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Novan Inc. (NOVN - NASDAQ)

One for Ten: Catalyst for Decisive Launch

Based on our DCF model and a 15% discount rate, Novan is valued at approximately $4.50 per share. Our model applies a 50% probability of ultimate approval and commercialization for SB206 for molluscum contagiosum. The model includes contributions from the United States and Japan.

Current Price (5/24/21)	$1.40
Valuation	**$4.50**

OUTLOOK

Novan is a research and development company which employs nitric oxide (NO) to address a number of indications for a variety of skin conditions including molluscum contagiosum (MC), acne, dermatitis, psoriasis, warts and HPV. Novan uses its Nitricil technology to efficiently deliver NO to desired locations and release it at a controlled rate. Novan's lead candidate, SB206 is now being investigated in a pivotal Ph3 trial for MC. SB206 and other Novan compounds store NO in large polymer macromolecules which allows for stable and druggable NO. Additional Nitricil compounds are in clinical and preclinical stages of development for other skin conditions. However, Novan is primarily focused on developing SB206.

We expect pivotal trials for SB206 to generate registrational data for MC by 2021 followed by the submission of an NDA in 3Q:22 if data are supportive. Our valuation assumes a 2023 regulatory approval and commercialization of SB206 in the US. Partner Sato will advance the candidate through the regulatory and commercialization process in Japan and we anticipate a 2023 regulatory submission in that jurisdiction followed by a 2024 launch.

SUMMARY DATA

52-Week High	**$2.59**
52-Week Low	**$0.30**
One-Year Return (%)	**208**
Beta	**-0.09**
Average Daily Volume (sh)	**5,802,700**
Shares Outstanding (mil)	**152**
Market Capitalization ($mil)	**212**
Short Interest Ratio (days)	**0.52**
Institutional Ownership (%)	**12.1**
Insider Ownership (%)	**7.27**
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 2020 Estimate	**N/A**
P/E using 2021 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)
2020	$1.2 A	$1.3 A	$1.3 A	$1.1 A	$4.9 A
2021	$0.8 A	$0.9 E	$0.9 E	$0.9 E	$3.5 E
2022					$3.6 E
2023					$147.5 E

Earnings per Share

	Q1 (Mar)	Q2 (Jun)	Q3 (Sep)	Q4 (Dec)	Year (Dec)
2020	-$0.17 A	-$0.10 A	-$0.06 A	-$0.05 A	-$0.30 A
2021	-$0.06 A	-$0.05 E	-$0.05 E	-$0.04 E	-$0.20 E
2022					-$0.12 E
2023					$0.37 E

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WHAT'S NEW

1-for-10 Reverse Stock Split

Novan Inc. (NASDAQ: NOVN) filed a press release today stating that it will execute a 1 for 10 reverse stock split, effective as of the close tonight. On May 26, the shares will trade on a split-adjusted basis. At the company's 2020 Annual Meeting of Stockholders,[1] shareholders approved the amendment to effect a reverse stock split in a ratio of anywhere between 1:2 to 1:15 which allows the Board to determine the implementation and timing of the action. Novan is close to reaching its authorized number of shares outstanding given the current share balance and warrant, option and Aspire purchase agreement obligations. With an anticipated commercialization and potential partnering arrangement in the near future, Novan will require sufficient capital to execute a decisive launch of SB206.

Novan needs the flexibility of a greater number of shares available to raise enough capital to prepare for SB206 sales. Executing a reverse stock split is an effective way to free up sufficient equity units to issue when capital is needed. Novan now has a stronger hand when executing strategic initiatives.

The primary benefits of the 1:10 reverse split include:

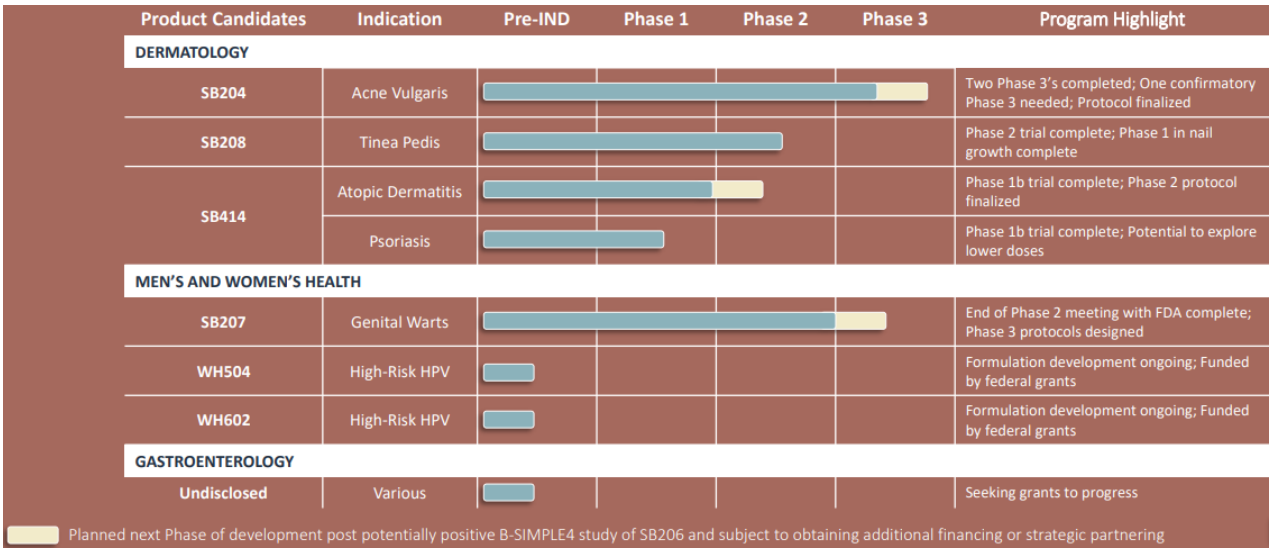
- Ability to raise sufficient funds to:
  - Initiate commercialization activities and hire sales team;
  - Develop favorable negotiating stance in partnership negotiations;
- Provide wide margin to remain within NASDAQ compliance requirements;
- Increase attractiveness to institutional shareholders that require $5 minimum share price.

There has been investor concern that management's decision to go through with a reverse stock split is indicative of a negative outcome for the B-SIMPLE4 trial. However, we do not believe this is the case.

Management is blinded to results and is not privy to any of the analysis prior to the delivery of the full report, which we expect in June. The executive team is prevented from taking any action such as this when it is in possession of material non-public information and would be required to disclose it to the public prior to any major decisions. Choosing to announce and execute the reverse stock split now was partially dependent upon the company not yet receiving the report for B-SIMPLE4.

We maintain our favorable view and valuation (which we will adjust after the split) as we eagerly await results.

Exhibit I – Novan Pipeline[2]



[1] See related SEC filing here: https://novan.gcs-web.com/static-files/08be3180-1bdb-427e-bb99-84b73c3f8d63
[2] Source: Novan March 2021 Corporate Overview Slide Deck

Our Thesis

Novan's lead candidate, SB206, uses the company's Nitricil platform to suspend nitric oxide (NO) in a gel that allows for controlled release. Nitricil can deliver a variable dose of NO to the epithelium to address a broad variety of skin lesions including molluscum contagiosum. NO presents a unique mechanism of action and a favorable safety and scarring profile. The agent has been tested in approximately 3,400 patients in clinical work, with a 24 week safety assessment conducted in the B-SIMPLE trials demonstrating a favorable safety profile.

There is no standard of care for MC and most healthy individuals clear the virus on their own. In the population where treatment is desired, the lesions can be physically removed or oral and topical therapies can be administered. Some of the more common topical approaches include the use of cantharidin, ZymaDerm and imiquimod; however, none have been approved for treatment for MC and demonstrated consistent efficacy in clinical evaluation. Alternate approaches also have side effects, including pain and severe skin reactions, highlighting the need for a tolerable and effective treatment.

We see a fair estimate of an MC population of around six million in the United States and from two to three million in Japan. We anticipate that the availability of an approved, effective and safe treatment may increase the number of diagnoses and the addressable population could be larger. While a portion of the addressable market will prefer to wait it out, we anticipate there will be a significant number of patients that will seek treatment given the availability of an approved medicine.

Summary

The reverse share split opens up the possibility to raise additional capital, which in turn places Novan in a stronger position to either commercialize SB206 or seek out licensing opportunities. Other benefits, such as having a share price more attractive to some institutional investors, also exist.

While some shareholders may be concerned that the announcement presages negative news, management is prohibited from taking actions such as this when in possession of material nonpublic information. Part of the rationale for executing the reverse stock split is that we still have about a month until the data and analysis are expected to be submitted to the company and disclosed to investors. We maintain our confidence that B-SIMPLE4 will be successful with a larger population and improved protocols and maintain our valuation of $4.50 per share. Following the completion of the stock split we will update our target price in line with the 1:10 ratio.

PROJECTED FINANCIALS

Novan, Inc. - Income Statement[3]

Novan, Inc.	2020 A	Q1 A	Q2 E	Q3 E	Q4 E	2021 E	2022 E	2023 E
Total Revenues ($US)	**$4,920**	**$819**	**$890**	**$890**	**$890**	**$3,489**	**$3,550**	**$147,518**
YOY Growth	*0%*	*-32%*	*-33%*	*-32%*	*-17%*	*-29%*		
Research & Development	$19,814	$6,418	$5,900	$5,800	$5,600	$23,718	$10,000	$5,000
Selling, General & Administrative	$11,271	$2,686	$2,700	$2,850	$2,800	$11,036	$14,000	$31,736
Other	$4,049	$0	$0	$0	$0	$0	$0	$0
Income from operations	($30,214)	($8,285)	($7,710)	($7,760)	($7,510)	($31,265)	($20,450)	$88,655
Operating Margin	*-614%*	*-1012%*	*-866%*	*-872%*	*-844%*	*-896%*	*-576%*	*60%*
Other Income	$870	($670)	$0	$0	$0	$0	$0	$0
Interest Income	$51	$3	$2	$2	$2	$9	$0	$0
Pre-Tax Income	($29,293)	($8,952)	($7,708)	($7,758)	($7,508)	($31,256)	($20,450)	$88,655
Provision for Income Tax	$0	$0	$0	$0	$0	$0	$0	$22,164
Tax Rate	*0.0%*	*0.0%*	*0.0%*	*0.0%*	*0.0%*	*0.0%*	*0.0%*	*25.0%*
Net Income	**($29,293)**	**($8,952)**	**($7,708)**	**($7,758)**	**($7,508)**	**($31,256)**	**($20,450)**	**$66,491**
Net Margin	*-595%*	*-1093%*	*-866%*	*-872%*	*-844%*	*-896%*	*-576%*	*45%*
Reported EPS	**($0.30)**	**($0.06)**	**($0.05)**	**($0.05)**	**($0.04)**	**($0.20)**	**($0.12)**	**$0.37**
Basic Shares Outstanding	98,808	150,029	152,000	155,000	168,000	156,257	170,000	182,000

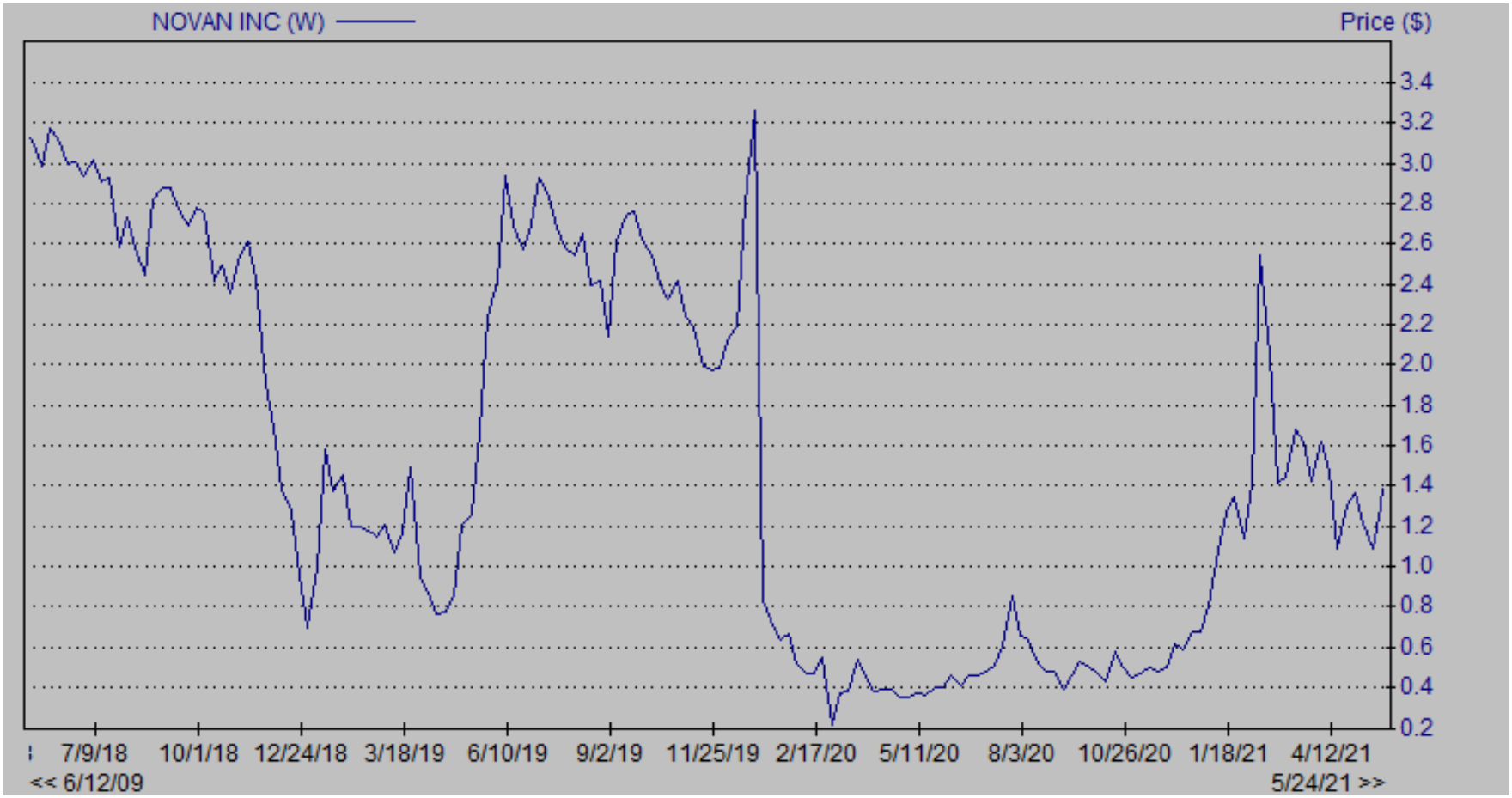
Source: Company Filing // Zacks Investment Research, Inc. Estimates

[3] Financial statement information presents data as originally reported.

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HISTORICAL STOCK PRICE

Novan, Inc. – Share Price Chart[4]



[4] Source: Zacks Research System

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