Zacks Small-Cap Research

August 6, 2013
Jason Napodano, CFA
312-265-9421
jnapodano@zacks.com

scr.zacks.com
111 North Canal Street, Chicago, IL 60606

Trius Therapeutics (TSRX-NASDAQ)

TSRX: Trius To Be Acquired By Cubist Pharma For $13.50 per share…

Current Recommendation	**Neutral**
Prior Recommendation	Buy
Date of Last Change	07/31/2013
Current Price (08/06/13)	$13.71
Target Price	**$13.50**

UPDATE

Cubist will acquire all outstanding shares of Trius for $13.50 per share in cash or approximately $707 million on a fully diluted basis. In addition to the upfront cash payment, each Trius stockholder will receive one Contingent Value Right (CVR), entitling the holder to receive an additional cash payment of up to $2.00 for each share they own if certain commercial sales milestones are achieved ($1.00 per share if net sales of tedizolid in the U.S., Canada and Europe are greater than or equal to $125 million in 2016 and up to an additional $1.00 per share, paid on a pro rata basis, for 2016 net sales between $125 million and $135 million). Thus, the total potential transaction is valued at up to $818 million on a fully diluted basis.

SUMMARY DATA

52-Week High	**$14.10**
52-Week Low	**$4.45**
One-Year Return (%)	**151.55**
Beta	**-0.76**
Average Daily Volume (sh)	**2,429,627**
Shares Outstanding (mil)	**48**
Market Capitalization ($mil)	**$659**
Short Interest Ratio (days)	**3.38**
Institutional Ownership (%)	**39**
Insider Ownership (%)	**25**
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**

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)
2012	9.8 A	6.2 A	6.0 A	5.2 A	27.2 A
2013	1.7 A	1.3 A	1.5 E	1.5 E	6.0 E
2014					5.0 E
2015					25.6 E

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

	Q1 (Mar)	Q2 (Jun)	Q3 (Sep)	Q4 (Dec)	Year (Dec)
2012	-$0.22 A	-$0.37 A	$0.46 A	-$0.36 A	-$1.42 A
2013	-$0.38 A	-$0.41 A	$0.37 E	-$0.40 E	-$1.53 E
2014					-$1.45 E
2015					-$0.95 E

© Copyright 2013, Zacks Investment Research. All Rights Reserved.

WHAT'S NEW

Cubist To Acquire Trius For $13.50

On July 30, 2013, Cubist Pharmaceuticals (CBST) announced a broad-sweeping acquisition of Trius Therapeutic (TSRX) and Optimer Pharmaceuticals. The terms of each deal are as follows:

- Trius Therapeutics: Cubist will acquire all outstanding shares of Trius for $13.50 per share in cash or approximately $707 million on a fully diluted basis. In addition to the upfront cash payment, each Trius stockholder will receive one Contingent Value Right (CVR), entitling the holder to receive an additional cash payment of up to $2.00 for each share they own if certain commercial sales milestones are achieved ($1.00 per share if net sales of tedizolid in the U.S., Canada and Europe are greater than or equal to $125 million in 2016 and up to an additional $1.00 per share, paid on a pro rata basis, for 2016 net sales between $125 million and $135 million). Thus, the total potential transaction is valued at up to $818 million on a fully diluted basis.

- Optimer Pharmaceuticals: Cubist will acquire all of the outstanding shares of Optimer common stock for $10.75 per share in cash, or approximately $535 million on a fully diluted basis. In addition to the upfront cash payment, each stockholder of Optimer will receive a Contingent Value Right (CVR), which is expected to be publicly traded, entitling the holder to receive an additional one-time cash payment of up to $5.00 for each share they own if certain net sales of Dificid fidaxomicin) are achieved (Terms of the contingent value right (CVR) call for an additional one-time cash payment of up to $5.00 per share based on cumulative net sales of DIFICID in the U.S. and Canada between July 1, 2013 and December 31, 2015. The CVR payment will be $3.00 if cumulative net sales exceed $250 million, $4.00 if cumulative net sales exceed $275 million and $5.00 if cumulative net sales exceed $300 million ($3.00 if cumulative net sales exceed $250 million, $4.00 if cumulative net sales exceed $275 million and $5.00 if cumulative net sales exceed $300 million). Thus, the total transaction value is up to $801 million on a fully diluted basis.

...On Trius...

Trius brings to Cubist a highly complementary, late-stage antibiotic candidate, tedizolid phosphate (TR-701), as well as several pre-clinical antibiotic programs. Tedizolid phosphate is an IV and orally administered second generation oxazolidinone in development for the potential treatment of certain Gram-positive infections, including methicillin-resistant Staphylococcus aureus (MRSA). Tedizolid phosphate met all primary and secondary endpoints in two Phase 3 clinical trials studying patients with acute bacterial skin and skin structure infections (ABSSSI). Our analysis of the phase 3 trials can be found here and here.

Trius has partnered with Bayer Pharma AG for the development and commercialization of tedizolid phosphate outside of the U.S., Canada and the European Union. It is currently expected that a New Drug Application for tedizolid phosphate seeking approval for an indication in ABSSSI will be submitted to the U.S. Food and Drug Administration (FDA) during the second half of 2013 and a Marketing Authorization Application will be submitted to the European Medicines Agency in the first half of 2014.

We believe the combination of Cubist and Trius makes excellent strategy sense. Cubists stated goal is to extending its global leadership in the acute care environment. Tedizolid has the potential to be an important new tool in the treatment of resistant infectious disease, more specifically MRSA. We wrote as recently as May 2013 that Cubist and Trius would make an interesting combination. We see Tedizolid as a potential $750 million drug worldwide, with upside upon expanding the label outside of ABSSSI in bacteremia and pneumonia.

...On Optimer...

Optimer received U.S. FDA approval in May 2011 for Dificid, the first antibacterial drug approved in more than 25 years to treat *Clostridium difficile*-associated diarrhea (CDAD) in adults 18 years of age or older. The drug was launched in the U.S. in July 2011. In April 2011, Cubist and Optimer entered into a two-year agreement under which Cubist has been co-promoting Dificid to physicians, hospitals, and other healthcare institutions in the U.S. Concurrently with the merger agreement, the companies have agreed to extend the co-promotion agreement for up to one year. The deal between Cubist and Optimer is a natural fit for Cubist given the existing co-promotion agreement in place for Dificid.

Optimer was set to release second quarter financial results on August 1, 2013, however, concurrent with the release of the news on the acquisition, the company released the following highlights to the second quarter numbers: Second quarter 2013 Dificid net product sales in the U.S. and Canada were $19.0 million, compared to $15.2 million in the corresponding quarter in 2012 and up 13% from $16.8 million in the first quarter of 2013. Total revenues in the quarter were $20.1 million. Net loss for the second quarter was $26.9 million, or $0.55 per share. Optimer held cash, cash equivalents and short-term investments at June 30, 2013 of $77.5 million.

Rating Change on Trius

On July 31, 2013, we are lowered our rating on shares of Trius Therapeutics to 'Neutral' and pegging our price target to the $13.50 per share buy-out price. We most recently called the stock, "One of our best ideas" in May 2013 at $6.25 per share. We previously initiated coverage of Trius Therapeutics in January 2011 with an 'Outperform' rating at $3.92 per share. Our call from initiation to acquisition netted investors 244% return.

Did Trius Get Full Value

Since the time of the deal announced on July 30, 2013, several law firms have filed lawsuits against the company arguing a break of fiduciary duty by the Board of Directors in connection with the sale to Cubist Pharma. The lawsuits argue that the company did not receive adequate value for shareholders in accepting a bid of $13.50 per share for Trius along with $2.00 in contingent value rights. Above we noted the CVR milestones look easily achievable by Cubit once tedizolid is approved. In the end, shareholders on record will receive net $15.50 per share in our view. Shareholders Foundation, Inc. has filed a lawsuit to halt the takeover on a similar belief.

Our price target prior to the takeover was $12.00 per share. This has been our target since December 2011. We have adjusted our model to account for absorption into Cubist Pharma. The net result of our adjusted DCF model suggest fair-value at $13.65 per share – remarkably similar to the takeover price and where the shares are currently trading today based on some small value being assigned to CVR rights.

A snap-shot of our DCF model can be found on the next page. Our assumptions are as follows:

→ Tedizolid NDA filing for ABSSSI to be filed in the next few months. U.S. FDA approval of Tedizolid in ABSSSI around the middle of 2014.

→ Peak market share (as a percent of U.S. hospital treatment days for serious gram-positive infections of 6% in 2019. We believe 5% is fair given the current 75% market share for vancomycin, 16% market share for linezolid, 8% market share for daptomycin, pending generic launch of linezolid in 2015, and several new treatment options coming to market in the next few years, including dalbavancin, oritavancin, delafloxacin, JNJ-Q2, and BC-3781.

→ Phase 3 studies for pneumonia to being in late 2013, with potential sNDA's for HAP/VAP in 2015. Phase 3 studies in bacteremia to begin in 2014, with a potential sNDA in 2015. Peak market share in lung infections at 12% (in 2020) and blood infections of 15% (in 2020). Similar market penetration in the EU and Asia / Pacific for the 3 core indications.

→ Tedizolid to price at approximately $250 per share.

→ Trius to receive approximately 15% royalty on Asia / Pacific sales from Bayer.

→ 12.5% discount rate, 2% terminal growth rate, 47.9 million basic shares outstanding + 5.6 million warrants and stock options in the money.

→ Revenue and expense forecasts can be found on the next page in the snap-shot of the model.

Our conclusion: Trius did a fine job accepting $13.50 per share, which we calculate to be darn close to the approximate fair-value of the company prior to the $2.00 CVR, which offers investors as additional 15% upside between the closing of the deal and 2016. We note 15% slightly greater than our discount rate in our DCF.

PROJECTED FINANCIALS

Trius Therapeutics, Inc.
DCF

Trius Therapeutics (TSRX)	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023
Tedizolid N.A. Sales (Full)	**$0**	**$0**	**$15.4**	**$56.2**	**$121.3**	**$206.4**	**$291.9**	**$358.2**	**$383.9**	**$372.0**	**$368.3**
YoY Growth	-	-	-	*264%*	*116%*	*70%*	*41%*	*23%*	*7%*	*-3%*	*-1%*
Royalty on Ex-N.A. Sales	**$0**	**$0**	**$5.6**	**$16.2**	**$27.5**	**$37.2**	**$44.7**	**$52.4**	**$58.8**	**$63.4**	**$68.3**
YoY Growth	-	-	-	*187%*	*70%*	*35%*	*20%*	*17%*	*12%*	*8%*	*8%*
Pipeline	**$0**	**$0**	**$0**	**$0**	**$0**	**$0**	**$0**	**$0**	**$0**	**$0**	**$0**
Grants, Licensing & Collabs	**$30.0**	**$5.0**	**$10.0**	**$0.0**	**$5.0**	**$0.0**	**$5.0**	**$0.0**	**$0.0**	**$0.0**	**$0.0**
Cash Revenues (in Millions)	**$30.0**	**$5.0**	**$31.0**	**$72.3**	**$153.8**	**$243.7**	**$341.6**	**$410.6**	**$442.7**	**$435.4**	**$436.6**
CoGS	*$0*	*$0*	*$1.5*	*$5.6*	*$11.5*	*$18.6*	*$24.8*	*$28.7*	*$30.7*	*$29.8*	*$29.5*
R&D	*$58.7*	*$50.0*	*$40.0*	*$35.0*	*$35.0*	*$35.0*	*$35.0*	*$35.0*	*$35.4*	*$34.8*	*$34.9*
SG&A	*$19.8*	*$30.0*	*$36.4*	*$40.5*	*$47.0*	*$55.5*	*$64.0*	*$70.7*	*$73.2*	*$72.0*	*$71.7*
Other Expenses	*$0*	*$13.0*	*$2.5*	*$7.8*	*$14.5*	*$21.7*	*$28.4*	*$34.0*	*$37.1*	*$37.9*	*$39.2*
EBITDA	($48.6)	($88.0)	($49.4)	($16.5)	$45.8	$112.8	$189.4	$242.3	$266.2	$260.9	$261.3
Depreciation and amortization	*$0.5*	*$0.5*	*$0.5*	*$0.5*	*$0.5*	*$1.0*	*$1.5*	*$2.0*	*$2.5*	*$3.0*	*$3.5*
EBIT	**($49.1)**	**($88.5)**	**($49.9)**	**($17.0)**	**$45.3**	**$111.8**	**$187.9**	**$240.3**	**$263.7**	**$257.9**	**$257.8**
EBITDA margin	*-163.6%*	*-1770.0%*	*-160.7%*	*-23.6%*	*29.5%*	*45.9%*	*55.0%*	*58.5%*	*59.6%*	*59.2%*	*59.1%*
Cash Taxes	$0	$0	$0	$0	($2.3)	($22.4)	($60.1)	($76.9)	($84.4)	($82.5)	($82.5)
Tax Rate	*0%*	*0%*	*0%*	*0%*	*5.0%*	*20.0%*	*32.0%*	*32.0%*	*32.0%*	*32.0%*	*32.0%*
Discounted Cash Flow											
Cash Income	($49.1)	($88.5)	($49.9)	($17.0)	$43.1	$89.5	$127.8	$163.4	$179.3	$175.3	$175.3
Net Cash Changes	$5.5	$6.0	$6.5	$7.0	$7.5	$8.0	$8.5	$9.0	$9.5	$10.0	$10.5
Post-Tax Operating Cash Flow	**($43.6)**	**($82.5)**	**($43.4)**	**($10.0)**	**$50.6**	**$97.5**	**$136.3**	**$172.4**	**$188.8**	**$185.3**	**$185.8**
Dividends / Payments	$0	$0	$0	$0	$0	$0	$0	$0	$0	$0	$0
Free Cash Flow	**($43.6)**	**($82.5)**	**($43.4)**	**($10.0)**	**$50.6**	**$97.5**	**$136.3**	**$172.4**	**$188.8**	**$185.3**	**$185.8**

Assumptions	
Discount Rate:	12.5%
Terminal Growth:	2%
Net Cash Position:	$60.1

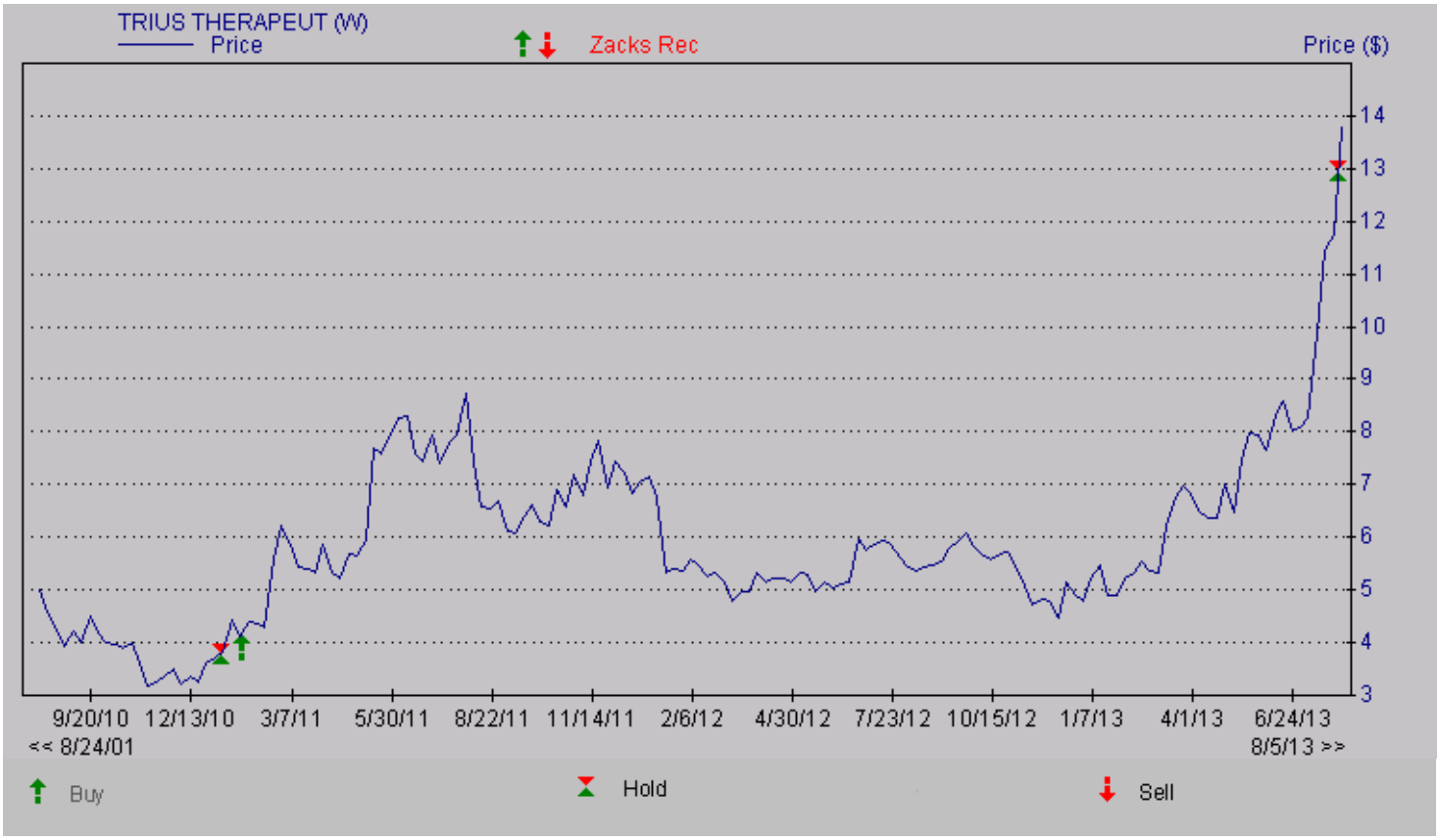
Valuation	
10-Year Model:	$184.9
Terminal Value:	$484.4
Firm Value:	**$729.5**

Price Target	
Basic Outstanding:	47.9
Warrants / Options:	5.6
Price Price:	**$13.65**

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

© Copyright 2013, Zacks Investment Research. All Rights Reserved.

HISTORICAL ZACKS RECOMMENDATIONS



DISCLOSURES

The following disclosures relate to relationships between Zacks Investment Research ("ZIR"), Zacks & Company (ZCO") and Zacks Small-Cap Research ("Zacks SCR") and the issuers covered by the Zacks SCR analysts in the Small-Cap Universe.

ZIR or Zacks SCR Analysts do not hold or trade securities in the issuers which they cover. Each analyst has full discretion on the rating and price target based on their own due diligence. Analysts are paid in part based on the overall profitability of Zacks SCR. Such profitability is derived from a variety of sources and includes payments received from issuers of securities covered by Zacks SCR for non-investment banking services. No part of analyst compensation was, is or will be, directly or indirectly, related to the specific recommendations or views expressed in any report or blog.

ZIR and Zacks SCR do not make a market in any security nor do they act as dealers in securities. Zacks SCR has never received compensation for investment banking services on the small-cap universe. Zacks SCR does not expect received compensation for investment banking services on the small-cap universe. Zacks SCR has received compensation for non-investment banking services on the small-cap universe, and expects to receive additional compensation for non-investment banking services on the small-cap universe, paid by issuers of securities covered by Zacks SCR. Non-investment banking services include investor relations services and software, financial database analysis, advertising services, brokerage services, advisory services, investment research, and investment management.

Additional information is available upon request. Zacks SCR reports are based on data obtained from sources we believe to be reliable, but is not guaranteed as to accuracy and does not purport to be complete. Because of individual objectives, the report should not be construed as advice designed to meet the particular investment needs of any investor. Any opinions expressed by Zacks SCR Analysts are subject to change. Reports are not to be construed as an offer or the solicitation of an offer to buy or sell the securities herein mentioned.

ZCO and Zacks SCR are separate legal entities. ZCO is U.S. broker-dealer registered with the U.S. Securities and Exchange Commission and a member of the Financial Industry Regulatory Authority and the Securities Investor Protection Corp. This report is for your information only and is not an offer to sell, or a solicitation of an offer to buy, the securities or instruments through ZCO.

Zacks SCR uses the following rating system for the securities it covers. Buy/Outperform: The analyst expects that the subject company will outperform the broader U.S. equity market over the next one to two quarters. Hold/Neutral: The analyst expects that the company will perform in line with the broader U.S. equity market over the next one to two quarters. Sell/Underperform: The analyst expects the company will underperform the broader U.S. Equity market over the next one to two quarters.

The current distribution of Zacks Ratings is as follows on the 1024 companies covered: Buy/Outperform- 15.0%, Hold/Neutral- 77.7%, Sell/Underperform – 6.3%. Data is as of midnight on the business day immediately prior to this publication.

© Copyright 2013, Zacks Investment Research. All Rights Reserved.