



Buy Presentation

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Company Overview



Depomed, Inc. is an international pharmaceutical company, which mainly develops products for treatment in neurology, pain and diseases of the central nervous system.

Key Financials

Ticker	NASDAQ: DEPO
Market Cap	\$861M
Enterprise Value	\$658M
Current Price	\$15.19
52 Week Range	\$6.95-15.51
EV / EBITDA	10.5x

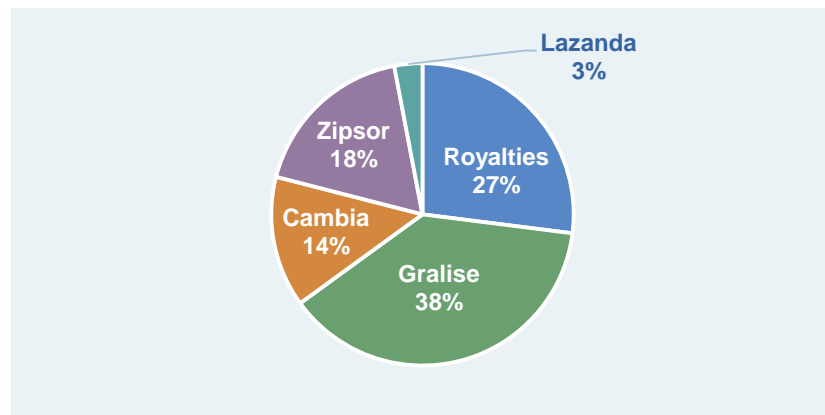
Stock Performance



Business Overview

- Specialty pharmaceuticals company focused on developing and commercializing products to treat pain and other CNS conditions.
- Unique patented drug-delivery technology (Acuform) enables extended, controlled delivery of drugs.
- Currently markets 4 FDA-approved products and receives royalties from additional 4 partnered products.

Revenue Breakdown







Summary of Operations



The majority of the company's core products are already fully marketed, with high growth potential stemming from a new Parkinson's disease treatment offering.

Core Products



		PHASE I/II	PHASE III	REGISTERED	MARKETED
	Management of post-therapeutic neuralgia	<input checked="" type="checkbox"/>	<input checked="" type="checkbox"/>	<input checked="" type="checkbox"/>	<input checked="" type="checkbox"/>
	Mild to moderate acute pain in adults 18 years or older	<input checked="" type="checkbox"/>	<input checked="" type="checkbox"/>	<input checked="" type="checkbox"/>	<input checked="" type="checkbox"/>
	Breakthrough pain in cancer patients 18 years or older	<input checked="" type="checkbox"/>	<input checked="" type="checkbox"/>	<input checked="" type="checkbox"/>	<input checked="" type="checkbox"/>
	Acute treatment of migraine attacks in adults 18 or older	<input checked="" type="checkbox"/>	<input checked="" type="checkbox"/>	<input checked="" type="checkbox"/>	<input checked="" type="checkbox"/>
DM-1992	Parkinson's disease	<input checked="" type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>

Summary of Operations



Acuform technology allows for greater efficacy and reduced dosage; provides a significant, recurring source of milestone and royalty payments.

Acuform Technology

		PHASE I/II	PHASE III	REGISTERED	MARKETED
 <p>NEW XARTEMIS[®] XR oxycodone HCl/acetaminophen extended-release (II)</p>	Management of post-therapeutic neuralgia	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
 <p>NUCYNTA[®] ER (II) tapentadol extended-release tablets</p>	Mild to moderate acute pain in adults 18 years or older	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
MNK-155	Breakthrough pain in cancer patients 18 years or older	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
IW-3718	Acute treatment of migraine attacks in adults 18 or older	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>

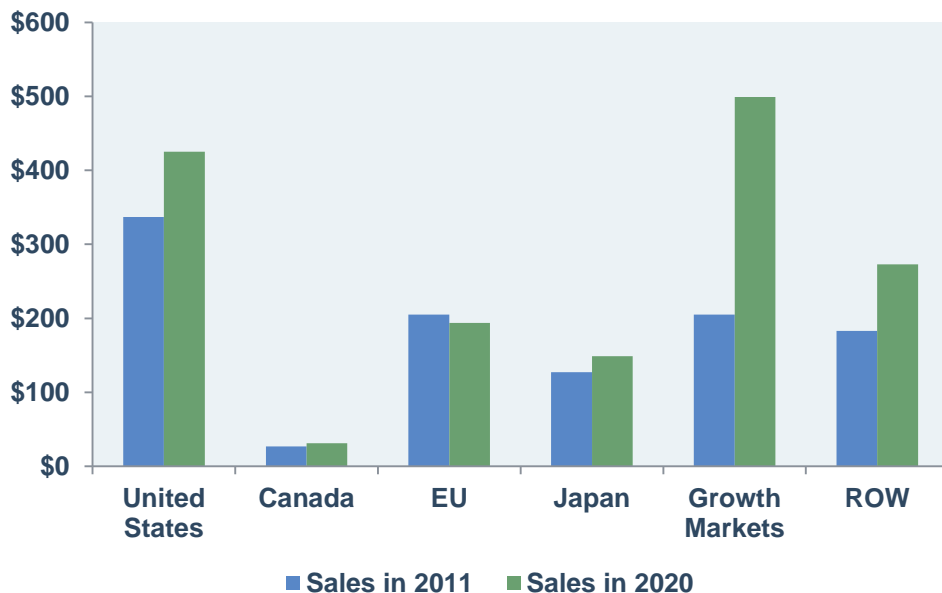
External Analysis

The pharmaceutical sector has been slowly but steadily recovering from the impact of the patent cliff being faced by several companies over the past few years.

Industry Outlook

- The hit to the Pharmaceutical Market due to patent expiry reached its peak in 2012, when approximately \$38 billion in revenue evaporated.
- Since then, nearly \$85 billion of forecasted new drug sales has been approved by the FDA, signaling an end to the market contraction that had been the hallmark of the last five years.

Projected Growth



- The global pharmaceutical market is predicted to grow to nearly \$1.6 trillion by 2020, with the United States and Growth Markets being the key industry drivers.
- High royalties result in long-term and sustainable revenue generation strategy over the lifetime of the patent.

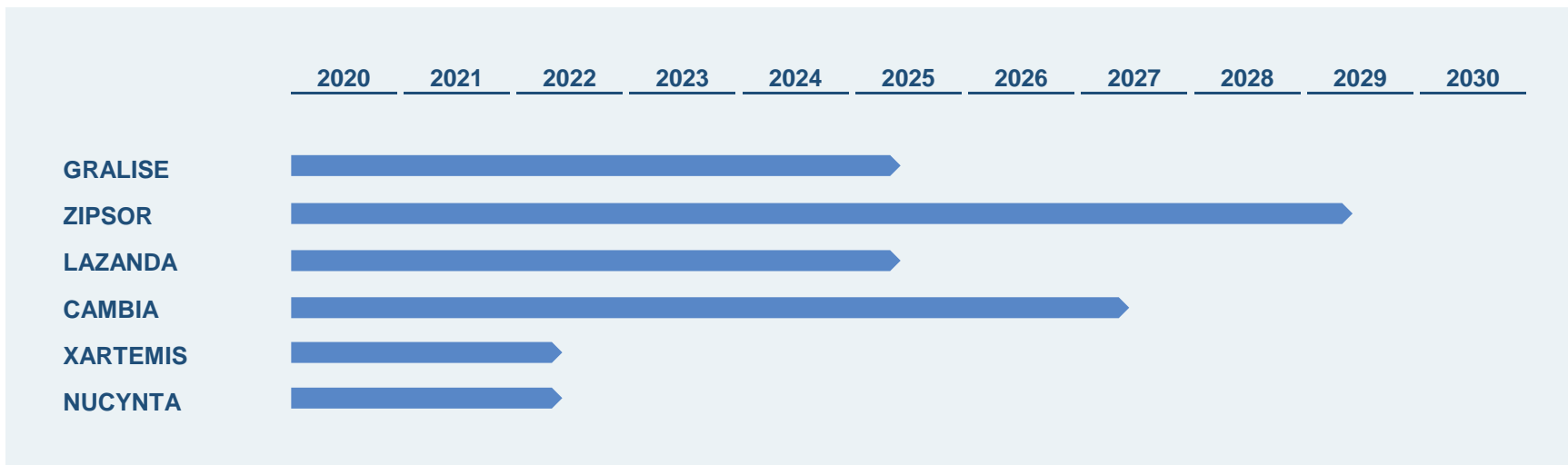


Investment Thesis



Depomed's long-lasting patents ensure sustainable revenue growth for the next 10+ years and create strong economic moat for investors.

Patent Expiry Dates



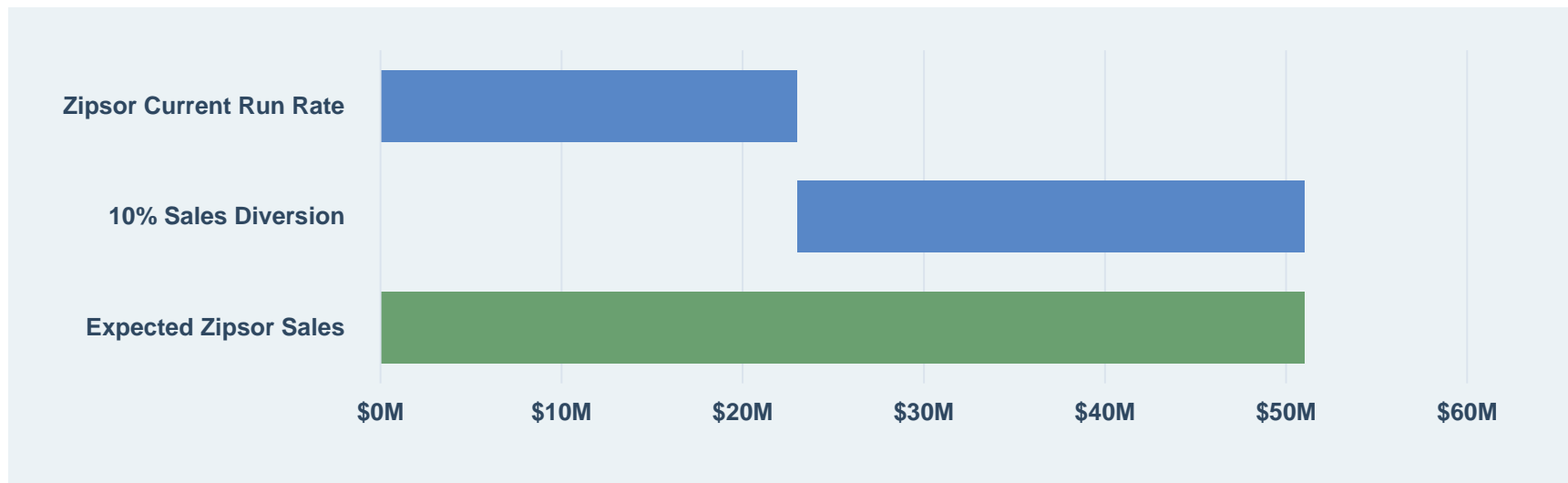
- Depomed recently won a patient litigation lawsuit against Actavis, blocking generic Gralise until 2024.
- Gralise is the company's flagship drug and currently accounts for 38% of revenues.
- Royalty contracts with Xartemis and Nucynta will continue to hold until 2021, thereby providing consistent cash flows with minimal risk.

Investment Thesis



Sales of the company's core product, Zipsor, are poised to increase substantially in 2015 due to a recent loss of formulary coverage for Depomed's two major competitors.

Zipsor Sales Increase



- Zipsor revenues are expected to increase based on the recent loss of formulary coverage in 2015 for its 2 main competitors: Duexis and Vimovo.
- Horizon Pharma management estimates that 20-30% of prescriptions will be at risk.
 - Duexis and Vimovo contribute \$250M+ in combined revenues at Horizon Pharma; even a 10% diversion in sales will almost double Zipsor's current run-rate of \$27M.
 - This sales increase has not been priced into the valuation.



Investment Thesis



Current investors are undervaluing the potential of Zipsor, which could add up to \$2.49 per share in implied value and a 15.9% implied upside.

Zipsor Sales Increase

Zipsor Overview

- After Duexis and Vimovo are removed from formulary coverage by two of the largest pharmacy benefit managers, we can assume a conservative 10% sales diversion from their combined \$250M in revenue.
- This translates into a potential \$2.49 increase in share price.
 - Using TTM P/E Ratio of 11.30x, projected COGS margin of 12.4% and an assumed 38% tax rate.
- Consequently, this results in an additional upside of 15.93% to the current share price of \$15.19
 - This has not been priced into our current valuation.

Valuing Potential Upside

Duexis and Vimovo Sales	\$25,000.0
10% Diversion to Zipsor	25,000.0
Less: COGs	(3,075.0)
Less: Tax	(8,332.0)
Earnings from Diversion	13,593.0
P/E Ratio	11.3x
Increase in Share Price	\$2.49
Implied Upside	15.9%

Investment Thesis



Depomed has a history of strong post-acquisition performance and is likely to make further acquisitions in 2015 with up to \$500M in cash on hand.

Potential Acquisition To Portfolio

- Cash balance currently at \$211M; which is expected to increase to \$500M+ after a recently announced senior note offering of \$300M.
 - Strongly indicates a potential acquisition to their portfolio by the end of 2014.
- Very active in the specialty pharmaceuticals M&A space; acquired 3 drugs in the past 2 years with no acquisitions announced yet in 2014.
- With \$500M in cash, Depomed has the capacity for a large-scale acquisition, generating immediate revenues that have not been priced into the valuation.

Past Acquisition Performance

Product	Date Acquired	Acquisition Price	Revenues To Date	Current Run-Rate
Zipsor	Jun-12	\$25.9M	\$42.3M	\$27.3M
CAMBIA	Dec-13	\$48.7M	\$10.1M	\$19.8M
Lazanda	Jul-13	\$4.00m	\$3.3M	\$5.40M

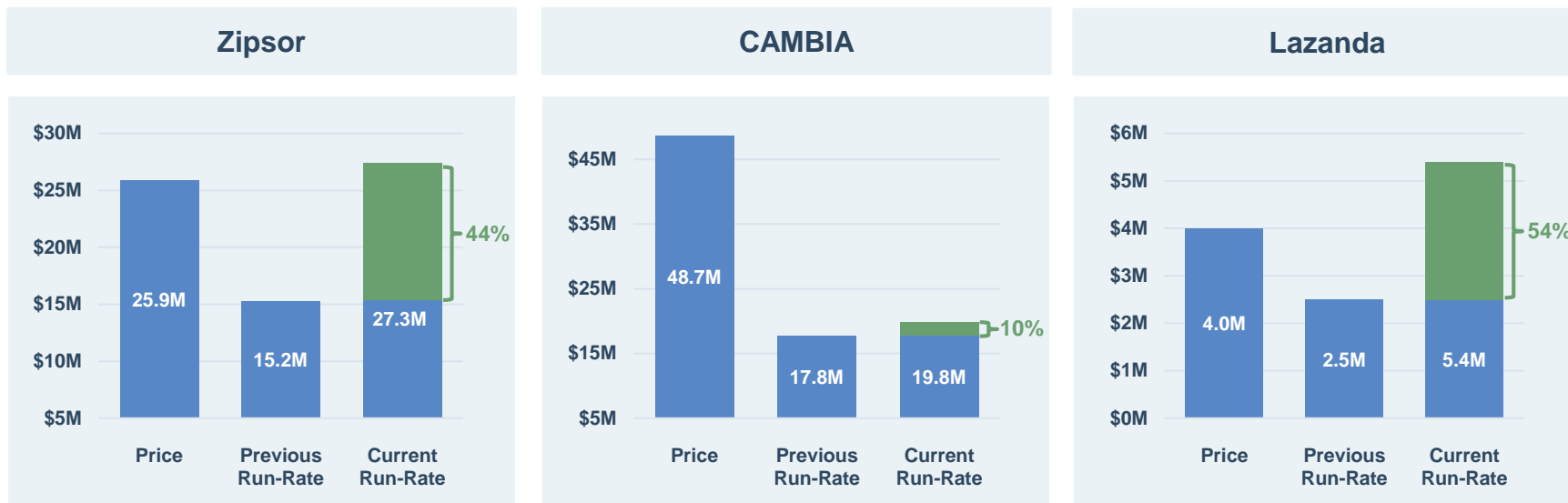


Investment Thesis



Depomed has a history of strong post-acquisition performance and is likely to make further acquisitions in 2015 with up to \$500M in cash on hand.

Past Acquisition Performance



Strong Value Creation

- Portfolio synergies and a sales force of 165 representatives drove an increase of sales run-rates of up to 54%.
- Acquisition target is likely an inexpensive late stage or commercialized product with the focus of pain or neurology.
- Note the low EV to TTM sales ratios for Zipsor (1.4x), CAMBIA (2.7x), Lazanda (1.2x).

Investment Thesis



An acquisition in the near future could cause DEPO's price to rise sharply, forcing short sellers to liquidate their shares, further pushing up the price.

Historical Stock Price



Valuation



Depomed trades at a 10.0x EV / EBITDA and 3.0x EV / Revenue multiple, which is at significant discount to its comparable trading group.

Comparable Companies Analysis

(\$ in millions, except ratios)									
Company	Price	Market Cap	Enterprise Value	LTM	EV/EBITDA 2015E	2016E	LTM	2015E	2016E
Specialty Pharma									
Horizon Pharma	\$12.37	\$925	\$911	-	10.15x	5.96x	5.30x	3.30x	2.38x
ANI Pharmaceuticals	29.81	337	284	32.60x	14.36x	8.29x	7.90x	5.99x	4.11x
INSYS Therapeutics	34.07	1,176	1,121	19.90x	14.63x	10.55x	6.70x	5.30x	4.26x
Mean				26.25x	13.05x	8.27x	6.63x	4.86x	3.58x
Median				26.25x	14.36x	8.29x	6.70x	5.30x	4.11x
Technology-Based Pharma									
Infinity Pharmaceuticals	\$14.27	\$693	\$559	-	21.98x	-	-	2.98x	6.71x
Enanta Pharmaceuticals	39.92	742	648	32.50x	37.67x	3.48x	13.90x	13.25x	2.59x
Mean				32.50x	29.83x	3.48x	13.90x	8.12x	4.65x
Median				32.50x	29.83x	3.48x	13.90x	8.12x	4.65x
DepoMed	\$14.96	\$876	\$658	7.30x	10.05x	7.27x	3.00x	3.06x	2.21x
Overall Mean				28.33x	19.76x	7.07x	8.45x	6.16x	4.01x
Overage Median				32.50x	14.63x	7.13x	7.30x	5.30x	4.11x

Valuation



Depomen's pipeline provides a predictable, high revenue generating opportunity for investors.

Revenue Breakdown

(\$ in USD thousands)	2012A	2013A	2014E	2015E	2016E	2017E	2018E	2019E	2020E	2025E	2030E	2035E
Product Sales:												
Gralise Sales	\$17,288	\$36,188	\$65,864	\$88,916	\$120,037	\$156,048	\$195,060	\$234,073	\$269,183	\$201,926	\$141,085	\$134,170
CAMBIA Sales	-	555	24,405	39,049	54,668	71,069	88,836	106,603	122,593	75,824	61,704	58,680
Zipsor Sales	9,835	20,341	27,924	40,490	58,710	76,323	95,403	114,484	135,091	209,293	146,879	102,624
Lazanda Sales	-	1,218	6,258	17,524	28,038	44,861	62,805	78,506	94,208	83,402	58,273	55,417
License and Royalties:												
XARTEMIS XR Royalties	-	-	1,624	6,720	10,752	17,203	25,805	30,966	34,062	42,978	-	-
NUCYNTA Royalties	-	-	2,912	12,544	22,579	36,127	54,190	70,447	91,581	-	-	-
Other Royalties	44,895	45,003	494	-	-	-	-	-	-	-	-	-
License and Other Revenue:	18,798	12,796	17,520	9,000	-	-	-	-	-	-	-	-
Pipeline:												
DM-1992 Expected Value	-	-	-	-	-	-	-	-	-	59,535	176,230	110,074
MNK-155 Expected Value	-	-	-	765	2,678	5,355	9,639	14,459	21,688	46,222	23,227	20,340
IW-3718 Expected Value	-	-	-	-	-	-	-	-	-	2,678	22,555	35,451
Risk-Adjusted Revenues	\$90,816	\$116,101	\$147,002	\$215,007	\$297,462	\$406,985	\$531,739	\$649,537	\$768,407	\$721,858	\$629,953	\$516,756

- Revenues for each drug are projected until the date of patent expiry at which point a 60% revenue decay is assumed.
- Projected sales for drugs still in the pipeline are discounted by a “Phase Success” probability based on industry averages for the pain/CNS space.

Phase	LOA	Phase Success
PI	22.1%	70.0%
PII	31.5%	50.0%
PIII	63.0%	70.0%
NDA	90.0%	90.0%

Valuation



Using an exit multiple of 7.50x and a WACC of 12.6%, DEPO is currently trading at a 34.0% discount to its fair value of \$15.19 per share.

Discounted Cash Flow Analysis

(\$ in USD thousands)	2012A	2013A	2014E	2015E	2016E	2017E	2018E	2019E	2020E	2025E	2030E	2035E
Unlevered Free Cash Flow	(51,700)	(46,476)	(14,471)	\$2,950	\$38,756	\$85,795	\$138,773	\$187,236	\$235,424	\$132,657	\$101,122	\$50,508
Discount Factor				0.94	0.84	0.74	0.66	0.59	0.52	0.29	0.16	0.09
PV of Free Cash Flows			(13,636)	\$2,780	\$32,432	\$63,758	\$91,581	\$109,728	\$122,520	\$38,127	\$16,050	\$4,427

WACC 12.6%

Exit Multiple 7.50x
 2035E EBITDA \$192,409
 Terminal Value \$1,443,064

Total Enterprise Value \$1,046,679

Debt \$300,000
 Cash \$511,145

Total Equity Value \$1,257,824

Shares Outstanding 58,590
 Senior Note Dilution 3,206

Fair Value Per Share \$20.35

Current Price \$15.19
 Implied Upside 34.0%

SENSITIVITY ANALYSIS – IMPLIED UPSIDE

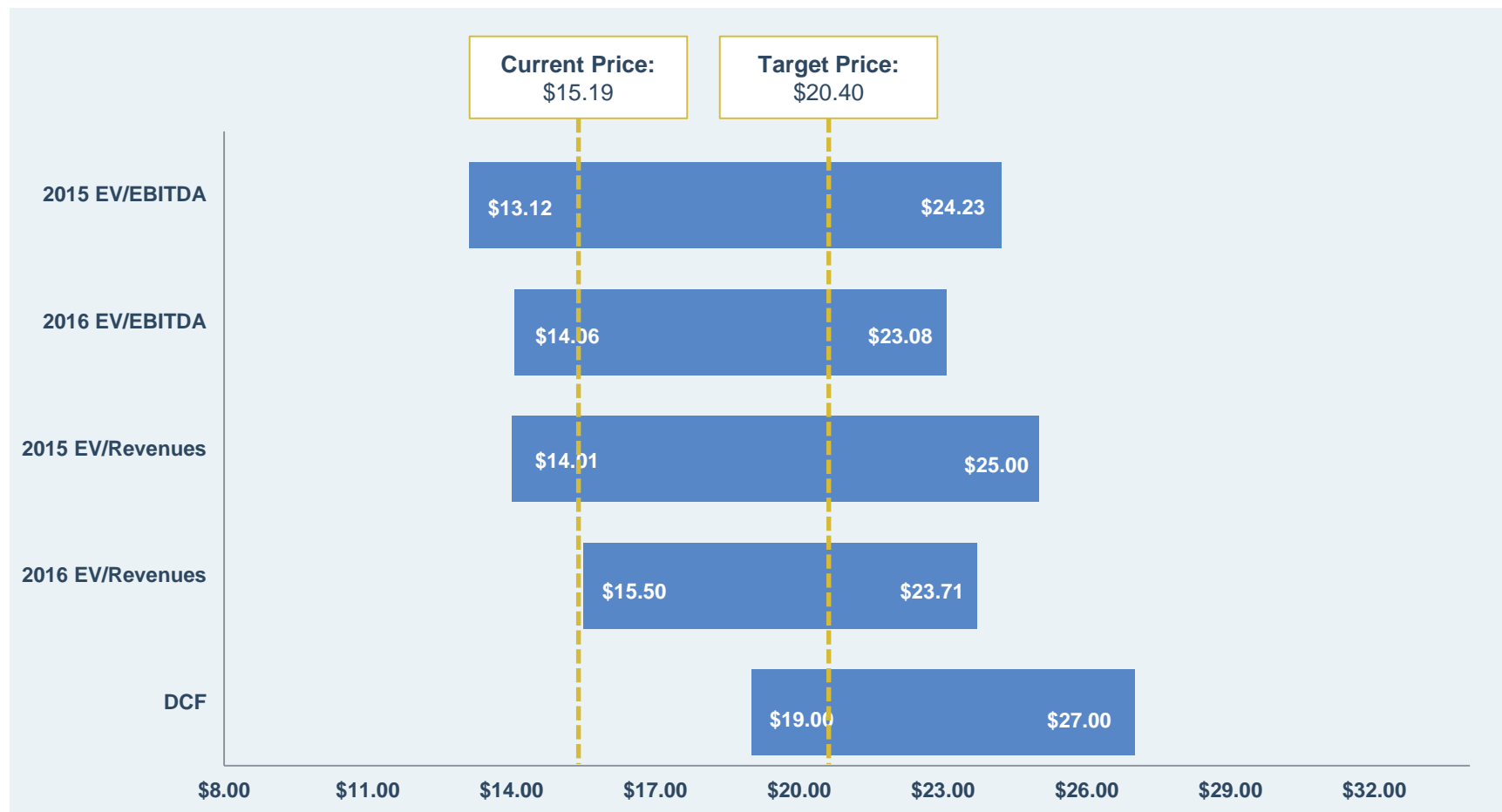
		Exit Multiple				
		6.5x	7.0x	7.5x	8.0x	8.5x
WACC	11.6%	41.7%	42.7%	43.8%	44.8%	45.8%
	12.1%	36.9%	37.8%	38.8%	39.7%	40.6%
	12.6%	32.4%	33.2%	34.1%	34.9%	35.8%
	13.1%	28.1%	28.9%	29.7%	30.4%	31.2%
	13.6%	24.1%	24.8%	25.5%	26.2%	26.9%

Valuation



Based on our combined valuation analysis, the target price for Depomed is \$20.40, which is significantly undervalued from its current trading price of \$15.19.

Valuation Summary



- **The Affordable Care Act could increase expenses and negatively affect the commercial success of the products.**
 - The ACA requires pharmaceutical discounts to certain hospitals and federally subsidized clinics.
 - Annual fee imposed on all manufacturers of brand prescription drugs in the United States

- **Acquisition of new businesses, products and technologies is a key element of the corporate strategy.**
 - If DEPO is unable to successfully acquire and integrate new businesses moving forward, future growth could be limited.

- **Clinical development is an expensive and risky process; approval at each phase and subsequently commercialization of drugs in development is uncertain.**
 - Sefelsa, one of DEPO's previous drugs in development was not approved by the FDA after an NDA submission.

**RECOMMENDATION:
BUY DEPOMED AT \$15.19**



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