Investors Alley
Biotech Gems

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"De-Risking" Our Portfolio over the Coming Weeks and Months

Fellow Investor,

2016 has not started off the same as investors were hoping for, to say the least. As of this past holiday weekend, the S&P 500 has posted an 8.5% loss for the year. Losses in the NASDAQ are in the low teens, oil remains stubbornly under $30 a barrel, and not surprisingly, concerns about volatility and stability in the high-yield credit markets remain stubbornly high.

In This Issue

Eagle Pharmaceuticals (EGRX) 3
Portfolio Update 6
Current Portfolio.....7
Closed Positions.....8

High-beta sectors of the market like small caps, emerging markets, transports, and biotech have been crushed through the first six weeks of the year. The biotech space has gotten hit so hard it is in a bear market not matched since the financial crisis. MarketWatch posted a story on Tuesday showing 50 to 70 small biotech stocks that currently are trading for under the net cash on their balance sheets.

The only other time I can ever remember seeing that happen was near the nadir of the internet bust in 2001 when companies like Ask Jeeves were trading at $2.00 a share but had some $3.75 a share in net cash on the books. This, of course, turned out to be a great time to buy, but few knew it at the time. I remember Ask Jeeves very fondly as it provided my portfolio with a 13-fold return when it was bought out a few years later. However, I passed on many other such opportunities as the fear factor on any small company in the internet space was pretty much at the same levels it is now for small biotech companies.

Large cap biotech companies are selling at their lowest valuations since at least 2011. It is stunning to see **AbbVie (NYSE: ABBV)**, which should post earnings growth in the high teens this year, be priced at just over 10 times earnings with a better than 4.3% dividend, it almost borders on criminal. The current consensus has the company earning nearly $6.00 a share in FY2017 and the shares trade for just over $52.00 a share. **Gilead Sciences (NASDAQ: GILD)** is selling for less than seven times earnings and should have a free cash flow yield of 10% or better this year. The company is buying back more than one percent of its float every month at these levels. **Amgen (NASDAQ: AMGN)** trades for 12 times forward earnings with nearly a three percent yield and is also significantly undervalued. It may be many, many years before we see these kind of valuations again. Usually the sector trades at a premium to the overall market, right now it is selling at a deep discount. This divergence will not last.

As noted in our weekly update, we will be moving to "de-risk" the portfolio in the coming weeks and months. The fall in the biotech sector over the past six months has not only been stunning, it also has been pretty indiscriminate. Small caps with earnings or newly approved products have nearly taken as big of hits as earlier

stage developmental companies that are quarters or years away from any commercialized success. Moving out of some of the earlier stage developmental companies into entities that have greater "visibility" and less "pipeline" risk seems prudent. Stocks that sold for 20-30 times forward earnings six months ago, are going for 10-15 times forward earnings now.

This brings us to our first replacement pick for the portfolio. It is a company called **Eagle Pharmaceuticals (NASDAQ: EGRX).** This is not a new name for Small Cap Gems subscribers. This stock was recommend in late 2014 at approximately $14.00 a share. Earlier this summer we took the position off at just over $80.00 a share. The equity then crested at just north of $100.00. We cashed out of that position with a 464% retrun. Now, after a better than 40% decline within the bear market that has swept over the biotech sector, it is once again solidly in Buy territory especially at less than 10 times forward earnings.

Eagle will be replacing **Protalix BioTherapeutics (NYSE: PLX)** in the portfolio. Protalix has slipped to under a $1.00 a share in the recent deep bear market sell-off that has brought the entire biotech sector down. I still like Protalix as a high risk/high reward play as it enters into Phase III testing on its compound to treat Fabry's Disease. I plan to continue to hold it within my own personal portfolio. However, it is the type of mid-stage biotech concern that clearly is out of favor in the current market. In addition, I could see the company having to do a reverse stock split as it has dipped under $1.00 a share and will probably need to do a secondary at unfavorable prices. Eagle is the better and lower risk bet at this time.

If you ever have a question or comment you can reach me at bret.jensen@investorsalley.com.

Thank you and Happy Hunting.



Bret Jensen
Editor
Bret Jensen's Biotech Gems

P.S. Warm up this winter at The MoneyShow Orlando, March 2-5, 2016! Join me, Steve Forbes, Bruce Johnstone, and over 100 other investment experts as we will show you how to put your cash to work in 2016!

This is the only time these experts will join forces in pursuit of one shared goal: To help you uncover the safest, most reliable income and growth investments on the market today!

I'll be covering the best stocks for an election year as well as giving an in-depth presentation on how to be capture large gains from the biotech sector.

Register for free now!

Eagle Pharmaceuticals is a Buy Once Again

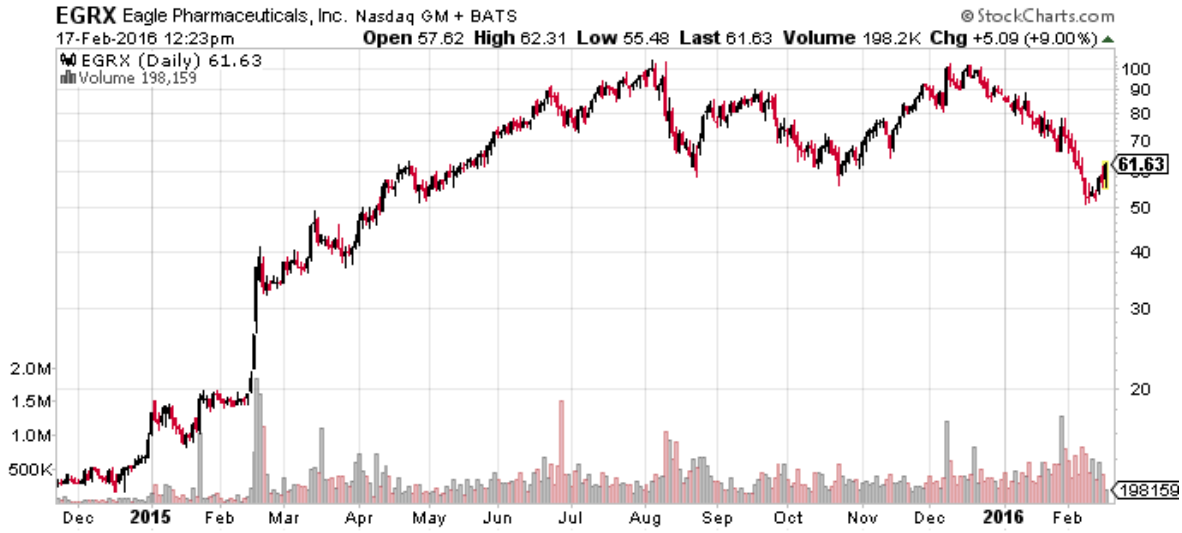
Small Cap Gems subscribers are familiar with out next selection for Biotech Gems. **Eagle Pharmaceuticals (NASDAQ: EGRX)** was placed in the Small Cap Gems portfolio in the low teens back in mid-December of 2014. In February of 2015, the company signed a major collaboration deal with drug giant **Teva Pharmaceuticals (NASDAQ: TEVA).** This transaction powered huge capital appreciation on the shares over the next six months. We advised to take profits on Eagle at just over $80.00 a share in early summer as the stock looked like it had come a bit too far, a bit too fast. The stock still had juice for another month or so before reaching a peak at just over $100.00 a share in July.

The stock held up very well given the bear market in biotech and biopharma that commenced the very same month Eagle was cresting, but the stock finally caved into the general malaise that has overtaken these sectors and is now trading at just $55.00 a share. Ironically, the decline has occurred just as Eagle's earnings and profit trajectory have never had more visibility. The stock is also dirt cheap on a forward earnings basis and it again finds itself part of a Gems portfolio.

Company Overview:

Eagle Pharmaceuticals is a specialty pharmaceutical company focused on developing and commercializing injectable products primarily in the critical care and oncology areas utilizing a streamlined regulatory pathway available from the FDA for companies making different methods for delivering existing and approved drugs. Currently, Eagle Pharmaceuticals has a market capitalization of approximately $850 million. As of the last completed quarter, just over 10% of Eagle's market capitalization is represented by the net cash and cash equivalents on its balance sheet. The company came public in early 2014 and is based in Woodruff, NJ.

The streamlined approval path Eagle takes advantage of has several advantages over developing a new drug from scratch. Obviously, the approval process is much easier. It is also more predictable and substantially cheaper to navigate from the new drug approval pathway. A company also knows what the potential demand and end markets are by creating a better version of an existing drug. The downside is a patent ensuring 17 years of patent protection is not always in place, but a company can get years of exclusivity which



makes this a promising and profitable area of the market. This has allowed Eagle to launch two better versions of existing drugs and build a substantial pipeline that should come to market in the next few years.

BENDEKA:

What has been the main driver behind the stock's rally was the deal it struck with Teva in mid-February of 2015 around Eagle's compound known by the brand name BENDEKA. This is a more effective and faster acting reformulation of the chemo drug bendamustine. Teva was selling bendamustine under the name Treanda and Teva had $741 million in sales of Treanda in FY2015. Sales would have been significantly higher for not for the impact of the strong dollar. Teva believes BENDAKA will garner a substantial amount of those sales going forward given its improved formulation.

Eagle entered into a partnership with the generic drug giant for what was then Eagle's late stage compound for the treatment of chronic lymphocytic leukemia and indolent B-cell non-Hodgkin lymphoma. Late in 2015, the FDA approved BENDEKA for the treatment of both these conditions.

BENDEKA has significant advantages over the regular dose of bendamustine as it can be administered in 10 minutes, as opposed to 30 or 60 minutes for the current standard mixture that it existed prior to BENDEKA. It also can be administered via a 50 milliliter IV bag as opposed as the current 500 milliliter IV bag. Eagle holds a total of four patents on BENDEKA, offering patent protection through 2033 and market exclusivity for seven years.

Eagle received a $30 million upfront payment along with potentially $90 million in additional milestone payments as the drug went through the approval process as well as sales milestones ($65 million of $90 million total). Eagle will now start to receive 20% royalty percentages on the sales of the drug now that it is approved and will be marketed and distributed by Teva Pharmaceuticals.



 Taken from EGRX Corporate Presentation – Link: http://bit.ly/1VnyebR

Product Portfolio and Pipeline:

Currently, Eagle has a couple of products on the market that are providing a small revenue stream. This includes their reformulation of argatroban which is used as an anticoagulant in individuals with thrombosis and heparin induced thrombocytopenia. This drug is marketed through partners Medicines Company and Sandoz.

Eagle also has RYANODEX® which is a skeletal muscle relaxant drug indicated for the treatment of malignant hyperthermia and Prevention of malignant hyperthermia in patients at high risk. This compound is in Phase II testing for heat exposure. That indication, if approved, could exponentially expand RYANODEX®'s potential customer base and revenues. Eagle believes this market has a potential of $400 million annually.

Their improved and non-alcohol based version of DOCETAXEL was just approved and will be on the market this year. This compound is used for the treatment of breast cancer, non-small cell lung cancer, prostate cancer, adenocarcinoma and head and neck cancer. DOCETAXEL was approved in 1996 and has generic sales of some $75 million annually. Eagle, over time, should garner a good portion of the market given their improved formulation. The FDA approved Eagle's version near the very end of 2015 and it is just about to hit the market this quarter.

The company's rapid infusion version of Angiomax (Bivalirudin) has a PDUFA date in May with the FDA and should launch sometime in 2016. Angiomax recently came off patent. Eagle also is just starting work on **Pemetrexed** which will be a more effective liquid version of Alimta®, another drug used in oncology. This drug is own and patented to **Eli Lilly (NYSE: LLY)** and does more than $600 million a quarter in sales currently. However, it does not come off patent until 2020. Analysts seem to believe that Eagle's version will hit right around patent expiration. Eagle has made comments because of its patent position, it could potentially launch as soon as the end of 2017.

Analyst Commentary:

After being dormant for many months, analyst commentary has picked up some over the past month or so and the consensus view on Eagle is solidly positive. On January 6th, RBC Capital reiterated their Buy rating on Eagle with a $100.00 a share price target. On January 31st, William Blair decided to maintain their Buy rating and $109.00 a share price target on EGRX. Finally on February 14th, a five-star ranked Mizuho Securities analyst maintained her Buy rating and $112.00 a share price target on Eagle. Overall, four analysts have coverage on Eagle Pharmaceuticals. All have Buy ratings and price targets range from $100.00 a share to $119.00 a share. At the mid-price of that range Eagle would be almost a double from here.

Valuation and Outlook:

I always take analyst price targets with a grain of salt. However, if Eagle comes close to achieving its projected growth trajectory, the stock looks exceedingly cheap at current levels. After breaking even in FY2014, Eagle should post just over 60 cents a share in profits in FY2015. Most of the company's revenues and profits in FY2015 came from upfront and milestone payments on BENDAKA. Eagle's fourth quarter earnings report is due next week.

In FY2016, a huge jump in revenues and earnings are projected to occur mainly due to sales of BENDEKA. The consensus earnings estimates for EGRX is just over $6.25 a share in FY2016 as revenues more than triple to over $250 million in the coming fiscal year. Earnings estimates currently range from $5.77 a share to $7.22 a share. Even at the low end of that range, Eagle goes for slightly less than 10 times forward earnings.

That is way too cheap given its growth prospects, pipeline, and business model. In addition, companies in this space that have this sort of projected growth typically go for 5-8 times sales depending on sentiment in the market. Stripping out cash and Eagle goes for just under three times 2016's projected revenues. In the

middle of that more traditional range, Eagle would trade right at its current median price target by analysts right now.

We also can't dismiss a buyout from Teva as this would allow them to claw back future royalty streams on BENDAKA. They could also apply some of Eagle's technology to make their huge staple of existing drugs more effective just as they did in a back door way with Treanda. The bottom line is the prospects are bright for Eagle and 2016 should be filled with numerous milestones and rapidly expanding earnings and revenues.

Recommendation: BUY EGRX up to $65.00 a share.

Position: Long EGRX

Portfolio News

Mylan (NASDAQ: MYL) had a significant sell-off this week because of investors' reaction to an announced $10 billion acquisition was that the company overpaid for this European purchase. As I noted in an article on SeekingAlpha, after the sell-off, this reaction seems more than a little extreme. The acquisition will be accretive by 35 to 40 cents a share to earnings by FY2017 and gets Mylan into faster growing emerging markets. I would not be surprised if the shares recapture a decent amount of their decline this week or in the weeks ahead. I raised my stake in this core holding by 25% during this week's sell-off. The stock is selling at just seven times the profits management just guided to for FY2017 and just over eight times this year's likely earnings.

Gilead Sciences (NASDAQ: GILD) continues to gain significant strength even in a down market since blowing away earnings estimates on February 2nd. I don't want to overly optimistic but it sure seems the bottom is in on this core holding.

Portfolio Modifications:

Given the huge downdraft in the biotech sector this year, we will be reviewing opportunities to "de-risk" the portfolio in coming weeks. Almost all small biotechs and biopharma concerns have fallen substantially in this deep bear market. Given this it makes sense to move the portfolio away from any early or mid-stage developmental concerns and replacing them with positions in small caps that just had drugs approved or just commercialized their first products.

This includes **Relypsa (NASDAQ: RLYP)** or **BioDelivery Sciences (NASDAQ: BDSI)** as well as those small caps that have a variety of products on the market like **Horizon Pharma (NASDAQ: HZNP)**. This way we can take some of the "pipeline" risk out of the portfolio while still participating fully in the rally when sentiment on the sector gets less negative. The first of this type of this change is the replacing of **Protalix Biotherapeutics (NASDAQ: PLX)** with Eagle Pharmaceuticals.

It will be the first of several we will make over the month or two to take advantage of much lower prices on shares of companies who have been hit despite little pipeline risk.

As of this issue, Protalix Biotherapeutics will no longer be covered and will now be found in the 'Closed Positions' section of the portfolio.

Current Portfolio

Company	Entry Date	Entry Price	Recent Price	Buy Up To	Returns
Eagle Pharmaceuticals (EGRX)	02/16/16	$56.54	$56.54	$65.00	N/A
TG Therapeutics (TGTX)	01/13/16	$8.47	$9.00	$11.00	6.3%
Relypsa (RLYP)	11/13/15	$18.96	$18.32	$22.50	-3.4%
Biogen Idec (BIIB) - **Core**	10/23/15	$276.99	$256.52	$300.00	-7.4%
Xencor Inc. (XNCR)	10/07/15	$12.49	$11.50	$15.00	-7.9%
AbbVie (ABBV) - **Core**	09/28/15	$52.50	$53.51	$62.50	1.9%
Horizon Pharma (HZNP)	09/10/15	$28.58	$18.01	$32.00	-37.0%
Synthetic Biologics (SYN)	09/10/15	$2.44	$1.07	$2.75	-56.1%
Lexicon Pharmaceuticals (LXRX)	08/24/15	$11.33	$9.43	$12.50	-16.8%
Mylan (MYL) - **Core**	08/10/15	$57.52	$43.15	$60.00	-25.0%
TRACON Pharmaceuticals (TCON)	08/10/15	$11.40	$6.59	$13.00	-42.2%
Celsion Corporation (CLSN)	07/21/15	$2.45	$1.21	$3.00	-50.6%
Pernix Therapeutics (PTX)	07/07/15	$5.63	$2.11	$6.50	-62.5%
Amgen (AMGN) - **Core**	07/07/15	$155.39	$147.15	$160.00	-5.3%
pSivida Corporation (PSDV)	06/22/15	$4.03	$2.81	$4.50	-30.3%
XOMA Corporation (XOMA)	06/22/15	$4.28	$0.79	$5.00	-81.5%
Heat Biologics (HTBX)	06/05/15	$6.51	$2.07	$7.00	-68.2%
Synergy Pharmaceuticals (SGYP)	06/05/15	$4.90	$3.75	$5.50	-23.5%
Gilead Sciences (GILD) - **Core**	05/08/15	$103.85	$91.15	$115.00	-12.2%
Pacific Biosciences of Calif. (PACB)	05/08/15	$6.09	$8.90	$7.00	46.1%
Inovio Pharmaceuticals (INO)	05/08/15	$8.01	$6.57	$10.00	-18.0%

**Recent price is determined by the last "Close" price at the closing of the market on the day before publication; most recent update: 02/16/16.

Closed Positions

Company	Entry Date	Entry Price	Close Price	Returns	Close Date
Protalix BioTherapeutics (PLX)	05/08/15	$2.17	$0.86	-60.4%	02/16/16

Notes:

Positions designated as **"Core"** represent the large-cap stocks in the portfolio that should make up 50% to 75% of an investors biotech portfolio depending on each subscriber's individual risk profile.

Entry price is determined by the last "Close" price at the closing of the market on the day before publication, which also serves as the Entry Date. Buy Up To is the upper share price limited recommended for buying new shares. Returns data is share price appreciation or depreciation between entry price and recent price.

This is not real-time data and should not be interpreted as such. All data is subject to change without notice.

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