Zacks Small-Cap Research

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Sorrento Therapeutics (SRNE-NASDAQ)

SRNE: Post Cynviloq, moving forward to focus on immunotherapy--- Buy

Current Recommendation	**Buy**
Prior Recommendation	N/A
Date of Last Change	12/10/2013
Current Price (11/18/15)	$8.12
Twelve- Month Target Price	**$15.00**

OUTLOOK

Sorrento is a biopharmaceutical company focused on cancer. Its lead candidate Cynviloq, a competitor to Abraxane®, has completed the pivotal trial. The second lead program Resiniferatoxin (RTX) is in mid-stage development for cancer pain. Sorrento also owns two drug development platforms: G-MAB® and antibody drug conjugates (ADCs), which target the therapeutic antibody market. Both G-MAB® and ADCs have great potential for partnerships that could provide near term revenue for the Company.

We continue to be optimistic about the prospect of Sorrento and rate its shares Buy.

SUMMARY DATA

52-Week High	**$24.36**
52-Week Low	**$3.80**
One-Year Return (%)	**98.25**
Beta	**1.42**
Average Daily Volume (sh)	**411,961**
Shares Outstanding (mil)	**38**
Market Capitalization ($mil)	**$299**
Short Interest Ratio (days)	**5.09**
Institutional Ownership (%)	**N/A**
Insider Ownership (%)	**N/A**
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 2013 Estimate	**N/A**
P/E using 2014 Estimate	**N/A**
Zacks Rank	**N/A**

Risk Level	**N/A,**
Type of Stock	**N/A**
Industry	**Med Products**
Zacks Rank in Industry	**N/A**

ZACKS ESTIMATES

Revenue
(in millions of $)

	Q1 (Mar)	Q2 (Jun)	Q3 (Sep)	Q4 (Dec)	Year (Dec)
2014	0.98 A	0.78 A	1.28 A	0.80 A	3.83 A
2015	0.98 A	1.17 A	1.10 A	1.35 E	4.60 E
2016					8.00 E
2017					18.50 E

Earnings per Share
(EPS is operating earnings before non recurring items)

	Q1 (Mar)	Q2 (Jun)	Q3 (Sep)	Q4 (Dec)	Year (Dec)
2014	-$0.44 A	-$0.33 A	-$0.27 A	-$0.29 A	-$1.30 A
2015	-$0.29 A	-$0.30 A	-$0.29 A	-$0.37 E	-$1.28 E
2016					-$1.62 E
2017					-$1.73 E

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

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WHAT'S NEW

Update on Third Quarter Financial Results

Total revenue was $1.1 million in 3Q15, as compared to $1.3 million for the three months ended September 30, 2014. The decrease was primarily due to lower sales and service revenues generated from the sale of customized reagents and providing contract development services partially offset by more active grants and an increase in activities under the company's active grants for the three months ended September 30, 2015 compared to the corresponding period of 2014.

Total revenue consisted of grant revenue and product/service revenue. Grant revenue was $0.37 million in 3Q15, as compared to $0.15 million in 3Q14. Product/service revenue was $0.74 million in 3Q15, as compared to $1.13 million in 3Q14.

Cost of revenue for 3Q15 was $0.6 million, as compared to $0.5 million for 3Q14.

R$D expenses in 3Q15 were $7.2 million, as compared to $5.4 million for 3Q14. The increase was primarily attributable to salaries and compensation related expense, consulting and lab supply costs incurred in connection with the company's expanded research and development activities and activities to advance RTX into clinical trials and potentially pursue other development.

Acquired in-process R&D expenses for 3Q15 were 2014 were $24 million, as compared to $0 for 3Q14. Acquired in-process research and development expenses for 3Q15 included costs associated with the purchase price of the license rights from Mabtech Limited, the purchase price of the license rights from the City of Hope and the purchase price of CARgenix and BDL.

G&A expenses for 3Q15 were $4.7 million, as compared to $1.9 million for 3Q14. The increase was primarily attributable to higher legal costs, higher stock-based compensation, higher salaries and related compensation expenses and rent and facility expenses partially offset by lower general corporate and IP matters and consulting and business development expenses.

We expect general and administrative expenses to increase in absolute dollars as we: (i) incur incremental expenses associated with expanded operations and development efforts, (ii) compliance with our public reporting obligations, (iii) increased infrastructure costs, and (iv) invest in our JV's or other third party agreements.

GAAP net loss for 3Q15 was $0.9 million ($0.03 per share), as compared to $7.6 million ($0.27 per share) for 3Q14. The decrease in net loss is mainly attributable to the gain on sale of IgDraSol partially offset by increased research and development activities, acquired in-process research and development expense and general and administrative expenses.

Non-GAAP net loss for 3Q15 was $10.8 million ($0.29 per share), as compared to $7.6 million ($0.27 per share) for 3Q14.

As of September 30, 2015, Sorrento had $123.4 million in cash and cash equivalents and marketable securities. Current cash balance will last into second half of 2017 according to our financial model.

Update on Cynviloq

NantWorks Acquires Cynviloq™ For Up to $1.3+ Billion

In mid-May, 2015, Sorrento announced that NantPharma agreed to acquire the rights to **Cynviloq** through the acquisition of Igdrasol, Inc., a wholly-owned subsidiary of Sorrento. Igdrasol has been developing Cynviloq in a bio-equivalence trial.

Under the terms of the agreement, Sorrento will receive more than $90 million in an up-front cash payment plus the potential for more than $600 million in regulatory and $600 million in sales milestone payments. Sorrento will also receive additional transfer pricing payments from total unit sales. Furthermore, Sorrento has the option to co-develop and/or co-market Cynviloq on terms to be negotiated.

After the acquisition, Dr. Patrick Soon-Shiong and his NantPharma team plan to expand Cynviloq into multiple cancer indications, as well as combine it with immunomodulatory antibodies and cell therapies from Sorrento's pipeline.

Moving forward, Sorrento plans to focus on truly innovative **immuno-oncology** and **cellular therapies** and position it as the leader in the emerging immunotherapy space.

This transaction not only boosts its balance sheet immediately, but further validates the company's prior Igdrasol acquisition.

Sorrento and City of Hope Enter Exclusive License to Develop First-In-Class Immunotherapies Against Intracellular Targets

In September, 2015, Sorrento formed a new company – named **LA Cell, Inc**. – to focus on the development of groundbreaking cell-penetrating antibody therapies. LA Cell has exclusively licensed technology developed at City of Hope that enables modified monoclonal antibodies (mAbs) to penetrate into cells and target "undruggable" disease-causing molecules.

The City of Hope technology, which was developed in the laboratory of Hua Yu, Ph.D., Billy Wilder Endowed Professor and Co-Leader of the Cancer Immunotherapeutics Program, and Andreas Herrmann, Ph.D, Associate Research Professor, overcomes limitations of existing antibody-based therapies, potentially enabling a wave of new therapeutics for treatment of cancer and other life-threatening diseases. The technology is based on a proprietary chemical modification of mAbs that allows them to enter a cell's cytoplasm and nucleus while maintaining their ability to target specific proteins.

The total deal value is in excess of $170 million for the development of these modified mAbs and includes an equity provision as well as upfront and milestone payments to City of Hope.

Utilizing mAbs derived from Sorrento's antibody portfolio, LA Cell is positioned to develop therapies against important oncology targets, including but not limited to c-MYC, mutated KRAS, STAT3, and FoxP3. Notably, this technology can also be applied to medically-relevant targets in other indications, such as inflammation, auto-immune disorders, diabetes, central nervous systems (CNS), cardiovascular diseases and viral infections.

Sorrento Establishes TNK Therapeutics Subsidiary with Focus on Cellular Immunotherapies

Also in mid-May, 2015, Sorrento announced that it has formed a wholly-owned subsidiary, TNK Therapeutics, Inc. This subsidiary will focus on developing **CAR.TNKs** (Chimeric Antigen Receptor Tumor-attacking Neukoplast®) as well as other complementary cellular and immunotherapies targeting both solid tumors and hematological malignancies.

As we discussed briefly above, after the acquisition of Cynviloq by Dr. Patrick Soon-Shiong's NantPharma, Sorrento will focus on developing innovative immuno-oncology and cellular therapies utilizing its proprietary G-MAB antibody library platform and clinically advancing resiniferatoxin (RTX) development for associated cancer pain.

The establishment of TNK Therapeutics will allow the company to fully leverage Sorrento's G-MAB library to create novel CAR constructs for the generation of CAR.TNKs and other cellular therapies. This

important step in Sorrento's corporate development positions Sorrento to be a leader in the highly promising and rapidly emerging field of adoptive cellular immunotherapies, which show promise as potent weapons against solid tumors and hematological malignancies.

In Dec 2014, Sorrento and **Conkwest** entered into a definitive agreement to jointly develop next generation CAR-TNK™ immunotherapies for the treatment of cancer.

Conkwest is a privately-held immuno-oncology company focused on developing proprietary Neukoplast®(NK-92™), a Natural Killer (NK) cell-line based therapy. The CAR-TNK technology platform combines Conkwest's proprietary Neukoplast cell line with Sorrento's proprietary G-MAB® fully human antibody technology and CAR designs to further enhance the potency and targeting of Neukoplast.

Under the terms of the agreement, Sorrento and Conkwest will establish an exclusive global strategic collaboration focused on accelerating the development of CAR-TNKs for the treatment of cancers. Both companies will jointly own and share development costs and revenues from any developed CAR-TNK products. As part of the transaction, Sorrento will make a $9 million strategic equity investment in Conkwest and provide $2 million in research credit payments towards the development of novel CAR-TNK cell lines.

Conkwest's "off-the-shelf" CAR-TNK approach utilizes bioreactor-grown NK-92 cell line, Neukoplast, as the immune effector cells. These Neukoplast cells can be re-engineered in a virus-free process to express surface receptors using Sorrento's G-MAB library to yield a stable line of effector cells that recognize and target specific antigens on tumor cells. The CAR-TNK cells can also be generated and produced in large quantities, thereby obviating the need for expensive, decentralized 'biologistics'- a critical drawback of current CAR-T and dendritic cell therapies.

Sorrento plans to rapidly move several of the CAR-TNK cell lines into the clinic to offer patients suffering from hematological malignancies and solid tumors an innovative immunotherapy to fight their cancers.

Profit sharing from future sales and potential strategic collaborations with other pharmaceutical partners will be determined by the development stage of the drug candidates.

Since the establishment in May, 2015, TNK Therapeutics has acquired multiple preclinical and clinical stage chimeric antigen receptor (CAR)-T immunotherapy programs as well as underlying CAR-T technology through the acquisition of **two privately-held biotechnology** companies. The CAR-T programs focus on targeting solid tumors as well as infectious diseases. The company recently in-licensed late clinical stage biobetter mAbs of the marketed antibodies infliximab, cetuximab, and basiliximab, as well as a biosimilar mAb of omalizumab.

TNK Therapeutics also has entered into a binding term sheet to exclusively license the NanoVelcro Circulating Tumor Cell (CTC) profiling assay technology from CytoLumina Technologies Corp. and FetoLumina Technologies Corp., two privately-held sister biotechnology companies in Los Angeles, California. The exclusive licenses will cover the applications of the NanoVelcro CTC assay and its portfolio technologies for precision medicine diagnostics in conjunction with all cellular therapies and Sorrento antibody therapeutics.

Sorrento and NantBioScience Form Joint Venture to Develop Moonshot Program Targeted Small Molecule Therapies against Cancer

In early July, 2015, Sorrento and NantBioScience, Inc., a majority owned subsidiary of NantWorks, LLC, announced that they have established a joint venture to focus on the development of 'first-in-class' **small molecules** against targets that have eluded the pharmaceutical industry to date and which may address important drivers of cancer growth including cancer stem cells.

Sorrento will contribute key small molecule programs (lead inhibitors of the proto-oncogenes c-Myc, and the master metabolism regulator HIF-1 alpha, and an inducer of the tumor suppressor cytokine TRAIL) to the joint venture which will be 60% owned by NantBioScience and 40% owned by Sorrento, and funded accordingly.

In Dec, 2014, NantWorks and Sorrento established a first joint venture **NantiBody, LLC** to jointly develop next generation immunotherapies for the treatment of cancer and auto-immune diseases. The Immunotherapy Antibody JV will be an independent biotechnology company with **$20** million initial joint funding. As part of a strategic investment, Dr. Soon-Shiong's affiliated entity will acquire a **19.9%** equity stake in Sorrento by purchasing common stock priced at $5.80 per share. In addition, Sorrento granted the investor a 3-year warrant to purchase 1,724,138 shares of common stock at an exercise price of $5.80 per share.

The JV will focus on the development of multiple immuno-oncology monoclonal antibodies (mAbs) for the treatment of cancer, including but not limited to anti-PD-1, anti-PD-L1, anti-CTLA4 mAbs, and other immune-check point antibodies as well as antibody drug conjugates (ADCs) and bispecific antibodies.

It's our belief that Nantworks will provide the majority of the initial $20 million funding for the joint venture and that Sorrento will provide its technology and some cash funding for the JV.

In Mar, 2015, the two companies entered into another binding agreement to initiate a **global collaboration** to discover and develop novel anti-cancer immunotherapies derived from Sorrento's proprietary G-MAB® library against neoepitopes of tumor-specific antigens discovered using NantWorks' proprietary pan-omics based, precision medicine approach.

Under the terms of the agreement, Sorrento will exclusively license to **NantCell, LLC**, a NantWorks company, certain antibodies and CAR-TNK™ products in exchange for $10 million in cash and $100 million in NantCell's equity. In addition to the equity and cash payments, Sorrento will also have a share of all future profits resulting from the collaboration.

Sorrento In-Licenses Four Late-Stage Clinical Biobetter and Biosimilar Antibodies

In August, 2015, Sorrento entered into an exclusive licensing agreement to develop and commercialize multiple prespecified and undisclosed biosimilar or biobetter antibodies from Mabtech Limited, a holding company for premier antibody development and manufacturing companies in China.

Under the terms of the agreement, Sorrento will develop and market 4 monoclonal antibodies (mAbs) for the North American, European and Japanese market. Each of the mAbs has completed a Phase III study; two are currently in registration for marketing approval in China, while the other two are under data analyses for subsequent NDA submission in China. One of the biobetter mAbs is based on a Top 10-selling oncology drug and the other a Top 5-selling antibody to treat auto-immune diseases. Together these 4 mAbs target an established market with combined annual global sales in 2014 in excess of $13 Billion.

We see this collaboration as a transformational event for Sorrento and are excited about its potential to complement the company's expanding and deep internal biologics portfolio. With this exclusive license agreement, Sorrento takes a significant step toward becoming a major player in the biopharmaceutical industry.

Our Takeaways from the Deals

We welcome these deals Sorrento recently entered into. These are exciting news for Sorrento in a few aspects.

First, the deals immediately boost Sorrento's balance sheet. All upfront payments and proceeds from the equity investment generates cash to Sorrento.

Second, the deals with NantWorks further validate Sorrento's antibody technology. Over the years, Sorrento has developed two important drug development platforms: **G-MAB®** library and antibody drug conjugate (**ADC)** technology. Sorrento's G-MAB® library is one of the industry's most diverse **fully human** antibody libraries available in the market today. And its proprietary C-lock™ and K-lock™ **conjugation chemistries** enable site-specific conjugation of toxins to the antibody, which will produce next generation **homogenous ADCs** with well-defined drug antibody ratios (DAR).

Third, the collaborations will accelerate the development of Sorrento's diverse portfolio of fully human monoclonal antibodies, ADCs, and bispecific antibodies. Management of Sorrento has been actively seeking strategic alliance in order to accelerate the development of its programs. The deals underscore Sorrento's commitment. Combination of Sorrento's antibody technology with partners' proprietary technologies will bring drug candidates into clinic more quickly.

We Maintain Our Buy Rating on Sorrento Shares

We maintain our Buy rating on Sorrento share and our 12-month price target is $15.00 per share.

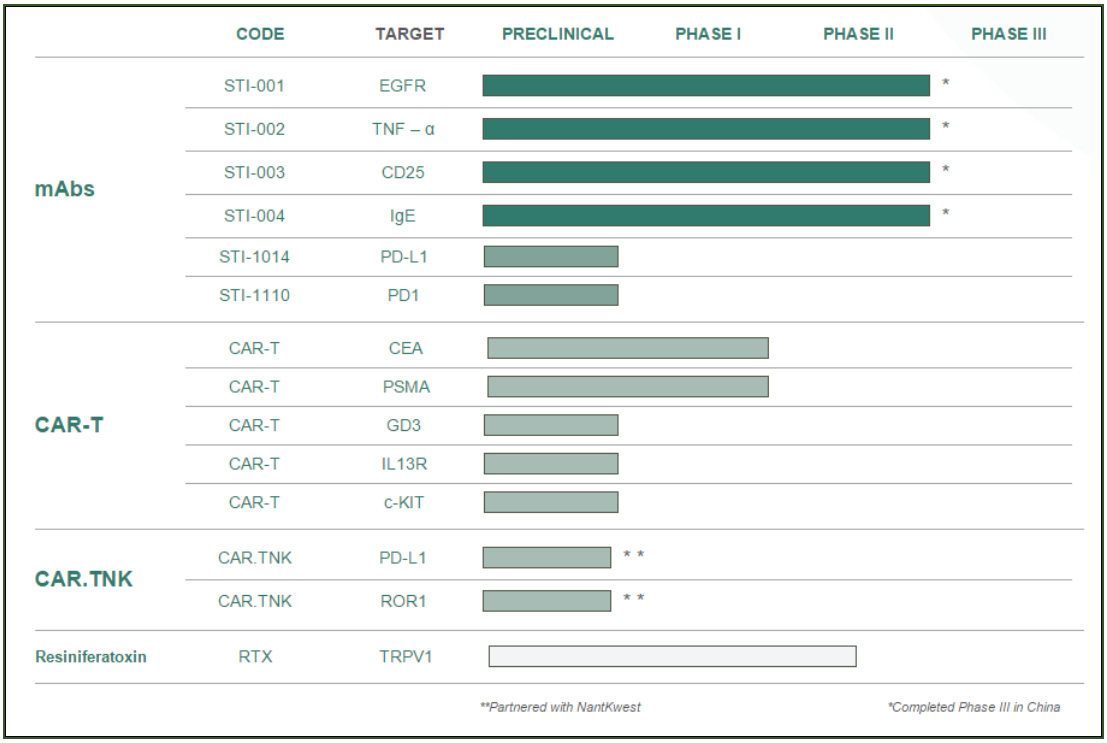
Sorrento is a late stage development biopharmaceutical company with diversified pipeline. The company's lead candidate **Cynviloq** has advanced to **pivotal clinical** trial and the company will use 505(b)(2) regulatory pathway to file for approval. This approach will shorten the development time of Cynviloq dramatically and reduce the development risks accordingly. We estimate Cynviloq will reach the market in 2016. Cynviloq targets the multibillion dollar cancer therapeutics market.

In mid-May, 2015, Sorrento announced that NantPharma agreed to acquire the rights to **Cynviloq** through the acquisition of Igdrasol, Inc. for up to $1.3+ billion.

The company's second lead clinical program **RTX** targets the huge **cancer pain market**. Its unique mechanism of action and potency will help RTX command a niche of the cancer pain market if approved. RTX is currently in an investigator-sponsored Phase I/II clinical trial and Sorrento plans to initiate additional Phase I/II clinical trial for cancer pain in 2014. Recent formation of a subsidiary Ark Animal Therapeutics further expands the use of RTX in animal health.

In addition to the two lead clinical programs Cynviloq and RTX, Sorrento also owns proprietary **G-MAB® antibody library** and **ADC technology**. Therapeutic antibodies and ADCs represent the biggest market in the current pharmaceutical industry with multibillion dollar sales. Sorrento's G-MAB® is one of the most diverse fully human antibody library in the industry and its ADC technology holds key advantages over currently used competitor ADC technologies. The combination of these two platforms will not only expand its pipeline, but also provide partnership opportunities for the company to generate near term revenues.

Post Cynviloq acquisition, Sorrento will focus on immunotherapy for cancers and infectious disease.



Sorrento has all the makings of a successful biotech company. In terms of valuation, we think Sorrento's shares are undervalued at current market price.

Current share price of $8.0 values the company at $302 million in market cap based on 38 million outstanding shares. This is a discount compared to its peers. Sorrento is a late stage development company with diversified pipeline. Its lead candidate Cynviloq, which targets the multibillion dollar cancer market, will be approved as early as in 2016 according to our estimate. The Company's second lead product RTX, which targets the huge cancer pain market, will also reach the market in 2017. Sorrento's G-MAB® and ADC platforms have great potential to target a variety of indications and provide partnership opportunities.

Our target price of $15 values Sorrento at $570 million in market cap, which is still conservative in our view.

Risks Related to Our Price Target Include:

- **Development/Regulatory Risk:** All of Sorrento's candidates face clinical and regulatory challenges. Any development failure or delay will have a major negative impact on the price of the company's share.

- **Market Risk:** Market fluctuation will also impact our price target though it's independent from the company's fundamentals.

PROJECTED INCOME STATEMENT

	2014 (Dec)					2015E (Dec)					2016E (Dec)	2017E (Dec)	2018E (Dec)
$ in million except per share data	Q1	Q2	Q3	Q4	FYA	Q1	Q2	Q3	Q4	FYE	FYE	FYE	FYE
Grant revenue	$0.10	$0.08	$0.15	$0.16	$0.49	$0.24	$0.46	$0.37	$0.30	$1.36	$1.50	$2.00	$2.50
Collaboration revenue	$0.00	$0.00	$0.00	$0.00	$0.00	$0.00	$0.00	$0.00	$0.00	$0.00	$1.50	$1.50	$1.50
Product/Service revenue	$0.88	$0.69	$1.13	$0.64	$3.34	$0.74	$0.71	$0.74	$1.05	$3.24	$5.00	$15.00	$50.00
Total Revenues	**$0.98**	**$0.78**	**$1.28**	**$0.80**	**$3.83**	**$0.98**	**$1.17**	**$1.10**	**$1.35**	**$4.60**	**$8.00**	**$18.50**	**$54.00**
YOY Growth	628.0%	447.3%	1422.8%	692.5%	731.3%	0.1%	51.4%	-13.6%	69.2%	20.3%	73.8%	131.3%	191.9%
CoGS	0.56	0.51	0.53	0.44	2.04	0.51	0.31	0.60	0.74	2.17	1.20	2.78	8.10
Gross Income	**$0.41**	**$0.27**	**$0.75**	**$0.36**	**$1.78**	**$0.47**	**$0.86**	**$0.50**	**$0.61**	**$2.43**	**$6.80**	**$15.73**	**$45.90**
Gross Margin	42.3%	34.2%	58.7%	44.5%	46.6%	47.9%	73.2%	45.2%	45.0%	52.9%	85.0%	85.0%	85.0%
R&D	$6.32	$5.31	$5.44	$7.13	$24.19	$7.84	$7.97	$31.31	$8.50	$55.62	$35.50	$32.00	$30.00
% R&D	647.1%	685.0%	426.3%	893.1%	632.5%	802.5%	679.5%	2838.8%	629.6%	1208.4%	443.8%	173.0%	55.6%
SG&A	$3.39	$2.36	$1.85	$2.39	$9.99	$2.22	$3.07	$4.71	$5.00	$15.00	$30.00	$50.00	$60.00
%SG&A	347%	305%	145%	299%	261%	227%	262%	427%	370%	326%	375%	270%	111%
Amortization	$0.59	$0.59	$0.59	$0.59	$2.35	$0.59	$0.35	$0.11	$0.59	$1.64	$2.90	$2.90	$2.90
Operating Income	**($9.9)**	**($8.0)**	**($7.1)**	**($9.7)**	**($34.7)**	**($10.2)**	**($10.5)**	**($35.6)**	**($13.5)**	**($69.8)**	**($61.6)**	**($69.2)**	**($47.0)**
Operating Margin	-	-	-	-	-	-	-	-	-	-	-	-	-87.04%
Other Net	($0.2)	($0.5)	($0.5)	($0.5)	($1.6)	($0.4)	($0.4)	$68.9	($0.5)	$67.5	($0.1)	($0.1)	($0.1)
Pre-Tax Income	**($10.1)**	**($8.5)**	**($7.6)**	**($10.2)**	**($36.4)**	**($10.6)**	**($11.0)**	**$33.2**	**($14.0)**	**($2.3)**	**($61.7)**	**($69.2)**	**($47.1)**
Income taxes(benefit)	$0.0	$0.0	$0.0	($1.7)	($1.7)	($0.2)	$0.0	$35.3	$0.0	$35.1	$0.0	$0.0	$0.5
Tax Rate	-	-	-	-	-	-	-	-	-	-	-	-	-
Reported Net Income	**($10.1)**	**($8.5)**	**($7.6)**	**($8.5)**	**($34.7)**	**($10.4)**	**($11.0)**	**($0.9)**	**($14.0)**	**($37.5)**	**($61.7)**	**($69.2)**	**($47.6)**
YOY Growth	-	-	-	-	-	-	-	-	-	-	-	-	-31.3%
Net Margin	-	-	-	-	-	-	-	-	-	-			
Diluted Shares Out	23.1	25.3	28.5	29.8	26.7	36.2	36.3	37.0	38.0	36.9	38.0	40.0	45.0
Reported EPS	**($0.44)**	**($0.33)**	**($0.27)**	**($0.29)**	**($1.30)**	**($0.29)**	**($0.30)**	**($0.03)**	**($0.37)**	**($1.02)**	**($1.62)**	**($1.73)**	**($1.06)**
One time charge	*$0.00*	*$0.00*	*$0.00*	*$0.00*	*$0.00*	*$0.00*	*$0.00*	*($9.88)*	*$0.00*	*-$9.88*	*$0.00*	*$0.00*	*$0.00*
Non GAAP Net Income	**($10.1)**	**($8.5)**	**($7.6)**	**($8.5)**	**($34.7)**	**($10.4)**	**($11.0)**	**($10.8)**	**($14.0)**	**($47.4)**	**($61.7)**	**($69.2)**	**($47.6)**
Non GAAP EPS	**($0.44)**	**($0.33)**	**($0.27)**	**($0.29)**	**($1.30)**	**($0.29)**	**($0.30)**	**($0.29)**	**($0.37)**	**($1.28)**	**($1.62)**	**($1.73)**	**($1.06)**

Source: Company filings and Zacks estimates

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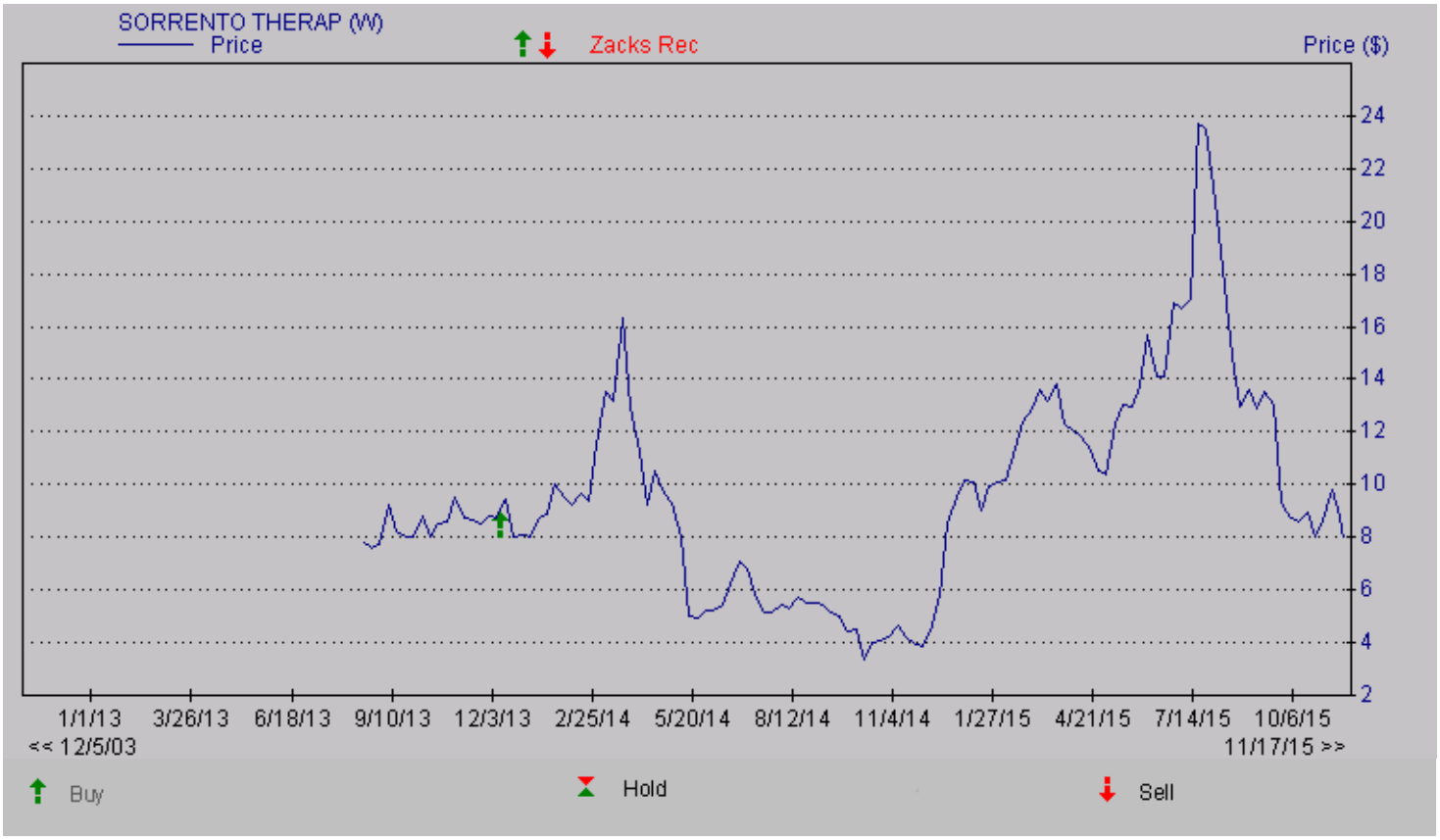
HISTORICAL ZACKS RECOMMENDATIONS



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The current distribution is as follows: Buy/Outperform- 17.2%, Hold/Neutral- 76.3%, Sell/Underperform – 5.6%. Data is as of midnight on the business day immediately prior to this publication.