Zacks Small-Cap Research

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Depomed, Inc. (DEPO-NASDAQ)

DEPO: *NUCYNTA sales continued to grow since its relaunch in mid-Jun; strong initial sales convince us the billion-dollar potential of NUCYNTA---Buy*

Current Recommendation	**Buy**
Prior Recommendation	Hold
Date of Last Change	08/09/2011
Current Price (11/09/15)	$20.11
Target Price	**$36.00**

UPDATE

DepoMed just reported another strong quarter of its financials.

We are impressed with the NUCYNTA sales of $64.9 in 3Q15, compared to $56.7 million in 2Q15, an increase of 15%. This further convinces us the blockbuster potential of NUCYNTA for DepoMed.

We continue to remain optimistic regarding the Depomed story, especially as it pertains to the NUCYNTA® franchise, as we strongly believe the transaction will be transformational for the company.

Current market price undervalues the company. We continue to rate its shares a Buy.

SUMMARY DATA

52-Week High	**$33.28**
52-Week Low	**$14.27**
One-Year Return (%)	**38.21**
Beta	**1.29**
Average Daily Volume (sh)	**1,938,997**
Shares Outstanding (mil)	**60**
Market Capitalization ($mil)	**$1,214**
Short Interest Ratio (days)	**4.81**
Institutional Ownership (%)	**N/A**
Insider Ownership (%)	**N/A**
Annual Cash Dividend	**$0.00**
Dividend Yield (%)	**0.00**
5-Yr. Historical Growth Rates	
Sales (%)	**7.9**
Earnings Per Share (%)	**N/A**
Dividend (%)	**N/A**
P/E using TTM EPS	**N/M**
P/E using 2015 Estimate	**18.3**
P/E using 2016 Estimate	**14.7**

Risk Level	**Average,**
Type of Stock	**Small-Blend**
Industry	**Med-Drugs**

ZACKS ESTIMATES

Revenue
(in millions of $)

	Q1 (Mar)	Q2 (Jun)	Q3 (Sep)	Q4 (Dec)	Year (Dec)
2014	76.5 A	67.7 A	51.5 A	194.6 A	390.4 A
2015	32.2 A	94.5 A	104.9 A	114.7 E	346.3 E
2016					478.5 E
2017					601.5 E

Earnings per Share
(Adjusted EPS)

	Q1 (Mar)	Q2 (Jun)	Q3 (Sep)	Q4 (Dec)	Year (Dec)
2014	-$0.01 A	$0.01 A	$0.03 A	$0.21 A	$0.26 A
2015	-$0.13 A	$0.27 A	$0.33 A	$0.37 E	$1.09 E
2016					$1.36 E
2017					$2.23 E

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WHAT'S NEW

DepoMed Reports Strong Financials for Fiscal Third Quarter of 2015

On November 9, DepoMed reported its third quarter financials ended September 30, 2015.

Total product sales for 3Q15 reached $104.7 million, compared to $33.9 million for 3Q14, an increase of 242.4%, and an increase of 11.1% compared to $94.3 million for second quarter of 2015. Total product sales for 3Q15 were in line with our estimate.

Sales from the company's flagship NUCYNTA franchise (including NUCYNTA immediate release and NUCYNTA ER) continued to grow dramatically, which contributed $64.9 million to the total product revenue. This number is also in line with our estimate of $65 million for 3Q15. NUCYNTA sales in 3Q15 also grew 14.6% compared to initial sales of NUCYNTA products of $56.7 million in 2Q15.

As a reminder, DepoMed acquired NUCYNTA franchise from JNJ in April and initiated the marketing and promotion since then.

Even without NUCYNTA, product sales in 3Q15 still booked 30.1% increase year over year and 5.7% increase sequentially.

Other products also contributed to the strong 3Q15 product sales growth.

Gralise sales for 3Q15 increased to $21.1 million from $16.3 million, an increase of 29.3%. Total Gralise prescriptions of 83,000 were recorded for 3Q15, up 11% compared to the same period last year.

Cambia® sales for 3Q15 were a record $7.1 million, an increase of 21% compared to $5.8 million in the third quarter of 2014. Total prescriptions of 34,000 were up 25% compared to the same period last year.

Lazanda® also booked record sales of $5.4 million in 3Q15, an increase of 139.3% compared to $2.3 million for the third quarter of 2014, and an increase of 41% compared to $3.9 million in the second quarter of 2015. Total sprays of 157,000 in the third quarter 2015 were up 114% compared to third quarter 2014.

After an 11.8% decline in 2Q15, Zipsor sales in 3Q15 slightly increased 0.5% to $6.2 million from $6.1 million in 3Q14.

Three Months Ended September 30 (in $millions)			
	2015	**2014**	**Increase (%)**
NUCYNTA	$64.9	N/A	**N/A**
Gralise	$21.1	$16.3	29.3%
Cambia	$7.1	$5.8	21.0%
Lazanda	$5.4	$2.3	139.3%
Zipsor	$6.2	$6.1	0.5%
Total	**$104.7**	**$33.9**	**242.4%**

Non-GAAP adjusted EBITDA was $38.2 million for 3Q15 compared to $3.1 million for 3Q14.

GAAP net loss was $11.8 million ($0.20 per share). Non-GAAP adjusted net income was $24.9 million ($0.33 per share).

DepoMed exited third quarter of 2015 with cash of $175 million, an increase of $52 million over June 30, 2015 and $107 million for the first six months since the NUCYNTA acquisition (~ $1.75 per outstanding share in 6 months). The strong balance sheet allows the company to focus on long term growth strategy without any worry for short term cash burn.

Guidance Further Raised for 2015

As a result of the strong financial performance in 3Q15, especially the strong performance of newly acquired NUCYNTA franchise, DepoMed is again raising its 2015 financial guidance for total product sales, adjusted earnings and adjusted EBITDA.

	Prior Guidance	Updated Guidance
Total Product Sales	$320 to $340 million	$336 to 348 million
Total SG&A and R&D Expense*	$195 to $210 million	$200 to 210 million
Non-GAAP Adjusted Earnings	$40 to $50 million	$58 to 66 million
Non-GAAP Adjusted EBITDA	$95 to $110 million	$108 to 116 million

Initial Sales Ramp Convinces US that NUCYNTA Has Blockbuster Potential

Since DepoMed took control of NUCYNTA in early April 2015, sales growth from this franchise is accelerating. The franchise has become the company's flagship product.

DepoMed recorded full second quarter NUCYNTA net sales of $56.7 million in 2Q2015, an increase of 29% compared to sales of $44 million in 4Q14 generated by JNJ.

Product franchise was officially re-launched in mid-June with expanded sales force of 275 plus full marketing and medical support. The sales force of 275 reps more than tripled compared to sales force of 80-90 reps for JNJ.

Per management, product positioning will be focused on NUCYNTA's dual mechanism of action designed to target both nociceptive and neuropathic pain. The company plans to capture market share in large and growing markets including chronic pain and chronic lower back pain (CLBP). Over 100 million US patients suffer from chronic pain, while 31 million US patients suffer from chronic lower back pain. DepoMed will specifically targeting the CLBP patient population. The company also launched NUCYNTA for moderate to severe painful diabetic peripheral neuropathy (DPN), which affects another 1-2 million patients.

As a result of the relaunch strategy, third quarter net sales of NUCYNTA increased to $64.9 million, an increase of 15% compared to $56.7 million from second quarter of 2015.

Three Months (in $millions)			
	3Q2015	**2Q2015**	**Increase (%)**
NUCYNTA	$64.9	$56.7	**14.6%**

Total NUCYNTA ER prescriptions were 80,000 in third quarter, an increase of 8% compared to the second quarter of 2015. Also, records of NUCYNTA ER weekly prescription volume were set in consecutive weeks in October and year-over-year 4-week rolling prescription volume growth surpassed 15%.

NUCYNTA ER total prescription share in the total LAO market has increased to 1.65% up from 1.49% since just prior to relaunch of the product in mid-June 2015.

We believe the effect of the re-launch strategy and the tripled sales force is expected to impact NUCYNTA prescription growth further in 4Q2015 and beyond. The strong initial sales, combined with the relaunch strategy, make us believe that NUCYNTA has blockbuster potential and will become the company's flagship brand.

We Continue to Be Bullish on DepoMed Shares

We maintain our Buy rating on Depomed shares and reiterate our 12-month price target of $36 per share.

We continue to remain positive on the DepoMed story, especially as it pertains to the NUCYNTA® franchise, as we believe the transaction to acquire NUCYNTA® / ER is transformational for the company. The strategic fit is excellent and past execution has been outstanding. There is clearly a lot of future execution that still must take place for this to benefit shareholders but the plan is in place, and in our opinion, looks solid. We view the name as a good core-holding in the specialty pharmaceutical industry with significant upside should the NUCYNTA® / ER product take off.

In 3Q15, DepoMed generated $64.9 million in NUCYNTA sales, an increase of 15% from $56.7 million for generated for 2Q15, which is an increase of 29% over the $44 million in 4Q14 under JNJ control.

Based on the initial sales and the prescription data so far, we have reasons to believe that NUCYNTA sales are poised to take off in 2016 and beyond.

Actually, as a result of the strong initial sales of NUCYNTA in 2Q and 3Q15, DepoMed has raised its 2015 financial guidance for total product sales, adjusted earnings and adjusted EBITDA.

We model NUCYNTA sales of $195 million for 2015. Sales will reach $400 million in 2017.

In terms of valuation, we think Depomed shares are undervalued at current market price. Currently share price of Depomed is trading at about $21, valuing the company at $1.3 billion in terms of market cap. We think this deeply undervalues Depomed.

Based on our financial model, revenue will reach $345 million in 2015 with non-GAAP earnings per share (EPS) of $1.09. We continue to expect that the NUCYNTA® / ER deal will be strongly accretive, and that DepoMed will generate $400 million in sales from NUCYNTA franchise in 2017. Non-GAAP EPS will grow from $1.09 in 2015 to $2.23 in 2017 based on total revenue of $602 million.

We think DepoMed shares should be valued using a 25x P/E multiples, which is close to the biotech industry's average P/E ratio of 22.6. Using this P/E ratio, multiplied by our estimated EPS of $2.23 for 2017, discounted at 25% for two years, we come up with our fair value of DepoMed **at $36 per share**. Our price target values the company at $2.2 billion, which is still conservative in our view.

We consider Hillary Clinton's comments on drug price control more as politics rather than policy. Any proposal with respect to drug price control is unlikely to become a law in a short period of time in our view. Therefore, the recent decline in share price of Depomed due to the industry correction should be considered great buying opportunity.

We also noticed Horizon's recent offer. According to our calculation, Horizon's share exchange offer values Depomed shares at approximately $28/share, which is lower than our fair price target of $36 per share.

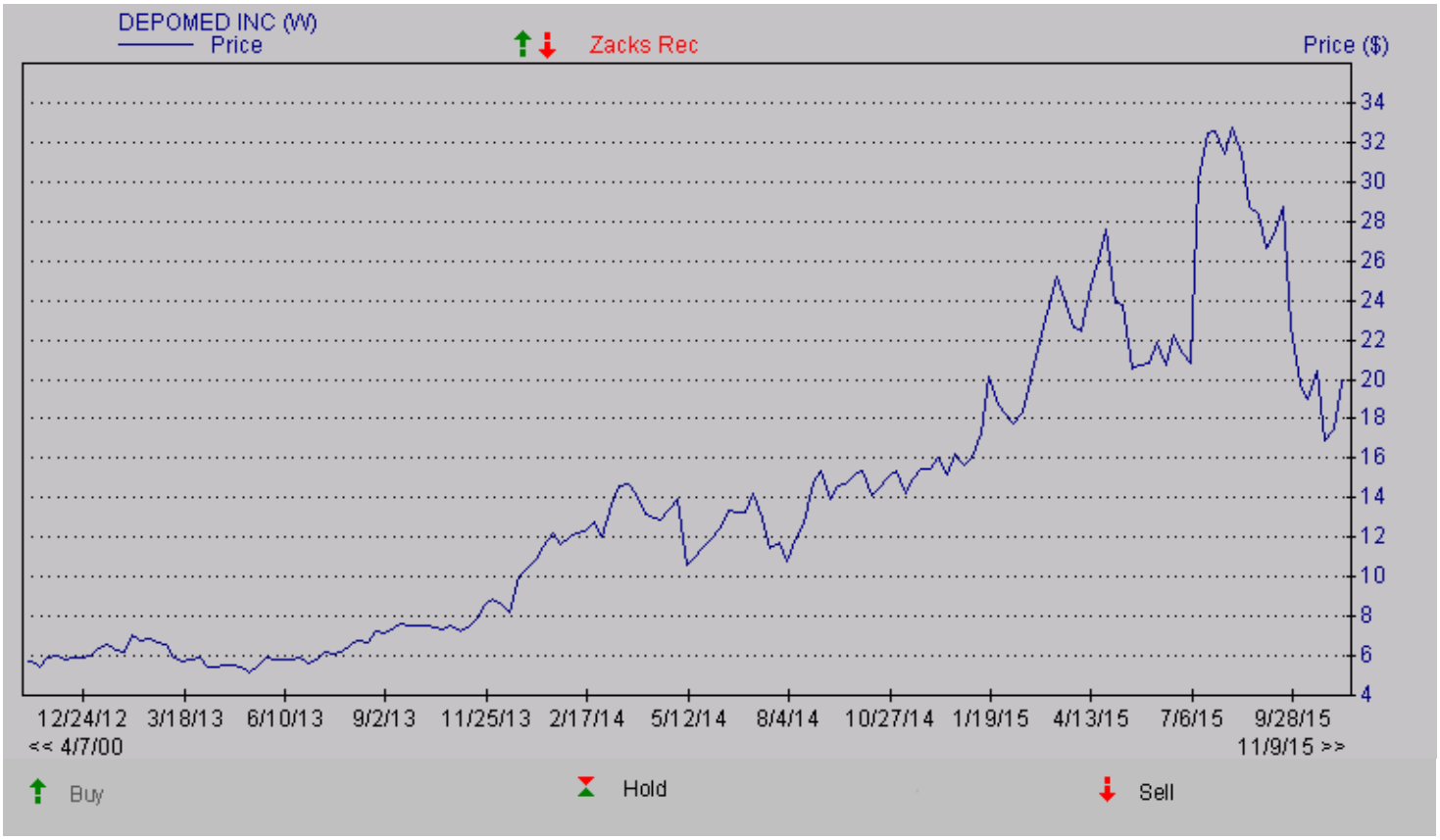
PROJECTED INCOME STATEMENT

DEPOMED, INC.	Q1A	Q2A	Q3A	Q4A	2014 A	Q1A	Q2A	Q3A	Q4E	2015 E	2016 E	2017 E
Gralise	$10.9	$15.1	$16.3	$18.1	$60.4	$17.3	$20.9	$21.1	$21.5	$80.8	$90.0	$100.0
YOY Growth	*78.4%*	*76.7%*	*66.4%*	*54.4%*	*66.9%*	*59.1%*	*38.5%*	*29.3%*	*18.7%*	*33.8%*	*11.4%*	*11.1%*
Zipsor	$5.3	$6.8	$6.1	$6.8	$25.2	$5.8	$6.0	$6.2	$6.5	$24.5	$27.0	$30.0
YOY Growth	*75.8%*	*22.9%*	*2.1%*	*19.5%*	*23.7%*	*9.4%*	*-11.8%*	*0.5%*	*-5.0%*	*-2.5%*	*10.0%*	*11.1%*
Lazanda	$0.7	$1.4	$2.3	$2.7	$7.0	$3.2	$3.9	$5.4	$5.5	$18.0	$20.0	$25.0
YOY Growth	-	-	-	-	*472.4%*	*368.5%*	*184.6%*	*139.3%*	*106.4%*	*157.9%*	*11.2%*	*25.0%*
CAMBIA	$4.6	$5.0	$5.8	$6.3	$21.7	$5.4	$6.8	$7.1	$7.5	$26.8	$32.0	$40.0
YOY Growth	-	-	-		-	*16.1%*	*38.1%*	*21.0%*	*19.7%*	*23.5%*	*19.5%*	*25.0%*
Nucynta / ER	-	-	-	*$44*	*$172*	$0	$56.7	$64.9	$73.5	$195.1	$305.0	$400.00
YOY Growth	-	-	-	-	-	-	-	-	-	-	*56.3%*	*31.1%*
Total Product Sales	**$21.5**	**$28.2**	**$30.6**	**$33.9**	**$114.2**	**$31.7**	**$94.3**	**$104.7**	**$114.5**	**$345.2**	**$474.0**	**$595.0**
YOY Growth	*135.6%*	*100.2%*	*87.9%*	*80.3%*	*95.9%*	*47.3%*	*233.8%*	*242.4%*	*237.9%*	*202.2%*	*37.3%*	*25.5%*
Total Royalties	**$43.3**	**$33.7**	**$20.1**	**$13.8**	**$110.9**	**$0.5**	**$0.2**	**$0.1**	**$0.2**	**$1.1**	**$2.0**	**$4.0**
YOY Growth	*207.4%*	*123.4%*	*30.6%*	*-25.6%*	*146.4%*	*-98.8%*	*-99.4%*	*-99.4%*	*-98.5%*	-	-	-
Total Licenses Revenues	**$11.8**	**$5.8**	**$0.8**	**$147.0**	**$165.2**	**$0**	**$0**	**$0**	**$0**	**$0**	**$2.5**	**$2.5**
YOY Growth	*296.8%*	*657.9%*	*-86.8%*	*4337.1%*	*828.5%*	-	-	-	-	-	-	-
Total Revenues	**$76.5**	**$67.7**	**$51.5**	**$194.6**	**$390.4**	**$32.2**	**$94.5**	**$104.9**	**$114.7**	**$346.3**	**$478.5**	**$601.5**
YOY Growth	*192.4%*	*126.1%*	*37.4%*	*379.2%*	*190.9%*	*-57.9%*	*39.5%*	*103.7%*	*-41.1%*	*-11.3%*	*38.2%*	*25.7%*
Cost of Goods Sold	$3.7	$4.7	$3.5	$3.2	$15.1	$3.1	$22.9	$20.9	$23.0	$69.9	$90.1	$107.1
Product Gross Margin	*82.8%*	*83.4%*	*88.5%*	*90.4%*	*86.7%*	*90.2%*	*75.8%*	*80.0%*	*79.9%*	*79.8%*	*81.0%*	*82.0%*
SG&A	$32.5	$32.6	$27.1	$29.0	$121.1	$34.5	$57.4	$49.1	$50.0	$191.0	$185.0	$195.0
% SG&A	*42.5%*	*48.1%*	*52.6%*	*14.9%*	*31.0%*	*107.3%*	*60.7%*	*46.8%*	*43.6%*	*55.2%*	*38.7%*	*32.4%*
R&D	$2.0	$1.4	$1.6	$2.0	$7.1	$1.9	$4.7	$4.6	$4.5	$15.7	$20.0	$25.0
% R&D	*2.7%*	*2.1%*	*3.2%*	*1.0%*	*1.8%*	*5.8%*	*5.0%*	*4.4%*	*3.9%*	*4.5%*	*4.2%*	*4.2%*
Amortization	$2.5	$2.5	$2.5	$2.5	$10.2	$2.5	$26.7	$27.0	$27.0	$83.3	$115.0	$115.0
Operating Income	$35.7	$26.5	$16.7	$157.8	$236.8	($9.8)	($17.2)	$3.2	$10.2	($13.6)	$68.4	$159.4
Operating Margin	-	-	-	-	*60.7%*	-	-	-	-	*-3.9%*	*14.3%*	*26.5%*
Non-Cash PDL Int. Exp.	($5.4)	($4.9)	($4.4)	($57.2)	($71.9)	$0	$0	$0	$0	$0	$0	$0
Other Income (Net)	($0.6)	($0.6)	($5.9)	($2.6)	($9.6)	($6.0)	($4.4)	($22.6)	($22.5)	($55.5)	($30.0)	($30.0)
Pre-Tax Income	$29.8	$21.0	$6.5	$98.0	$155.3	($15.8)	($21.7)	($19.3)	($12.3)	($69.1)	$38.4	$129.4
Taxes	$11.8	$8.3	$0.0	$0.0	$20.1	($4.2)	$0.0	($7.6)	($7.5)	($18.0)	$10.0	$33.6
Tax Rate	*40%*	*39%*	*40%*	*0%*	*13%*	*26%*	*0%*	*39%*	*61%*	*26%*	*26%*	*26%*
GAAP Net Income	$17.9	$12.7	$6.5	$98.0	$136.0	($11.6)	($21.7)	($11.8)	($4.8)	($51.1)	$28.4	$95.8
Net Margin	-	-	-	-	*34.8%*	-	-	-	-	*-14.8%*	*5.9%*	*15.9%*
GAAP EPS	**$0.30**	**$0.21**	**$0.11**	**$1.23**	**$2.05**	**($0.20)**	**($0.36)**	**($0.20)**	**($0.08)**	**($0.85)**	**$0.44**	**$1.37**
YOY Growth	-	-	-	-	*172.4%*	-	-	-	-	*-141.2%*	*-151.7%*	*212.6%*
Adjustments to GAAP	($18.7)	($12.4)	($4.3)	($83.7)	($119.2)	$3.6	$41.7	$36.7	$35.0	$117.0	$60.0	$60.0
Non-GAAP Net Income	($0.8)	$0.3	$2.1	$14.4	$16.0	($8.0)	$20.0	$24.9	$30.2	$65.8	$88.4	$155.8
Adjusted (Non-GAAP) EPS	**($0.01)**	**$0.01**	**$0.03**	**$0.21**	**$0.26**	**($0.13)**	**$0.27**	**$0.33**	**$0.37**	**$1.09**	**$1.36**	**$2.23**
Diluted Wt. Ave Shares Out	59.9	60.4	60.9	79.4	66.3	59.6	60.0	60.3	62.0	60.5	65.0	70.0

Source: Company filing and Zacks Estimates

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