

Sucampo Pharmaceuticals, Inc.

NasdaqGM:SCMP

Analyst: Andrew Varone

Sector: Healthcare

BUY

Price Target: \$27.83

Key Statistics as of 10/15/2015

Market Price:	\$18.23
Industry:	Pharmaceuticals
Market Cap:	\$815.24
52-Week Range:	\$6.88-29.67
Beta:	1.06

Thesis Points:

- Short-term losses due to company's industry.
- Opportunity for growth with main drug Amitiza.
- New acquisition could lead to new opportunities.

Company Description:

Sucampo Pharmaceuticals, Inc. is a biopharmaceutical company focused on the discovery, development and commercialization of proprietary drugs based on protons, a class of compounds derived from functional fatty acids that occur naturally in the human body. Sucampo is focused on developing protons for the treatment of gastrointestinal, vascular and central nervous system diseases and disorders for which there are unmet or underserved medical needs and significant commercial potential. Sucampo was established in December 1996.



Thesis

Sucampo Pharmaceuticals, behind its drug Amitiza, finished the second quarter on pace to have the highest revenues in their history. Compared to last year, high revenues have caused net income to be up 575.57% though six months. This helped the stock to reach a new record high in mid-September. A few days after reaching its high, the company's stock has faced declines of around 40%. This is due to the large macroeconomic pressures that pharmaceutical companies have recently been exposed to. There has been a push in politics to lower the price of prescription drugs. This would cut into the profits of pharmaceutical companies such as Sucampo Pharmaceuticals. There are some concerns with the company in terms of competitiveness. A major competitor has risen in the United States. Despite this, Amitiza's sales are expected to continue to climb in the United States. The biggest area for growth is expected to be in Japan as there has been little competition there. The company's CEO, Peter Greenleaf, has reshaped the company since joining in 2014. Mr. Greenleaf put emphasize into the company's main drug Amitiza. He then furthered his company's position by acquiring R-Tech Ueno for a price of \$278 million. Following the announcement of the acquisition, the stock price rose by 2.6%. The acquisition was done to add assets to the company while giving Sucampo the resources necessary to speed up development and better focus in therapeutic areas where needs at unmet. This acquisition also pairs with their drug Amitiza as they gained control over its manufacturing process.

A BUY is recommended for Sucampo Pharmaceuticals, Inc. as the stock is currently priced at \$18.23 which opens a window for entry. With a price target of \$27.83, there is an upside potential of 52.66%.

Pharmaceutical Industry

The pharmaceutical industry is one that strives off of revenues and competitive edge gained through patents. Last month, there has been a push for a price ceiling to be put in place on prescription drugs from the democratic candidacy party. This has hurt the stock price of pharmaceutical companies as investors became wary of the possibility of such laws. These laws would decrease revenues and future cash flows of these pharmaceutical companies. Because of this, the pharmaceutical industry as a whole has seen the value of their stocks go down. As seen in the graph below, as the index (red) goes down, the stock of SCMP (blue) decreases.



This means that the devaluation of Sucampo has been a macro economy issue. This devaluation has led to an entry opportunity for investors as the stock's price reflects this macro pressure. An election of a democratic president does not ensure that a price ceiling will be put into place. The laws still have to get pass by congress, which itself will be no easy task. Also, Democratic frontrunner, Hillary Clinton, has enjoyed her fair share of money received from pharmaceuticals/health companies. If the democratic party decides to stop making a push, or do not receive the necessary positions in politics, this price laws will not be put into place. If there is any indication that these laws will not be put into place, the stock prices of pharmaceutical companies will increase. For a company like Sucampo, the stock price should return to its previous values before the prescription drug announcement. This is due to the devaluation mainly being a macro issue.

Main Product

Sucampo Pharmaceuticals leading drug is called Amitiza. The drugs main use is to help with constipation and can also be used to treat IBS in women. The drug has had major sales in the United States and in Japan. With lessor sales throughout Europe. Recently, the drug received permission to start distribution in the People's Republic of China.



Behind Amitiza, Sucmapo has reached \$0.67 EPS over the past twelve months. This has been the highest EPS that the company has reached over the past five years. The EPS is expected to be up 33% from last year. Though EPS are reaching its peak, the drug has been pulled off the shelves of CVS in favor of a competitor starting in 2016. Despite this, EPS are forcasted to increase through 2016. This is due to the fact that there

can still be growth in the United States even without CVS as a distributor. The Chinese market is one that has untapped potential for Sucampo. Overall, sales are expected to be up 44% from a year from now. In their second quarter earnings call, CEO Peter Greenlead had this entrance into the Chiense market was long overdue. Sucampo has received \$1.5 million upfront as part of the liensing agreement. Amizitza can see an increase sales due Japan and now China. If third quarter follows the trends of the second quarter where actual sales outpaced estimated sales by 9%, this could lead to furtther increasing of the price of the stock.

Acquisition

Sucampo has recently announced the results of their tender offer for R-Tech Ueno. By October 20th, they will have control of approximately 98% of R-Tech Ueno. Sucampo believes that this acquisition will give them around \$5M operational synergies. These synergies will raise adjusted EBITA by 5% and EPS by 8%. This acquisition also gives Sucampo control over their supplier that makes their drug, Amitiza. This acquisition is already reflected in the stock price as SCMP rose by 2.6% after the announcement of a tender offer.

This acquisition also gives Sucampo access to pipeline drugs. They could eventually add these new drugs to their company, making them less dependent on Amitiza. Currently, they are working on spinoffs of Amitiza that include, one with a new formula and two that are suitable for children. These are currently in Phase III of the development stage. They are also working on new types of drug that deal oral mucositis and non-erosive reflux disease. There two drugs are currently in Phase II of development. Being able to complete these drugs through all three phases of

CLINICAL FOCUS	STAGE OF CLINICAL DEVELOPMENT COMPLETED			
	PRE-CLINICAL	PHASE 1	PHASE 2	PHASE 3
Lubiprostone - Pediatric Functional Constipation (6 years - 17 years) +				
Lubiprostone - Alternate Formulation +				
Lubiprostone - Pediatric Functional Constipation (6 months - 6 years) +				
Cobiprostone - Oral Mucositis +				
Cobiprostone - Non-Erosive Reflux Disease (NERD) +				

development will make their stock price increase.

This is due to the new cash flows that will be created and the company will also be less risky. Sucampo was rated at a B3 from Moody's credit rating. This risky rating is not from being overly levered, as their capital structure is 1.7% long term debt. Their risky rating comes from their lack of assets and overreliance on sales from one drug. If the company is able to add another drug to its sales, Sucampo will become less risky as a result. This was increase the value of its stock as the risk premium of the company will decrease due to an increase in their rating.

Financials

The acquisition of their supplier will allow for higher margins and to capitalize on revenues to other drug pharmaceuticals. The operating margin of the company has increased by 49.7% over the past year. For going forward, this level of margin increase can be sustainable through the use of their new acquisition. By increasing margin, EPS will increase as a result furthering increasing the stock price. For the forecasted year 2016, EPS will increase to 1.13 which is a 51% increase.

Despite the company high risk rating, it is not from being over levered. This can be seen from the balance sheet as they have decreased debt by almost half, going from \$52.7-25.8M. Also, their recent acquisition was done through cash as they had \$108.5M on their balance sheets. If their company is able to acquire more assets and produce more products, Sucampo will become less risky. When they become less risky, they will be able to become more levered increasing EPS.

Porters 5 Forces

The threats of new entrants is relatively low as there is currently seventeen patents put into place on their drug, Amitiza. This will make it hard for new competitors to enter the market as they will have to pay royalties to Sucampo if they want to enter the same dietary market as Sucampo.

The threat of substitutes is also relatively low for this company. The main concern for substitutes comes from the selling of generic pharmaceuticals. Currently, there is no generic brand on Amitiza in the United States making the threat of substitutes low.

The threats of customers is neutral. Since there are no generic substitutes, the consumer has to

pay the price that the drugs are priced at. Future laws could change this as movements have been made to try and lower the premiums on pharmaceutical drugs. Since no laws have been passed yet, the threat is neutral.

The threat of suppliers is low. Currently there are five suppliers that supply the compound needed to create Amitiza. Sucampo has acquired a company that supplies them with this drug compound.

The last threat is the threat of rivals. This last threat is neutral as Amitiza has seen some rivalry. Starting in 2016, their drug will be pulled from the shelves of CVS for a competitors. Despite this, sales are expected to rise because there is enough market share that they can still obtain.

Conclusion

The downsides of Sucampo are macro with the downturn of the pharmaceutical industry. The only micro downside they face is their product taken off the shelves in CVS. On the other side, there are many upsides with their exposure to new drug patents through their acquisition. Since their company has been devalued through macro economy trends, SCMP is at a low price for investors looking for a stock to enter the market.

Sources:

- Capital IQ
- Bloomberg
- www.sucampo.com
- www.drugpatentwatch.com
- www.opensecret.org

CENTER FOR GLOBAL FINANCIAL STUDIES

Sucampo Pharmaceuticals, Inc.		Analyst Andrew Varone	Current Price \$18.23	Intrinsic Value \$22.46	Target Value \$24.18	Divident Yield 0%	1-y Return: 32.66%	BULLISH	
General Info		Peers	Market Cap.	Management					
Sector	Healthcare	Pernix Therapeutics Holdings, Inc.	\$224.01	Professional	Title	Comp. FY2012	Comp. FY2013	Comp. FY2014	
Industry	Pharmaceuticals	Supernus Pharmaceuticals, Inc.	\$785.31	Greenleaf, Peter	Chief Executive Officer and Director	\$0	\$0	\$3,630,759	
Last Guidance	August 5, 2015	Akrom, Inc.	\$3,330.00	Ueno, Ryuji	Co-Founder, Chairman Emeritus and Scienti	\$809,585	\$865,632	\$183,282	
Next earnings date	November 5, 2015	Sagent Pharmaceuticals, Inc.	\$562.26	Smith, Andrew	Chief Financial Officer	\$0	\$405,914	\$570,362	
Market Data		Nektar Therapeutics	\$1,437.55	Kiener, Peter	Chief Science Officer	\$0	\$0	\$1,812,214	
Enterprise value	\$728.48	Avanir Pharmaceuticals, Inc.		Alder, Matthias	Executive Vice President of Business Develop	\$0	\$0	\$1,700,673	
Market Capitalization	\$77.79	Ironwood Pharmaceuticals, Inc.	\$1,633.91	Donler, Matthew	Executive Vice President of Human Resourc	\$0	\$0	\$1,117,429	
Daily volume	0.02	Salix Pharmaceuticals Ltd.		Past Earning Surprises					
Shares outstanding	44.72	Cumberland Pharmaceuticals, Inc.	\$88.46	Revenue		EBITDA		Norm. EPS	
Diluted shares outstanding	45.72	SciClone Pharmaceuticals, Inc.	\$372.86	Last Quarter	9.44%	0.00%	50.00%	Standard Error of "Surprise"	
% shares held by institutions	21.62%	Current Capital Structure			Last Quarter-1	-2.25%	35.28%	7.69%	11.23%
% shares held by insiders	0.16%	Total debt / Common Equity (LTM)	0.15	Last Quarter -2	-1.69%	-21.62%	10.53%	9.37%	
Short interest	11.50%	Cost of Borrowing (LTM)	3.56%	Last Quarter -3	21.56%	125.00%	250.00%	66.04%	
Days to cover short interest	4.52	Estimated Cost of new Borrowing	0.00%	Last Quarter -4	-1.63%	3.22%	0.00%	1.43%	
52 week high	\$29.67	Altman's Z	8.77	Standard error	4.7%	25.8%	47.4%	17.91%	
52-week low	\$7.34	Estimated Debt Rating	AAA	Standard Error of Revenues prediction	4.7%				
5y Beta	1.59	Current levered Beta	1.06	Imputed Standard Error of Op. Cost predictio	25.4%				
6-month volatility	77.12%	LTM WACC	7.52%	Imputed Standard Error of Op. Cost predictio	39.7%				
Proforma Assumptions									
Convergence Assumptions		General Assumptions		Items' Forecast Assumptions			Other Assumptions		
	Money market rate (as of today)	0.28%		Base year (LTM)	Convergence period (Sub-industry)	Adjustment per year	Tobin's Q	80%	
All base year ratios linearly converge towards the Sub-industry ratios over an explicit period of 10 years	Risk-Free rate (long term estimate)	2.94%	Operating Cash / Rev.	0.00%	0.00%	0.0%	Excess cash reinvestment	Cost of capital	
	Annual increase (decrease) in interest rates	0.1%	NWV / Rev.	2.88%	14.66%	1.2%	Other claims on the firm's assets	\$0.00	
	Marginal Tax Rate	35.0%	NPPE / Rev.	0.40%	41.77%	4.1%	Capitalization		
	Country Risk Premium	5.0%	Dpt / NPPE	111.03%	15.40%	-9.6%	100% of all rent expenses are capitalized and amortized 'straightline' over 10 years		
			NOPAT MARGIN	34.53%	19.58%	-1.5%	100% of all R&D expenses are capitalized and amortized 'straightline' over 10 years		
Forecast Year	Revenue Growth Forecast	Revenue (\$)	Forecast	Op. Exp. / Rev.	59.49%	72.50%	1.3%	E&P expenses are not capitalized	
LTM		\$131.31		SBC / Rev.	3.84%	1.62%	-0.2%	SG&A expenses are not capitalized	
FY2015	6.5%	\$143.79		Rent Exp. / Rev.	1.07%	0.83%	0.0%	Valuation Focus	
FY2016	41.7%	\$212.22		R&D / Rev.	18.85%	11.33%	-0.8%	DCF Valuation	100%
FY2017	9.7%	\$242.77		E&D / Rev.	0.00%	0.00%	0.0%	Relative valuation	0%
FY2018	8.0%	\$273.50		SG&A / Rev.	26.20%	26.42%	0.0%	Distress Valuation	0%
FY2019	10.4%	\$314.05		ROC	18%	13.29%	-0.50%	Monte Carlo Simulation Assumptions	
FY2020	9.6%	\$356.54		EV / Rev.	5.07x	3.75x	-0.13x	Revenue Growth deviation	Normal (0%, 1%)
FY2021	-1.5%	\$363.29		EV / EBITA	10.73x	12.45x	0.17x	Operating expense deviation	Normal (0%, 1%)
FY2022	11.3%	\$416.76		Debt / Equity	15%	44%	2.9%	Continuing Period growth	Triangular (5.335%, 5%, 5.665%)
FY2023	-2.4%	\$417.90		Unlevered beta	0.96	0.78	-0.02	Country risk premium	Triangular (2.91%, 3%, 3.09%)
FY2024	0.5%	\$431.18		Cost of Borrowing	0%	5%	0.5%	Intrinsic value of (€)	\$0.48
Continuing Period	3.0%	\$455.29		Dividends / REV	0%	7%	0.7%	1-year target price of (€)	\$0.50
Valuation									
Forecast Year	ROC	WACC	Total Capital	Implied Enterprise Value	Other Claims on Assets and Dilution Cost	Shares Outstanding	Price per Share	Monte Carlo Simulation Results	
LTM	18.3%	7.5%	\$250.95	\$910.28	\$125.19	44.72	\$23.37		
FY2015	22.3%	7.3%	\$271.32	\$941.02	\$115.72	44.72	\$25.20		
FY2016	22.8%	7.4%	\$361.09	\$1,038.43	\$115.62	44.72	\$26.85	The 3σ(€)-adjusted intrinsic value is \$22.46; the 3σ(€)-adjusted target price is \$24.18; and the analysts' median target price is \$27.83	
FY2017	17.5%	7.4%	\$413.33	\$1,104.20	\$113.19	44.72	\$28.15		
FY2018	15.6%	7.4%	\$460.99	\$1,169.37	\$110.13	44.72	\$29.50		
FY2019	14.7%	7.5%	\$511.93	\$1,239.59	\$106.68	44.72	\$30.84		
FY2020	14.0%	7.5%	\$559.57	\$1,307.99	\$102.39	44.72	\$31.74		
FY2021	12.5%	7.5%	\$576.16	\$1,352.61	\$96.01	44.72	\$32.89		
FY2022	13.6%	7.5%	\$623.30	\$1,422.90	\$90.54	44.72	\$33.78	Sensitivity Analysis Revenue growth variations account for 95.9% of total variance Risk premium's variations account for 2.3% of total variance Operating expenses' variations account for 1.4% of total variance Continuing period growth variations account for 0.2% of total variance	
FY2023	12.6%	7.5%	\$634.11	\$1,461.63	\$0.00	44.72	\$35.38		
FY2024	13.2%	7.5%	\$654.14	\$1,507.60	\$0.00	44.72	\$36.59		
Continuing Period	13.3%	7.6%	\$670.71						