

SciClone Pharmaceuticals, Inc.

NASDAQ:SCLN

Analyst: Laura Pladys

Sector: Healthcare

BUY

Price Target: \$10.43

Key Statistics as of 4/9/2015

Market Price:	\$8.97
Industry:	Drug Manufacturer
Market Cap:	\$452.5 M
52-Week Range:	\$4.24-9.65
Beta:	0.97

Thesis Points:

- In-licensing agreement
- Chinese healthcare industry outlook
- Undervaluation & secured investment

Company Description:

SciClone Pharmaceuticals, Inc., a specialty pharmaceutical company, provides therapies for oncology, infectious diseases, and cardiovascular disorders in the People's Republic of China, the United States, and Hong Kong. Its lead product is ZADAXIN, which is used for the treatment of hepatitis B and hepatitis C viruses, and certain cancers, as well as for use as a vaccine adjuvant, and as a chemotherapy adjuvant for cancer patients with weakened immune systems. The company also focuses on development ZADAXIN for the treatment of sepsis. ZADAXIN has approval in approximately 30 countries, which include China, the Pacific Rim, Latin America, Eastern Europe, and the Middle East regions. The company markets and sells ZADAXIN through distribution arrangements, local importers, and distributors. In addition, it markets approximately seven partnered products in China, including Aggrastat, an interventional cardiology product. Further, the company holds license, promotion, distribution, or marketing agreements with various parties for products, including DC Bead, Holoxan, Mesna, Endoxan, Methotrexate, Estracyt, Farlutal, Neucardin, ProFlow, Angiomax, and Cleviprex. SciClone Pharmaceuticals, Inc. also has an agreement with MEDA Pharma GmbH & Co. KG for the development of Tramadol. The company was founded in 1989 and is headquartered in Foster City, California.



Thesis

SciClone is a growing company. It is led by talented people with every one of them having more than 20 years of experience in the healthcare industry. The pharmaceutical industry is a very competitive one. In order to increase its presence, SciClone uses in-licensing agreements to increase its brand recognition and benefit from bigger players in the industry. In addition, the company is China-focused. The healthcare industry in China is a promising industry with a lot of growth opportunities. SCLN has been established in China for more than 10 years. The company knew how to take advantage of the market a decade ago and the potential for growth is still increasing. Finally, the company is debt free, generates cash and creates value. Thanks to the multiples approach, the company shows sign of undervaluation. Thus, thought he upside potential is in the 15% range, the company downside is very limited, which makes it a 99.45% risk-free investment.

Management

Dr. Friedhelm Blobel has been the Chief Executive Officers and President of SciClone since 2006. He has a Ph.D in Biochemistry and Microbiology as well as an advanced degree in Chemistry and Biochemistry. He has more than 20 years of experience in the pharmaceutical and healthcare industries. Prior to his current positions, he held several positions within SciClone such as Acting Chief Financial Official. He was involved in different healthcare companies prior to joining SciClone.

Wilson W Cheung has been the Chief Financial Officer and Senior Vice President of Finance and Secretary since 2013. Mr. Cheung has experience in Asian markets as he served as CFO at Velti PLC from 2009 to 2013. Prior to those experiences, Mr. Cheung held several senior finance positions within Yahoo Inc and did work in public accounting with KPMG and Deloitte & Touche.

Hong Zhao has been the Chief Executive Officer of China operations since 2013. Prior to joining SciClone, he held different positions within pharmaceutical companies in China and has nearly 20 years of experience in this industry. Hong Zhao holds a bachelor in Medicine and an EMBA degree. His fluency in Mandarin and English is a strong asset for a developing and growing business in China such as SCLN.

Competitors

SciClone's competition mainly arises from ZADAXIN's sales in China, the company's well-known product. Competition is due to generic drug manufacturers selling their products in China at a lower price. Outside of China, competition arises from other pharmaceutical companies, biotechnology firms, universities and research institutions actively engaged in R&D in the same therapeutic areas. SciClone's direct competitors are Gilead Sciences, Inc, Roche Holding AG and Shaanxi Ao-Xing Pharmaceutical.

Products Proposed

SciClone's pipeline is the one of a growing business. The company only has a few products but they are well established in the market. Their top selling product, ZADAXIN, launched in 1996 in China, is marketed in over 30 countries. It is to be used in case of Hepatitis B, C, and certain cancers as well as a vaccine adjuvant depending on the approvals the company has in different countries. ZADAXIN is one of largest imported pharmaceuticals products in China with 14% of market share. The company already has a substantial portfolio of products in China, marketed products as well as those under development.

SciClone distributes its products through different methods. ZADAXIN is the only products that SCLN develops, manufactures, and distributes by itself. It is the reason why this product results in higher margins for the company. For every other product, the company uses in-licensing for product's development (see the chart below for more details).

	ZADAXIN	HBV, HCV, cancer adjuvant, vaccine enhancer, immunostimulant
	Holoxan	Bone and soft tumors, lymphoma, lung cancer, cervical cancer, ovarian cancer, testicular cancer and child solid tumors, bladder cancer, head and neck cancer and breast cancer
	Mesna	Urotoxicity (combined with ifosfamide)
	Endoxan	Breast cancer, lymphoma, ovarian cancer, small cell lung cancer and sarcoma
	Farlutal	Breast cancer, carcinoma of the endometrium, prostate cancer and renal cancer
	Methotrexate	Acute leukemia, osteosarcoma, breast cancer
	Estracyt	Hormone resistant advanced prostate cancer
	Aggrastat	Acute coronary syndrome
	DC Bead	Embolitic bead delivered through a minimally invasive, non-surgical procedure to block the blood flow to tumors; registered in China for the embolization of malignant hypervascularized tumors such as hepatocellular carcinoma ("HCC"), the most common form of primary liver cancer
Partnering with Tier-One Pharmaceutical Companies		

Thanks to its strategic business with its partners, SciClone is enable to market therapeutically

differentiated products in China. Indeed, the company has successfully launched licensed products with the potential to become future market leaders.

In addition, the company received a Food and Drug Administration approval in the third quarter of 2014 for the DC Bead, a product to be used in the case of embolization of malignant hypervascularized tumors.

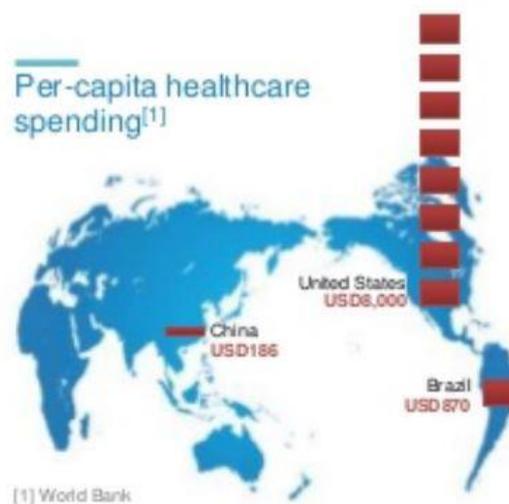
The Chinese market opportunity

SciClone status as a US-based but China-focused specialized pharmaceutical company is a clear advantage over regular American pharmaceuticals doing business in China. The company has more than a decade of expertise in this market. In 2014, 96% of the company's revenues came from sales in China. Almost the totality of the company's business is done in China. The Chinese healthcare market is expected to grow at a rate of 12 to 15% per annum in the years to come. Therefore, the Chinese market is representing a clear growth opportunity for this specialized company.

Valuated at \$357 billion in 2011, the Chinese market is expected to grow to \$1 trillion by 2020. Thanks to its diversified market – from pharmaceuticals to medical products to consumer health – the Chinese healthcare market is one of the most attractive but most importantly the one growing the fastest (within emerging markets). It remains a very competitive market.

The company areas of expertise gather oncology, infectious diseases and cardiovascular, urological, respiratory, and central nervous system disorders. Cardiovascular problems happen most of the time in the elderly. The aging population and a longer life expectancy, urbanization with increased care provisions in Chinese rural areas, Chinese's health spending advances, increased healthcare reforms, a rapid expansion in the mobile health market, and China's expectations to become the world's second largest pharmaceuticals market create opportunities in China for both local and international companies. Since the market is very competitive, barriers to entry are high. Thanks to its business practices and standards, SciClone has by far outperformed local companies in terms of sales, revenues, and performance.

China's healthcare growth drivers given previously add to the per-capita healthcare spending as of 2014.



The picture above shows the level of healthcare spending. China has a lot of room for expansion. Its per capita spending is only of \$186 compared to \$870 in Brazil or \$8,000 in the US.

Due to its strategic position in the Chinese market (better performance over local companies and already established company in China); SciClone is the perfect fit for a growing market like the healthcare Chinese market. SCLN is one of the only companies being able to take advantage of the growth opportunity that the Chinese market represents.

In-licensing agreements

In-licensing is the business strategy of SciClone. It is a partnership between two companies that share the same intention, goals, or field of interest. In the pharmaceutical industry, especially for drug companies, it could be very beneficial. Indeed, both companies will share their expertise in order to develop a product. One can bring its research and development and the second one its distribution channel. It reduces the costs for both companies but reduces the margins as well.

The main advantage that SciClone can earn by conducting in-licensing partnerships is brand recognition. By partnering with bigger player than SCLN, the company can earn recognition faster. For instance, Baxter and Pfizer have a better recognition than what SciClone has.

SciClone is a perfect target for in-licensing agreements. Indeed, the company is established in China, a market that a lot of players try to enter. Because of the

competitiveness of the industry, bigger players trying to enter the Chinese healthcare market could use SciClone as a distributor or could use their expertise. It would benefit both companies. SCLN would benefit by increasing its brand recognition in China and establishing one in other markets. The company can also benefit from other players knowledge and facilities.

Financials and Valuation

The company is focusing on growing its revenue and profitability from its main business: the People's Republic of China (PRC). 93% of the company's revenues come from China. Their leading product ZADAXIN (only sold by SCLN) has the highest margins in the company's portfolio and represented 76% of the company's revenues in 2013.

SciClone has been a debt-free company since the early 2000s. However, in 2010, the company had to take debt of \$2.5 million to settle an agreement after the Foreign Corrupt Practices Act (FCPA) derivative suits. The company has been investigated by the SEC for a possible FCPA violation concerning its operations in China.



As the graph above depicts it, all the events related to this FCPA investigation have not impacted the stock price of the company. It kept increasing during the investigation time frame. The company has paid back its debt and is debt-free since 2013.

In addition to being debt free, the company is holding 48% of its assets in cash. The company generates cash and has positive free cash flows. Thus, the company's net income margin is 24% of revenues. It could become a target for an acquisition and this could substantially increase its stock price.

Since 2013, the company has been able to decrease its operating expenses by 22% while keeping on increasing

its revenues. Revenues increased 6% from last year to reach \$134.8 million. While revenues increased 6% from last year, EBITDA increased 28%, almost 5 times more than revenues, creating value for the company. The company's gross profit is 83% of revenues.

Concerning the multiples, the current PE of 20.93x is 1.4 times lower than its peers average. While looking at the TTM PE of 14.62x for SciClone, the peers average is 3 times higher, showing signs of undervaluation. The EV to EBITDA multiple of 13.57x for SCLN is 2 times lower than the peers average of 27.21x. The EV to Sales multiple of 2.70x for the company is 3.7 times lower than the one of the peers of 9.96x, with the same trend forecasted in the next fiscal year. The TTM Price to Sales ratio of 3.42x is 10 times lower than the peers average of 35.27x. SCLN is considered a better investment since investors are paying less for each unit of sales. Since sales do not give the full picture, the profitability ratios are going to strengthen the undervaluation. The company's profit margin is currently at 18.70%, meaning the company generates around a fifth of their revenues in earnings. SCLN return on assets of 13.92% means that the company generates \$13.92 of net income for every \$100 of assets. Finally, the company is able to generate 16.70% of profit out of the stockholders investment.

Conclusion

SciClone's revenues are dependent on ZADAXIN in China. The healthcare industry in China looks promising and creates a lot of opportunities for a growing business like SCLN. The company's strategy of using in-licensing agreements with other pharmaceuticals enables the company to reduce its costs. In addition, the company is debt free, generates cash, creates value and shows sign of undervaluation. This growing company has a 16.25% potential of upside with a limited downside. Indeed, the Monte Carlo simulation revealed that there is 99.45% chance that the stock price will be higher than the current stock price of \$8.97.

SciClone Pharmaceuticals is a clear buy has it has a potential of growth and a very limited downside.

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SciClone Pharmaceuticals, Inc.		SCLN	Analyst Laura Pladys	Current Price \$8.97	Intrinsic Value \$9.45	Target Value \$10.43	Divident Yield 0%	Target Return 1-y Return: 16.25%	NEUTRAL
General Info		Healthcare	Peers Pernix Therapeutics Holdings, Inc.	Market Cap. \$406.12	Professional Blobel, Friedhelm	Title Chief Executive Officer, Presiden	Management Comp. FY2012	Comp. FY2013	Comp. FY2014
Sector	Healthcare						\$ 2,671,054.00	\$ 1,623,067.00	\$ -
Industry	Pharmaceuticals						\$ -	\$ 835,287.00	\$ -
Last Guidance	Mar-11-2015						\$ -	\$ 699,361.00	\$ -
Next earnings date	NM						\$ 340,055.00	\$ 390,637.00	\$ -
							\$ 386,178.00	\$ 518,502.00	\$ -
							\$ -	\$ -	\$ -
Market Data			Current Capital Structure		10y-Median Performance				
Enterprise value	\$367.20		Total debt/market cap	0.00%	Growth	SCLN	Peers	Industry	All U.S. firms
Market Capitalization	\$453.51		Cost of Borrowing	0.00%	ROIC	17.3%	21.7%	10.9%	7.4%
Daily volume	0.13		Interest Coverage	786.73%	NOPLAT Margin	17.2%	39.9%	9.2%	14.3%
Shares outstanding	50.06		Altman Z	7.87	REV./Invested Capital	21.0%	15.3%	13.2%	10.4%
Diluted shares outstanding	52.68		Debt Rating	AAA	Excess Cash/Rev.	81.8%	261.6%	69.6%	137.4%
% shares held by institutions	73.98%		Levered Beta	0.94	Total Cash / Rev.	64.0%	20.4%	13.5%	12.9%
% shares held by insiders	8.00%		WACC (based on market value weights)	7.62%	Unlevered Beta	1.39	1.71	0.91	0.95
Short interest	8.00%				TEV/REV	1.6x	5.0x	4.0x	2.5x
Days to cover short interest	11.07				TEV/EBITDA	4.9x	53.0x	12.1x	13.1x
52 week high	\$9.65				PE	16.4x	26.2x	24.3x	23.5x
52-week low	\$4.24				P/BV	1.2x	10.9x	1.9x	2.2x
5y Beta	2.20				Non-GAAP Adjustments in estimates computations				
6-month volatility	43.99%				Operating Leases Capitalization	100%	Straightline		10 years
					R&D Exp. Capitalization	100%	Straightline		10 years
					Expl./Drilling Exp. Capitalization	0%	N/A		N/A
					SG&A Capitalization	0%	N/A		N/A
Past Earning Surprises		Revenue	EBITDA	Norm. EPS	Forecast				
Last Quarter	6.4%		0.0%	81.3%	Invested Capital	NOPLAT Margin	ROIC	WACC	
Last Quarter-1	-1.6%		0.0%	21.4%					
Last Quarter-2	-2.5%		0.0%	100.0%					
Last Quarter-3	-17.5%		0.0%	0.0%					
Last Quarter-4	-14.5%		0.0%	-53.3%					
Proforma Assumptions		\$	Rev. Growth	Adj. Op. Cost/Rev					
Money market rate as of today	0.54%		LTM	6.1%	\$162.17	21%	17.2%	7.6%	
Annual increase (decrease) in interest rates	0.1%		NTM	5.0%	\$165.51	24%	21.2%	7.7%	
Yield Spread acceleration	1.2		NTM+1	4.5%	\$169.42	24%	21.2%	7.8%	
Marginal Tax Rate	25.0%		NTM+2	4.3%	\$173.50	23%	21.3%	7.9%	
Risk-free rate	2.5%		NTM+3	4.1%	\$177.56	23%	21.5%	8.0%	
Tobin's Q	1.00		NTM+4	4.1%	\$181.48	23%	21.7%	8.1%	
Op. Cash/ Rev.	2%		NTM+5	4.0%	\$185.22	23%	22.0%	8.2%	
Growth in PPE	NPPE Growth tapers to zero until continuing period		NTM+6	4.0%	\$188.75	23%	22.3%	8.3%	
Long term Growth	4.0%		NTM+7	4.0%	\$192.07	23%	22.7%	8.4%	
Long term EBITDA Margin	23.0%		NTM+8	4.0%	\$195.15	23%	23.1%	8.5%	
Long term NOPLAT Margin	20.0%								
Long term ROIC	12.0%								
Most recent Unlevered Beta	2.08								
Long term Unlevered Beta	0.91								
Valuation		Invested Capital x (ROIC-WACC)	Enterprise Value (UPCF Valuation only)	Total Debt	Other claims	Equity Value	UDCF Valuation	Relative Valuation	Weighted Price Per Share
LTM	\$15.52	\$415.82	\$0.00	-\$34.13	\$449.95	\$9.20	\$10.57	\$9.54	
NTM	\$22.28	\$421.25	\$0.00	-\$66.61	\$487.86	\$9.95	\$12.22	\$10.52	
NTM+1	\$22.62	\$420.10	\$0.00	-\$99.86	\$519.96	\$10.57	\$13.40	\$11.28	
NTM+2	\$23.17	\$418.54	\$0.00	-\$134.59	\$553.13	\$11.24	\$14.59	\$12.07	
NTM+3	\$23.85	\$416.07	\$0.00	-\$170.84	\$586.90	\$11.86	\$15.80	\$12.85	
NTM+4	\$24.63	\$412.34	\$0.00	-\$199.56	\$611.90	\$12.39	\$16.86	\$13.51	
NTM+5	\$25.48	\$407.08	\$0.00	-\$229.13	\$636.21	\$12.96	\$17.96	\$14.21	
NTM+6	\$26.39	\$400.07	\$0.00	-\$282.10	\$682.17	\$13.75	\$19.53	\$15.20	
NTM+7	\$27.35	\$391.06	\$0.00	-\$313.87	\$704.93	\$14.20	\$20.69	\$15.83	
NTM+8	\$169.44	\$379.80	\$0.00	-\$347.34	\$727.15	\$14.53	\$21.91	\$16.37	
Monte Carlo Simulation Assumptions		Base	Stdv	Min	Max	Distribution	Monte Carlo Simulation Results		
Revenue Variation	0	10%	N/A	N/A	Normal	Mean est.	\$9.54	\$10.52	
Op. Costs Variation	0	10%	N/A	N/A	Normal	σ(e)	\$0.03	\$0.03	
Country Risk Premium	6%	N/A	5%	7%	Triangular	3 σ(e) adjusted price	\$9.45	\$10.43	
Long term Growth	4%	N/A	3%	22%	Triangular	Current Price	\$8.97		
						Analysts' median est.		\$8.00	