Zacks Small-Cap Research

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Titan Pharmaceuticals, Inc. (TTNP-OTC)

TTNP: Titan Enters Exclusive Talks For Probuphine, NDA Still Expected In October…

Current Recommendation	**Outperform**
Prior Recommendation	N/A
Date of Last Change	06/01/2011
Current Price (09/14/12)	$0.84
Target Price	**$2.50**

UPDATE

On September 14, 2012, Titan Pharmaceuticals announced it had entered into a stock purchase and option agreement with a larger pharmaceutical company for the potential license of Probuphine. As part of the transaction, Titan sold 3.4 million shares of common stock to the potential partner at a price of $1.25 per share, netting proceeds to Titan of $4.25 million.

We are very pleased with the above deal. We believe Titan can secure a commercialization deal for Probuphine in October or November 2012 that will bring upfront money, backend milestones, and potential royalties on sales of a $300 million product in Probuphine. We expect the NDA filing in October 2012, with the potential for priority review.

We see fair-value as $2.50 per share.

SUMMARY DATA

52-Week High	**$1.85**
52-Week Low	**$0.65**
One-Year Return (%)	**-64.86**
Beta	**9.76**
Average Daily Volume (sh)	**94,418**
Shares Outstanding (mil)	**66**
Market Capitalization ($mil)	**$43**
Short Interest Ratio (days)	**0.25**
Institutional Ownership (%)	**1**
Insider Ownership (%)	**15**
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 2012 Estimate	**N/A**
P/E using 2013 Estimate	**N/A**

Risk Level	**Above Average**
Type of Stock	**Small-Growth**
Industry	**Med-Biomed/Gene**

ZACKS ESTIMATES

Revenue
(In millions of $)

	Q1 (Mar)	Q2 (Jun)	Q3 (Sep)	Q4 (Dec)	Year (Dec)
2011	0.9 A	0.7 A	1.0 A	1.4 A	4.1 A
2012	1.3 A	1.4 A	1.3 E	16.3 E	20.2 E
2013					30.0 E
2014					17.5 E

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

	Q1 (Mar)	Q2 (Jun)	Q3 (Sep)	Q4 (Dec)	Year (Dec)
2011	-$0.08 A	-$0.12 A	-$0.01 A	-$0.05 A	-$0.26 A
2012	-$0.09 A	-$0.03 A	-$0.04 E	$0.19 E	$0.08 E
2013					$0.19 E
2014					$0.05 E

Zacks Projected EPS Growth Rate - Next 4 Years % **N/A**

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WHAT'S NEW

Titan Enters Exclusive Talks For Probuphine

On September 14, 2012, Titan Pharmaceuticals announced it had entered into a stock purchase and option agreement with a larger pharmaceutical company for the potential license of Probuphine. As part of the transaction, Titan sold 3.4 million shares of common stock to the potential partner at a price of $1.25 per share, netting proceeds to Titan of $4.25 million.

Given that Titan's stock was trading at $0.72 before the announcement, we interpret the transaction as roughly $2.5 million in a straight stock purchase transaction and $1.75 million in an exclusivity option for talks on Probuphine. The exclusivity period the talks expires on October 31, 2012, but can be mutually extended to December 31, 2012. In our conversation with Titan management, Titan noted that both companies are expecting to close a licensing agreement, "Sooner rather than later," so at this point we think it is very possible a deal gets done in October or November 2012.

We are very pleased with the above deal. Sure, we would have loved for the pharmaceutical company to have just out-right licensed Probuphine for an upfront payment, backend milestones, and royalties on future sales, but prior to the NDA filing it seems as though the potential partner still has due diligence remaining. That being said, the fact that the company was willing to fork over $4.25 million today clearly shows serious interest in the product. On the company's second quarter earnings call in August 2012, Titan reported being in talks with three potential partners. Clearly this partner today wanted to secure the rights to continue negotiating with Titan without the risk of losing out to a competitor.

Plus, now the pharmaceutical company can assist Titan in the filing of the NDA. Titan management noted to us that the partner has been intimately involved in the process to date. We remind investors that Titan expects to file the NDA in October 2012. The FDA has 74 days to accept the application. Titan will seek a Priority Review for Probuphine. Probuphine is not a new molecular entity, so under PDUFA-V the FDA should respond to the application in six months.

We note none of the above transaction is refundable, so if continued talks do not lead to a deal for Probuphine, Titan keeps the $4.25 million. However, we think a deal will get done with this partner. We expect that the deal will include all of the things we noted above, an upfront payment, backend milestones, and royalties on future sales. We think Probuphine has peak sales in the area of $300 million. In the past we have written that we believe Titan should be able to obtain upfront cash in the area of $15 million, a similar approval milestone in mid-2013, backend milestone totaling $100 million, and a ~20% royalty on sales.

Under this scenario, we see the net present value (NPV) of Titan's cash from a deal, risk-adjusted backend milestones, and royalties on sales worth $200 million, or around $2.50 per diluted share. We've posted our DCF model below:

Titan Pharmaceuticals	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022
Royalty on Fanapt (8-10%)	$0	$0	$0	$0	$0	$0	$0	$0	$0	$0	$0
YoY Growth	-	-	-	-	-	-	-	-	-	-	-
Royalty on Probuphine (22%)	$0	$5.2	$13.3	$23.7	$34.5	$42.3	$50.3	$58.7	$63.6	$61.1	$62.3
YoY Growth	-	-	*155%*	*79%*	*46%*	*22%*	*19%*	*17%*	*8%*	*-4%*	*2%*
Licensing & Milestones	$15.0	$15.0	$0	$0	$10.0	$0	$10.0	$0	$10	$0	$0
Revenues (in Millions)	**$15.0**	**$20.2**	**$13.3**	**$23.7**	**$44.5**	**$42.3**	**$60.3**	**$58.7**	**$73.6**	**$61.1**	**$62.3**
CoGS	*$0*	*$0*	*$0*	*$0*	*$0*	*$0*	*$0*	*$0*	*$0*	*$0*	*$0*
R&D	*$8.5*	*$5.0*	*$6.0*	*$5.0*	*$5.0*	*$5.0*	*$5.0*	*$5.0*	*$5.0*	*$5.0*	*$5.0*
SG&A	*$5.1*	*$6.0*	*$7.0*	*$7.0*	*$7.0*	*$7.0*	*$7.0*	*$7.0*	*$7.0*	*$7.0*	*$7.0*
Other Expenses	*$0.0*	*$0.0*	*$0.0*	*$0.0*	*$0.0*	*$0.0*	*$0.0*	*$0.0*	*$0.0*	*$0.0*	*$0.0*
EBITDA	$1.4	$9.2	$0.3	$11.7	$32.5	$30.3	$48.3	$46.7	$61.6	$49.1	$50.3
Depreciation and amortization	*$1.0*	*$1.0*	*$1.0*	*$1.0*	*$1.0*	*$1.0*	*$1.0*	*$1.0*	*$1.0*	*$1.0*	*$1.0*
EBIT	**$0.4**	**$8.2**	**($0.7)**	**$10.7**	**$31.5**	**$29.3**	**$47.3**	**$45.7**	**$60.6**	**$48.1**	**$49.3**
EBITDA margin	*2.7%*	*40.6%*	*-5.4%*	*45.2%*	*70.8%*	*69.3%*	*78.4%*	*77.8%*	*82.3%*	*78.7%*	*79.1%*
Cash Taxes	$0	$0	$0	$0	$0	($4.4)	($14.2)	($13.7)	($18.2)	($14.4)	($14.8)
Tax Rate	*0%*	*0%*	*0%*	*0%*	*0%*	*15.0%*	*30.0%*	*30.0%*	*30.0%*	*30.0%*	*30.0%*
Balance Sheet											
Capital Expenditures	$0.1	$0.1	$0.1	$0.1	$0.1	$0.1	$0.1	$0.1	$0.1	$0.1	$0.1
Working Capital	$1.0	$1.0	$1.0	$1.0	$1.0	$1.0	$1.0	$1.0	$1.0	$1.0	$1.0
Interest & Other Expense	$1.0	$1.0	$1.0	$0.5	$0.0	($0.5)	($0.5)	($0.5)	($0.5)	($0.5)	($0.5)
Non-Cash Expenses	($1.0)	($1.0)	($1.0)	($1.0)	($1.0)	($1.0)	($1.0)	($1.0)	($1.0)	($1.0)	($1.0)
Capital Adjustment	**$1.1**	**$1.1**	**$1.1**	**$0.6**	**$0.1**	**($0.4)**	**($0.4)**	**($0.4)**	**($0.4)**	**($0.4)**	**($0.4)**
ROIC	*-127.2%*	*-837.0%*	*-25.3%*	*-1950.6%*	*-32543.1%*	*7571.2%*	*12081.0%*	*11667.3%*	*15397.2%*	*12262.8%*	*12569.6%*
Discounted Cash Flow											
Net Income	$0.4	$8.2	($0.7)	$10.7	$31.5	$24.9	$33.1	$32.0	$42.4	$33.6	$34.5
Depreciation and amortization	$1.0	$1.0	$1.0	$1.0	$1.0	$1.0	$1.0	$1.0	$1.0	$1.0	$1.0
Net Cash Changes	($1.1)	($1.1)	($1.1)	($0.6)	($0.1)	$0.4	$0.4	$0.4	$0.4	$0.4	$0.4
Post-Tax Operating Cash Flow	**$0.3**	**$8.1**	**($0.8)**	**$11.1**	**$32.4**	**$26.3**	**$34.5**	**$33.4**	**$43.8**	**$35.0**	**$35.9**
Dividends	$0	$0	$0	$0	$0	$0	$0	$0	$0	$0	$0
Free Cash Flow	**$0.3**	**$8.1**	**($0.8)**	**$11.1**	**$32.4**	**$26.3**	**$34.5**	**$33.4**	**$43.8**	**$35.0**	**$35.9**

Assumptions	
Beta:	1.50
Equity Risk Premium:	7.0%
Risk Free Rate:	1.5%
Firm Risk Premium:	50%
Discount Rate:	**12.0%**

Valuation	
10-Year Model:	$111.4
Terminal Growth:	2%
Terminal Value:	$98.3
CA - CL & Debt:	($6.1)
Firm Value:	**$203.6**

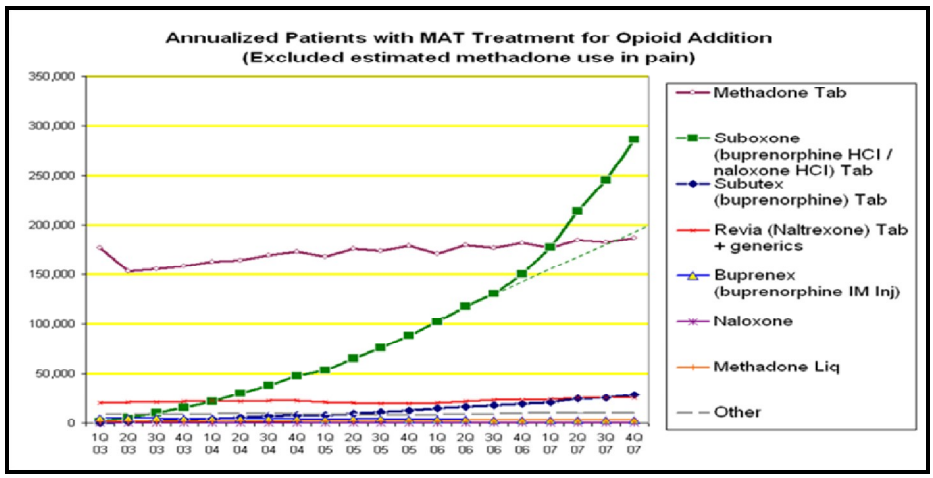
Price Target	
Basic Outstanding:	67.5
Options / Warrants:	12.5
Dilution:	0
Fully Diluted:	79.9
Target Price:	**$2.55**

Source: Zacks Investment Research, Inc. *Jason Napodano, CFA*

INVESTMENT THESIS

Large Market Opportunity

Sublingual buprenorphine sales are just over $1 billion in the U.S., with another $250 million outside the U.S.



Probuphine has several key advantages over Suboxone. On Titan's second quarter update call, management hosted two of the lead investigators in the PRO-806 phase 3 study. They were Dr. Walter Ling, M.D., Professor of Psychiatry and Director, Integrated Substance Abuse Programs at the David Geffen School of Medicine at UCLA and Dr. Richard N. Rosenthal, M.D., Chairman of Psychiatry at St. Luke's-Roosevelt Hospital Center, a teaching hospital of Columbia University, past president of the American Academy of Addiction Psychiatry. Both doctors expressed their enthusiasm for Probuphine and why they believe it will see meaningful commercial uptake.

We do not see the implant procedure as greatly limiting uptake for Probuphine. Management full acknowledges that there will be some patients adverse to an implantable drug, but we suspect that it will be only a small percent of the patients seeking treatment. In our view, and the views of Dr. Ling and Dr. Rosenthal, Probuphine improves compliance greatly over the once daily oral medication, as well as eliminates the risk for diversion or misuse.

It eliminates the need for monthly visits to the clinic or the need for the physician to actively monitor the patient to make sure dosing is on schedule. Once Probuphine is implanted, the drug goes to work unencumbered for six months. Dr. Rosenthal called Probuphine, "The right drug with the right delivery system."

Opioid addiction is a major health and social issue, especially in the U.S. An estimated 5+ million people worldwide, nearly 4 million of which are in the U.S., are abusing or addicted to opioids. In the U.S. alone, opioid abuse has increased 140% from 1992 to 2003. It's a $10+ billion burden to the U.S. healthcare market.

The World Health Organization estimates that between 4.6 and 5.2 million individuals in the U.S. and Europe use illicit opioids such as heroin, and more than 2.0 million individuals in the U.S. alone are addicted to prescription opioid medications. It is estimated that more than 1.0 million people in the U.S. and Europe currently receive pharmacological treatment for opioid addiction. A six month prescription of Suboxone costs roughly $2,000, with patients averaging duration between 8 and 10 months. At a slight premium price of $2,500 per implant, if Probuphine can capture 10% market share, the drug is a $300+ million opportunity for Titan.

- Estimated 5 million individuals addicted to opioids…
  - 25% seeking treatment (Suboxone does 500,000+ Rx per year)…
    - 10% try Probuphine (six month implant)…
      - Probuphine costs $2500 per implant…
        - 5 million * 25% * 10% * $2500 per implant ~ $300 million

PROJECTED FINANCIALS

Titan Pharmaceuticals, Inc.
Income Statement

	2010 E	2011 A	Q1 A	Q2 A	Q3 E	Q4 E	2012 E	2013 E	2014 E
Probuphine Royalty	**$0**	**$0**	**$0**	**$0**	**$0**	**$0**	**$0**	**$4.7**	**$12.1**
YOY Growth	-	-	-	-	-	-	-	-	*155.0%*
Fanapt Royalty	**$2.5**	**$3.6**	**$1.2**	**$1.4**	**$1.3**	**$1.3**	**$5.2**	**$5.3**	**$5.4**
YOY Growth	-	*42.7%*	*71.5%*	*125.9%*	*33.6%*	*0.5%*	*44.7%*	*2.2%*	*1.9%*
Licensing & Grant Revenue	**$7.6**	**$0.5**	**$0.0**	**$0**	**$0**	**$15.0**	**$15.0**	**$20.0**	**$0**
Total Revenues	**$10.1**	**$4.1**	**$1.3**	**$1.4**	**$1.3**	**$16.3**	**$20.2**	**$30.0**	**$17.5**
YOY Growth	-	*-59.7%*	-	-	-	-	*397.3%*	*48.5%*	*-41.8%*
CoGS	$0	$0	$0	$0	$0	$0	$0	$0	$0
Product Gross Margin	*100.0%*	*100.0%*	-	-	-	-	*100.0%*	*100.0%*	*100.0%*
R&D	$12.9	$11.2	$3.1	$2.0	$2.0	$1.5	$8.5	$5.0	$6.0
% R&D	*127.4%*	*275.5%*	-	-	-	-	*42.2%*	*16.6%*	*34.3%*
SG&A	$3.3	$3.4	$1.7	$1.1	$1.1	$1.1	$5.1	$6.0	$7.0
% SG&A	*32.3%*	*82.8%*	-	-	-	-	*25.0%*	*20.0%*	*40.1%*
Operating Income	($6.0)	($10.5)	($3.5)	($1.7)	($1.8)	$13.7	$6.6	$19.0	$4.5
Operating Margin	*0.0%*	*-258.3%*	-	-	-	-	*32.8%*	*63.4%*	*25.6%*
Total Other Income	($0.8)	($4.7)	($1.6)	$0.0	($0.7)	($0.4)	($1.5)	($1.0)	$1.0
Pre-Tax Income	($6.8)	($15.2)	($5.2)	($1.7)	($2.5)	$13.3	$5.1	$18.0	$5.5
Taxes & Other	($1.2)	$0	$0	$0	$0	$0	$0	$2.7	$1.6
Tax Rate	*0%*	*0%*	*0%*	*0%*	*0%*	*0%*	*5%*	*15%*	*30%*
Net Income	($5.6)	($15.2)	($5.2)	($1.7)	($2.5)	$13.3	$5.1	$15.3	$3.8
Net Margin	*0.0%*	*-373.7%*	-	-	-	-	*25.4%*	*51.0%*	*21.9%*
Reported EPS	**($0.09)**	**($0.26)**	**($0.09)**	**($0.03)**	**($0.04)**	**$0.19**	**$0.08**	**$0.19**	**$0.05**
YOY Growth	*-6.2%*	*171.5%*	-	-	-	-	*-130.7%*	*143.4%*	*-76.5%*
Weight Ave. Shares Out	59.2	59.3	59.4	65.0	66.2	70.0	65.1	80.0	85.0

Source: Zacks Small-Cap Research, Inc. *Jason Napodano, CFA*

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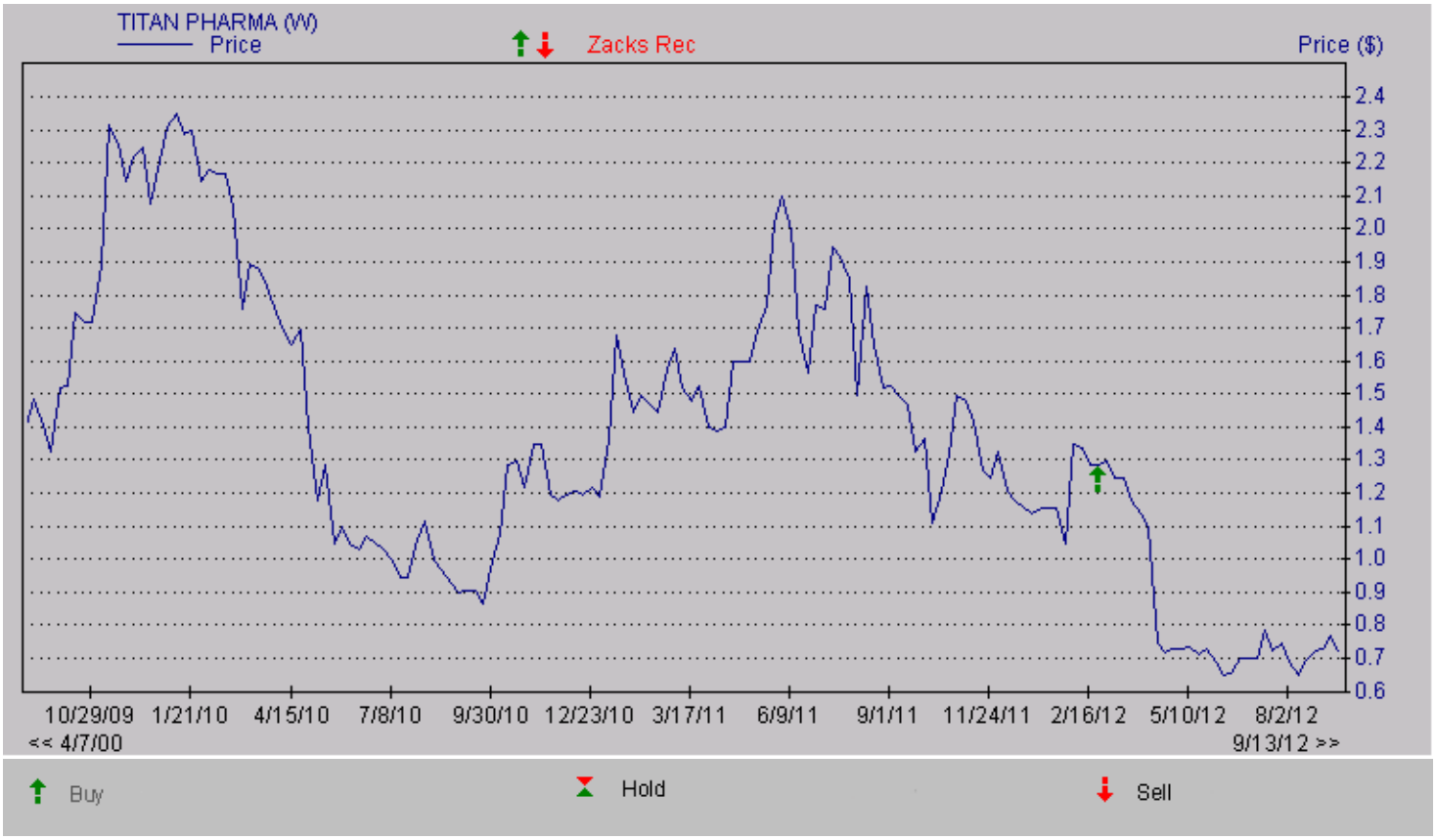

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