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Pernix Therapeutics (PTX-AMEX)

PTX: Q1 Misses on Revenue and EPS. Long-Term Outlook Remains Intact.

Current Recommendation	**Outperform**
Prior Recommendation	N/A
Date of Last Change	08/24/2010
Current Price (05/17/11)	$10.00
Target Price	**$13.00**

OUTLOOK

Q1 revenue and EPS came in significantly below our estimates. Upper respiratory sales were soft relative to our expectations and rebates continue to hamper EPS growth. The Natroba launch, expected in Q3, continued ramp in Cedax and anticipated SGA leverage has us hopeful that EPS will gain more traction in the back half of 2011. We have made adjustments to our model and now look for EPS of $0.40 for the full year. Our price target has moved from $14.5 to $13/share.

Our longer-term outlook remains mostly unchanged. Our investment thesis remains intact and we continue to be highly positive on Pernix.

We are maintaining our Outperform rating on shares of Pernix.

SUMMARY DATA

52-Week High	**$13.23**
52-Week Low	**$2.60**
One-Year Return (%)	**193.40**
Beta	**1.05**
Average Daily Volume (sh)	**8,285**
Shares Outstanding (mil)	**23**
Market Capitalization ($mil)	**$272**
Short Interest Ratio (days)	**2.67**
Institutional Ownership (%)	**2**
Insider Ownership (%)	**66**
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	**25**
P/E using 2011 Estimate	**25.0**
P/E using 2012 Estimate	**11.4**
Zacks Rank	**N/A**

Risk Level	**Average,**
Type of Stock	**Small-Growth**
Industry	**Med-Generic Drg**

ZACKS ESTIMATES

Revenue
(in millions)

	Q1 (Mar)	Q2 (Jun)	Q3 (Sep)	Q4 (Dec)	Year (Dec)
2010	$8.9 A	$4.4 A	$7.8 A	$12.2 A	$33.2 A
2011	$10.1 A	$9.5 E	$11.5 E	$16.5 E	$47.6 E
2012					$72.3 E
2013					$99 E

Earnings per Share

	Q1 (Mar)	Q2 (Jun)	Q3 (Sep)	Q4 (Dec)	Year (Dec)
2010	$0.24 A	$0.01 A	$0.10 A	$0.07 A	$0.40 A
2011	$0.04 A	$0.07 E	$0.11 E	$0.18 E	$0.40 E
2012					$0.88 E
2012					$1.38 E

Zacks Projected EPS Growth Rate - Next 4 Years % **49**

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Q1 2011 RESULTS

Pernix reported financial results for the first quarter on May 17, 2011. Net sales and EPS both came in significantly below what we were expecting.

Gross product sales of $18.3MM was $3.6MM (16%) below our $21.8MM estimate as a result of lower than modeled sales of upper respiratory products. Pernix does not break out sales of individual drugs so it is difficult to tell where the relative (relative to our numbers) softness in sales was. Net sales (i.e. - gross sales after discounts and rebates) came in at $10.1MM, $5.0MM (33%) lower than our estimate. Medicaid/Medicare rebates, which have hampered earnings growth in the past and exposure to which management has been trying to reduce, came in at about 28% of gross product sales versus our 15% estimate. Even after stripping out the $1.1MM that was attributed to provisions related to prior year sales, these government rebates were still about 21% of gross sales. In aggregate, total rebates (which also includes sales discounts, returns, customer rebates) equaled 51% of gross product sales - compared to our 34% estimate and 39% for the full year 2010. As we have noted in the past, management will need to be diligent in reducing the impact from these rebates in order to maximize earnings growth.

Operating expenses of $6.0MM came in just about dead-on with our estimate but as a percentage of sales SG&A, at 25% of gross product sales, was significantly higher than our 22% estimate. Pernix has been ramping up support functions in anticipation of accelerating sales and noted in the 10-Q filed today that they began paying reps higher sales commissions to get more in-line with competitors. Management indicated on the call that SG&A should be more scalable going forward.

Q1 EPS came in at $0.04, compared to our $0.18 estimate. This miss, a compilation of lower gross sales, higher rebates, and higher operating expenses as a percentage of sales.

Cash
The balance sheet remains very healthy. Cash balance at the end of Q1 stood at $13MM (excluding another $502k in restricted cash), up from $8.3MM at the end of 2010. Debt consisted of $6MM drawn on a $10MM credit line. Cash flow from operations was $5.0MM in Q1. Ex-changes in working capital operating cash flow was $1.0MM.

Product Update

- **Natroba:** Natroba, the high-potential lice product, is now expected to launch in July of this year - which is a slight delay from prior expectations of launch in Q2 2011. Management noted today that there have been delays in getting FDA approval of the commercial manufacturing facility that will produce Natroba. In the event that FDA approval does not happen in the near term, Pernix and co-pro partner ParaPRo will utilize the manufacturing facility that was used for clinical trials in order to hit their July 2011 launch timeline. Pernix noted on today's call that the clinical trial facility should have ample capacity to meet expected demand. Pernix reps, which will be pushing Cedax and the cough-cold line prior to the summer camp season, will switch their main focus to Natroba coming into the summer months. We expect the combination of Natroba's efficacy (and benefits in application) and Pernix's sales acumen to result in a rapid and steep sales ramp. Natroba, with its peak season in the warmer months, should also afford some offset to the seasonality in revenue of the cough/cold products.

- **Theobromine:** Management did not have much in the way of an update to theobromine, the new pipeline antitussive candidate, other than noting that they are still considering selling the asset through an auction process. Pernix expensed $330k during Q1 related to development of theobromine - this is a non-cash expense - essentially amortization of Pernix's $1.5MM contribution that they made in late-2010 to the JV with SEEK.

OUR REVISED 2011 OUTLOOK

We have made updates to our model based on today's results. For 2011 we now look for gross product sales of $72MM (from $83MM prior to Q1 results), net sales of $47.6MM (revised from $57.3MM) and EPS of $0.40 (revised from to $0.60).

Our price target has moved from $14.5 to $13 per share. We value PTX using a comp average PE/G ratio of .92. We look for PTX to grow EPS at a CAGR of 35% over the next five years, which using the comp PE/G, values PTX at approximately $13/share. The stock traded off today following the earnings release and currently trades at about $10/share. We are maintaining our Outperform rating.

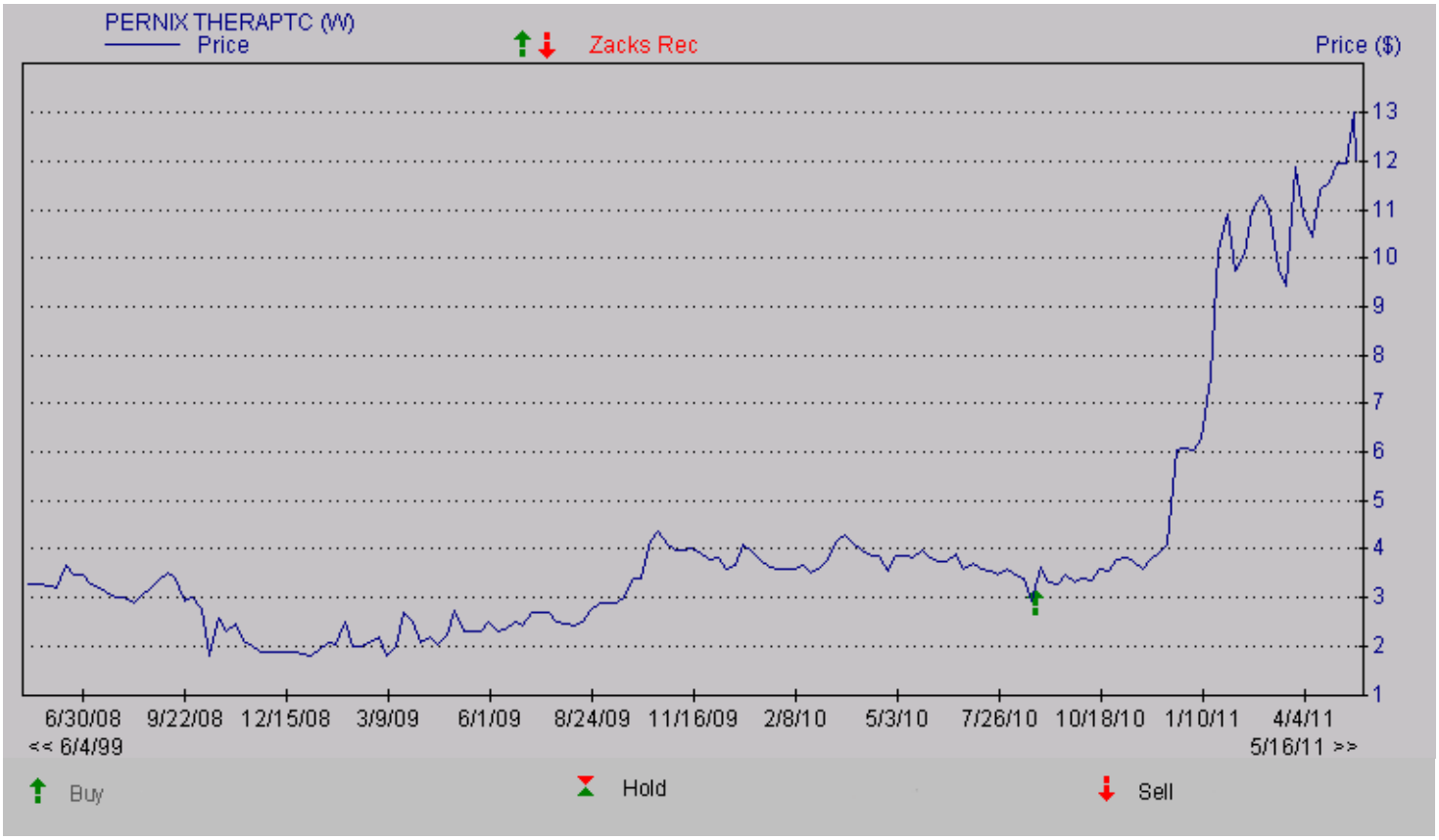
FINANCIAL MODEL

Pernix Therapeutic Holdings, Inc

	2010 A	Q1A	Q2E	Q3E	Q4E	2011 E	2012 E	2013 E	2014 E
Gross product sales	$50,079.0	$18,252.0	$15,505.0	$15,325.0	$22,986.0	$72,068.0	$104,008.0	$132,705.0	$183,795.0
YOY Growth	*31.1%*	*68.5%*	*124.9%*	*32.9%*	*16.0%*	*43.9%*	*44.3%*	*27.6%*	*38.5%*
Collaboration revenue	$2,489.8	$1,166.0	$725.0	$2,275.0	$2,135.0	$6,301.0	$8,725.0	$14,725.0	$20,475.0
YOY Growth	*753.9%*	*122.4%*	*57.4%*	*573.1%*	*82.9%*	*153.1%*	*38.5%*	*68.8%*	*39.0%*
Sales discounts	($1,337.4)	($382.0)	($387.6)	($383.1)	($574.7)	($1,727.4)	($2,600.2)	($3,317.6)	($4,594.9)
% of Gross product sales	*2.7%*	*2.1%*	*2.5%*	*2.5%*	*2.5%*	*2.4%*	*2.5%*	*2.5%*	*2.5%*
Sales returns allowances	($2,199.9)	($1,106.0)	($983.8)	($972.1)	($1,458.1)	($4,520.0)	($6,620.5)	($8,465.8)	($11,754.7)
% of Gross product sales	*4.4%*	*6.1%*	*6.3%*	*6.3%*	*6.3%*	*6.3%*	*6.4%*	*6.4%*	*6.4%*
Allwnce for cust rebates/chgbcks	($6,517.0)	($2,793.0)	($2,325.8)	($2,452.0)	($2,068.7)	($9,639.5)	($12,481.0)	($15,924.6)	($22,055.4)
% of Gross product sales	*13.0%*	*15.3%*	*15.0%*	*16.0%*	*9.0%*	*13.4%*	*12.0%*	*12.0%*	*12.0%*
Medicaid rebates	($9,288.0)	($5,042.0)	($3,023.5)	($2,314.1)	($4,482.3)	($14,861.8)	($18,721.4)	($21,232.8)	($27,936.8)
% of Gross product sales	*18.5%*	*27.6%*	*19.5%*	*15.1%*	*19.5%*	*20.6%*	*18.0%*	*16.0%*	*15.2%*
Rebates/discounts % of Gross	*38.6%*	*51.1%*	*43.3%*	*39.9%*	*37.3%*	*42.7%*	*38.9%*	*36.9%*	*36.1%*
Net Sales	$33,227.4	$10,095.0	$9,509.3	$11,478.7	$16,537.3	$47,620.3	$72,309.9	$98,489.2	$137,928.2
YOY Growth	*19.0%*	*13.8%*	*118.2%*	*47.6%*	*35.4%*	*43.3%*	*51.8%*	*36.2%*	*40.0%*
Cost of product sales	$6,500.3	$2,319.2	$1,705.6	$1,915.6	$3,562.8	$9,503.2	$13,521.0	$16,588.1	$22,606.8
Ex-discounts/rebates products margin	*87.0%*	*87.3%*	*89.0%*	*87.5%*	*84.5%*	*86.8%*	*87.0%*	*87.5%*	*87.7%*
Gross Income	$26,727.1	$7,775.8	$7,803.8	$9,563.1	$12,974.4	$38,117.0	$58,788.8	$81,901.0	$115,321.4
Gross Margin	*80.4%*	*77.0%*	*82.1%*	*83.3%*	*78.5%*	*80.0%*	*81.3%*	*83.2%*	*83.6%*
SG&A	$14,130.7	$4,856.6	$4,277.2	$4,261.8	$5,064.3	$18,459.9	$23,110.3	$28,748.9	$36,768.6
% SG&A	*28.2%*	*26.6%*	*27.6%*	*27.8%*	*22.0%*	*25.6%*	*22.2%*	*21.7%*	*20.0%*
Royalty expenses	$738.9	$261.4	$100.0	$100.0	$100.0	$561.4	$625.0	$625.0	$625.0
% Royalty	*1.5%*	*1.4%*	*0.6%*	*0.7%*	*0.4%*	*0.8%*	*0.6%*	*0.5%*	*0.3%*
R&D	$998.2	$436.2	$396.0	$480.0	$470.0	$1,782.2	$1,815.0	$1,644.0	$1,445.0
% R&D	*2.0%*	*2.4%*	*2.6%*	*3.1%*	*2.0%*	*2.5%*	*1.7%*	*1.2%*	*0.8%*
Dep & Amort	$1,238.8	$493.3	$588.0	$588.0	$588.0	$2,257.3	$1,756.0	$1,105.0	$1,105.0
Operating Income	$9,620.5	$1,728.3	$2,442.6	$4,133.3	$6,752.1	$15,056.3	$31,482.6	$49,778.2	$75,377.8
Operating Margin	*29.0%*	*17.1%*	*25.7%*	*36.0%*	*40.8%*	*31.6%*	*43.5%*	*50.5%*	*54.7%*
Interest income, net	$5.6	($30.2)	($22.0)	($20.0)	($18.0)	($90.2)	$75.0	$150.0	$270.0
Other income	$287.3	$0.0	$0.0	$0.0	$0.0	$0.0	$0.0	$0.0	$0.0
Pre-Tax Income	$10,795.4	$1,698.2	$2,420.6	$4,113.3	$6,734.1	$14,966.1	$31,557.6	$49,928.2	$75,647.8
Taxes (benefit)	$1,486.0	$723.0	$919.8	$1,563.0	$2,559.0	$5,764.8	$10,610.6	$16,856.6	$28,746.2
Tax Rate	*13.8%*	*42.6%*	*38.0%*	*38.0%*	*38.0%*	*38.5%*	*38.0%*	*38.0%*	*38.0%*
Income to non-controlling interest	$0.0	$0.0	$0.0	$0.0	$0.0	$0.0	$0.0	$0.0	$0.0
% of total	*0.0%*	*0.0%*	*0.0%*	*0.0%*	*0.0%*	*0.0%*	*0.0%*	*0.0%*	*0.0%*
Net Income	9,309.4	975.2	1,500.8	2,550.2	4,175.2	9,201.3	20,947.0	33,071.6	46,901.7
Net Margin	*28.0%*	*9.7%*	*15.8%*	*22.2%*	*25.2%*	*19.3%*	*29.0%*	*33.6%*	*34.0%*
EPS	$0.40	$0.04	$0.07	$0.11	$0.18	$0.40	$0.88	$1.38	$1.95
YOY Growth	*-10.0%*	*-82.5%*	*859.1%*	*12.8%*	*173.3%*	*-0.2%*	*121.6%*	*56.6%*	*41.8%*
Diluted Shares O/S	23,399	23,142	23,080	23,140	23,300	23,165	23,800	24,000	24,000

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