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Zacks Equity Research

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# Pernix Therapeutics (PTX-AMEX)

***PTX: Big Upside, Low Risk. Initiating PTX at Outperform.***

| | |
|---|---|
| **Current Recommendation** | **Outperform** |
| Prior Recommendation | N/A |
| Date of Last Change | 08/24/2010 |
| Current Price (08/25/10) | $3.06 |
| **Six- Month Target Price** | **$6.75** |

## OUTLOOK

The current share price offers tremendous upside with little downside risk, in our opinion. We believe, Cedax, which launched during Q2 2010, could eventually generate $100MM in peak annual sales. Sales growth projected at CAGR of over 35% for at least the next four years combined with PTX's lean operating structure and 80%+ gross margins should generate huge amounts of cash. We look for EPS to grow at four-year CAGR of over 40%.

PTX continues to reinvest for the future. We believe a new material-sized product or co-pro could be in place before year-end.

We are initiating PTX at Outperform. Our near-term price target is $6.75.

## SUMMARY DATA

| | |
|---|---|
| **52-Week High** | **$5.00** |
| **52-Week Low** | **$2.64** |
| **One-Year Return (%)** | **15.91** |
| **Beta** | **0.65** |
| **Average Daily Volume (sh)** | **12,003** |
| **Shares Outstanding (mil)** | **25** |
| **Market Capitalization ($mil)** | **$75** |
| **Short Interest Ratio (days)** | **0.64** |
| **Institutional Ownership (%)** | **1** |
| **Insider Ownership (%)** | **62** |
| **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** | **7.1** |
| **P/E using 2010 Estimate** | **7.8** |
| **P/E using 2011 Estimate** | **2.3** |
| **Zacks Rank** | **N/A** |

| | |
|---|---|
| **Risk Level** | **Average,** |
| **Type of Stock** | **Small-Value** |
| **Industry** | **Med-Generic Drg** |
| **Zacks Rank in Industry** | **N/A** |

## ZACKS ESTIMATES

**Revenue**
(in millions)

| | Q1 (Mar) | Q2 (Jun) | Q3 (Sep) | Q4 (Dec) | Year (Dec) |
|---|---|---|---|---|---|
| 2009 | $7.2 A | $6.5 A | $5.8 A | $8.4 A | $27.9 A |
| 2010 | | | | | $29.8 E |
| 2011 | | | | | $54.7 E |
| 2012 | | | | | $73.9 E |

**Earnings per Share**

| | Q1 (Mar) | Q2 (Jun) | Q3 (Sep) | Q4 (Dec) | Year (Dec) |
|---|---|---|---|---|---|
| 2009 | $0.13 A | $0.14 A | $0.05 A | $0.12 A | $0.43 A |
| 2010 | | | | | $0.39 E |
| 2011 | | | | | $0.75 E |
| 2012 | | | | | $1.17 E |

Zacks Projected EPS Growth Rate - Next 4 Years % **41**

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**Q2 2010 Results**
First quarter net sales were $8.87 million, up 23% year-over-year and were aided by the third quarter 2009 introduction of the Brovex line. Second quarter net sales of $4.36 million fell roughly 50% sequentially and were down 33% year-over-year. The launch of Cedax during the second quarter 2010 provided what we believe was a modest contribution to revenue in the quarter but was insufficient to offset significantly lower sales of the Aldex and Pediatex products for which Pernix launched authorized generics of. The discontinuation of Z-Cof 8DM in early 2010 also impacted sales growth in the most recent quarter as the drug generated $7.8 million in gross revenue in 2009.

While sales were somewhat disappointing in the quarter, we do not expect this to be a long-term trend going forward. Management noted that Cedax sales were stronger than expected (as a reminder management's prior guidance was "at least $12 million in the first twelve months on the market") and we expect the drug to be a huge catalyst in driving high double-digit sales growth over the next several years.

Second quarter net sales were also negatively affected by a significant surge in Medicaid rebates which equaled 33% of gross product sales, compared to 10% in the prior year quarter and 12% in the first quarter 2010. The spike in the Medicaid rebate was not entirely unexpected and was partially a result of the introduction of Cedax, which historically has an extraordinarily high exposure to Medicaid customers. A recent 2% hike in the federal Medicaid rebate as well as substantially higher state supplemental rebates also contributed to the Medicaid rebate hit that Pernix took during the quarter. Management is working on plans to substantially reduce their overall exposure to Medicaid and lessen the impact from these rebates – this likely includes some modification to their product line. They noted on the earnings call that they expect their exposure to these rebates to be substantially more muted as they enter the cough/cold season.

We calculate the y-o-y increase in Medicaid rebates cost Pernix almost $0.03/share in earnings in the quarter which is highly material, especially when considering EPS came in at only $0.01. As the company grows sales and gains significantly greater operating leverage, the impact from Medicaid rebates will certainly be much less meaningful to the bottom line. Nonetheless, we feel it is critical that management minimizes their exposure to exorbitant rebates in the future in order to maximize profitability. This will be something to keep an eye on, especially as sales of Cedax (with its historically high exposure to Medicaid) begin to account for the majority of gross product revenue – which we think could be as early as 2012. Our model incorporates the assumption that Pernix's exposure to these rebates is moderately high during Q3 and runs in the mid-teens (% of gross product sales) over the next several years – slightly scaling up with the growth of Cedax.

The company hired 25 new sales reps during the second quarter 2010, pushing the total sales team to 57 in anticipation of the full roll-out of Cedax and the entry into new geographic regions. This had the effect of pushing selling expenses up to almost 16% of gross product sales, compared to 13% in the prior year comparable quarter. We expect Pernix to realize some leverage on this expense going forward as initial ancillary expenses related to hiring of the new sales team members are absorbed and these reps become profitable, likely towards the back-half of the busy winter season. General and administrative expenses were also materially higher due to the addition of management personnel and professional fees. As we outline in our report, we expect Pernix to have ample opportunity to gain significant leverage on the G&A line over the long-term and expect to see benefits from this as early as the end of the current year.

Finally, R&D and amortization expenses were also substantially higher in the most recent quarter, largely as a result of the amortization of development expenses (related to new deals with Macoven and Kiel which run through R&D) and the initial amortization of the portion of the Cedax purchase price that was allocated to intangible assets (~$3.9MM over 8 year life).

The net result of lower net sales and higher operating expenses (slightly offset by product margin of 90% versus 88% in Q2 2009) was EPS of $0.01 in the second quarter compared to $0.14 in the prior year period.
Pernix exited the quarter with $11.4 million in cash.

**Recommendation / Valuation**
We believe Pernix represents an attractive investment based on our belief that the shares are undervalued by over 50%. We model EPS of $0.39 for the full year 2010, down 10% from the $0.43 posted in FY2009. We note, however, that 2010 is somewhat of a transition year for Pernix during which the company is shifting away from more

piecemeal products (i.e. – Aldex, Brovex, Pediatex) to drugs that hold more longer-term upside potential (i.e. – Cedax). The return on this transition should be almost immediate, with robust annual EPS growth expected to begin in 2011 when we model Pernix to generate EPS of $0.75. Pernix is actively seeking to reinvest its huge and growing cash balance which could result in even greater rate of revenue and earnings growth relative to our forecast.

The shares currently trade at $3.06, implying a 2011 P/E of 4.1x. We believe this cheap valuation may be largely a result of the market "not seeing the forest for the trees" with undue concern placed on choppy quarterly results. As we explain in our report, Pernix's competitive advantages rely on the company's ability to be highly dynamic in an attempt to maximize long-term growth. Management is clearly focused on maximizing the long-term growth of the company so we have little concern over "adjustments" in the business that may result in irregular short-term results but that benefit long-term success.

Peer 2011 P/E comps in the specialty pharma space are largely grouped between 6x – 9x, implying a valuation of Pernix between $4.50 - $6.75/share. Based on our expectations of 4-year EPS CAGR of 41%, we believe Pernix warrants a valuation at the upper end of this range. We also believe Pernix's numerous competitive advantages, along with the large and growing cash balance, substantially mitigates any downside risk.

We are initiating coverage of Pernix Therapeutics with an Outperform rating. We value the company at $6.75/share, based on 9x our 2011 EPS estimate of $0.75.

## BUSINESS

### SNAPSHOT

Pernix Therapeutic Holdings, Inc (Pernix) is a specialty pharmaceutical company primarily engaged in the selling of branded pharmaceutical products primarily in the area of pediatrics. Pernix was founded in 1999 and on March 9, 2010 completed a reverse merger with Golf Trust of America, Inc. where Pernix became the surviving entity. The company commenced trading on the NYSE Amex on March 10, 2010. Pernix has its headquarters in Magnolia, Texas and as of December 31, 2009 had 49 employees, including 35 sales people which promote products in 30 states. The company has no international operations.

Pernix's current product portfolio consists of 14 branded prescription drugs encompassing 6 product lines, with a primary therapeutic area of focus in cough/cold (allergies, congestion). The company recently acquired the rights to what could soon end up being, by far, Pernix's most successful drug to-date. Customers consist of drug wholesalers, retail drug stores, merchandisers and grocery store pharmacies.

Management has achieved 6-year revenue and pre-tax income CAGRs of 32% and 40%, respectively, through a highly efficient sales force and a low-cost, low-risk business model. The company boasts of operating margins approaching 50% and a balance sheet with $11.4 million in cash and no debt.

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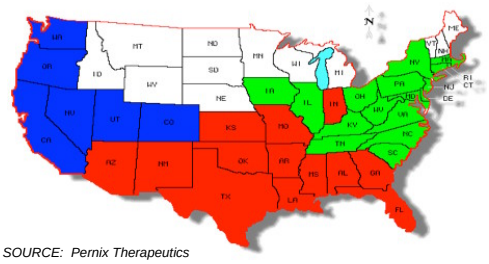
### BUSINESS MODEL / STRATEGY

Pernix is primarily a sales organization which acquires drugs through in-licensing and acquisitions. The company does not currently engage in research and development activities and outsources all of its manufacturing and logistics. This eliminates the risk of development failure and allows the company to operate with very lean infrastructure. And while outsourcing is an effective way to reduce risk, it typically comes at the expense of margins. This has not been the case with Pernix however, which has consistently generated gross margins over 80% and operating margins near 50%. Pernix's cost-base is mostly variable as compensation for sales personnel as well as management is heavily incentive-based.

Operating with lean infrastructure allows the company to quickly react to changing conditions - this allows the company to "fit" its cost base to a given level of sales, thereby significantly reducing any financial impact in the

event of declining sales. In fact management touts the company's flexibility (Pernix means "swift, nimble and agile" in Latin) and ability to take advantage of opportunities that more asset-intensive companies would pass on. Pernix's small size also allows it to quickly adapt its product menu to changing conditions such as launching generic equivalents to fend of branded competition. This flexibility allows the company to maximize profitability and helps to achieve peak efficiency of its sales force.

Pernix, which is headed by a CEO with a successful background in pharmaceutical sales, has created and implemented a selling strategy which has proven to be highly effective and profitable. This has not only been an impetus to the impressive compounded sales growth, it has maximized the efficiency of the sales force and kept overhead to a minimum. Management has been publicly adamant about their rigid criteria relative to hiring and retaining only those sales representatives which fit the company's incentive-based culture. Pernix's sales reps are paid a base salary equal to about one-half the average industry rate with the majority of their compensation tied to sales commissions. This has effectively aligned the sales reps' success with those of the entire company. Pernix's reps only target high-prescribing physicians, which has allowed the company to maintain a relatively small sales force (and minimize overhead) by maximizing the effectiveness of each rep. Pernix also employs more unique selling strategies such as sampling out-of-season (i.e. – summer and fall for cold/allergy products) when promoting a new product which allows early introduction to physicians prior to the peak season. While more costly initially, this strategy has been partially credited with the impressive ramp in sales following several of Pernix's recent product launches. In anticipation of the full roll-out of Cedax, Pernix hired 25 new sales reps in the second quarter 2010, pushing the total sales force to 57. This will also expand their geographic coverage from 30 states to approximately 36 states by year-end.




*SOURCE: Pernix Therapeutics*

Acquiring the rights to and re-promoting drugs that larger pharmaceutical companies have been willing to divest at fire-sale prices is another part of Pernix's successful strategy. In August 2009 the company launched its Brovex line of drugs, which it bought for just $450k in June of that year. Through the end of fiscal 2009 (i.e. - five months) Pernix was able to sell $5.8 million of the Brovex products. As this illustrates, this strategy has been exceptionally profitable for the company and is one which we expect management to continue to pursue – although we expect the company to begin transitioning away from this strategy several years down the road and instead focus on bringing new drugs to the market.

Pernix closed on its $6 million purchase of Cedax on March 24, 2010. Cedax is an antibiotic which we view as the company's most promising drug for the near to mid-term. We believe the re-promotion of "has-been" drugs will be one of several catalysts that will fuel growth of the company for the next several years. Aiding in the success of this strategy has been management's ability to identify those drugs which fit with the company's expertise and geographic footprint, are especially promotionally-sensitive and have a profitable sales-life remaining. Pernix generates significant amounts of cash, the growth rate of which we believe will steepen with the ramp of of Cedax.

Pernix supplements the outright acquisition of drugs through strategic alliances whereby the company in-licenses the rights to certain products. Pernix is responsible for manufacture of the drugs, which the company outsources. In consideration for the licenses, Pernix makes royalty payments based on product sales volumes. These in-licensing activities, which have accounted for the majority of Pernix's revenue since its inception, have been extremely successful and a good fit with the company's low-risk mantra. However, we expect revenue from in-licensing to account for a smaller percent of total product sales going forward. This is due to Pernix recently launching authorized generics of many of its in-licensed drugs as well as revenue from drugs acquired through outright purchase likely accounting for the majority of Pernix's sales growth over the next several years. While this strategy adds slightly more risk (as the purchase price may not be recouped), we feel this is mitigated by management's proven ability in identifying high-potential drugs through its strict due diligence process. The outright acquisition of products, if successful, should also afford Pernix wider margins and provide for a greater degree of operating leverage.

Pernix's business model also employs a somewhat unique but effective strategy in fending off competition to its branded products. Through a partnership with Macoven Pharmaceuticals, Pernix can launch authorized generics of its branded products, thereby reducing the incentive for competitors to detail their products to Pernix's physicians. This affords Pernix less branded competition and allows the company the ability to promote both their branded and generic product in the same markets. Launching authorized generics also allows Pernix to gain formulary coverage where their branded product may have been excluded.

Pernix's longer-term strategy includes eventually bringing new drugs to market. While planning is still in the early stages, the company would likely continue to stick with its low-risk and minimally asset-intensive outsourcing (or partnering) strategy to handle the research and development activities. Pernix owns the U.S. rights to a compound which appears to have antitussive (cough suppression for dry cough) efficacy on-par with codeine (i.e. – the most effective antitussive) without the adverse side effects such as drowsiness or addictiveness. Development of this antitussive candidate, which is currently marketed in parts of Asia but has yet to enter U.S. clinical trials, would likely be Pernix's initial foray into bringing a new drug to market.

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## KEY COMPETITIVE ADVANTAGES

- Time to market leader. Pernix is able to achieve remarkably high sales and prescription counts within months following a product launch.
- Highly successful in their niche. Target high-prescribing physicians in pediatric space with promotionally-sensitive drugs.
    - Significant generic competition in this space keeps larger competitors from detailing their branded products. Pernix capitalizes on this by being one of few companies promoting branded drugs in this market.
- Small size allows for more adaptability to changing conditions and new opportunities
    - Frequently updating product menu and mix maximizes profitability and sales for efficiency
- Highly effective sales force. Heavy incentive-based pay structure and strict hiring practices has enabled Pernix to assemble a highly motivated sales team with interests that are aligned with management's and shareholders'.
- Talented management team. CEO Cooper Collins comes from a very successful career in pharmaceutical sales. Management has been extremely adept at not only the operational side of the business but the business development portion as well.
    - Ability to identify attractive products. Highly successful at acquiring drugs at very attractive prices and squeezing the remaining sales lives out of them.
    - Sticklers on expense management.
    - Disciplined. Adherence to strict controls over which products and personnel fit with the company's culture and business model.
    - Plan for long-term growth. Expect to eventually transition to developing proprietary drugs - initially this will be through partnerships – will allow for long-term growth but maintain low-risk business model.
- Lean infrastructure and low-cost business model maximizes cash flow and profitability and minimizes risk.
- Authorized generics. Selling authorized generics reduces branded competitive threat and allows for expanded formulary coverage.
- Impressive financials. 6-year CAGR: Revenue = 32%, Pre-tax income = 40%. Current (6/30/2010) cash balance = $11.4 million. Debt free. Cash flow from operations: 1 year ending 12/31/2009 = $9.2 million, 6 months ending 6/30/2010 = $4.7 million.

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## PRODUCTS

Pernix's current product portfolio consists of 14 branded prescription drugs encompassing 6 product lines (Aldex, Pediatex, Brovex, Z-Cof, Cedax, Rezyst and Quinzyme) with a primary therapeutic area of focus in cough/cold (allergies, congestion) for the pediatric market. The recent Cedax purchase provides Pernix with a strong entry into the attractive antibiotic market. We believe Cedax has $100+ million annual sales potential and will quickly become their biggest selling drug to date. In addition to selling in-licensed and acquired branded drugs, Pernix also sells authorized generics of certain of its branded products through Macoven Pharmacueticals. Pernix also has co-promotion agreements to market other companies' products. Revenue from generic products and co-promotion agreements accounted for approximately 1% of net revenues in FY2009, although we expect this to increase to almost 9% in FY2010.

All of Pernix's currently marketed products face significant competition from well established brands (both prescription and OTC) by large competitors such as Sudafed (J&J), Zyrtec (J&J), Robitussin (Wyeth/Pfizer), Theraflu (Novartis), Contac (GSK) and Claritin (Merck/Schering-Plough). There are also numerous generic products which are direct competitors to Pernix's drugs which often are more price competitive. Pharmacists will typically fill prescriptions of cough/cold products with a generic product when available and often do so even for off-label uses. Due to the significant generic competition, the promotional sales life of most of Pernix's current branded product portfolio is typically relatively short – likely only 1 – 3 years before Pernix launches a generic equivalent and/or ceases promotion of the branded product altogether. This means Pernix is always looking to update its product menu through in-licensing, acquisitions, co-promotions and, in the future, product development.

While the majority of Pernix's drugs (excluding Brovex) have a patent-protected technology for drug-delivery ("Kiel Technology") as well as trademarked brand names, none of the drugs' active pharmaceutical ingredients are patent protected. This presents somewhat of a double-edged sword scenario – where the drugs are exposed to a significant amount of competition but also where they are highly promotionally sensitive due to the lack of detailing of the larger companies' products. Due to the significant competition from generics in this space there is little financial incentive for large pharmaceutical companies to promote their products - this allows smaller companies that do detail their drugs (i.e. – Pernix) to capture meaningful share of the branded market.

While Pernix's product lines contain first-generation antihistamines and decongestants that are among the most widely used in cold/allergy medicines, we do not believe their products' efficacy is necessarily superior to many of its competitors. In addition, Pernix's cough/cold product lines do not carry nearly the same level of brand recognition nor advertising support as many of the competing products. Despite this, Pernix has been very successful in growing sales of the drugs, all of which are highly promotionally-sensitive. And while we believe Pernix's product lines as a whole will continue to exhibit strong annual revenue growth over the next several years, as we highlighted above, we believe much of Pernix's competitive advantage is intangible and lies outside its product portfolio.

### Aldex Family

The Aldex product line encompasses Aldex AN, Aldex CT, Aldex D and Aldex DM, which are prescription oral antihistamine/decongestant/antitussive combinations indicated for the treatment of respiratory allergies, allergic rhinitis and symptoms of the common cold. Pernix was granted rights to these products through licensing agreements with Kiel Laboratories and Gaine, Inc. (discussed below under "Patents/License Agreements"). The Aldex line, which Pernix launched in 2006, generated $18.4 million in sales in 2009, an increase of 4% year-over-year. Aldex accounted for 67% and 48% of Pernix's gross product sales in 2008 and 2009, respectively. We believe sales of the Aldex line began to fall during the first half of 2010 (management does not break out quarterly sales of individual drugs) as a result of Pernix launching authorized generics of the "D" (in Q1 2010) and "DM" products (in Q3 2009). Combined, these products accounted for 77% of the Aldex line in 2009.

- Aldex AN
  Aldex AN is an antihistamine/decongestant combination administered orally in a chewable tablet form containing the active pharmaceutical ingredient (API) doxylamine succinate. It is indicated for the temporary relief of runny nose, sneezing, itching of nose or throat, itchy, watery eyes due to hay fever or other respiratory allergies. Sales of Aldex AN were $641k in 2009, down 32% from 2008.

- Aldex CT
  Aldex CT is an antihistamine/decongestant combination administered orally in a chewable tablet form containing the API diphenhydramine HCl (antihistamine) and phenylephrine HCl (decongestant). It is indicated for the temporary relief of nasal and sinus congestion, sneezing, runny nose and watery eyes that occur from respiratory allergies. Sales of Aldex CT grew 43% in 2009 to $3.67 million.

- Aldex D
  Aldex D is an antihistamine/decongestant combination for oral administration as a suspension. Aldex D contains the API phenylephrine HCI and pyrilamine maleate (antihistamine). It is indicated for the symptomatic relief of coryza (head cold) and nasal congestion associated with the common cold, sinusitis, allergic rhinitis and other upper respiratory tract conditions. Aldex D generated $7.6 million in sales in 2009, an increase of 84% year-over-year. Pernix launched Pyril D, an authorized generic of Aldex D, through Macoven in early 2010. As detailed below (under "Collaborations"), Pernix receives 100% of the net proceeds from sales of these authorized generics.

- Aldex DM
  Aldex DM is an antihistamine/nasal decongestant/antitussive combination for oral administration as a suspension. Aldex DM contains the API phenylephrine HCI, pyrilamine maleate and dextromethorphan HBr (antitussive). It is indicated for the symptomatic relief of coryza, nasal decongestion, and cough associated with the common cold, sinusitis, allergic rhinitis and other upper respiratory tract conditions. Aldex DM sales fell 35% in 2009 to $6.5 million. This was a result of Pernix launching an authorized generic equivalent of Aldex DM (called Pyril DM) through Macoven during the third quarter 2009. Proceeds from sales of Pyril DM amounted to $254k (accounted for as "collaboration revenue") through the end of FY2009.

**Pediatex TD**

Pernix obtained rights to Pediatex TD through a licensing deal with Gaine, Inc. Pediatex TD is a prescription antihistamine/nasal decongestant combination liquid for oral administration. Pediatex TD contains the API tripolidine HCI (antihistamine) and pseudoephedrine HCI (decongestant). Tripolidine HCl is a first generation antihistamine in the alkylamine class. Pediatex TD, which Pernix launched in August 2008, is indicated for the relief of runny nose, sneezing, itching of nose and throat, itchy, watery eyes due to hay fever or other respiratory allergies. The product generated $5.7 million in sales in 2009, up from $1.5 million for the four months the drug was on the market in 2008. In March 2010 Pernix launched an authorized generic equivalent of Pediatex TD (called Trip PSE) through Macoven. As a result, we expect Pediatex TD sales to continue to fall throughout 2010.

**Brovex Family**

The Brovex product line includes Brovex PEB, Brovex PEB DM, Brovex PSB, Brovex PSB DM, Brovex PSE and Brovex PSE DM. These are oral antihistamine/decongestant/antitussive (cough suppressant) combinations indicated for the treatment of allergies and symptoms of the common cold. Pernix purchased the Brovex products in June 2009 for $450k from DaySpring Pharma (which purchased it from Athlon Pharmaceuticals in 2007). Brovex generated approximately $600k in revenue for DaySpring for the 12 months prior to the sale of the drug to Pernix. Pernix's primary reason for acquiring Brovex was a defensive strategy against a competitor attempting to launch a generic version of the company's Z-Cof line. The relatively cheap price and the drug's wide formulary coverage offer other significant advantages. The acquisition has already turned out to be wildly successful for Pernix. Pernix launched the line in August 2009 and in just over four months achieved $5.8 million (~13x the purchase price) in sales and averaged over 1,600 prescriptions per sales rep. Brovex enjoys no patent protection however, so we expect the lines' sales life to be somewhat limited for Pernix. Pernix launched generic equivalents of Brovex PSB DM and PEB DM in some territories during the second quarter 2010 - the company continues to promote the branded product in other areas. We expect Pernix to continue to dedicate significant detailing to the Brovex family of products but believe branded Brovex sales will be at or near peak levels for Pernix by the end of 2010.

- Brovex PEB
  Brovex PEB is an antihistamine/decongestant combination administered orally in a liquid form containing the API phenylephrine HCl and brompheniramine maleate (antihistamine). It is indicated for the temporary relief of nasal and sinus congestion, sneezing, runny nose and watery eyes that occur from seasonal and perennial allergic rhinitis. Sales of Brovex PEB were $429k in 2009.

- Brovex PEB DM
  Brovex PEB DM is an antihistamine/decongestant/antitussive combination administered orally in a liquid form containing the API phenylephrine, brompheniramine maleate and dextromethorphan. It is indicated for

the relief of nasal and sinus congestion, coughing, sneezing, runny nose, and watery eyes that occur from seasonal and perennial allergic rhinitis or the common cold. Sales of Brovex PEB DM were $2.6 million in 2009. Pernix launched a generic equivalent of PEB DM during the second quarter 2010 in some territories. The company continues to promote the branded product in other areas.

- Brovex PSB
  Brovex PSB is an antihistamine/decongestant administered orally in a liquid form containing the API pseudoephedrine HCl and brompheniramine maleate. It is indicated for the temporary relief of nasal and sinus congestion, sneezing, runny nose, and watery eyes that occur from seasonal and perennial allergic rhinitis. Sales of Brovex PSB were $413k in 2009.

- Brovex PSB DM
  Brovex PSB DM is an antihistamine administered orally in a liquid form containing the API pseudoephedrine HCl, brompheniramine maleate and dextromethorphan. It is indicated for the temporary relief of nasal and sinus congestion, coughing, sneezing, runny nose, and watery eyes that occur from seasonal and perennial allergic rhinitis or the common cold. Sales of Brovex PSB DM were $1.6 million in 2009. Pernix launched a generic equivalent of PSB DM during the second quarter 2010 in some territories. The company continues to promote the branded product in other areas.

- Brovex PSE
  Brovex PSE is an antihistamine administered orally in tablet form containing the API pseudoephedrine HCl and brompheniramine maleate. It is indicated for the temporary relief of nasal and sinus congestion, sneezing, runny nose, and watery eyes that occur from seasonal and perennial allergic rhinitis. Sales of Brovex PSE were $144k in 2009.

- Brovex PSE DM
  Brovex PSE DM is an antihistamine administered orally in tablet form containing the API pseudoephedrine HCl, brompheniramine maleate and dextromethorphan. It is indicated for the temporary relief of nasal and sinus congestion, coughing, sneezing, runny nose, and watery eyes that occur from seasonal and perennial allergic rhinitis or the common cold. Sales of Brovex PSE DM were $602k in 2009.

**Z-Cof**

The rights to Z-Cof were also obtained through the 2006 licensing arrangement with Kiel. Pernix began promoting Z-Cof 8DM in 2008 after discontinuing a legacy product, Z-Cof 12DM, at the end of 2007 due to a request by the FDA for manufacturers to discontinue similar products. While the FDA's request was not specifically targeted at Pernix's product, the company's manufacturers decided to discontinue producing it. Pernix subsequently discontinued selling 8DM during the first quarter 2010 due to a competing generic launch – Pernix has initiated legal actions against the company and expects to launch a new Z-Cof product during the winter of 2010.

Z-Cof 8DM is a prescription alcohol-free antitussive/decongestant/expectorant suspension indicated for the treatment of nasal congestion, chest congestion and cough that can lead to sinusitis. It contains the API dextromethorphan hydrobromide, pseudoephedrine HCl and guaifenesin (expectorant).

The Z-Cof products have been another home-run for the company. Generating $7 million of sales in 2007 (36% of total product sales), $6.7 million in 2008 (following the 12DM retirement and 8DM launch) and another $7.8 million in 2009. Details of the new Z-Cof product have not been released but we expect sales of it will be relatively unaffected by the generic 8DM product that is in the market. Pernix will likely introduce the product during the early part of the 2010 cold season. Based on the success of the legacy Z-Cof products, we expect sales of this new product to ramp very quickly and make a significant contribution to revenue beginning in late-2010.

**Rezyst IM and Quinzyme**

Rezyzst IM and Quinzyme are both medical food products which are either chewed or dissolved in the patients mouth, thereby eliminating the need for swallowing the drug whole. Rezyst IM and Quizyme launched in February 2009 and July 2009, respectively. Combined sales of the two drugs were approximately 1% of Pernix's total product sales in 2009 and we do not expect them to be a meaningful contributor to sales going forward.

Rezyst IM is a prescription probiotic (i.e. - dietary supplements or foods that contain beneficial bacteria similar to those normally in the body ) chewable tablet formulated to replace active bacterial cultures that are destroyed by

diet and antibiotics. It contains the API lactobacillus acidophilus and bifidobacterium (a bacteria with probiotic characteristics).

Quinzyme, which contains the API ubiquinone, is a prescription supplement for patients with depleted levels of ubiquinone. Coenzyme Q10 (CoQ10), also known as ubiquinone, is a fat-soluble, vitamin-like substance found in every human cell. It is involved in key biochemical reactions that produce energy in cells. Pernix's target market for Quizyme is the ~ $20B U.S. statin market as statin-induced ubiquinone deficiency is reversible with supplemental ubiquinone. While Quinzyme competes with branded OTC Coenzyme Q10 products, there is currently no other prescription ubiquinone supplement product on the market.

**Cedax**

In March 2010 Pernix closed on a deal for the purchase of Cedax from Shionogi Pharma, Inc. for $6.1 million. The purchase price will be paid over three installments ($3MM paid, $3.1MM due by 12/2010) and funded with cash on hand. Cedax generated approximately $6 million in sales in 2009, which implies an acquisition value of just 1x sales. Cedax (ceftibuten) is a prescription oral third-generation cephalosporin. The product is available in a 400mg capsule which will be primarily sold to the adult market and three suspension strengths which are largely targeted to the pediatric market. Pernix will market the suspension products and has entered a co-promotion agreement with WraSer Pharmaceuticals for marketing of the capsule form. WraSer will receive 70% of net sales proceeds of the capsule product.

Cedax is indicated for the treatment of mild to moderate acute bacterial exacerbations of chronic bronchitis, acute bacterial otitis media, pharyngitis and tonsillitis (i.e. – treatment of infections of the throat, middle-ear and respiratory tract). Acute bacterial exacerbation of chronic bronchitis is common among the roughly 14 million Americans suffering from chronic bronchitis. And while this is an attractive market for Pernix with Cedax, middle-ear infections (otitis media) with the suspension formula is largely where Pernix expects to focus its promotional efforts as this is the drug's sweet-spot for the pediatric space. Acute otitis media is the most commonly diagnosed infection among children. By age three, 84% of all children will have experienced at least one episode of the infection and nearly 50% will have had three or more episodes.

Cedax, which gained FDA approval in December 1995, was originally discovered by Shionogi and licensed to Schering-Plough. Schering-Plough launched the drug in the U.S. in early 2006, which reached peak sales of $52 million in 1997. Schering-Plough largely abandoned further promotion of Cedax after the disappointing launch and its introduction of seemingly greater potential products such as the highly successful Claritin brand. Biovail began marketing Cedax in October 2000 until terminating their sub-license agreement with Schering-Plough in August 2004. Biovail, which generated almost $900 million in revenue in 2004, cited its desire to shift resources towards "more important therapeutically focused products" as the reason to terminate the deal with Schering-Plough.

Cedax will compete with other cephalosporins including generics cephalexin (Keflex), cefaclor (Cefaclor), cefuroxime (Zinacef), cefdinir (Omnicef), cefprozil (Cefzil) and cefpodoxime (Vantin). It will also compete with Lupin Pharmaceuticals' Suprax (cefixime) product, the only other branded third generation cephalosporin currently on the market that is indicated for the treatment of otitis media. Lupin relaunched the drug in 2004 after licensing it from Wyeth which had ceased promoting it in 2003. Suprax is available in two suspension strengths and a 400mg tablet. However, unlike Cedax, which has patent protection for method of treatment until February 2014 (capsule form patent expires 2013, suspension strengths' patents expire 2014), all the patents covering Suprax have already expired, exposing all dosage forms of the drug to generic competition. We believe a generic Suprax product could launch sometime in 2011.

These third generation cephalosporins are highly promotionally-sensitive and the entry of a generic equivalent of Suprax would likely significantly benefit prescriptions of Cedax. While Pernix may compromise some margin, the launch of generic Suprax would afford Pernix's sales force the luxury of no branded competition when detailing to physicians. In addition, through couponing, Pernix can discount Cedax's co-pay to the same level of generic cephalosporin's, which carries a relatively high co-pay. This affords Pernix the ability to compete on price as well as efficacy, which is a tremendous benefit for their sales force. Lupin, via targeted sales campaigns, grew sales of Suprax from just $14.1 million in the first year of launch to approximately $100 million in the fifth year (~62% CAGR). This demonstrates the opportunity that Pernix has, with its highly motivated and effective sales force, to quickly ramp sales of Cedax.

We estimate the target market in which Cedax will compete to be approximately $700 million per year, with roughly 60% of that cornered by generics. According to an independent prescription tracking service Suprax generated approximately $95 million - $100 million in sales in 2009 for just their suspension formula. Assuming no other direct

branded competition exists (following a generic Suprax launch), we believe Cedax could generate annual peak sales in excess of $100 million after only a few years on the market. However, given Pernix's ability to quickly ramp and sustain extraordinarily high sales growth rates of newly acquired drugs (as evidenced by the Brovex launch) even this peak sales estimate may prove to be conservative. Having acquired the product for just $6 million, Cedax looks like it could easily become Pernix's most profitable drug ever.

Pernix will use couponing in order to compete with the generic competition, which will effectively bring the patient co-pay on Cedax down to approximately the same amount as the generic co-pay. Pernix hired an additional 25 sales reps during the second quarter 2010 to support the roll-out of Cedax. The second quarter launch largely consisted of initially introducing the product to physicians and rolling out the sampling campaign – although early indications are that the launch has been very successful from a gross product sales standpoint. We expect Cedax sales to really begin to ramp in the third quarter.

Cedax has historically had an extraordinarily high exposure to Medicaid customers which was largely the result of Pernix's Medicaid rebate expense jumping to 33% of gross product sales in the second quarter 2010 from just 12% in Q1. Management has noted that they are working on plans to reduce their overall exposure to Medicaid customers, which will become ever more critical as Cedax makes up a greater percent of overall product sales. This will be something to keep an eye on as exorbitant rebates could significantly impair the profitability of the drug. Our model incorporates the assumption that Pernix's exposure to these rebates is moderately high during Q3 and runs in the mid-teens (% of gross product sales) over the next several years – slightly scaling up with the growth of Cedax.

On the first quarter call management noted that while they would not give specific guidance relative to sales of Cedax, they noted that their minimum expectation was that in the first twelve months under Pernix's tutelage, that Cedax would generate sales of at least twice the ~$6 million it turned in during 2009. We think this is likely conservative and have modeled Cedax to generate $8.5 million through the end of 2010 (~7 months post-launch) and $32 million in 2011.

The remaining patent on Cedax expires in February 2014, after which the drug will be exposed to competition from generic equivalents. Management noted on the second quarter call that they are working on a plan post-patent expiry to help Cedax compete against generic competition – but, for competitive reasons, would not disclose anymore information on their strategy than this.

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**COLLABORATIONS / CO-PROMOTIONS**

In addition to selling their own products, Pernix also books revenue from collaboration and co-promotion arrangements. The company booked $292k and $461k from these in FY 2009 and the second quarter 2010, respectively. We expect collaboration (authorized generics plus co-promotion) revenue to be much more meaningful in the near-future and to account for almost 9% of net sales in 2010 and 7% of net sales in 2011.

The largest of these arrangements is with Macoven Pharmaceuticals, LLC. Macoven was created as a wholly-owned subsidiary of Pernix for the purpose of launching generic drugs. The entity was spun off during 2009 and is now majority owned by officers and directors of Pernix. Pernix has granted Macoven the right to develop and sell authorized generic equivalents of the company's branded products. In return for an upfront development fee of $1.5 million, Pernix is entitled to 100% of the proceeds of the generic products. Through the second quarter 2010 Macoven had launched generic versions of Aldex DM (Pyril DM), Aldex D (Pyril D), Pediatex TD (Trip PSE), Brovex PSB DM (Brom Pseudo DM) and Brovex PEB DM (Brom Phenyl DM). Pernix booked revenue of $163k and $576k related to these generics during the second quarter and first half of 2010, respectively. We expect Macoven revenue to become much more meaningful over the next several years due to the recent Aldex generic launches as well as potential further authorized generic launches of the Brovex line.

The entry of authorized generics is typically highly detrimental to sales of large, well-established brand name drugs but is an effective strategy to ward off competition to smaller, highly promotionally-sensitive brand name products such as Pernix's portfolio of drugs. By introducing a generic equivalent, competitors are much less inclined to detail their branded competing product in the same territory where Pernix is. This minimizes the number of branded competitors that their physicians are exposed to. By controlling the generic product Pernix also has the latitude to adjust pricing of both their branded and generic product, which can actually result in higher gross margins for the

products without the usual compromise of market share. This is an enormous advantage in our opinion. Selling authorized generics while continuing to detail their branded product in other territories also allows Pernix's to gain certain formulary coverage where their branded product may have been excluded.

Pernix has also entered into various co-promotion agreements whereby the company markets other companies' products in return for sales royalties. As of June 30, 2010 Pernix was involved in three co-promotion agreements. Revenue from co-promotions was negligible in FY2009 and totaled $297k and $408k in the first quarter and first half of 2010, respectively.

On June 22, 2010 Pernix entered into a co-promotion agreement with Macoven for the exclusive marketing of Zema Pak. The agreement calls for Pernix to receive 100% of sales of the drug through August 2010 and then to receive a monthly maximum based on sales of the product. Zema Pak is a glucocorticoid used to treat conditions such as arthritis and allergic reactions.

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**LICENSE AGREEMENTS**

84% of Pernix's gross product sales in 2009 were generated by products that Pernix acquired through licensing arrangements with Kiel Laboratories and Gaine, Inc. The license with Kiel granted Pernix the right to use Kiel's patented drug delivery technology to manufacture and sell Aldex CT, Aldex D, Aldex DM and Z-Cof 8DM (Pernix discontinued 8DM in early 2010). In return, Pernix was paying Kiel royalties on sales of these products. The patents covering the Kiel technology expire in 2026 and 2027. Licenses to market these drugs were subsequently obtained by Gaine, Inc.

In October 2006 Gaine, Inc., a holding company for intellectual property rights related to pharmaceutical products, acquired the manufacturing and marketing rights to Aldex AN and Pediatex TD from Kiel. Pernix gained rights to the drugs through Gaine. Pernix had owned a 50% interest in Gaine until June 21, 2010 when Pernix bought the remaining 50% it did not own. Terms of the deal call for Pernix to pay the sellers of Gaine $500k at closing (which has been paid), another $500k on October 31, 2010 and another $1 million in cash or PTX stock on January 31, 2011.

Prior to owning 100% of Gaine, Pernix was making royalties on sales of Aldex, Z-Cof and Pediatex to Gaine and Kiel. Now with Pernix controlling 100% of Gaine, these royalty payments (~$1.2 million in FY 2009) will now go away.

In addition to the $1 million purchase price, Pernix is required to pay the sellers $10 million in the event an NDA receives FDA approval for one of Pernix's antitussive candidates which incorporates a patent owned by Gaine. In April 2010 Pernix paid Kiel $200k related to a one-year consulting agreement whereby Kiel will assist in the development of two of its antitussive candidates incorporating patents owned by Gaine.

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**PIPELINE**

Pernix's management has indicated that they have one pipeline candidate which they believe holds enormous potential. Pernix has been relatively tight-lipped about it although they did disclose that they acquired the U.S. patent for a cough suppressant compound and that the patent originated with Sanofi-Aventis (although Pernix did not purchase the patent from SNY). Management indicated that in clinical trials (we assume international trials) the candidate was as effective as codeine in suppressing cough without the adverse side effects. Pernix has not disclosed whether the mechanism of action of this candidate is similar to that of opioids, although we believe that to be the case. The company noted that the drug was approved and is currently available in parts of Asia. Pernix is currently seeking a development partner for it and has apparently had conversations with larger pharmaceutical companies relative to partnering arrangements. Partnering reduces Pernix's development risk and allows the company to maintain its low fixed asset base, lean infrastructure and variable cost dominant operating structure. One potential arrangement Pernix is considering is swapping adult rights to the drug in return for development (with

Pernix keeping pediatric rights). On the first quarter call management noted that they expectedt to give an update to their plans for the candidate sometime during the summer. On the second quarter call management offered that they are currently in discussions with a particular company related to the further development of the candidate and that several "well known" companies have expressed interest in partnering with Pernix on the product.

Given the dearth of information on this cough suppressant, it is impossible to accurately gauge the likelihood of eventual FDA approval or its revenue potential. Codeine has been widely regarded as the most effective antitussive and is the API for cough suppression in several popular brand name and generic prescription medicines including Robitussin AC and Dimetane DC. However, codeine's serious adverse side effects, including being highly addictive and causing drowsiness, limits its use. Codeine, for all practical purposes can only be used at night and should only be used sparingly (or not at all) in pediatric patients.

If Pernix's pipeline candidate is indeed found to be as effective as codeine but lacks the serious side effects of opioids (both of which management claims it does), it would be in a class of its own and in our opinion could easily have multi-hundred million dollar (or more) potential in the pediatric space alone. We also believe there may be an opportunity to eventually bring the drug to the OTC market which would significantly expand the reach and revenue potential of the drug. Based on the limited information we have on this candidate and the likelihood that eventual FDA approval and a subsequent launch will be many years down the road, we do not currently model any sales of the drug. We will be very interested in hearing additional updates from management, hopefully later this year, and will revise our model to include a contribution from this product if and when appropriate.

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## FINANCIAL CONDITION

Through the second quarter ending June 30, 2010 Pernix had $11.4 million in cash (plus $500k in restricted cash) and no debt. Pernix generated $980k and $4.75 million in cash from operations through the first quarter and first half of the year, respectively.

We believe the current cash balance along with ongoing positive cash flow will be more than sufficient to fund operations for the foreseeable future. Near term uses of cash include the remaining $3.1 million owed for the Cedax purchase (due December 2010), $500k - $1.5 million for controlling interest of Gaine ($500k cash due 10/31/2010, $1 million cash or stock due 1/31/2011) and a recently announced stock buyback program authorizing the repurchase of up to $5.0 million in shares (no expiration date).

We also expect Pernix to continue to look for business development opportunities. In the near term we believe this will be mostly in the form of in-licensing deals, co-promotions or the purchase of small existing drugs which should be manageable with cash on hand or through a moderate amount of financing – in fact, Pernix noted in their Q2 10-Q that they are currently in discussions with a lender to obtain a $10 million revolver.

Longer-term, we expect development of the aforementioned cough suppressant product to require approximately $1 million - $2 million. Funding this with operating cash should also be easily manageable as we model Pernix to be generating as much as $25 million in cash by 2011 and for this to grow at about 35% per year through 2013.

## OUTLOOK

**Our Expectations**
We expect that forecasting Pernix's near-term financial metrics with any material degree of confidence may be bordering on futile as the company is highly dynamic and constantly changing in an attempt to maximize long-term growth. Management, for competitive reasons, also keeps a tight lid on sales of its individual drugs which makes short-term revenue trend forecasting difficult. This, coupled with the product mix constantly changing, a regular flow of new drug introductions and co-promotion agreements, new generic launches, and allowances, discounts and rebates that can be highly variable - mean Pernix's results from quarter-to-quarter can be very unpredictable. While this can be somewhat unnerving from an investor's standpoint, it is largely the reason why management has been so successful in growing the business and generating enormous amounts of cash. Management is clearly focused on maximizing the long-term growth of the company so we have little concern over "adjustments" in the business that may result in irregular short-term results but that benefit long-term success.

We nonetheless believe there is some utility in offering our short-term, along with long-term, outlook for the company in order for investors to grasp the dynamics of the business as well as how management is preparing for the future.

**Near-term**
We believe revenue will show sequential and y-o-y growth in the second half of 2010. Aldex sales will likely continue to decline and we believe the Brovex line will be near peak sales or begin to fall by the end of the current year. This, however, should be offset by growth in other product areas including ramping sales of Cedax. The new Z-Cof product is expected to launch during the winter season which should also materially benefit sales growth. New co-promotion arrangements, including the recent deal to market Zema Pak, should push collaboration revenue up as a total percent of sales beginning in Q3 and make a meaningful contribution to sales growth going forward. We model Pernix to generate net sales of $16.6 million in the second half of the year (Q3 $5.5MM and Q4 $11.1MM), compared to $14.2 million in the second half of 2009, growth of 17%.

Relative to earnings, we model EPS of $0.16 in the second half of 2010, which is flat from the same period in 2009. We believe Pernix will gain some slight product margin improvement during the second half of the current year but for operating expenses to remain above the prior year period as a result of recent headcount additions and fees and expenses associated with operating as a public company. Non-cash expenses will also be materially higher as a result of amortization of intangibles related to the Cedax purchase and payments for new development contracts. We model Medicaid rebates, which spiked as a percent of gross product sales in Q2 2010 to remain elevated (although we believe below the Q2 level) but to show progression towards the mid-teens.

**What to do with all that cash?**
Assuming our financial projections are reasonably accurate (and barring a sizeable product acquisition), Pernix could have in excess of $12 million of cash on the balance sheet by year-end 2010 and as much as $30 million by the end of 2011. This is a sizeable amount of cash for a company of Pernix's size, lean cost structure and lack of capital needs.

However, we expect management will look to reinvest a portion of this cash through one or more product purchases, in-licensing deals or co-promotions in the near-term. Nonetheless, we believe it is possible that management will be faced with the enviable position of having potentially too much cash. Pernix recently announced a $5 million share buyback program but given the lack of trading volume in the stock and already thin float, there may be little repurchasing activity under this program. Barring other opportunities to wisely reinvest cash back into the company (i.e. – through acquisitions, licensing or partnering deals, stock buybacks, product development, etc.) we think Pernix may consider a special dividend.

While an excess of cash can be worrisome from the standpoint that it can increase the risk that a company will make unwise investments (i.e. – acquisitions), we believe this risk is mitigated by Pernix's history of only considering products that fit within the company's strict guidelines.

**Longer-term**
Going into 2011 we model net sales to grow 83%, aided by a full year of Cedax sales, as well as continued strong growth of collaboration revenue and the new Z-Cof product. We also model $10 million in sales from a new product acquisition or large co-promotion agreement which we think could come by year-end 2010. A larger deal could add some upside to our estimates.

In 2012 and 2013 we model revenue to grow another 35% and 33%, respectively. We believe Brovex will be at or near the end of its promotional life by the end of 2012 but expect Cedax to be generating over $50 million by this time and account for approximately 60% of total revenue in 2012. We model Pernix to generate $98.0 million in net sales in 2013 - implying a 4-year CAGR of 37% from 2009 net sales of $27.9 million. We expect Pernix will be able to continue to gain operating leverage as revenue grows which will dually benefit the bottom line and EPS. We model EPS to grow at a 4-year CAGR of 41% through 2013 to $1.69.

We think the next wave of revenue and earnings growth could begin with the launch of the cough suppressant product. Based on our assumptions the drug could have tremendous potential but with little visibility on the candidate, there remains significant risk that our estimates could prove to be off the mark or that the product fails to reach the market altogether. We currently do not model any sales of this candidate and eagerly await further updates on the product.

Longer-term, we think management has an eye towards bringing drug development in-house, although we believe this is likely five or more years off.

## RECOMMENDATION / VALUATION

We believe Pernix represents an attractive investment based on our belief that the shares are undervalued by over 50%. We model EPS of $0.39 for the full year 2010, down 10% from the $0.43 posted in FY2009. We note, however, that 2010 is somewhat of a transition year for Pernix during which the company is shifting away from more piecemeal products (i.e. – Aldex, Brovex, Pediatex) to products that hold more longer-term upside potential (i.e. – Cedax). The return on this transition should be almost immediate, with robust annual EPS growth expected to begin in 2011 when we model Pernix to generate EPS of $0.75. Pernix is actively seeking to reinvest its huge and growing cash balance which could result in even greater rate of revenue and earnings growth relative to our forecast.

The shares currently trade at $3.06, implying a 2011 P/E of 4.1x. We believe this cheap valuation may be largely a result of the market “not seeing the forest for the trees” with undue concern placed on choppy quarterly results. Pernix’s competitive advantages rely on the company’s ability to be highly dynamic in an attempt to maximize long-term growth. Management is clearly focused on maximizing the long-term growth of the company so we have little concern over “adjustments” in the business that may result in irregular short-term results but that benefit long-term success.

Peer 2011 P/E comps in the specialty pharma space are largely grouped between 6x – 9x, implying a valuation of Pernix between $4.50 - $6.75/share. Based on our expectations of 4-year EPS CAGR of 41%, we believe Pernix warrants a valuation at the upper end of this range. We also believe Pernix’s numerous competitive advantages, along with the large and growing cash balance, substantially mitigates any downside risk.

We are initiating coverage of Pernix Therapeutics with an Outperform rating. We value the company at $6.75/share, based on 9x our 2011 EPS estimate of $0.75.

# KEY MANAGEMENT AND DIRECTOR PROFILES

### *Cooper C. Collins*
### *President and Chief Executive Officer*

Cooper C. Collins has served as President of the Company since January 2007 and became Chief Executive Officer concurrent with the merger with Golf Trust of America, Inc. ("GTA") on March 9, 2010. During his six year career with Pernix, Mr. Collins has worked in every capacity from sales representative to the executive level. Mr. Collins has been responsible for acquiring products and assets, attracting investors and increasing the overall efficiency of the organization. As a sales representative, he improved territory sales by over 300% in the first year and quickly moved into management. While serving as President, Mr. Collins has contributed to the Company's overall profit increasing over 100% from the year ended December 31, 2007 to the year ended December 31, 2008. Prior to joining Pernix, Mr. Collins was employed by the NFL franchise The New Orleans Saints in their media relations department for three years. He also developed and sold a small internet company while earning a B.A. and a M.B.A. on a football scholarship from Nicholls State University in Thibodaux, Louisiana.

### *Michael C. Pearce*
### *Chairman of the Board of Directors*

Michael C. Pearce is a private investor with emphasis on the cleantech and healthcare industries. From December 2007 until March 2010, he led a repositioning of Golf Trust of America, Inc (NYSE Amex: GTA) while serving in the capacity of Chairman and Chief Executive Officer. Over the course of twenty-five years, Mr. Pearce was employed in various technology industry management positions. From late 1999-2001, he served as Chief Executive Officer of iEntertainment Network during a corporate restructuring. From 1996-1998, he was Senior Vice President of Sales and Marketing at publicly-traded VocalTec Communications, later returning in a consulting capacity to its Chairman on matters pertaining to strategic alternatives, business development and mergers and acquisitions. From 1983-1996, he was employed as Senior Vice President of Sales and Marketing at Ventana Communications, a subsidiary of Thomson Corporation; Vice President of Sales at Librex Computer Systems, a subsidiary of Nippon Steel Corporation and; National Sales Manager at Hyundai Electronics America. From 1979 to 1983, he attended Southern Methodist University. Mr. Pearce has also served on the board of directors of AVP, Inc.; Spatializer Audio Labs, Inc.; Reliability, Inc. and; Swiss Precision Corporation.

### *Michael Venters*
### *Executive Vice President of Operations*

Michael Venters has served as Vice President of Operations for the Company since January 2009. Prior to this, Mr. Venters was a founding stockholder of Cornerstone BioPharma/Aristos Pharmaceuticals and served as Vice President of Business Development of Aristos Pharmaceuticals (Cornerstone's Generic Division). Before joining Cornerstone BioPharma, Mr. Venters served as National Account Manager for DJ Pharma which was later purchased by Biovail Pharmaceuticals, Inc. from February 2000 to September 2003. His pharmaceutical career began in 1993 as a field sales representative at Dura Pharmaceuticals, Inc. He was later promoted to several other sales and marketing positions within Dura. Mr. Venters holds a B.A. in Marketing from the University of Kentucky.

### *Tracy S. Clifford*
### *Chief Financial Officer, Secretary and Treasurer*

Tracy Clifford became Chief Financial Officer, Secretary and Treasurer of the Company on March 9, 2010 through its merger with Golf Trust of America, Inc. ("GTA"). Ms. Clifford served as the Chief Financial Officer of Golf Trust of America, Inc. since January 2008 and as GTA's Secretary since February 2007. Prior to becoming GTA's CFO, Ms. Clifford held the positions of Principal Accounting Officer from February 2007 to January 2008 and as Corporate Controller from September 1999 to February 2007 at GTA. Before joining GTA, Ms. Clifford served as a Director of Finance (February 1999 to September 1999) and Manager of Accounting and Financial Reporting (May 1995 to February 1999) at United Healthcare of Georgia in Atlanta. From June 1993 to May 1995, Ms. Clifford served as Manager of Accounting (January 1994 to May 1995) and Senior Accountant (June 1993 to January 1994) at North Broward Hospital District in Fort Lauderdale, Florida. Ms. Clifford began her career at Deloitte & Touche in Miami, Florida where she was an auditor primarily for clients in the healthcare industry from September 1991 to June 1993. Ms. Clifford holds a B.S. in Accounting from the College of Charleston and a M.B.A.with a concentration in Finance from Georgia State University. Ms. Clifford is a member of the South Carolina Association of CPAs and the American Institute of CPAs and serves as an adjunct faculty member in the School of Business and Economics at the College of Charleston.

### *David E. Waguespack*
### *Vice President of Internal Operations*

David E. Waguespack was named Vice President of Internal Operations for the Company upon its merger with Golf Trust of America, Inc. ("GTA"). Mr. Waguspack previously served as Vice President, Secretary and Treasurer for Pernix from April 2007 to March 2010. He joined Pernix in May 2003 as Vice President and managed a variety of projects within the organization. Before joining Pernix, Mr. Waguespack compiled over 25 years of experience in health care management and administration. He also has extensive training in Human Resources. Mr. Waguespack holds a B.A. in History/Pre-Law from Nicholls State University in Thibodaux, Louisiana.

### *Beth Bonner DeVille*
### *Vice President of Sales and Marketing*

Beth Bonner DeVille has served as Vice President of Sales and Marketing for the Company since November 2005. Mrs. DeVille began her career with Pernix in August 2001 as a sales representative and quickly became the top sales representative in the company, a title she earned three times. Mrs. DeVille also served in the capacity of Field Trainer simultaneous to her work as a sales representative. Prior to joining Pernix, Mrs. DeVille was employed for two years by Praeses Corporation in Shreveport, Louisiana as a Business Development Manager. Mrs. DeVille earned a volleyball scholarship and a B.A. in Business Communications from Centenary College of Louisiana in Shreveport, Louisiana.

### *Robert H. Cline, Jr.*
### *Pharm D., Vice President of Supply Chain Management*

Robert Cline has served as Vice President of Supply Chain Management for the Company since October 2009. From July 2007 to October 2009, Mr. Cline led Amneal Pharmaceuticals LLC's supply chain operations, serving as Vice President of Supply Chain Management from July 2008 to October 2009 and Director of Supply Chain Management from June 2007 to July 2008. Prior to this, Mr. Cline served as Vice President of Marketing from September 1999 to June 2004 and then Vice President of Product Development from June 2004 to June 2007 for Akyma Pharmaceuticals LLC (formerly R&S Pharma, Inc.), a generic pharmaceutical manufacturer which was acquired by Amneal in June 2007. Mr. Cline began his pharmaceutical career as a retail pharmacist for an independently owned pharmacy in 1999 and continues to maintain market awareness by working as a relief pharmacist in his local community. Mr. Cline earned his Pharm D. from the University of Kentucky in 1999 and is a licensed pharmacist in Kentucky and Tennessee.

## FINANCIAL STATEMENTS

### INCOME STATEMENT

Pernix Therapeutic Holdings, Inc

| | 2009 A | Q1A | Q2A | Q3E | Q4E | 2010 E | 2011 E | 2012 E | 2013 E |
|---|---|---|---|---|---|---|---|---|---|
| Gross product sales | $38,210.6 | $10,832.6 | $6,894.8 | $7,301.0 | $13,956.0 | $38,984.0 | $67,810.0 | $92,128.0 | $123,975.0 |
| *YOY Growth* | *45.2%* | *9.8%* | *-22.5%* | *7.4%* | *37.8%* | *2.0%* | *73.9%* | *35.9%* | *34.6%* |
| Collaboration revenue | $291.6 | $524.3 | $460.5 | $550.0 | $1,000.0 | $2,534.8 | $4,000.0 | $5,000.0 | $6,000.0 |
| *YOY Growth* | - | - | - | - | - | *769.3%* | *57.8%* | *25.0%* | *20.0%* |
| Royalty revenue | $0.0 | $0.0 | $21.4 | $21.0 | $21.0 | $63.4 | $100.0 | $150.0 | $200.0 |
| *YOY Growth* | - | - | - | - | - | - | *57.7%* | *50.0%* | *33.3%* |
| Sales discounts | ($2,937.8) | ($921.6) | ($323.8) | ($511.1) | ($1,116.5) | ($2,872.9) | ($5,424.8) | ($6,909.6) | ($9,298.1) |
| *% of Gross product sales* | *7.7%* | *8.5%* | *4.7%* | *7.0%* | *8.0%* | *7.4%* | *8.0%* | *7.5%* | *7.5%* |
| Sales returns allowances | ($2,809.9) | ($255.2) | ($426.0) | ($365.1) | ($697.8) | ($1,744.0) | ($2,915.8) | ($3,777.2) | ($4,959.0) |
| *% of Gross product sales* | *7.4%* | *2.4%* | *6.2%* | *5.0%* | *5.0%* | *4.5%* | *4.3%* | *4.1%* | *4.0%* |
| Medicaid rebates | ($4,824.1) | ($1,306.7) | ($2,269.2) | ($1,460.2) | ($2,093.4) | ($7,129.5) | ($8,883.1) | ($12,713.7) | ($17,852.4) |
| *% of Gross product sales* | *12.6%* | *12.1%* | *32.9%* | *20.0%* | *15.0%* | *18.3%* | *13.1%* | *13.8%* | *14.4%* |
| Net Sales | $27,930.4 | $8,873.3 | $4,357.8 | $5,535.7 | $11,069.3 | $29,835.7 | $54,686.3 | $73,877.5 | $98,065.5 |
| *YOY Growth* | *35.2%* | *22.6%* | *-33.1%* | *-5.0%* | *32.5%* | *6.8%* | *83.3%* | *35.1%* | *32.7%* |
| Cost of product sales | $5,437.0 | $1,192.0 | $704.2 | $1,095.2 | $2,093.4 | $5,084.7 | $9,493.4 | $11,516.0 | $14,877.0 |
| *Products margin* | *85.8%* | *89.0%* | *89.8%* | *85.0%* | *85.0%* | *87.0%* | *86.0%* | *87.5%* | *88.0%* |
| Gross Income | $22,493.4 | $7,681.3 | $3,653.6 | $4,440.5 | $8,975.9 | $24,751.4 | $45,192.9 | $62,361.5 | $83,188.5 |
| *Gross Margin* | *80.5%* | *86.6%* | *83.8%* | *80.2%* | *81.1%* | *83.0%* | *82.6%* | *84.4%* | *84.8%* |
| Selling | $4,742.0 | $1,456.1 | $1,089.7 | $1,095.2 | $1,884.1 | $5,525.0 | $9,154.4 | $11,976.6 | $16,116.8 |
| *% Sell&Mktg* | *12.4%* | *13.4%* | *15.8%* | *15.0%* | *13.5%* | *14.2%* | *13.5%* | *13.0%* | *13.0%* |
| Royalty expenses | $1,224.0 | $0.0 | $0.0 | $0.0 | $0.0 | $0.0 | $0.0 | $0.0 | $0.0 |
| *% Royalty* | *3.2%* | *0.0%* | *0.0%* | *0.0%* | *0.0%* | *0.0%* | *3.0%* | *0.0%* | *0.0%* |
| G&A | $6,388.0 | $1,634.5 | $1,697.8 | $1,606.2 | $1,674.7 | $6,613.2 | $8,137.2 | $9,304.9 | $10,909.8 |
| *% G&A* | *16.7%* | *15.1%* | *24.6%* | *22.0%* | *12.0%* | *17.0%* | *12.0%* | *10.1%* | *8.8%* |
| R&D | $712.0 | $271.3 | $316.0 | $366.0 | $375.0 | $1,328.2 | $825.0 | $1,172.0 | $1,644.0 |
| *% R&D* | *1.9%* | *2.5%* | *4.6%* | *5.0%* | *2.7%* | *3.4%* | *1.2%* | *1.3%* | *1.3%* |
| Dep & Amort | $211.0 | $68.8 | $190.2 | $312.0 | $313.0 | $884.0 | $1,222.0 | $1,118.0 | $1,118.0 |
| Operating Income | $9,216.4 | $4,250.8 | $359.8 | $1,061.2 | $4,729.1 | $10,400.9 | $25,854.3 | $38,789.9 | $53,399.9 |
| *Operating Margin* | *33.0%* | *47.9%* | *8.3%* | *19.2%* | *42.7%* | *34.9%* | *47.3%* | *52.5%* | *54.5%* |
| Interest income, net | $19.6 | $2.9 | $4.7 | 4.0 | $5.0 | $16.6 | $50.0 | $150.0 | $300.0 |
| Other income | $2.0 | $0.0 | $0.4 | 0.0 | $0.0 | $0.4 | $0.0 | $0.0 | $0.0 |
| Pre-Tax Income | $9,238.0 | $4,253.7 | $364.9 | $1,065.2 | $4,734.1 | $10,417.9 | $25,904.3 | $38,939.9 | $53,699.9 |
| Taxes (benefit) | $39.0 | ($1,018.1) | $201.7 | $362.2 | $1,609.6 | $1,155.4 | $8,688.5 | $13,120.6 | $18,139.0 |
| *Tax Rate* | *N/A* | *N/A* | *55.3%* | *34.0%* | *34.0%* | *11.1%* | *33.5%* | *33.7%* | *33.8%* |
| Income to non-controlling interest | ($41.0) | $3.7 | (3.7) | 0.0 | 0.0 | $0.0 | $0.0 | $0.0 | $0.0 |
| *% of total* | *-0.4%* | *0.1%* | *-2.2%* | *0.0%* | *0.0%* | *0.0%* | *0.0%* | *0.0%* | *0.0%* |
| Net Income | $9,239.98 | $5,268.16 | $166.84 | $703.01 | $3,124.53 | $9,262.55 | $17,215.84 | $25,819.35 | $35,560.95 |
| *Net Margin* | *33.1%* | *59.4%* | *3.8%* | *12.7%* | *28.2%* | *31.0%* | *31.5%* | *34.9%* | *36.3%* |
| EPS | $0.43 | $0.24 | $0.01 | $0.03 | $0.13 | $0.39 | $0.75 | $1.17 | $1.69 |
| *YOY Growth* | *#DIV/0!* | - | - | - | - | *-10.2%* | *94.7%* | *56.1%* | *44.3%* |
| Diluted Shares O/S | 21,488 | 21,867 | 24,608 | 24,690 | 24,800 | 23,991 | 22,900 | 22,000 | 21,000 |

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## BALANCE SHEET

Pernix Therapeutic Holdings, Inc

| | June 30, 2010 | December 31, 2009 |
|---|---|---|
| **ASSETS** | | |
| Current assets: | | |
| Cash and cash equivalents | $ 11,426,355 | 4,578,476 |
| Restricted cash | 500,000 | — |
| Accounts receivable, net | 3,978,705 | 4,133,357 |
| Inventory, net | 1,384,460 | 1,081,970 |
| Prepaid expenses and other current assets | 1,461,242 | 1,625,719 |
| Income tax receivable | 780,860 | — |
| Deferred tax assets – current | 1,798,000 | 61,000 |
| Total current assets | 21,329,622 | 11,480,522 |
| Property and equipment, net | 1,133,403 | 139,456 |
| Other assets: | | |
| Intangible assets, net of amortization | 6,471,712 | 1,409,337 |
| Deferred tax assets – long term | 685,000 | — |
| Other long-term assets | 300,000 | 383,333 |
| **Total assets** | $ 29,919,737 | 13,412,648 |
| **LIABILITIES** | | |
| Current liabilities: | | |
| Accounts payable | $ 2,305,894 | 436,663 |
| Accrued personnel expense | 724,970 | 560,657 |
| Accrued allowances | 5,975,000 | 6,795,542 |
| Income taxes payable | — | 100,000 |
| Other accrued expenses | 191,099 | 101,196 |
| Contract payable | 4,420,806 | 42,382 |
| **Total current liabilities** | 13,617,769 | 8,036,440 |
| Commitments and contingencies | — | — |
| **STOCKHOLDERS' EQUITY** | | |
| Common stock, $.01 par value, 90,000,000 shares authorized, 24,558,594 and 20,900,000 outstanding at March 31, 2010 and December 31, 2009, respectively | 246,907 | 209,000 |
| Treasury stock | (30,014) | — |
| Additional paid-in capital | 6,463,038 | 788,979 |
| Retained earnings | 9,622,037 | 4,308,491 |
| Total stockholders' equity | 16,301,968 | 5,306,470 |
| Non-controlling interest | — | 69,738 |
| **Total equity** | 16,301,968 | 5,376,208 |
| **Total liabilities and stockholders' equity** | $ 29,919,737 | 13,412,648 |



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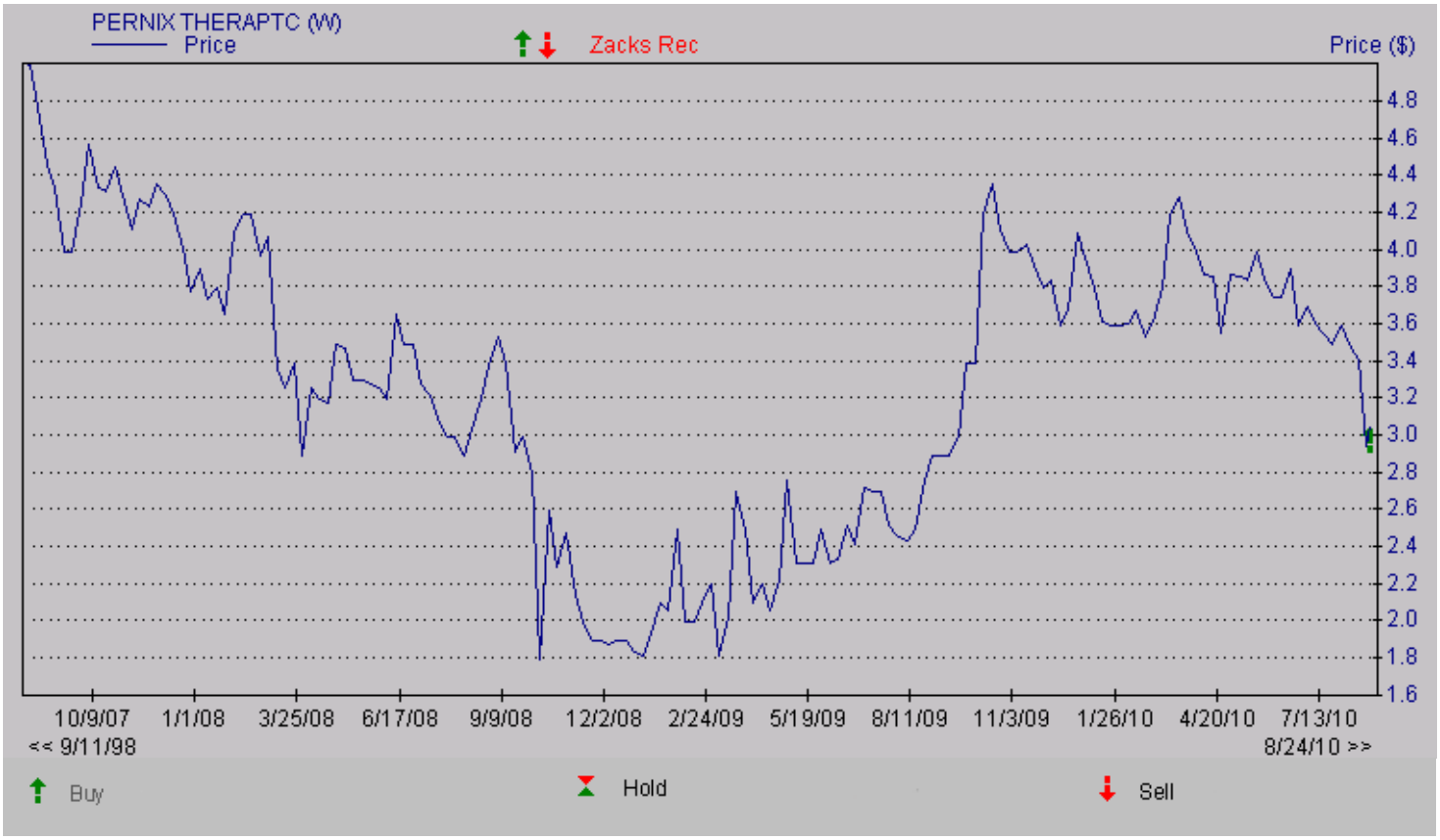
## CASH FLOW STATEMENT

Pernix Therapeutic Holdings, Inc

| | Six months June 30, 2010 | 2009 |
|---|---|---|
| **Cash flows from operating activities:** | | |
| Net income | $ 5,435,007 | 5,601,501 |
| Adjustments to reconcile net income to net cash provided by operating activities: | | |
| Depreciation and amortization | 258,969 | 114,532 |
| Provision for allowance for returns | 690,000 | 1,415,000 |
| Provision for deferred income tax benefit | (2,422,000) | — |
| Non-cash interest | (3,544) | — |
| Stock compensation expense | 126,838 | 681,000 |
| Changes in operating assets and liabilities: | | |
| Accounts receivable | 194,209 | 433,079 |
| Inventory | 415,919 | 784,765 |
| Prepaid expenses and other assets | 348,240 | (583,521) |
| Other assets – long term | 83,333 | — |
| Accounts payable | 1,869,228 | 268,296 |
| Income taxes | (880,860) | — |
| Accrued expenses | (1,389,579) | (1,121,864) |
| Net cash provided by operating activities | 4,725,760 | 7,592,788 |
| **Cash flows from investing activities:** | | |
| Acquisition of CEDAX – initial payment | (1,500,000) | — |
| Acquisition of non-controlling interest in Gaine | (326,623) | — |
| Acquisition of Brovex | — | (450,000) |
| Purchase of intangible assets | — | (100,000) |
| Purchase of equipment | (8,969) | — |
| Net cash used in investing activities | (1,835,592) | (550,000) |
| **Cash flows from financing activities:** | | |
| Cash acquired in connection with the merger, net of costs paid | 5,965,529 | — |
| Transfer to restricted cash for issuance of letter of credit | (500,000) | |
| Payments received on notes receivable | 66,334 | |
| Payment on acquistion obligation - CEDAX | (1,500,000) | |
| Proceeds from stock issuance | 77,600 | |
| Repurchase of stock | (30,291) | |
| Distributions to stockholders | (121,940) | (6,107,600) |
| Net cash provided by (used in) financing activities | 3,957,711 | (6,107,000) |
| Net increase (decrease) in cash and cash equivalents | 6,847,879 | 935,188 |
| Cash and cash equivalents, beginning of period | 4,578,476 | 4,874,296 |
| Cash and cash equivalents, end of period | $ 11,426,355 | $ 5,809,484 |

*Pernix Therapeutic Holdings, Inc*

## HISTORICAL ZACKS RECOMMENDATIONS




## DISCLOSURES

**The analysts contributing to this report do not hold any shares of PTX. Zacks EPS and revenue forecasts are not consensus forecasts.** Additionally, the analysts contributing to this report certify that the views expressed herein accurately reflect the analysts' personal views as to the subject securities and issuers. Zacks certifies that no part of the analysts' compensation was, is, or will be, directly or indirectly, related to the specific recommendation or views expressed by the analyst in the report. Additional information on the securities mentioned in this report is available upon request. This report is 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 herein are subject to change. This report is not to be construed as an offer or the solicitation of an offer to buy or sell the securities herein mentioned. Zacks or its officers, employees or customers may have a position long or short in the securities mentioned and buy or sell the securities from time to time. Zacks uses the following rating system for the securities it covers. **Outperform**- Zacks expects that the subject company will outperform the broader U.S. equity market over the next one to two quarters. **Neutral**- Zacks expects that the company will perform in line with the broader U.S. equity market over the next one to two quarters. **Underperform**- Zacks expects the company will under perform the broader U.S. Equity market over the next one to two quarters. The current distribution of Zacks Ratings is as follows on the 1007 companies covered: Outperform- 13.7%, Neutral- 79.3%, Underperform – 6.6%. Data is as of midnight on the business day immediately prior to this publication.