

# LANNETT CO.

HEALTHCARE STOCK PITCH – FEBRUARY 9 2015

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# HOLDINGS ~~S~~ REVIEW

# VASCULAR SOLUTIONS

## HOLDING REVIEW

### SUMMARY

- Medical devices company focused on clinical solutions for coronary and peripheral vascular procedures
- Operates US and internationally through 91 direct sales representatives in the US and established independent distributor network covering nearly 50 countries

### MARKET SUMMARY

Share Price	\$28.64
Market Capitalization	\$492.7M
52-Week Range	\$18.42 – 30.965
Beta	0.89
EPS	\$0.86

Market summary data as of 2/8/2015. 2014 FY EPS shown.

### Q4 2014 EARNINGS

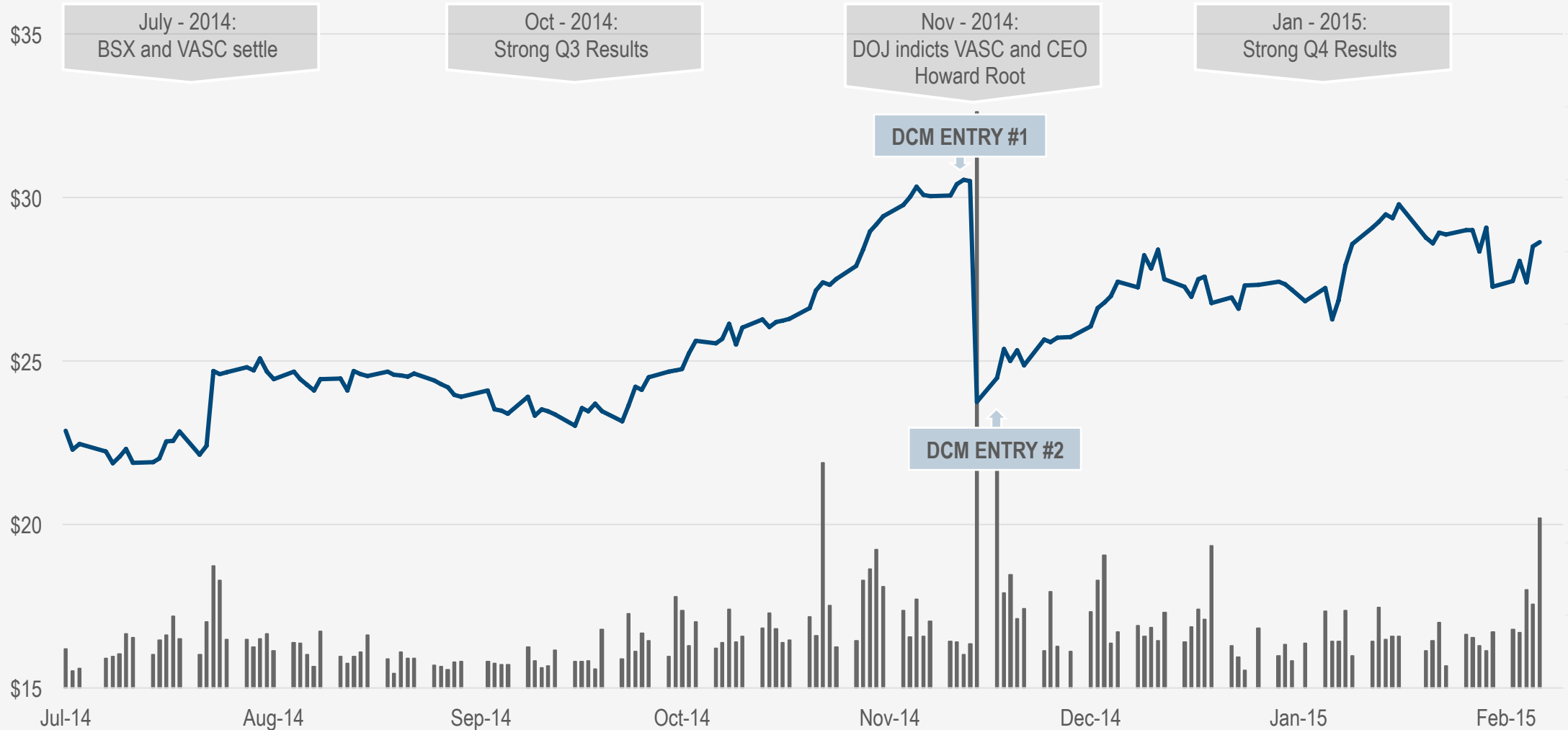
- GAAP EPS of \$0.23, up 20% YoY
- Q4 Sales of \$33.6M, up 15.5% YoY, exceeding top-end of guidance
- FY 2014 Sales up 14% YoY
- 2015 Guidance:
  - Full product pipeline (+40 products)
  - 12<sup>th</sup> consecutive year of double-digit sales growth

### UPDATES TO LITIGATION

- NO UPDATES

# 1Y TRADING PERFORMANCE

## SOLID RECOVERY POST DOJ LEGAL STUMBLE



# LANNETT COMPANY

# **INTERNAL ENVIRONMENT**

# LANNETT CO.

## COMPANY OVERVIEW

### SUMMARY

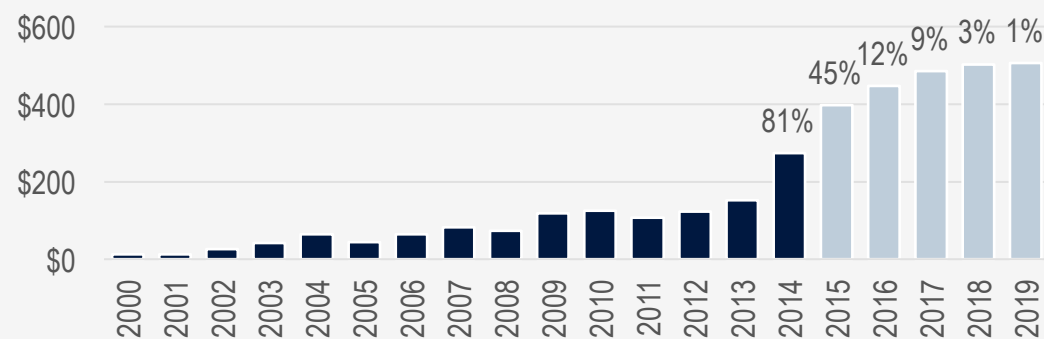
- Top 25 generic pharmaceuticals company focused on off-patent drugs in the US exclusively
- Primed for continued fast growth with 15 pending FDA applications, and 58 additional development-stage products

### MARKET SUMMARY

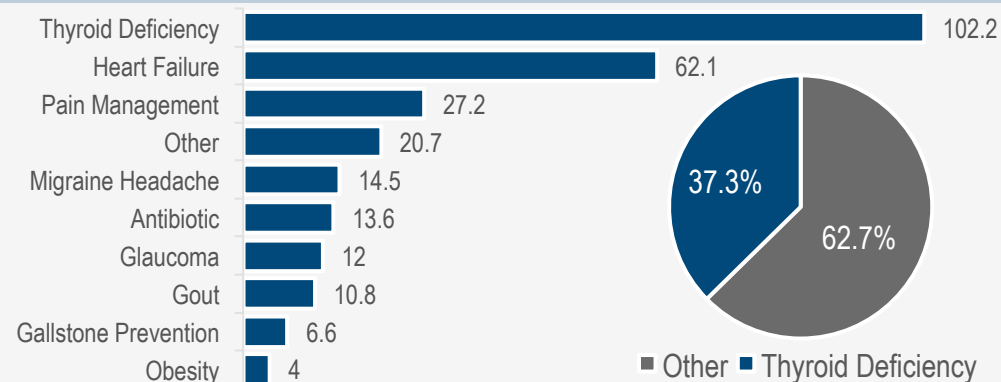
Share Price	\$52.04
Market Capitalization (M)	\$1,863
52-Week Range	\$29.12 – 59.44
Beta	1.8
EPS	\$1.21

Market summary data as of 2/5/2015.

### REVENUE GROWTH (M)



### 2014 REVENUE BREAKDOWN BY SEGMENT





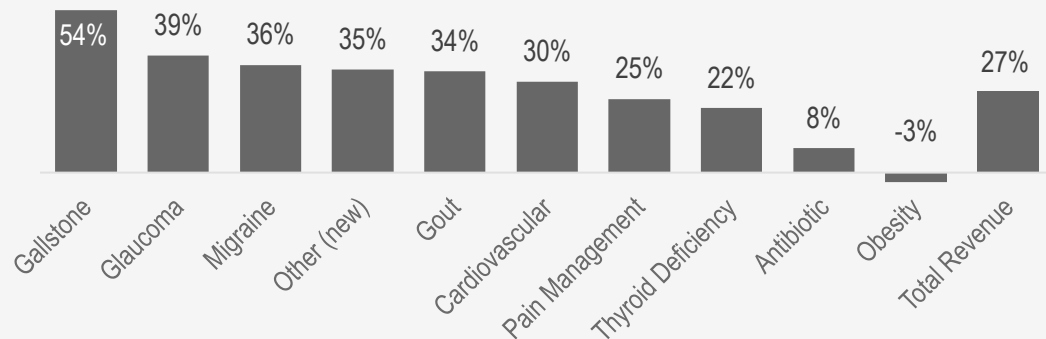
# LANNETT CO.

## COMPANY OVERVIEW

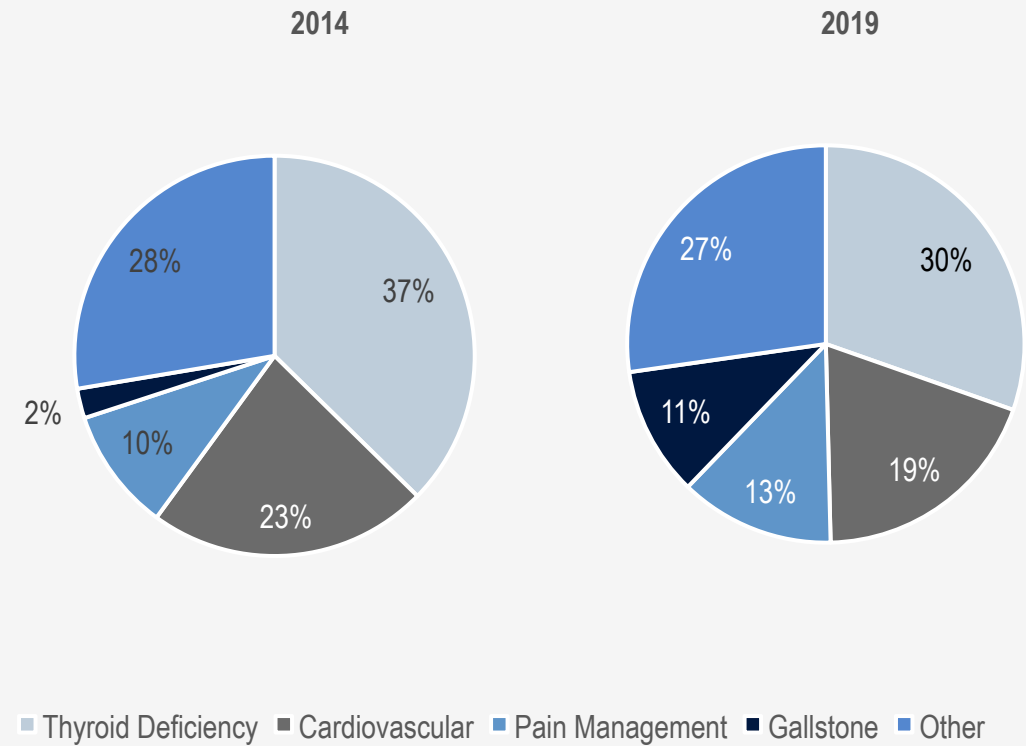
### KEY DRUGS

	% of 2015 Revenues	Q4 2014 % Price Change	Medical Indication	Equivalent Brand
Levothyroxine	32%	58%	Thyroid Deficiency	Levoxyl® / Synthroid®
Digoxin	23%	60%	Congestive Heart Failure	Lanoxin®
Ursodial	15%	1389%	Gallstone	Actigall®

### SEGMENTS REVENUE GROWTH

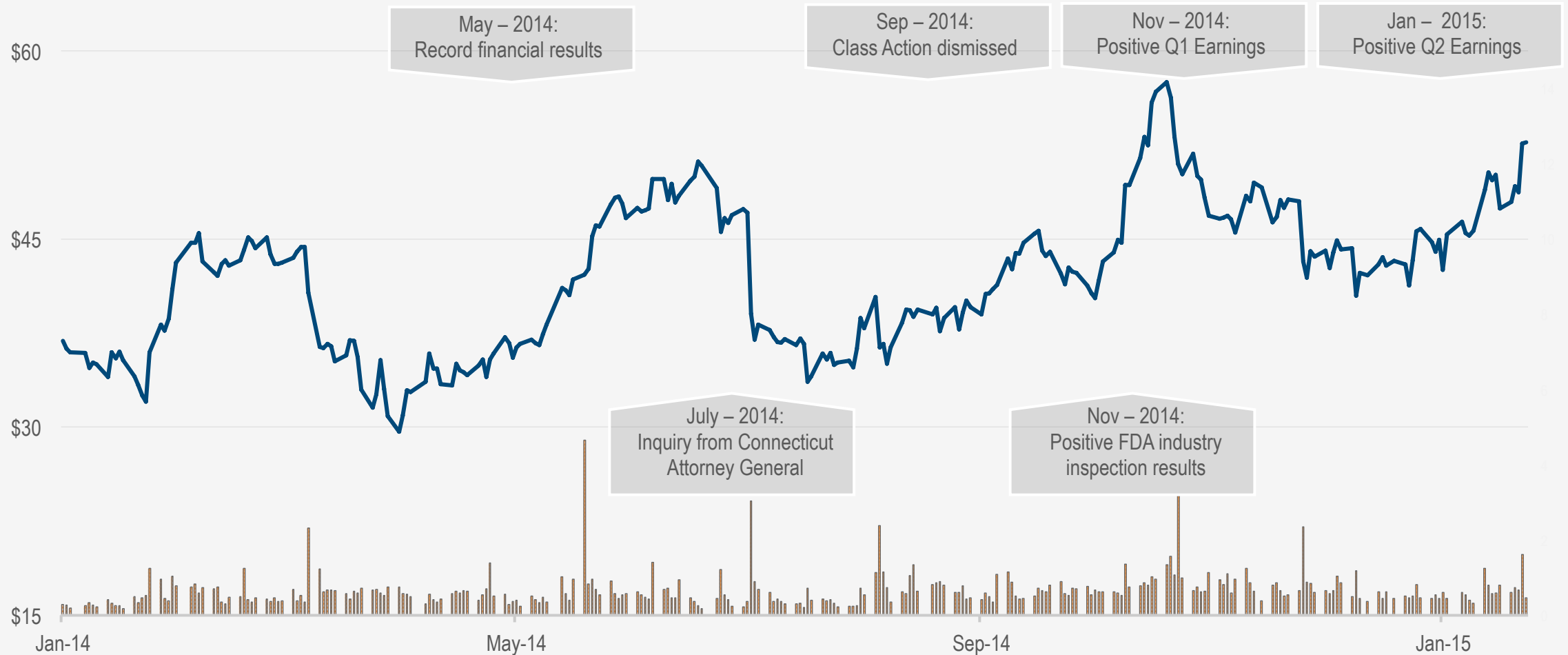


### KEY SEGMENTS % OF TOTAL SALES



# 1Y TRADING PERFORMANCE

## LEGAL<sup>2</sup> WITH A DASH OF GOOD EARNINGS



# INVESTMENT THESIS

BUYING AN EXCELLENT BUSINESS AT A GOOD PRICE

DCM BUY RATING WITH \$70 PRICE TARGET – 35% UPSIDE

## BUSINESS MODEL

### 1. DIVERSIFYING REVENUES

Revenue diversification trend helps insulate company against FDA and industry risks (ex: 2011 Oxycodone)

### 2. REELING IN R&D

Hybrid R&D model: in-house and purchasing ANDAs to reduce R&D intensity (optionality value)

### 3. CONTROLLING COSTS

Vertical integration in key growth segments allows LCI to control costs and boost margins against peers

## SECULAR TRENDS

### EXPOSURE TO US GENERICS UNDER ACA

Positive secular trends to capitalize on US healthcare's favorable legislative landscape for low cost drugs

## VALUATION

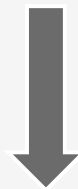
### ATTRACTIVE BOTH RELATIVELY AND INTRINSICALLY

Recent revenue explosion has yet to translate into price appreciation due to “noise” leaving LCI relatively cheap

# BUSINESS MODEL (PART 1)

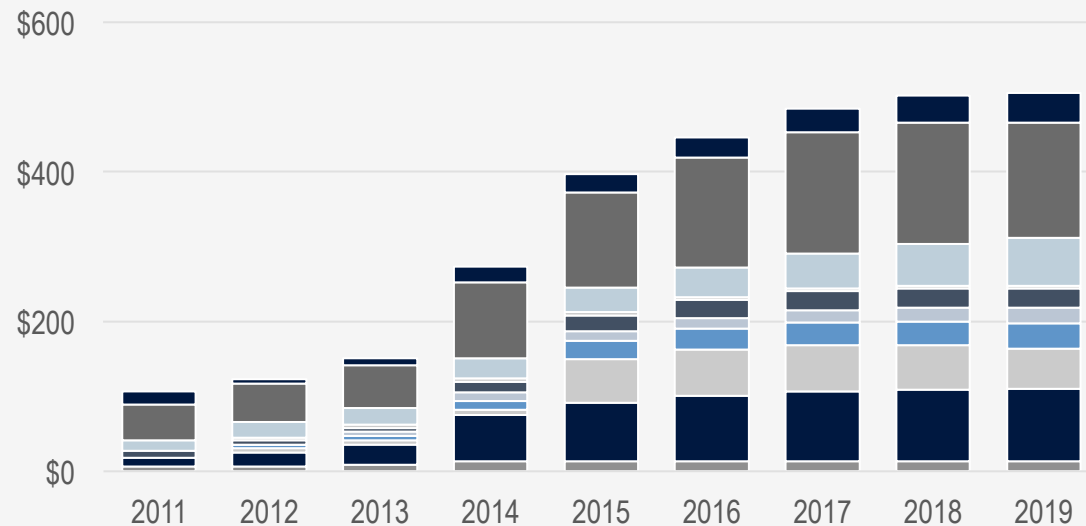
## FIGHT THE FDA

### STEADY CADENCE OF PRODUCT APPROVALS



Steady cadence of new product approvals insulates the company from FDA risk given slowing trend of ANDA approvals (will discuss later)

### DIVERSIFIED REVENUES: SAFETY IN NUMBERS

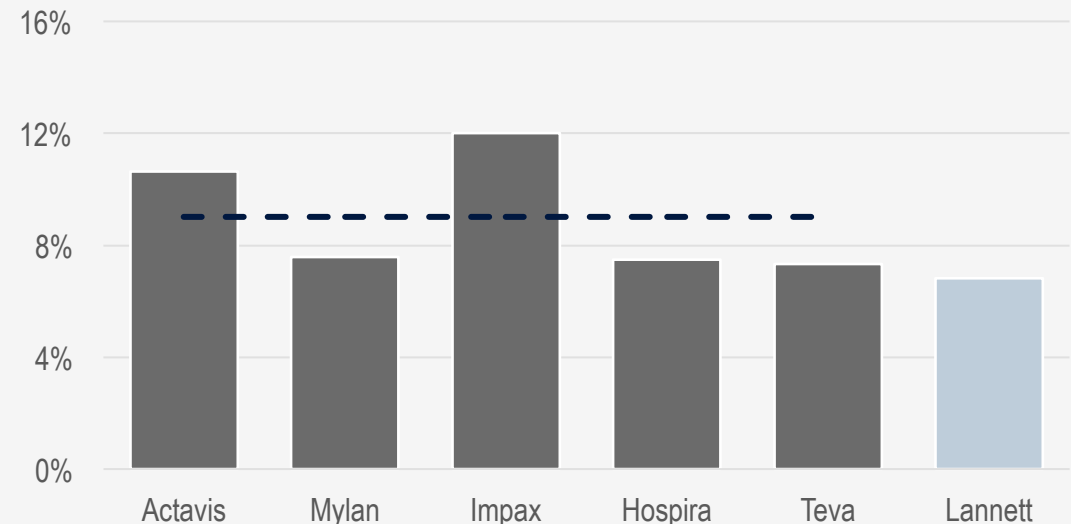


### R&D OPTIONALITY: BUYING ANDAs

By purchasing ANDAs from other generic manufacturers to complement in-house R&D LCI can control R&D costs through optionality



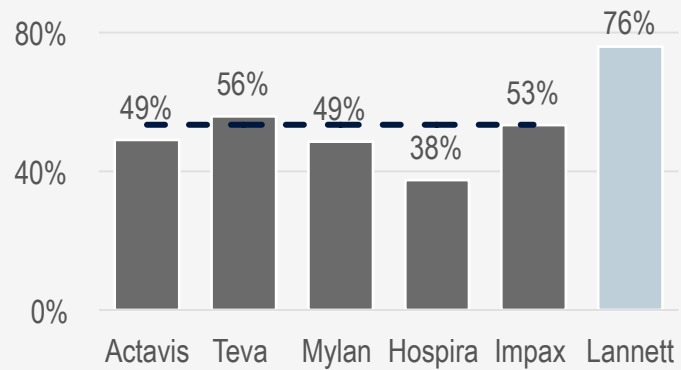
### CONTROLLING R&D INTENSITY



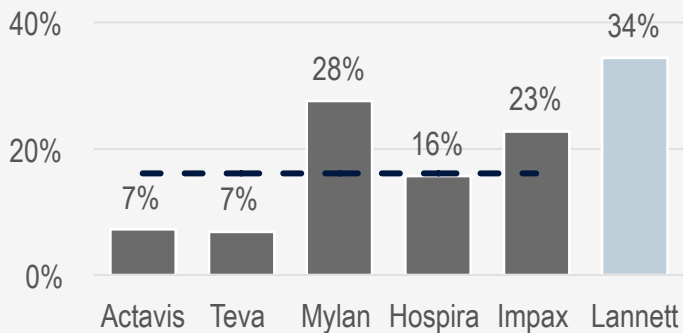
# BUSINESS MODEL (PART 2.1)

## MARGINS? SO GROSS!

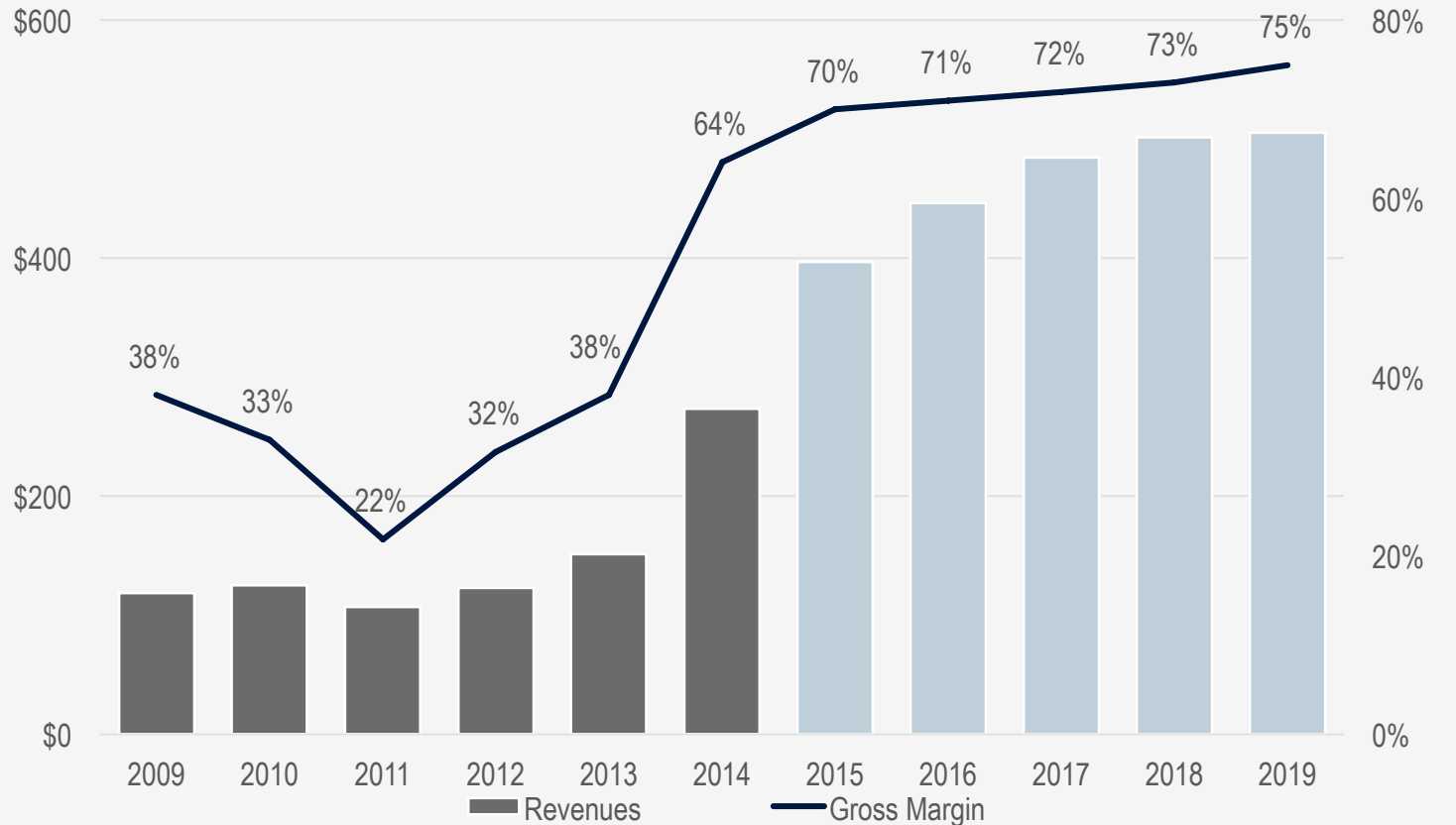
### GROSS MARGINS



### EBITDA MARGINS



### BEAUTIFUL MARGIN EXPANSION WITH REVENUE GROWTH



# BUSINESS MODEL (PART 2.2)

## VERTICAL INTEGRATION FT. OPIUM AND COCAINE

### CODY LABS ACQUISITION

Lannett buys Cody Labs for \$11.7 million in April 2007 for access to DEA granted license to import poppy straw for opioid-based APIs (only six other companies have license in US)

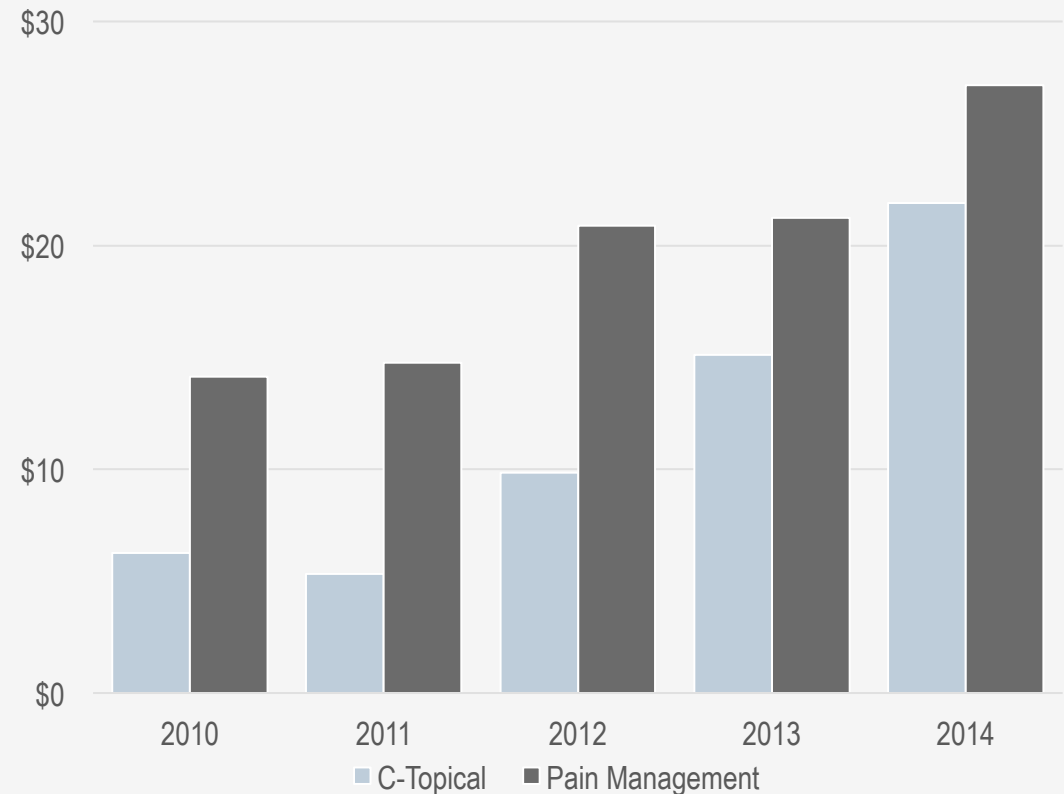
### COCAINE HYDROCHLORIDE SOLUTION

First foray into branded market with vasoconstriction topical solution currently has FDA IND approval and awaiting FDA full approval (highest margin business)

### GROWTH OF BABY BOOMER MARKET TO DRIVE CONTROLLED SUBSTANCE SALES

Pain management and migraine sectors to benefit

### C-TOPICAL AND PAIN REVENUES (M)

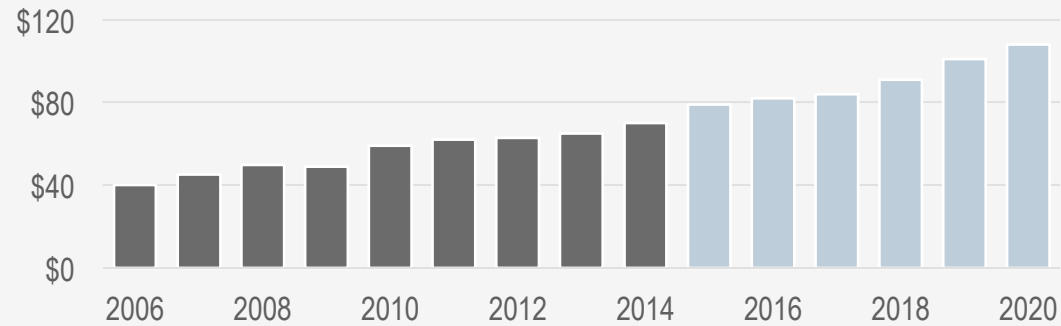


# EXTERNAL ENVIRONMENT

# GENERICS AT A GLANCE

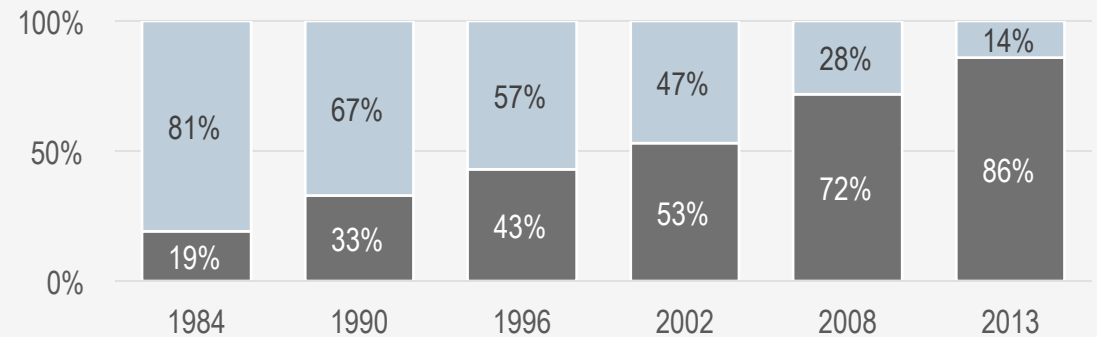
## THE GENERIC DRUGS INDUSTRY ALIVE AND WELL

### GLOBAL GENERICS SALES (BN)



Source: EvaluatePharma - For top 60 companies

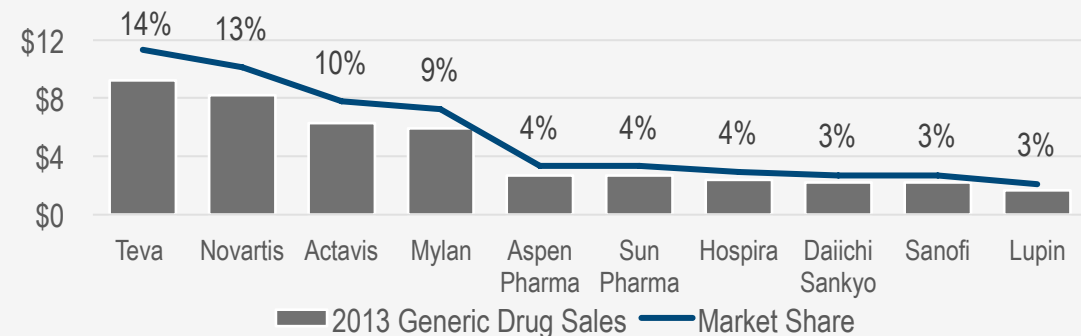
### US PRESCRIPTIONS GENERICS VS. BRANDED



Source: IMS Health

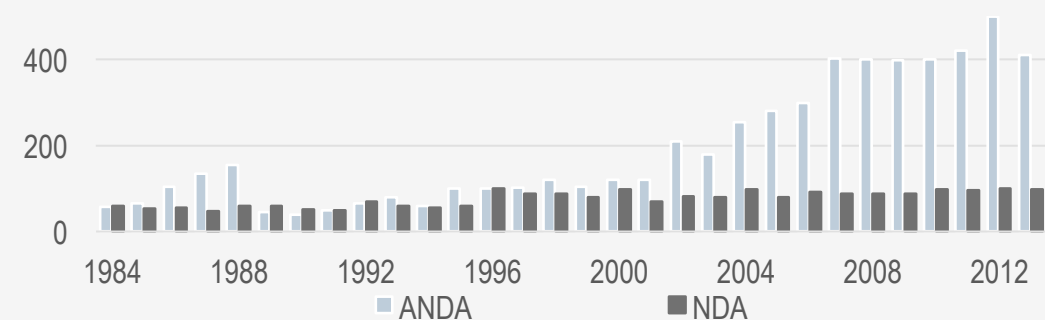
■ % Generics ■ % Branded

### STILL FRAGMENTED (BN)



Source: EvaluatePharma

### FDA APPLICATION APPROVALS



Source: Thomson Reuters



# FDA ALWAYS GETTING IN THE WAY

FIRST LAW MAKES A MESS. SOLUTION? A NEW LAW.

## HATCH-WAXMAN LAW EFFECT

↓ Yielded hundreds of unprecedented medical breakthroughs by rewarding innovation over the past 30 years

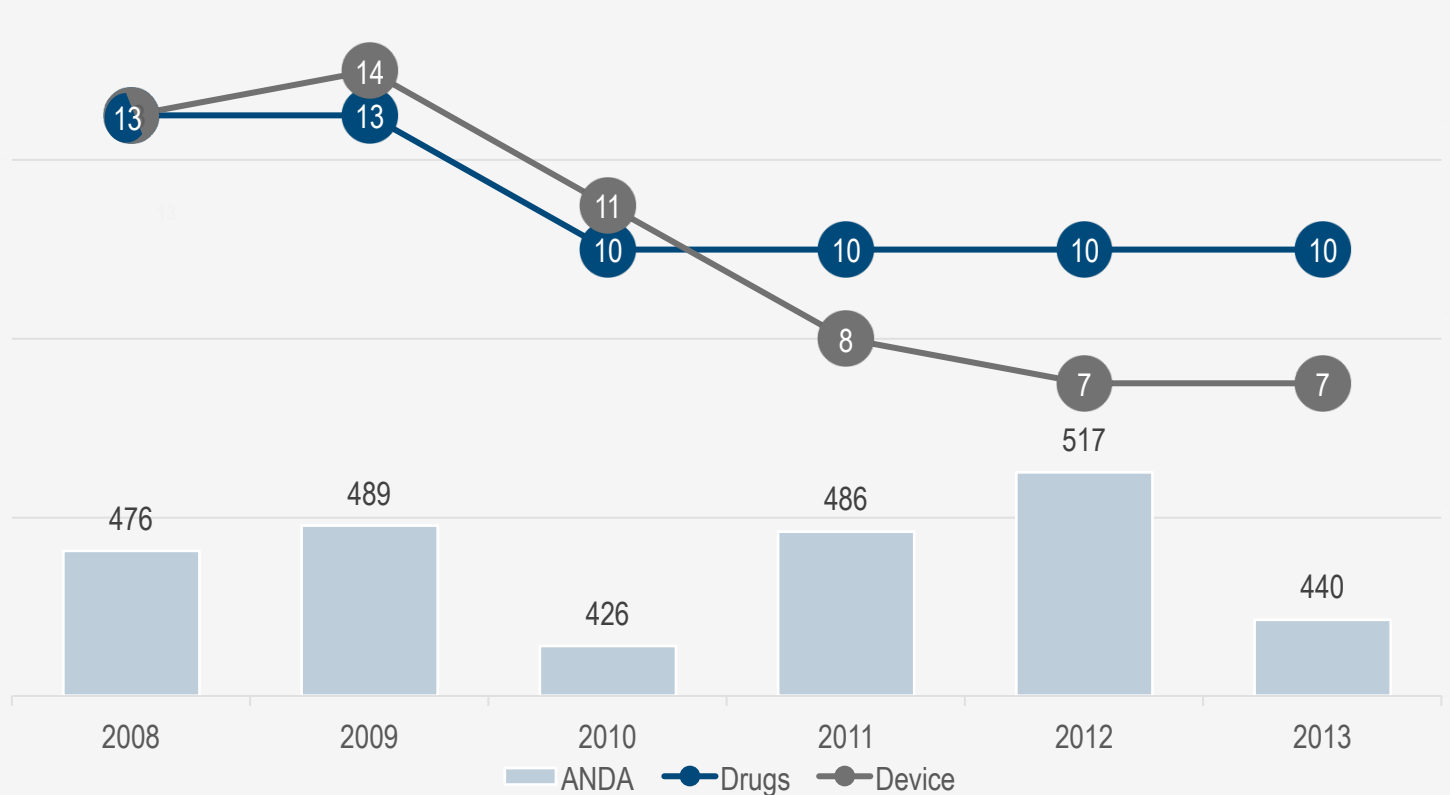
## FEE TO CLEAR BACKLOG

↓ Generic Drug User Fee Amendments to clear backlog of 3,000 ANDAs – estimated \$299M/year in fees

## IMPACT FOR LANNETT

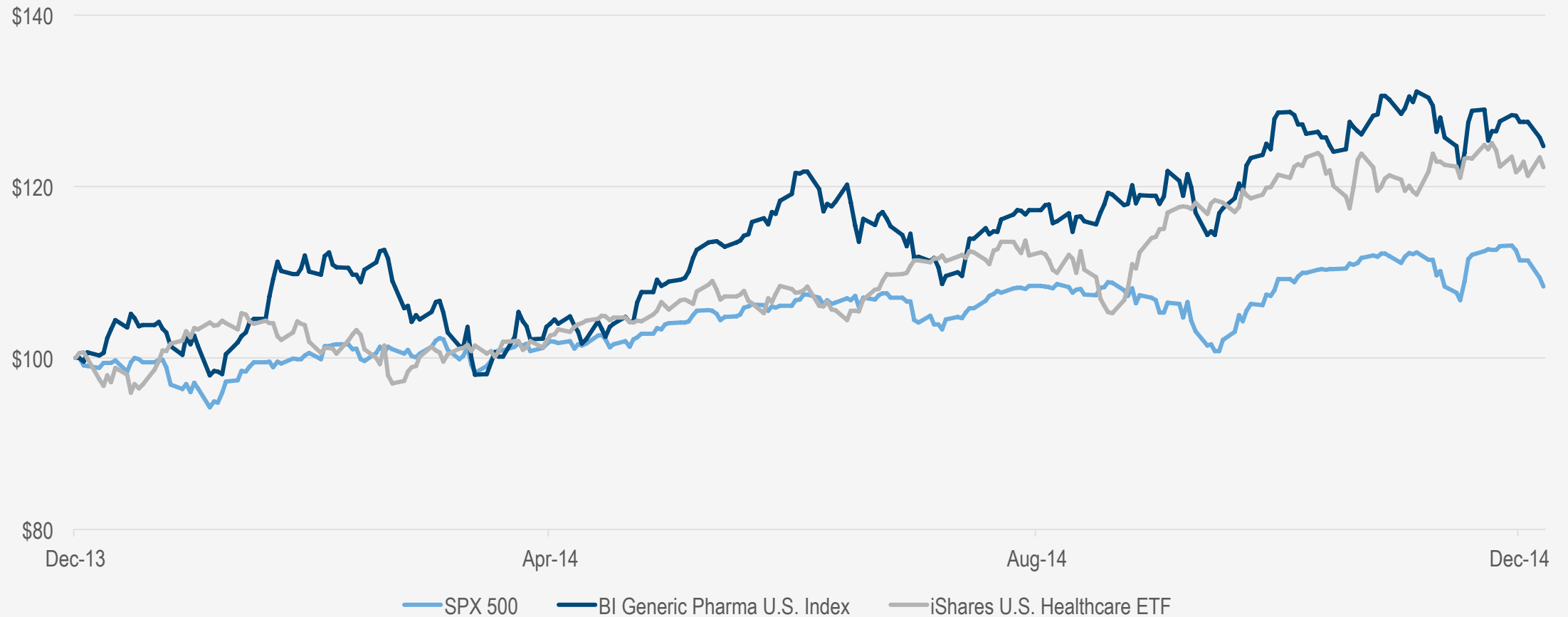
Being more selective: already have the expertise in place to purchase ANDAs should it be more profitable (a leg up on the competition)

## APPLICATIONS APPROVED BY FDA AND MONTHLY WAIT TIME



# GENERICS TRACKING HEALTHCARE

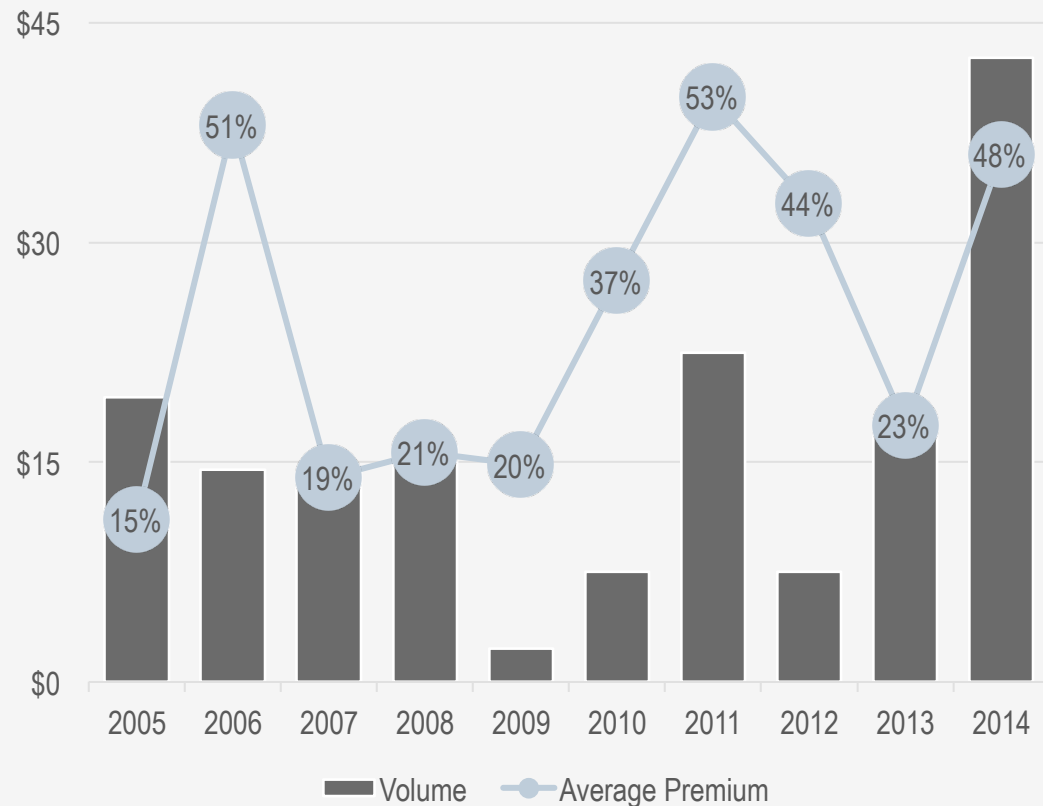
## RELATIVE TRADING PERFORMANCE



# GENERICS M&A

## IN THE PURSUIT OF HAPPINESS/GROWTH

### GENERICS M&A – 10Y (BN)



### WHAT'S DRIVING THE JUMP?

#### 1. INVERSION TAX DEAL

Quest for tax inversion pushed M&A numbers, with US companies buying Euro-based companies to lower their tax rates

#### 2. INORGANIC GROWTH

Assessing new products via acquisitions is critical, mid-sized specialty and generic companies often lacking the in-house R&D capabilities of larger peers

**US GENERICS M&A AT 10 YEAR HIGH**

# PRICING: THE GOOD AND THE BAD

TURNS OUT ALL THAT MATTERS IS NUMBER OF MANUFACTURERS

## GENERIC DRUGS PRICING DRIVERS

### SUPPLY AND DEMAND

As of July 2013, 302 drugs were in short supply, up from 2011 YoY. How could this happen in a free-market economy? Cartels have undermined the laws of supply and demand.

### COMPETITION

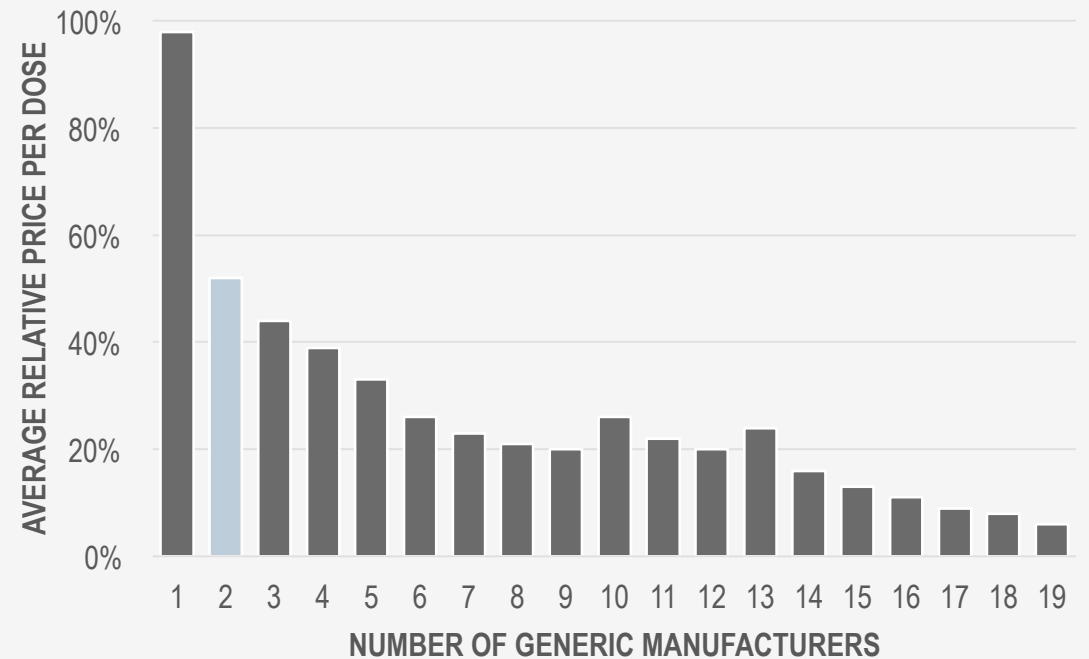
It is incorrect to take for granted that generic drugs are low-cost. They are only because of competition.

### LEGISLATION

Congress launched an investigation. To fight rising prices, tabling a bill requiring generic drug makers to pay rebate to Medicaid.

### LEFT UNEXPLAINED

## BASICALLY IT BOILS DOWN TO COMPETITION



Source: IMS Health 2005

**MORE THAN 25% OF GENERIC DRUGS SAW THEIR PRICES SPIKE BY 600% TO 2000% - NATIONAL COMMUNITY PHARMACISTS ASSOCIATION JAN 2014**

# PRICE HIKES: GOOD OR BAD?

## GOOD IF YOU GET AWAY WITH IT

### 4(PRICE<sub>DIGOXIN</sub>)

↓ In 2014, prices for digoxin spiked – pharmacies quadrupled the drug’s cost. Only two business dominated the market.

### OK, BUT WHY?

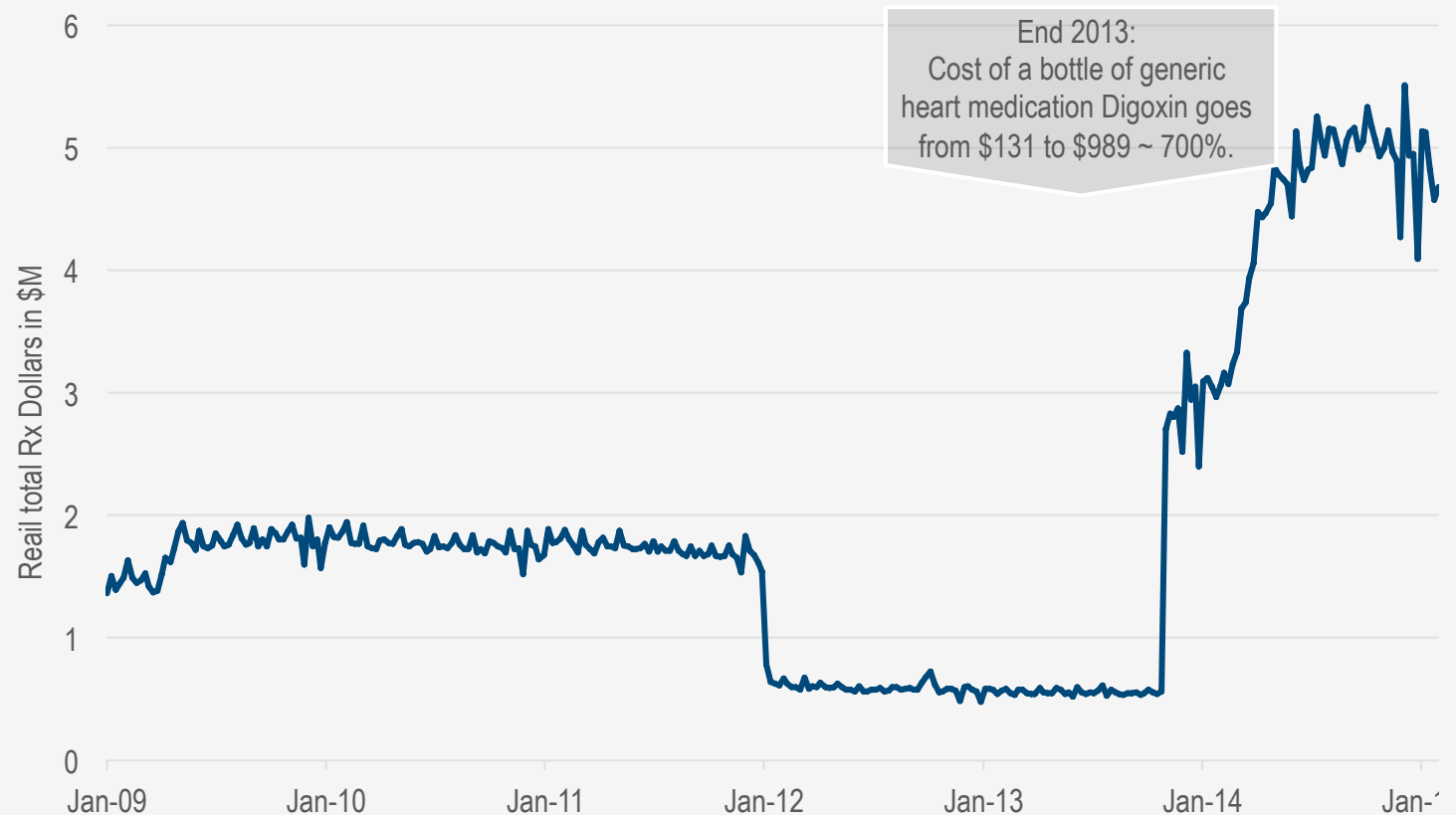
↓ In 2013, competitive landscape changes. Few players → better pricing → more money (!!!)

### SHOULD WE WORRY?

“Studies show it is not until you have four or five generics in the market that the prices really are down.”

Source: Harvard School of Public Health

## WHEN MY HEART MEDICATION GIVES ME A HEART ATTACK



# WHERE THERE IS HEALTHCARE

## LITIGATION, LITIGATION, MORE LITIGATION, THEN MORE LITIGATION

### ANTI-TRUST LAWS

↓ In July 2014, Lannett and Impax were served with grand jury subpoenas for possible violations of anti-trust laws

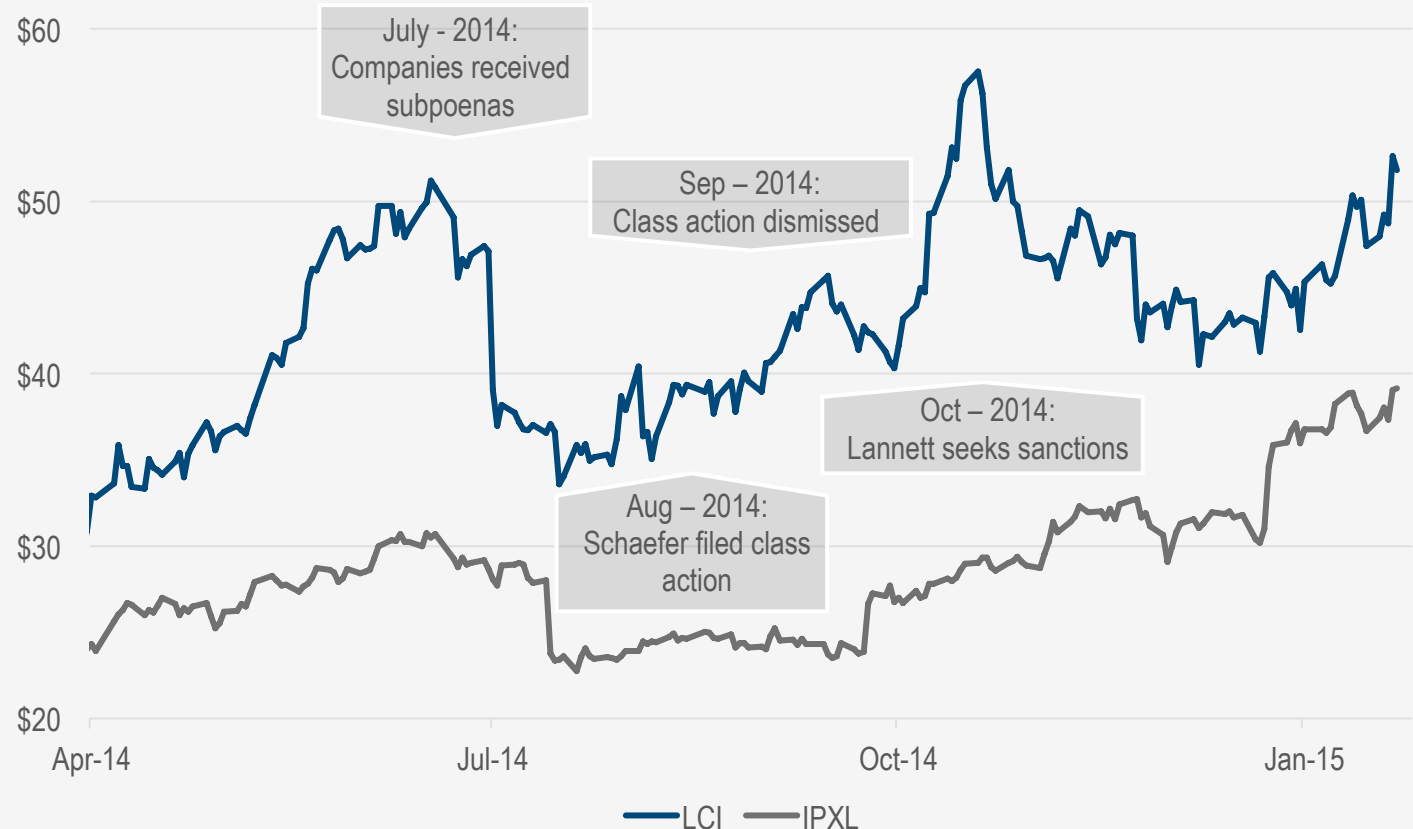
### OUTCOME: SETTLEMENT?

↓ To date, Lannett has completed its internal review in compliance with applicable laws and regulations

### WHY IT MATTERS

Lannett's Cardiovascular Sales	2013	2014
	\$25.9M	\$62.1M
% growth	140%	

### HOW THE MARKET FELT ABOUT THIS WHOLE ORDEAL

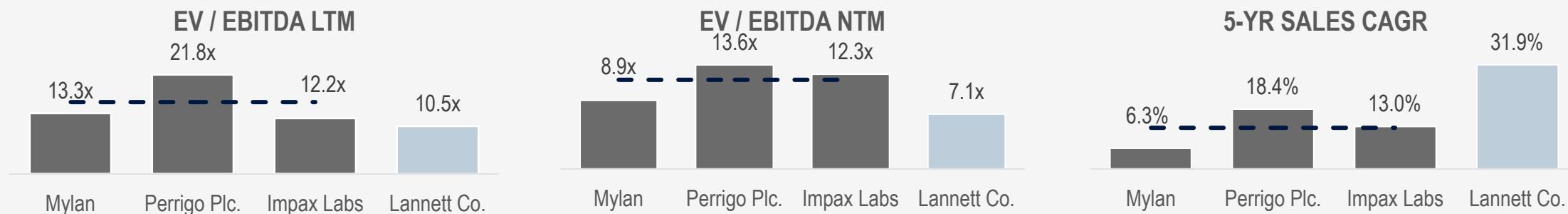


# VALUATION

# COMPARABLE COMPANIES

RELATIVELY CHEAP GIVEN RECENT JUMP IN EARNINGS AND NO ASSOCIATED JUMP IN PRICE

COMPANY	MKT CAP (M)	EV (M)	EV / EBITDA		EV / SALES		P / E		5-YR SALES CAGR	GROSS MARGIN	EBITDA MARGIN
			LTM	NTM	LTM	NTM	CURRENT	NTM			
Actavis	\$73,602	\$88,803	48.8x	10.8x	7.5x	4.2x	54.1x	16.1x	40.9%	48.9%	7.2%
Teva Pharma	49,741	57,884	9.8x	9.2x	2.9x	3.0x	16.1x	11.4x	2.7%	55.9%	6.9%
Perrigo Plc.	21,166	22,351	21.8x	13.6x	5.4x	4.1x	51.3x	17.7x	18.4%	35.8%	--
Mylan Inc.	20,170	26,682	13.3x	8.9x	3.6x	2.8x	18.3x	13.1x	6.3%	48.6%	27.6%
Hospira Inc. <sup>(1)</sup>	10,430	11,650	15.7x	14.1x	2.6x	3.5x	40.8x	36.6x	55.2%	37.5%	15.7%
Impax Labs	2,789	2,347	12.2x	12.3x	4.1x	3.3x	40.5x	27.8x	13.0%	53.4%	22.8%
Sagent Pharma	833	678	29.7x	15.6x	2.5x	2.0x	64.7x	41.8x	19.5%	28.7%	5.8%
<b>MEDIAN</b>			<b>15.7x</b>	<b>12.3x</b>	<b>3.6x</b>	<b>3.3x</b>	<b>40.8x</b>	<b>17.7x</b>	<b>18.4%</b>	<b>48.6%</b>	<b>11.4%</b>
<b>Lannett Co.</b>	<b>\$1,855</b>	<b>\$1,671</b>	<b>10.5x</b>	<b>7.1x</b>	<b>4.5x</b>	<b>3.9x</b>	<b>15.2x</b>	<b>13.8x</b>	<b>31.9%</b>	<b>75.9%</b>	<b>34.4%</b>



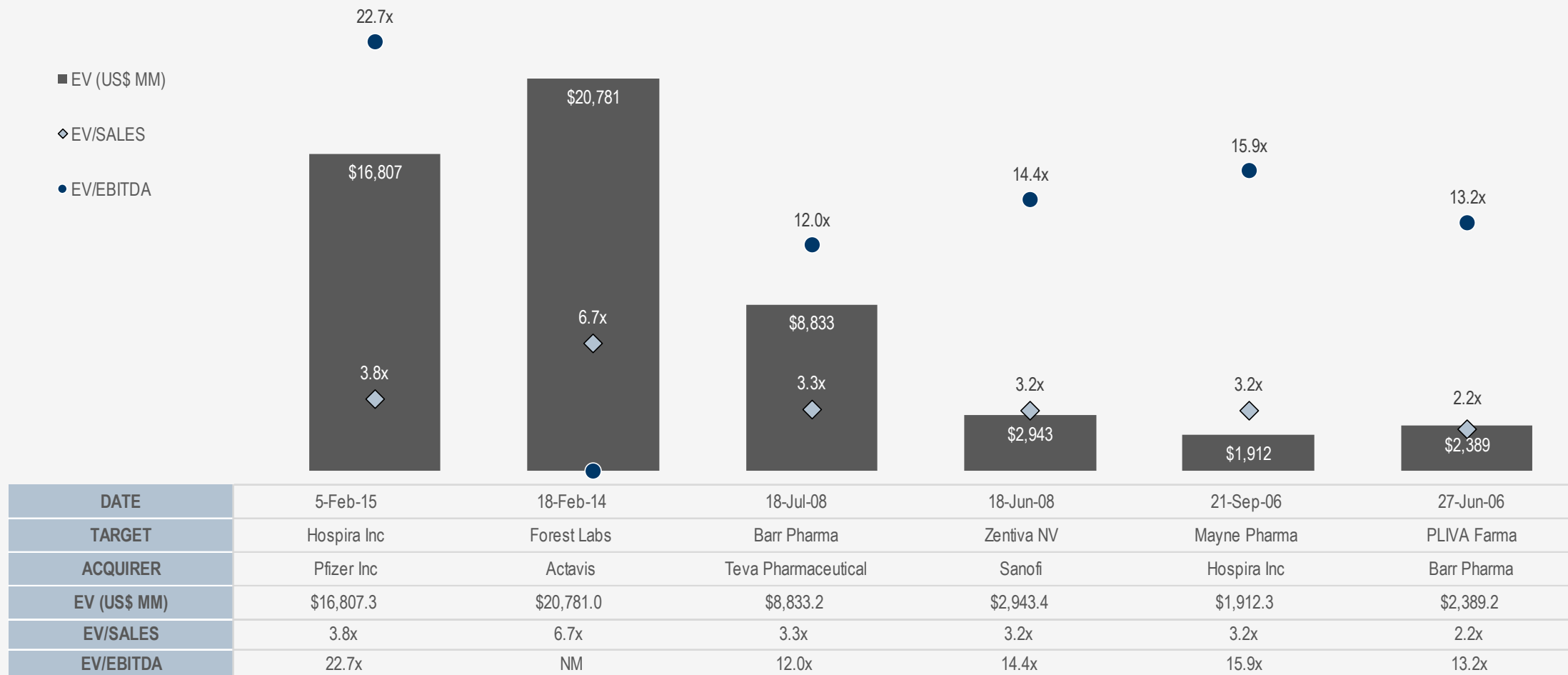
Market data as of 2/7/2015.

(1) Adjusted for pre-takeout enterprise value at 2/5/2015.



# PRECEDENT TRANSACTIONS

TRICKY TO FIND SOMETHING OUR SIZE AND GENERIC RECENTLY



# VALUATION SUMMARY

## ATTRACTIVE DESPITE PRICE APPRECIATION

### SUMMARY



### ASSUMPTIONS (YOU KNOW WHAT THEY SAY...)

	4Y HIST AVG.	WORST	BASE	BEST
Cardiovascular	57%	20% → -10%	25% → 2%	25% → 10%
Thyroid	25%	15% → -10%	25% → -5%	25% → -5%
Pain	18%	15% → -10%	20% → 15%	20% → 18%
<b>Revenue CAGR</b>	<b>27%</b>	<b>0%</b>	<b>5%</b>	<b>8%</b>

### VALUATION

		Discount Rate				
		10%	11%	13%	14%	15%
Terminal Multiple	11.5	\$71	\$68	\$63	\$61	\$59
	12.0	\$73	\$71	\$65	\$63	\$60
	12.5	\$76	\$73	\$67	\$65	\$62
	13.0	\$78	\$75	\$69	\$67	\$64
	13.5	\$81	\$77	\$72	\$69	\$66
	14.0	\$83	\$80	\$74	\$71	\$68
	14.5	\$85	\$82	\$76	\$73	\$70

(US\$M)

	2015	2016	2017	2018	2019
Revenues	396,902.4	446,476.5	484,671.3	501,625.7	505,496.8
EBIT	200,813.4	226,960.9	250,438.4	269,021.4	275,944.0
Net Income	130,655.1	147,672.1	162,955.7	181,538.7	181,996.5
Diluted EPS	3.6	4.1	4.6	5.1	5.1
Gross Profit Margin %	70.0%	71.0%	72.0%	73.0%	75.0%

# WRAP UP

# INVESTMENT THESIS

BUYING AN EXCELLENT BUSINESS AT A GOOD PRICE

DCM BUY RATING WITH \$70 PRICE TARGET – 35% UPSIDE

## BUSINESS MODEL

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Revenue diversification trend helps insulate company against FDA and industry risks (ex: 2011 Oxycodone)

### 2. REELING IN R&D

Hybrid R&D model: in-house and purchasing ANDAs to reduce R&D intensity (optionality value)

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Positive secular trends to capitalize on US healthcare's favorable legislative landscape for low cost drugs

## VALUATION

### ATTRACTIVE BOTH RELATIVELY AND INTRINSICALLY

Recent revenue explosion has yet to translate into price appreciation due to “noise” leaving LCI relatively cheap

# WHAT LIES AHEAD

## IT'S ALL ABOUT THE RISK-RETURN TRADE OFF

### CATALYSTS

#### NYSE LISTING

Common shares recently listed– increased liquidity could be positive

#### NEAR-TERM SETTLEMENT

Very likely that Lannett and Connecticut AG will reach settlement

#### M&A

Great small to mid sized target for larger pharma companies looking to growth their market share rapidly

#### CONTROLLED SUBSTANCES

C-Topical approval and growth in pain management and migraine businesses (management target 50% of long-term revenues)

TIME

### RISKS

#### KEY MAN RISK

Company success is highly dependent on CEO Arthur Bedrosian – failure to maintain his employment would long-term vision

#### OWNERSHIP STRUCTURE

Insider ownership is high ~ 20% held by Farber family – potential for price pressure if large share sales

#### LITIGATION OVERHANG

Congress is conducting investigation regarding pricing of generic drugs – Lannett is under review for Digoxin

#### JACC FEAR

Negative abstract around cardiovascular drugs could have adverse impact - sales account for large part of Lannett's revenue

OUTSIDE - INSIDE

VALUE REALIZATION: INCREASING SIZE BY GROWTH, ATTENTION FROM BIGGER PLAYERS (EX: LEGAL) AND REALIZATION OF CATALYSTS

**AMERICA'S HEALTHCARE  
SYSTEM IS NEITHER  
HEALTHY, CARING,  
NOR A SYSTEM.  
- WALTER CRONKITE**

# APPENDIX

# PATENT CLIFF

GOOD FOR GENERICS

