

## Cipher Pharmaceuticals Inc.

(DND-TSX)

***DND: Absorica Approved – Raising Price Target To \$3.00 Per Share.***

<b>Current Recommendation</b>	<b>Outperform</b>
Prior Recommendation	N/A
Date of Last Change	01/03/2012
Current Price (05/29/12)	\$2.11
<b>Target Price</b>	<b>\$3.00</b>

### UPDATE

On May 27, 2012, Cipher announced it had received U.S. FDA approval of Absorica, the company's novel, patented brand formulation of the acne medication isotretinoin, for the treatment of severe recalcitrant nodular acne. We see Absorica as a potential \$200 million opportunity in the U.S. Ranbaxy, Cipher's U.S. commercial partner, plans to launch the drug in the fourth quarter 2012. Ranbaxy will pay Cipher a \$9 million milestone related to Absorica approval, of which we expect Cipher to keep 50% after it pays sub-milestones to Galephar.

We continue to be optimistic on the Cipher story. Our DCF model now calculates fair-value at \$3.00 per share. Our rating is 'Outperform'.

### SUMMARY DATA

52-Week High	2.11
52-Week Low	0.64
One-Year Return (%)	68
Beta	1.22
Average Daily Volume (sh)	12

Shares Outstanding (mil)	24.3
Market Capitalization (\$mil)	51.2
Short Interest Ratio (days)	N/A
Institutional Ownership (%)	N/A
Insider Ownership (%)	N/A

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	N/A
P/E using 2012 Estimate	N/M
P/E using 2013 Estimate	N/A

<b>Risk Level</b>	<b>Average,</b>
<b>Type of Stock</b>	<b>Small-Value</b>
<b>Industry</b>	<b>Med-Biomed/Gene</b>

### ZACKS ESTIMATES

#### Revenue

(millions of \$)

	Q1	Q2	Q3	Q4	Year
	(Mar)	(Jun)	(Sep)	(Dec)	(Dec)
2011	0.7 A	0.7 A	1.1 A	1.0 A	3.6 A
2012	1.8 A	1.0 E	1.1 E	1.6 E	5.2 E
2013					9.6 E
2014					14.2 E

#### Earnings per Share

(EPS is operating earnings before non recurring items)

	Q1	Q2	Q3	Q4	Year
	(Mar)	(Jun)	(Sep)	(Dec)	(Dec)
2011	-\$0.05 A	-\$0.02 A	-\$0.01 A	-\$0.02 A	-\$0.10 A
2012	\$0.01 A	-\$0.01 E	-\$0.01 E	\$0.00 E	-\$0.02 E
2013					\$0.13 E
2014					\$0.28 E

## WHAT'S NEW

### Absorica Approved!

On May 27, 2012, Cipher Pharmaceuticals (DND.TO) announced it had received U.S. FDA approval of Absorica, the company's novel, patented brand formulation of the acne medication isotretinoin, for the treatment of severe recalcitrant nodular acne.

### *...Ranbaxy To Commercialize...*

We remind investors that in August 2008, the company entered into a distribution and supply agreement with Ranbaxy Pharmaceuticals Inc., under which Cipher granted Ranbaxy the exclusive right to market, sell and distribute Absorica (CIP-Isotretinoin) in the U.S. Cipher noted on its first quarter conference call three weeks ago that pre-commercialization activities are underway at Ranbaxy. Ranbaxy plans to launch Absorica in the fourth quarter 2012.

Approval triggers two milestone payments to Cipher totaling \$9.0 million from Ranbaxy, of which we expect Cipher to retain 50% after paying sub-milestones to Galephar. We model that Cipher will exit the second quarter 2012 with over \$13.5 million in cash and investments. Cipher will also receive royalties (mid-teens) on net U.S. sales and is eligible for future milestone payments (totaling net \$5 million to Cipher) based on sales targets.

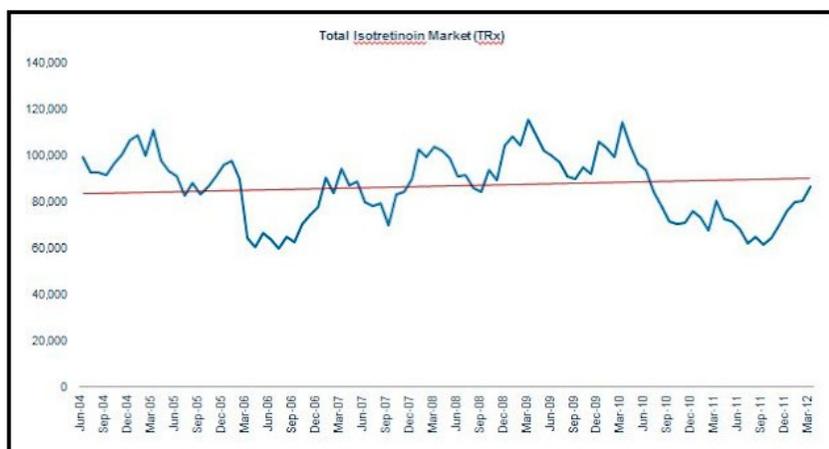
Through conversations with management, we believe the two net \$2.5 million sales-related milestones are achievable under the current expected plans with Ranbaxy. Ranbaxy has committed a dedicated 60-person sales force and to promote CIP-Isotretinoin in the primary position for a minimum of three years. Venkat Krishnan, Ranbaxy's Senior Vice President and Regional Director, noted that the company plans to position Absorica as the company's flagship brand with its specialized dermatology sales force.

We are excited that Cipher has partnered with Ranbaxy to commercialize Absorica. Ranbaxy has previous experience in the isotretinoin market with Sotret. We note that in 2009, Ranbaxy had to recall a single lot of Sotret when the FDA issued a Class-III warning on manufacturing, citing deviations from good manufacturing practice (GMP) at the company's plant in India. Sotret achieved annual sales of \$41 million in the U.S. in 2009. Sales were triple that in 2008 prior to the recall.

We are not concerned about history repeating itself with manufacturing issues on Absorica because Cipher is responsible for product supply and manufacturing, which will be fulfilled by its partner, Galephar.

### *...Big Opportunity...*

We see a significant opportunity for Absorica once launched. Despite strict FDA monitoring around prescriptions of isotretinoin, the market remains quite robust. Generic (multiple providers) isotretinoin does around \$500 million in sales in the U.S., and that is with no promotion. Prescriptions have remained fairly consistent over the past few years, perhaps trending down slightly since late 2009 once Roche exited promoting Accutane.



We estimate that in terms of a “branded” opportunity, the Isotretinoin market is nearly \$1 billion in size. We remind investors that Roche had Accutane sales over \$750 million at peak. We believe that Cipher’s Absorica product, being the only promoted branded Isotretinoin on the market, could achieve peak sales near 200 million. Absorica offers significant advantages over generic isotretinoin in terms of dosing flexibility.

The market is currently dominated by two un-promoted branded products, Mylan’s Amnesteem and Teva’s Claravis. Amnesteem posted sales of \$136 million in 2010 on 386K scripts. Claravis posted sales of \$330 million in 2010 on 670K scripts.

### ***...Canada Up Next...***

On January 30, 2012, Cipher announced that Health Canada had accepted the company’s New Drug Submission (NDS) for CIP-Isotretinoin for review. We are expecting a decision out of Health Canada in the first quarter 2013. The NDS was first submitted to Health Canada in late December 2011. We view CIP-Isotretinoin as a potential \$10 million opportunity in Canada. The total Isotretinoin market in Canada is small, only around \$20 million total.

Only two products, Roche’s Accutane and Mylan’s Clarus are on the market, with little to no promotion. Therefore, we believe that a sales force of 6 to 8 representatives could effectively promote the product in-house. We expect that Cipher will seek to commercialize the drug on its own in 2013. We think approval in Canada will create a meaningful shift in the company’s future development plans, as Cipher seeks to become a specialty pharmaceutical company with multiple products and its own sales force in Canada over time. We think CIP-Isotretinoin becomes cash flow positive for Cipher in Canada at sales around \$3 million. We think this can be achieved by the third year post-launch.

### **Raising Target to \$3.00 On Absorica Approval**

We have conducted a discounted cash flow (DCF) analysis to value the shares of Cipher Pharmaceuticals Inc. Our model now shows that Cipher is worth \$3.00 per share. Cipher will receive a net \$4.5 million cash payment from Ranbaxy based on Absorica approval. Our model (posted below) shows that operating cash flow should turn positive in 2013. By the end of 2012, Cipher will be collecting revenues from three approved products in the U.S., with a growing cash balance of over \$10 million in the bank, and generating positive cash flow on a sustained basis.

Approval of Absorica is transformational for Cipher. It presents the clear opportunity to in-license yet another 505(b)(2)-like product for late-stage development and commercialization in 2013. Cipher is now three-for-three. It’s time for U.S. investors to take notice. Our rating is ‘Outperform’.

## PROJECTED FINANCIALS

### Cipher Pharmaceuticals Inc. Income Statement

Model in Canadian Dollars (IFRS)	2010 A	2011 A	Q1 A	Q2 E	Q3 E	Q4 E	2012 E	2013 E	2014 E	2015 E
<b>Lipofen Net Revenues</b>	<b>\$5.0</b>	<b>\$2.2</b>	<b>\$1.4</b>	<b>\$0.6</b>	<b>\$0.6</b>	<b>\$0.7</b>	<b>\$3.3</b>	<b>\$2.8</b>	<b>\$3.0</b>	<b>\$0.7</b>
<i>CIP-Fenofibrate YOY Growth</i>	61.3%	-56.0%	133.3%	-	-	-	50.0%	-15.2%	7.1%	-76.7%
<b>CIP-Tramadol-ER Net Revenues</b>	<b>\$0</b>	<b>\$0.8</b>	<b>\$0.3</b>	<b>\$0.1</b>	<b>\$0.1</b>	<b>\$0.1</b>	<b>\$0.6</b>	<b>\$0.7</b>	<b>\$2.1</b>	<b>\$1.5</b>
<i>CIP Tramadol-ER YOY Growth</i>	-	-	-	-	-	-	-22.5%	16.1%	191.1%	-29.4%
CIP-Isotretinoin (U.S. Sales at Ranbaxy)	\$0	\$0	\$0	\$0	\$0	\$5.0	\$5.0	\$35.0	\$60.0	\$90.0
Milestones under Isotretinoin Licenses	\$0.4	\$0.6	\$0.1	\$0.4	\$0.4	\$0.4	\$1.2	\$2.3	\$2.3	\$3.5
CIP-Iso (CAN Sales)	\$0	\$0	\$0	\$0	\$0	\$0	\$0	\$1.0	\$2.0	\$3.0
<b>CIP-Isotretinoin Net Revenues</b>	<b>\$0.4</b>	<b>\$0.6</b>	<b>\$0.1</b>	<b>\$0.4</b>	<b>\$0.4</b>	<b>\$0.8</b>	<b>\$1.6</b>	<b>\$6.1</b>	<b>\$9.1</b>	<b>\$13.7</b>
<i>CIP-Isotretinoin YOY Growth</i>	300.0%	50.0%	-	-	-	-	158.3%	293.5%	49.2%	50.5%
<b>Total Revenues</b>	<b>\$5.385</b>	<b>\$3.569</b>	<b>\$1.811</b>	<b>\$1.0</b>	<b>\$1.1</b>	<b>\$1.6</b>	<b>\$5.5</b>	<b>\$9.6</b>	<b>\$14.2</b>	<b>\$15.9</b>
<i>YOY Growth</i>	69.4%	-33.7%	168.3%	40.6%	-5.2%	51.5%	53.3%	75.9%	47.6%	11.9%
Operating, General & Admin	\$3.779	\$3.186	\$1.016	\$0.9	\$0.9	\$0.9	\$3.7	\$4.5	\$4.7	\$5.1
<i>% SG&amp;A</i>	70.2%	89.3%	56.1%	88.1%	84.7%	56.7%	67.9%	46.3%	33.1%	31.8%
Research & Development	\$0.743	\$2.205	\$0.471	\$0.4	\$0.4	\$0.4	\$1.7	\$1.5	\$2.0	\$2.0
<i>% R&amp;D</i>	13.8%	61.8%	26.0%	39.1%	37.7%	25.2%	30.5%	15.6%	14.1%	12.6%
Amortization & Depreciation	\$0.757	\$0.578	\$0.225	\$0.1	\$0.1	\$0.2	\$0.6	\$0.5	\$0.5	\$0.5
Operating Income	\$0.106	(\$2.400)	\$0.099	(\$0.4)	(\$0.3)	\$0.1	(\$0.5)	\$3.2	\$7.0	\$7.3
<i>Operating Margin</i>	-	-67.2%	-	-	-	-	-9.9%	33.0%	49.3%	46.2%
Interest & Other Net	\$0.066	\$0.089	\$0.026	\$0.0	\$0.0	\$0.0	\$0.1	\$0.1	\$0.1	\$1.1
Pre-Tax Income	\$0.172	(\$2.311)	\$0.125	(\$0.4)	(\$0.3)	\$0.1	(\$0.4)	\$3.3	\$7.1	\$8.4
Taxes / Other	\$0	\$0	\$0	\$0	\$0	\$0	\$0	\$0	\$0	\$1
<i>Tax Rate</i>	0%	0%	0%	0%	0%	0%	0%	0%	0%	10%
Net Income	\$0.172	(\$2.311)	\$0.125	(\$0.4)	(\$0.3)	\$0.1	(\$0.4)	\$3.3	\$7.1	\$7.6
<i>YOY Growth</i>	-	-	-	-	-	-	-80.9%	-241.5%	-1705.4%	132.0%
<b>Reported EPS</b>	<b>\$0.01</b>	<b>(\$0.10)</b>	<b>\$0.01</b>	<b>(\$0.01)</b>	<b>(\$0.01)</b>	<b>\$0.00</b>	<b>(\$0.02)</b>	<b>\$0.13</b>	<b>\$0.28</b>	<b>\$0.29</b>
<i>YOY Growth</i>	-	-	-	-	-	-	-81.0%	-237.1%	-1633.9%	123.1%
Shares Outstanding	24.1	24.2	24.4	24.3	24.4	24.4	24.4	25.0	25.5	26.0

Source: Zacks Investment Research, Inc.

Jason Napodano, CFA

**Cipher Pharmaceuticals Inc.**  
DCF Model

Cipher Pharmaceuticals Inc.	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022
Net CIP-Fenofibrate Cash Revs	\$3.3	\$2.8	\$3.0	\$0.7	\$0.0	\$0	\$0	\$0	\$0	\$0	\$0
Net CIP-Tramadol Cash Revs	\$0.3	\$0.7	\$2.1	\$1.5	\$2.8	\$2.1	\$2.3	\$2.0	\$1.6	\$1.0	\$0.3
Net CIP-Isotretinoin Cash Revs	\$4.9	\$3.8	\$6.8	\$13.3	\$14.2	\$16.2	\$20.9	\$19.5	\$18.6	\$18.1	\$16.6
<b>Cash Revenues</b>	<b>\$8.5</b>	<b>\$7.3</b>	<b>\$11.9</b>	<b>\$15.5</b>	<b>\$17.0</b>	<b>\$18.3</b>	<b>\$23.2</b>	<b>\$21.5</b>	<b>\$20.2</b>	<b>\$19.1</b>	<b>\$16.9</b>
R&D	\$1.7	\$1.5	\$2.0	\$2.0	\$2.0	\$2.0	\$2.0	\$2.0	\$2.0	\$2.0	\$2.0
SG&A	\$3.7	\$4.5	\$4.7	\$5.1	\$5.3	\$5.5	\$5.5	\$5.5	\$5.6	\$5.6	\$8.0
<b>EBITDA</b>	<b>\$3.2</b>	<b>\$1.4</b>	<b>\$5.2</b>	<b>\$8.4</b>	<b>\$9.7</b>	<b>\$10.9</b>	<b>\$15.7</b>	<b>\$14.0</b>	<b>\$12.7</b>	<b>\$11.6</b>	<b>\$6.9</b>
Depreciation and amortization	\$0.6	\$0.5	\$0.5	\$0.5	\$0.5	\$0.5	\$0.5	\$0.5	\$0.5	\$0.5	\$0.5
<b>EBIT</b>	<b>\$2.5</b>	<b>\$0.9</b>	<b>\$4.7</b>	<b>\$7.9</b>	<b>\$9.2</b>	<b>\$10.4</b>	<b>\$15.2</b>	<b>\$13.5</b>	<b>\$12.2</b>	<b>\$11.1</b>	<b>\$6.4</b>
EBITDA margin	-	11.9%	39.5%	51.2%	54.1%	56.6%	65.5%	62.7%	60.1%	57.8%	37.9%
Cash Taxes	\$0	\$0	\$0	\$0	\$0	\$0	\$0	(\$2.7)	(\$3.0)	(\$2.8)	(\$1.9)
Tax Rate	-	\$35M in NOLs as of Q1-2012		-	-	-	-	20.0%	25.0%	25.0%	30.0%
<b>Balance Sheet</b>											
Capital Expenditures	\$0.1	\$0.1	\$0.1	\$0.1	\$0.1	\$0.1	\$0.1	\$0.1	\$0.1	\$0.1	\$0.1
Working Capital	(\$0.2)	(\$0.2)	(\$0.2)	(\$0.2)	(\$0.2)	(\$0.2)	(\$0.2)	(\$0.2)	(\$0.2)	(\$0.2)	(\$0.2)
Other Cash Adjustments	\$0.3	\$0.3	\$0.3	\$0.3	\$0.3	\$0.3	\$0.3	\$0.3	\$0.3	\$0.3	\$0.3
<b>Capital Adjustments</b>	<b>\$0.2</b>	<b>\$0.2</b>	<b>\$0.2</b>	<b>\$0.2</b>	<b>\$0.2</b>	<b>\$0.2</b>	<b>\$0.2</b>	<b>\$0.2</b>	<b>\$0.2</b>	<b>\$0.2</b>	<b>\$0.2</b>
Net Margin	29.6%	11.9%	39.5%	51.2%	54.1%	56.6%	65.5%	50.2%	45.1%	43.4%	26.6%
<b>Discounted Cash Flow</b>											
Net Income	\$2.5	\$0.9	\$4.7	\$7.9	\$9.2	\$10.4	\$15.2	\$10.8	\$9.1	\$8.3	\$4.5
Depreciation and amortization	\$0.6	\$0.6	\$0.6	\$0.6	\$0.6	\$0.6	\$0.6	\$0.6	\$0.6	\$0.6	\$0.6
Net Cash Adjustments	(\$0.2)	(\$0.3)	(\$0.3)	(\$0.3)	(\$0.3)	(\$0.3)	(\$0.3)	(\$0.3)	(\$0.3)	(\$0.3)	(\$0.3)
<b>Post-Tax Operating Cash Flow</b>	<b>\$3.0</b>	<b>\$1.2</b>	<b>\$5.0</b>	<b>\$8.2</b>	<b>\$9.5</b>	<b>\$10.7</b>	<b>\$15.5</b>	<b>\$11.1</b>	<b>\$9.4</b>	<b>\$8.6</b>	<b>\$4.8</b>
Dividends	\$0.0	\$0.0	\$0.0	\$0.0	\$0.0	\$0.0	\$0.0	\$0.0	\$0.0	\$0.0	\$0.0
<b>Free Cash Flow</b>	<b>\$3.0</b>	<b>\$1.2</b>	<b>\$5.0</b>	<b>\$8.2</b>	<b>\$9.5</b>	<b>\$10.7</b>	<b>\$15.5</b>	<b>\$11.1</b>	<b>\$9.4</b>	<b>\$8.6</b>	<b>\$4.8</b>

Assumptions	
Beta:	1.2
Equity Risk Premium:	7.0%
Risk Free Rate:	2.0%
Firm Risk Premium:	20%
<b>Discount Rate:</b>	<b>10.4%</b>

Valuation	
10-Year Model:	\$46
Terminal Growth:	2%
Terminal Value:	\$21
Net Cash - LT Debt:	\$14
<b>Firm Value:</b>	<b>\$81</b>

Price Target	
Basic Outstanding:	24.4
Options:	1.8
Dilution:	0.5
Fully Diluted:	26.7
<b>Target Price:</b>	<b>\$3.04</b>

Source: Zacks Investment Research, Inc. Jason Napodano, CFA

## HISTORICAL ZACKS RECOMMENDATIONS



Chart Generated by Yahoo! Inc.

↑ Buy

↔ Hold

↓ Sell

## DISCLOSURES

The following disclosures relate to relationships between Zacks Investment Research ("ZIR") and Zacks Small-Cap Research ("Zacks SCR") and the issuers covered by the Zacks SCR analysts in the Small-Cap Universe.

ZIR or Zacks SCR Analysts do not hold or trade securities in the issuers which they cover. Each analyst has full discretion on the rating and price target based on their own due diligence. Analysts are paid in part based on the overall profitability of Zacks SCR. Such profitability is derived from a variety of sources and includes payments received from issuers of securities covered by Zacks SCR for non-investment banking services. No part of analyst compensation was, is or will be, directly or indirectly, related to the specific recommendations or views expressed in any report or blog.

ZIR and Zacks SCR do not make a market in any security nor do they act as dealers in securities. Zacks SCR has never received compensation for investment banking services on the small-cap universe. Zacks SCR does not expect received compensation for investment banking services on the small-cap universe. Zacks SCR has received compensation for non-investment banking services on the small-cap universe, and expects to receive additional compensation for non-investment banking services on the small-cap universe, paid by issuers of securities covered by Zacks SCR. Non-investment banking services include investor relations services and software, financial database analysis, advertising services, brokerage services, advisory services, investment research, and investment management.

Additional information is available upon request. Zacks SCR reports are 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 by Zacks SCR Analysts are subject to change. Reports are not to be construed as an offer or the solicitation of an offer to buy or sell the securities herein mentioned. Zacks SCR uses the following rating system for the securities it covers. Buy/Outperform: The analyst expects that the subject company will outperform the broader U.S. equity market over the next one to two quarters. Hold/Neutral: The analyst expects that the company will perform in line with the broader U.S. equity market over the next one to two quarters. Sell/Underperform: The analyst expects the company will underperform the broader U.S. Equity market over the next one to two quarters.

The current distribution of Zacks Ratings is as follows on the 1025 companies covered: Buy/Outperform- 14.2%, Hold/Neutral- 80.6%, Sell/Underperform – 4.4%. Data is as of midnight on the business day immediately prior to this publication.