Pozen, Inc.

NasdaqGS:POZN

Analyst: Nils Weddig
Sector: Healthcare

BUY

Price Target: $9.30

Key Statistics as of 12/11/2015

Market Price:	$6.48
Industry:	Drug Manufacturers - Other
Market Cap:	$215.14 M
52-Week Range:	$5.49-$12.69
Beta:	1.74

Thesis Points:

- Recent acquisition will significantly diversify Pozen's product portfolio and provide future revenue growth
- Discount on POZN due to negative macroeconomic news and insider sales
- Pozen is creating value even without the FDA approval of their innovative drug YOSPRALA

Company Description:

Pozen, Inc. is a pharmaceuticals firm founded in 1996 and based in Chapel Hill, North Carolina. Pozen is in the business of manufacturing and licensing specialty drugs in the United States as well as internationally. Pozen's products are marketed for the treatment of acute and chronic pain, as well as therapies for other pain related conditions such as osteoarthritis, ankylosing spondylitis and rheumatoid arthritis. In addition, Pozen is offering various products for treatment of migraine attacks and is currently awaiting the FDA approval for one of their products, YOSPRALA which will provide the cardiovascular benefit of aspirin, causing less gastrointestinal side effects than aspirin.

Thesis

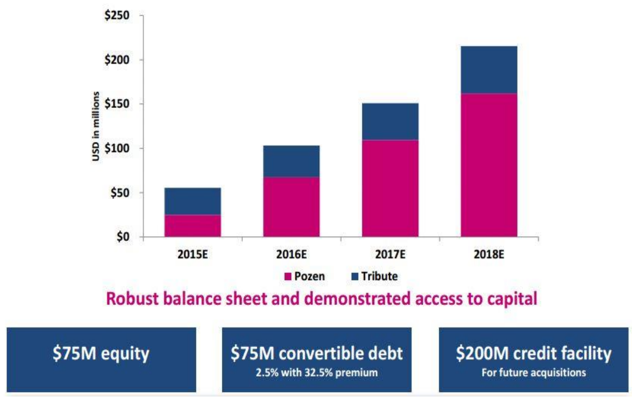
Pozen, Inc. (NasdaqGS: POZN) is a fast growing specialty pharmaceutical firm with a promising product portfolio as well as pending approval for an innovative drug that will further boost the company's revenue growth.
Negative macroeconomic news as well as insider sales caused the company's stock price to decrease by 35.46% since September. In addition, the recent acquisition of Tribute Pharmaceuticals Canada, Inc. caused a negative reaction of the market and further led to a discount on POZN although the acquisition will further diversify Pozen's product portfolio and lead to future growth of the merged firm Aralez Pharmaceuticals Inc. Lastly, Pozen's current financial performance demonstrates the company's ability to create value even without the FDA approval of their innovative drug, YOSPRALA.
A BUY of Pozen, Inc. (POZN) is therefore recommended with a one-year target price of $9.30. Currently trading at $6.48, it will provide an upside potential of 51.75%.

Industry Outlook

Pozen, Inc. is primarily providing products for the specialty drug industry. The outlook for the industry is very positive and Pozen is expecting significant growth in the upcoming years. Overall, the specialty pharmaceutical industry is growing at a fast pace. However, firm specific growth depends on each company's product portfolio and pipeline. Therefore, Pozen is positioned relatively well in the market due to their current diversified product portfolio and a promising drug in their pipeline.
YOSPRALA provides a unique market opportunity for growth. The target market of secondary prevention patients in the U.S. amount to approximately 24 million. Additional growth will come from Pozen's Canadian and European customers. Management expects mid-single digit market share for YOSPRALA.
The market outlook of Business Insights identifies multiple growth drivers for the specialty pharmaceutical industry. Drivers of the market will be the increase in government and national health bodies' reimbursements, biotechnology growth and industry consolidation. The biggest resistor on the other hand will be an increase in competition through the entry of large pharmaceutical firms into the market.
United Health Group states that U.S. spending on specialty drugs was approximately $87 billion in 2012 and is expected to grow to about $400 billion by 2020.

Acquisition Leading To Diversification of Product Portfolio

Pozen is expected to complete its acquisition of Tribute Pharmaceuticals in Q1 FY 2016. There have been several changes in the execution of the merger between the two companies. Originally, the merged firm Aralez Pharmaceuticals was supposed to be located in Ireland. Being forced to relocate the new firm to Canada received a negative reaction in the market and led to a discount of POZN in the market.
This negative reaction however is not justified. The acquisition of Tribute and relocation to Canada will still provide the intended tax advantages and the new management, under the lead of Pozen's new CEO Adrian Adams, will focus on a more value creating strategy combining both organic and inorganic growth of the company. Management stated that it will primarily focus on an aggressive business development strategy with value-creating acquisition that are targeted to increase the inorganic growth of the company. Financing of the acquisition will come from Deerfield Management, a venture capitalist that committed a $200 million credit line for future acquisitions. In addition, the acquisition will further diversify Pozen's product portfolio.



On November 23rd 2015, Pozen and Tribute released an update regarding their planned merger and announced for the first time that the new firm Aralez will now be located in Canada instead of Ireland. This caused a decrease of POZN's stock price by 4.47% and recently further declined due to the market's negative sentiment regarding this announcement. The discount however is not justified and Pozen's management is confident that the move to Canada instead of Ireland will have further competitive advantages since Aralez can take advantage of Tribute's current business foundation in Canada.

Why The Market Is Wrong: Overreaction to negative macroeconomic news

Since September, Pozen's stock price declined by 35.46% due to a tweet by Hillary Clinton as well as insider sales in the company.
On September 21st 2015, Presidency Candidate Clinton heavily criticized the past trend towards high prices in the specialty pharmaceutical industry. She released a statement planning to fight the high prices on specialty drugs. This announcement led to a sector wide decline of pharmaceutical stocks, primarily affecting pharmaceutical firms like Pozen. Clinton's critic was related to a large price increase of $736.50 on Turing Pharmaceuticals' drug for cancer treatment. Clinton's tweet caused the NYSE Arca Pharmaceutical Index (DRG) to decrease by 7.33% within one week. During the same period POZN decreased by 39.49% and has not yet recovered from this price decline.
Further downward pressure on POZN came in recent months from insider sales. However, new CEO Adrian Adams has purchased among others recently 1,000,000 shares of Pozen's stock which is an indicator of his confidence in the company and a possible indicator of POZN's current undervaluation.

Management

Pozen, Inc. is currently being managed by CEO Adrian Adams. He has an executive team around him with several years of experience in the specialty pharmaceutical industry.

Mr. Adams has recently been introduced as the new CEO after founder John Plachetka retired. Previous founder and CEO Plachetka played a large role in choosing the new CEO, Adams, and sees him as the right fit for the company. Mr. Adams is a highly regarded CEO in the specialty pharmaceutical industry with experience of more than 30 years. He especially has expertise in commercializing new products and is focused on business development and growth which will be important in the upcoming months in the transition to the new company Aralez Pharmaceuticals. Additionally, Mr. Adams has a proven track record of creating value for the companies he has been managing and increasing shareholders' wealth. Every company he has managed in the past has been acquired by a larger pharmaceutical firm, clarifying his ability to grow valuable companies.

Value Creation

The FDA approval of YOSPRALA will lead to a large increase of Pozen's revenue growth due to the potential opportunity to gain a large market share. In November 2014, POZN was trading 38% higher at a price of $10 when the market expected the approval of YOSPRALA to happen in 2016. The long process and continuous setbacks in the FDA approval process led to an uncertainty currently prevailing in the market regarding the possibility of the introduction of YOSPRALA to the market. This uncertainty is one of the reasons for the current discount on POZN.
Analyzing Pozen's past earnings calls however demonstrates the confidence of Pozen's management regarding the possible FDA approval. The management believes that Pozen is closer than ever in getting YOSPRALA approved in 2016. Especially the change in management and Mr. Adams willingness to use a different ingredient supplier of aspirin provides Pozen with a bigger opportunity of receiving the FDA approval. Issues regarding Pozen's current ingredient supplier caused the setbacks and the FDA's refusal of approving YOSPRALA since Pozen's ingredient supplier does not apply to the FDA's regulations.
A closer look into Pozen's financials proves the company's ability to create value even without an approval of Pozen's new drug, YOSPRALA. Therefore, Pozen does not necessarily depend on the FDA approval in order to continue operations in the upcoming years. Pozen's ROIC/WACC ratio of 7.44 demonstrates Pozen's ability to create value in the LTM. The additional revenue growth of the merger with Tribute will further enable the company to create value in the upcoming years.
(Source: S&P Capital IQ)

Financials

Pozen, Inc. has positioned itself with the upcoming merger among industry leaders in the specialty pharmaceutical industry and experienced large growth in the past years.

In FY2014 the company grew revenues by 213%. For the LTM revenue grew by 21.6%. Total operating expenses, excluding D&A and stock based compensation, only increased by 3.38% in the same period. The increase in operating expenses is primarily due to transitional costs related to the change in management, pre-commercialization expenses for YOSPRALA and preparations for the upcoming merger. In addition to the $200 million commited capital by Deerfield Management, Pozen has a current cash balance of $41.65 million. This puts the company in a promising position for future growth through value creating acquisitions.

Valuation

The valuation of Pozen, Inc. (POZN) is based on a proforma that values the company with a discounted cash flow model and focuses on the company's return on capital. A summary of the outputs of the valuation is attached to this report and can be found on the last page. When valuing Pozen, a conservative approach has been utilized. The revenue growth for FY 2016 and FY 2017 are analysts' median estimates of -20.1% and 169.4% respectively. Revenue growth has been set to decline year-over-year at a fast speed of reversion towards LT stability to reach a revenue growth for the long-term of 3%. This is a conservative approach, assuming revenue growth to follow long-term GDP growth.

Historically, the company's operating expenses as a percentage of revenue have been at 53.2%. Pozen plans to continue to acquire target firms that they identify of being value adding to increase organic growth. Therefore, the assumption of increasing operating costs up to a ten year convergence ratio of 72.5% has been used when valuing Pozen, Inc.

Summary

Pozen is currently heavily discounted in the market. Especially negative macroeconomic news led to an overreaction of the market. The continuous setbacks in the company's FDA approval process further discounts Pozen's stock price at this moment. Analysis however demonstrates that at the same time Pozen is able to create value which proves that the current valuation of Pozen at a price of $6.48 is not justified. A BUY of Pozen, Inc. (POZN) is therefore recommended with a one-year target price of $9.30. Currently trading at $6.48, it has an upside potential of 51.75%.

Sources:

- Pozen, Inc. 10-K
- Pozen, Inc. Investor Presentations
- Business Insights Market Outlook
- United Health Group Market Outlook
- Capital IQ
- Bloomberg
- SEC
- http://www.pozen.com/

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		Analyst	Current Price	Intrinsic Value	Target Value	Divident Yield		
POZEN Inc.	POZN	Nils Weddig	$6.13	$8.02	$9.30	0%	1-y Return: 51.75%	BULLISH

General Info

Sector	Healthcare
Industry	Pharmaceuticals
Last Guidance	November 6, 2014
Next earnings date	November 9, 2015

Market Data

Enterprise value	$157.09
Market Capitalization	$4,449.48
Daily volume	0.22
Shares outstanding	32.42
Diluted shares outstanding	32.38
% shares held by institutions	26.01%
% shares held by insiders	11.05%
Short interest	7.36%
Days to cover short interest	4.52
52 week high	$12.69
52-week low	$5.49
5y Beta	1.51
6-month volatility	73.12%

Peers	Market Cap.
Zogenix, Inc.	$295.45
Merck & Co. Inc.	$155,224.76
Johnson & Johnson	$282,698.63
Cumberland Pharmaceuticals, Inc.	$104.92
Xenoport, Inc.	$387.93
Concept Therapeutics Incorporated	$438.89
Pfizer Inc.	$216,227.21
Achaogen, Inc.	$101.45

Current Capital Structure

Total debt/Common Equity (LTM)	0.01
Cost of Borrowing (LTM)	0.00%
Estimated Cost of new Borrowing	2.63%
Altman's Z	8.98
Estimated Debt Rating	AAA
Current levered Beta	0.56
LTM WACC	7.30%

Management

Professional	Title	Comp. FY2012	Comp. FY2013	Comp. FY2014
Hodges, William	Chief Financial Officer and Senior Vice Preside	$744,867	$626,065	$885,327
Thomas, Gilda	Senior Vice President, General Counsel and Se	$713,213	$603,511	$854,173
McNamara, Dennis	Chief Business Operations Officer and Senior	$399,811	$302,992	$710,772
Fort, John	Chief Scientific Advisor	$758,543	$652,460	$910,498
Adams, Adrian	Chief Executive Officer and Director	$0	$0	$0
Koven, Andrew	President and Chief Business Officer	$0	$0	$0

Past Earning Surprises

	Revenue	EBITDA	Norm. EPS	Standard Error of "Surprise"
Last Quarter	-4.94%	NM	NM	NM
Last Quarter-1	-4.94%	NM	NM	NM
Last Quarter -2	15.67%	23.27%	40.00%	7.19%
Last Quarter -3	0.53%	0.00%	100.00%	33.24%
Last Quarter -4	10.75%	0.00%	50.00%	15.20%
Standard error	4.2%	7.8%	18.6%	9.64%

Standard Error of Revenues prediction	4.2%
Imputed Standard Error of Op. Cost prediction	6.5%
Imputed Standard Error of Non Op. Cost predictio	16.9%

Industry Outlook (Porter's Five Forces)

Bargaining Power of Suppliers (100th Percentile), Bargaining Power of Customers (100th Percentile), Intensity of Existing Rivalry (100th Percentile), Threat of Substitutes (100th Percentile), Threat of New Competition (100th Percentile), and Overall (100th

Proforma Assumptions

Convergence Assumptions

All base year ratios linearly converge towards the Sub-industry ratios over an explicit period of 10 years

General Assumptions

Money market rate (as of today)	0.37%
Risk-Free rate (long term estimate)	2.93%
Annual increase (decrease) in interest rates	0.1%
Marginal Tax Rate	26.5%
Country Risk Premium	8.0%

Forecast Year	Revenue Growth Forecast	Revenue ($) Forecast
LTM		$27.03
FY2015	-20.1%	$21.60
FY2016	169.4%	$58.20
FY2017	50.0%	$87.30
FY2018	26.5%	$110.43
FY2019	14.8%	$126.72
FY2020	8.9%	$137.97
FY2021	5.9%	$146.16
FY2022	4.5%	$152.69
FY2023	3.7%	$158.40
FY2024	3.4%	$163.73
Continuing Period	3.0%	$168.64

Items' Forecast Assumptions

	Base year (LTM)	Convergence period (Sub-industry)	Adjustment per year
Operating Cash/Rev.	20.72%	0.00%	-2.1%
NWV/Rev.	0.00%	14.66%	1.5%
NPPE/Rev.	0.10%	41.77%	4.2%
Dpr/NPPE	71.49%	15.40%	-5.6%
NOPAT MARGIN	50.78%	19.58%	-3.1%
Op. Exp./Rev.	53.24%	72.50%	1.9%
SBC/Rev.	15.81%	1.62%	-1.4%
Rent Exp./Rev.	1.55%	0.83%	-0.1%
R&D/Rev.	19.10%	11.33%	-0.8%
E&D/Rev.	0.00%	0.00%	0.0%
SG&A/Rev.	34.20%	26.42%	-0.8%
ROC	25%	13.29%	-1.19%
EV/Rev.	10.74x	2.39x	-0.83x
EV/EBITA	18.19x	8.98x	-0.92x
Debt/Equity	1%	44%	4.3%
Unlevered beta	0.55	0.78	0.02
Dividends/REV	0%	7%	0.7%

Other Assumptions

Tobin's Q	80%
Excess cash reinvestment	Money market rate
Other claims on the firm's assets	$0.00

Capitalization

100% of all rent expenses are capitalized and amortized 'straightline' over 10 years
100% of all R&D expenses are capitalized and amortized 'straightline' over 10 years
E&P expenses are not capitalized
SG&A expenses are not capitalized

Valuation Focus

DCF Valuation	100%
Relative valuation	0%
Distress Valuation	0%

Monte Carlo Simulation Assumptions

Revenue Growth deviation	Normal (0%, 1%)
Operating expense deviation	Normal (0%, 1%)
Continuing Period growth	Triangular (7.76%, 8%, 8.24%)
Country risk premium	Triangular (2.91%, 3%, 3.09%)
Intrinsic value σ(ε)	$0.09
1-year target price σ(ε)	$0.10

Valuation

Forecast Year	ROC	WACC	Total Capital	Implied Enterprise Value	Other Claims on Assets and Dilution Costs	Shares Outstanding	Price per Share
LTM	25.2%	7.3%	$56.08	$261.07	$17.24	32.42	$7.35
FY2015	17.8%	7.6%	$70.42	$285.19	$13.69	32.42	$8.81
FY2016	43.0%	7.9%	$109.38	$316.40	$17.97	32.42	$9.89
FY2017	37.8%	8.2%	$146.54	$338.01	$18.81	32.42	$10.62
FY2018	32.5%	8.4%	$180.35	$352.75	$16.54	32.42	$11.04
FY2019	27.5%	8.7%	$208.46	$362.02	$16.24	32.42	$11.20
FY2020	23.5%	9.0%	$231.29	$368.43	$14.80	32.42	$11.24
FY2021	20.4%	9.3%	$249.94	$374.17	$12.63	32.42	$11.26
FY2022	17.9%	9.6%	$265.40	$380.67	$10.01	32.42	$11.29
FY2023	15.9%	9.9%	$278.44	$388.90	$0.00	32.42	$11.35
FY2024	14.4%	10.1%	$289.72	$399.52	$0.00	32.42	$11.74
Continuing Period	13.3%	10.2%	$248.43				

Monte Carlo Simulation Results

The 3σ(ε)-adjusted intrinsic value is $8.02; the 3σ(ε)-adjusted target price is $9.3; and the analysts' median target price is $15.17

Sensitivity Analysis

Revenue growth variations account for 95.9% of total variance
Risk premium's variations account for 2.5% of total variance
Operating expenses' variations account for 1.4% of total variance
Continuing period growth variations account for 0.2% of total variance