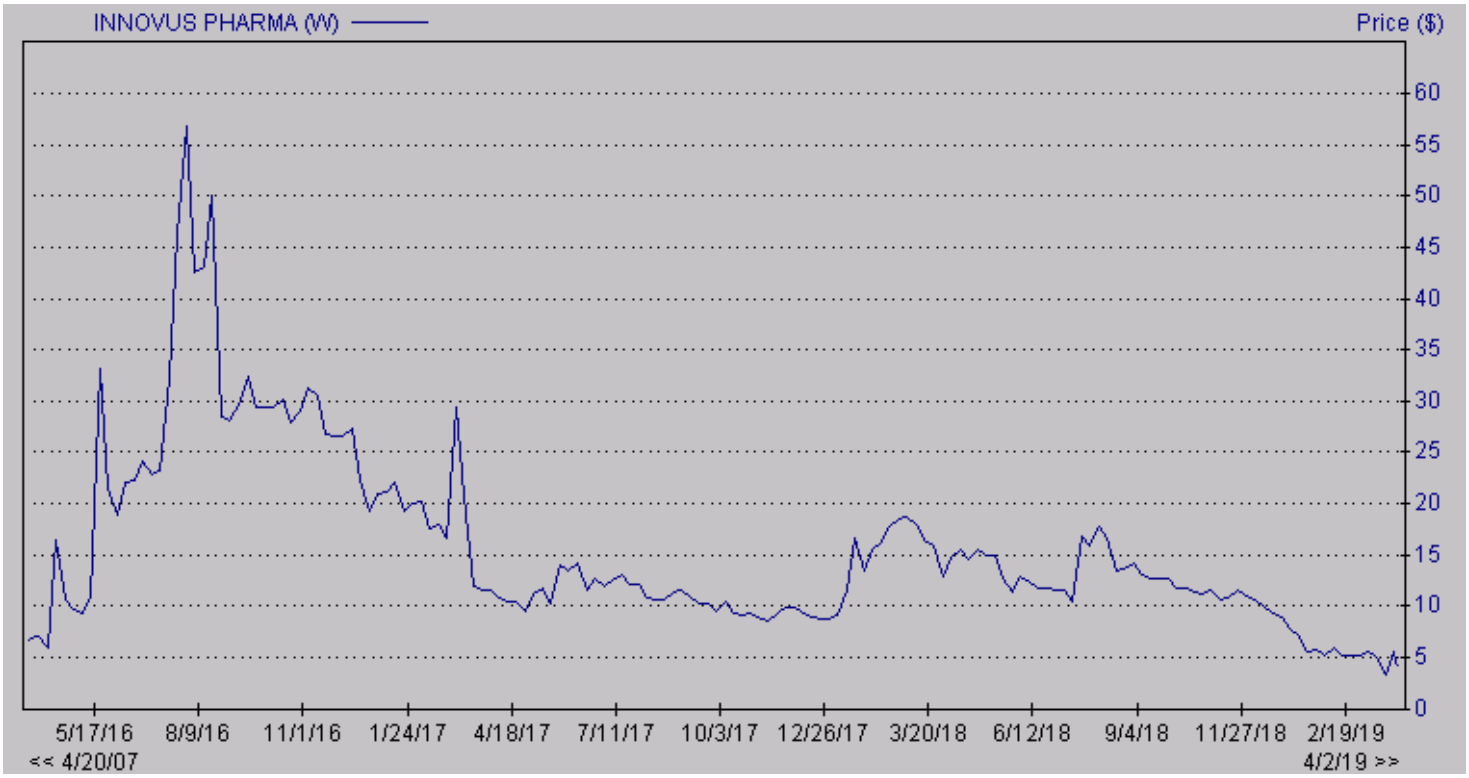
Product gross margins increased sharply in 4Q to 87% of product sales compared with 78% in 3Q18. The contraction in 3Q18 reflected management's decision to collect sales tax on many of its products regardless of where the products are shipped. We believe the balance of the margin contraction in 3Q18 stemmed from the increase in subscription revenues- where unit pricing is lower, but where there is no related marketing expense. INNV prices multiple unit orders at a discount to single unit purchases. For example, Diabesens is priced at $39.95 per unit, but a three-month supply is $29.98 per unit. We believe the increase in 4Q18 primarily stemmed from the Company's focus on selling its most profitable products instead of marketing its entire product line.

One of the Company's key goals in 2018 was moving to a more informed marketing program in order to focus on how to best deploy its marketing dollars. Sales and marketing expense fell to 65.5% of total sales (70.6% of product sales) in 4Q18, compared with 71.3% of total sales (75.6% of product sales) in 3Q18.

Finally, the Company reduced cash flow from operations outflow to $0.5 million in 4Q18, compared with $2.1 million in 3Q18. As we've noted, better inventory management is a key driver of CFFO improvement. Inventory now stands at 10% of sales, compared with 20% a year ago.

We are adjusting our DCF valuation to reflect the reverse split, 4Q18 offering, and notably the reduction in CFFO outflows. Our new valuation is $3.44. Our 10-year DCF model builds to sales of approximately $89 million by 2027 (down from $158 million). We model terminal sales with an EBIT margin of 18% (up from 15%) and a 35% tax rate. We assume a terminal growth rate of 2% and use a 13% WACC (down from 15%).

HISTORICAL SHAREPRICE



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