AEGIS CAPITAL CORP

Specialty Pharmaceuticals
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Initiating Coverage

November 14, 2016

Key Metrics

REPH - NASDAQ	$8.03
Pricing Date	Nov 11 2016
Price Target	$21.00
52-Week Range	$12.50 - $5.59
Shares Outstanding (mm)	11.8
Market Capitalization (mm)	$94.8
3-Mo Average Daily Volume	57,855
Institutional Ownership	43%
Debt/Total Capital	NM
ROE	NM
Book Value/Share	$3.17
Price/Book	2.5x
Dividend Yield	NM
LTM EBITDA Margin	NM

EPS FY: December

	2015A	Prior 2016E	Curr. 2016E	Prior 2017E	Curr. 2017E
1Q-Mar	(0.53)	--	(0.70)A	--	(0.30)E
2Q-Jun	(0.17)	--	(0.83)A	--	(0.19)E
3Q-Sep	(0.24)	--	(0.50)A	--	(1.55)E
4Q-Dec	1.03	--	(0.86)E	--	(1.00)E
FY	0.21	--	(2.88)E	--	(3.29)E
P/E	38.24x		NM		NM

REVENUE

	2015A	Prior 2016E	Curr. 2016E	Prior 2017E	Curr. 2017E
1Q-Mar	--	--	17.7A	--	17.1E
2Q-Jun	18.7	--	17.4A	--	16.8E
3Q-Sep	16.5	--	16.9A	--	16.6E
4Q-Dec	16.8	--	11.5E	--	12.1E
FY	52.0	--	63.4E	--	62.5E

Company Description:
Recro Pharma, Inc. (http://www.recropharma.com/) is a revenue generating specialty pharmaceutical company focused on products for hospital and ambulatory care settings, currently developing non-opioid products for the treatment of serious acute pain. The company is based in Malvern, PA.

Recro Pharma, Inc.

Rating: Buy

Non-Opioid Post-Op Pain Management With Recro, Initiated with Buy and $21 TP

Investment Highlights:

- **Recro Pharmaceuticals for Non-opioid pain management.** A clinical development stage pharmaceutical company geared towards the development of non-opioid treatments for the management of acute pain in hospital and ambulatory care settings, Recro currently earns revenue from a contract manufacturing, royalty and formulation business in Gainesville, Georgia that was acquired in April 2015. The company's primary product candidate, IV Meloxicam, is a cyclo-oxygenase 2 (COX-2) inhibitor in Phase III trials for post-op acute pain management. Recro acquired exclusive worldwide rights to IV Meloxicam from Alkermes, and recently announced positive Phase III results from IV Meloxicam in bunionectomy and we expect topline results from a second Phase III trial before year end 2016.

- **Market opportunity for IV Meloxicam as a non-opioid.** The size of the post-operative pain market was about $5.9 billion in sales in the US, with the majority of these sales representing opioid based pain medication. Opioids are addictive by nature and according to the CDC ~29,000 Americans die every year from opioid-related overdoses. Particularly in the post-op environment, where conventional analgesics such as morphine are still commonly used, demand exists for less addictive pain management drugs. In addition to providing a less addictive solution to morphine, IV Meloxicam can be delivered as a 15 second infusion and has been shown to have fast onset of action in clinical trials. We expect peak year revenue for IV Meloxicam in the range of $150-200 million.

- **Phase III trials trigger milestone payments in advancing IV Meloxicam in pathway to market.** Recro announced positive top-line data from the IV Meloxicam in bunionectomy phase III trial in July. The trial measured its primary endpoint in terms of summed pain intensity difference over 48 hours (SPID-48). The results from the multicenter, double-blind, randomized, placebo-controlled study reported that IV Meloxicam (30 mg dose per 24 hours) showed a statistically significant reduction in SPID-48 vs. placebo. The phase III trial also achieved statistical significance across 15 of 19 secondary endpoints. Next, we look for the Phase III readout for IV Meloxicam in abdominoplasty in 4Q16, and if positive, an NDA filing mid-summer 2017, followed by potential FDA approval mid-summer 2018. Milestone payments, pursuant to the agreement with Alkermes signed on April 10, 2015, are tied to the NDA filing and potential FDA approval.

- **Valuation.** We derive our target price of $21 through a DCF analysis, assuming a 8% discount rate that is applied to all cash flows and the terminal value, which is based on a 6 multiple of the projected 2021 EBITDA of $80 million. We further assume probability of success of the current Phase III program at 70%.

- **Risks.** Other than typical risks associated with investing in companies in the healthcare industries, such as R&D, regulatory, manufacturing, and commercialization risks, investing in Recro Pharmaceuticals, Inc. carries several firm-specific risks: 1) potential multiple binary events; 2) intense competition; 3) pricing and reimbursement pressures; 4) The company has not shown a history of profitability; and 5) additional funding may be required to successfully commercialize its products, leading to potential share dilution.

The Disclosure section may be found on pages 4 - 5 of this report.

- **Pivotal Phase III trials for IV Meloxicam.** In accordance with FDA guidance, the company has two pivotal phase III clinical trials for IV Meloxicam. The first one, which reported positive results (p=0.0034) in July 2016. SPID-48 in a hard tissue post-op environment (bunionectomy) was the primary end point. The trial enrolled 201 subjects that were randomized 1:1 to receive either 30 mg IV Meloxicam or placebo and followed standard analgesia design (Pain intensity assessments, allowed use of rescue medication, patient global assessment of pain control, and measured time to onset) results confirmed efficacy of the primary endpoint and met 15 of 19 secondary endpoints that included; SPID across various time measurements, time to first rescue analgesia, as well as number of subjects rescues, number of times rescued. The second phase III, which is scheduled to report top-line results in 4Q16, will measure SPID-24, as a primary endpoint, in a soft tissue, post-op environment (abdominoplasty).
- **Alkermes agreement and the Gainesville transaction.** The company will pay Alkermes up to $120 mil in milestone payments for IV Meloxicam acquisition. $10 mil is tied to the NDA filing and $30 mil is tied to FDA approval and net sales milestones. Royalties tied to sales of IV Meloxicam paid to Alkermes are in the 10% to 12% range, with a 30% post-patent expiration reduction (the IP for the original formulation extends through 2022). In addition, Recro acquired a manufacturing business: a 97,000 sq. ft facility used to manufacture five commercial products (Focalin XR, Ritalin LA, Zohydro ER, & Cerelan/verapamil) expected to net over $60 mil revenue in 2016. $50 mil, paid up front by Recro for the agreement, was secured via a five-year senior secured note with OrbiMed, of which $27.3 mil was outstanding as of September 30, 2016.
- **Equity Raise Strengthens Balance Sheet.** Recro completed an equity raise in August 2016 netting $13.4 million. 1,986,666 shares of common stock were issued at $7.50 per share, for which the proceeds will be used to help fund operations. Another form of equity financing for Recro stems from a purchase agreement, for which Aspire Capital Fund, LLC has agreed to purchase up to $10 mil in shares from Recro. As of September 30, 2016 Recro has raised $4.2 mil from 643,940 shares of common stock in accordance with the agreement.
- **Revenue and Earnings Beat for Recro.** For the third quarter of 2016 Recro reported top-line revenue of $16.9 mil vs. street's estimate of $13.4 mil. The revenue beat, which was partially offset by lower product shipment revenue, is the result of a one-time contractually based manufacturing revenue of $2.3 mil, as well as higher profit-sharing revenue stemming from one of Recro's commercial partner's new customer base. As such, management has guided full year revenue upwards from the $55-$60 mil range to over $60 million. Earnings also beat with loss per share coming in at $(0.50) vs. mean street's estimate of $(0.78). While Recro is a revenue generating company, the bulk of its future value is based on IV Meloxicam, whose progress towards potential FDA approval remains our primary focus.

RECRO PHARMA, INC
Income Statement
Fiscal Year ends December
(All amounts in 000s except per share items)

	2014A	1Q15	2Q15	3Q15	4Q15	2015A	1Q16A	2Q16A	3Q16A	4Q16E	2016E	1Q17E	2Q17E	3Q17E	4Q17E	2017E	2018E	2019E	2020E
Dex-IN for peri-procedural pain (US)	-																-	-	-
Meloxicam for post-operative pain (US)																	14,482	37,852	79,149
Manufacturing revenue			18,660	16,539	16,753	51,952	17,138	16,933	16,188	11,000	61,259	17,056	16,801	16,571	12,056	62,484	65,608	68,889	72,333
Research and development revenue							604	346	763	500	2,213								
Total revenues	**-**	**-**	**18,660**	**16,539**	**16,753**	**51,952**	**17,742**	**17,279**	**16,951**	**11,500**	**63,472**	**17,056**	**16,801**	**16,571**	**12,056**	**62,484**	**80,090**	**106,741**	**151,482**
COGS			9,395	10,039	8,620	28,054	10,271	9,547	5,745	6,600	32,163	9,422	8,965	9,802	9,301	37,490	34,069	54,582	71,102
R&D	7,952	1,754	2,821	2,716	4,990	12,281	7,808	8,320	7,046	7,751	30,925	6,061	5,041	14,416	4,386	29,904	55,418	12,709	12,074
SG&A	3,919	2,386	2,597	3,478	4,556	13,017	2,658	2,763	3,841	3,956	13,218	3,024	3,025	7,500	7,600	21,149	33,838	37,222	39,083
Other Expenses			3,474	470	1,626	5,570	2,030	3,420	4,240	646	10,336					2,573	2,573	2,573	2,573
Total operating expenses	**11,872**	**4,140**	**18,287**	**16,703**	**19,792**	**58,922**	**22,767**	**24,050**	**20,872**	**18,953**	**86,641**	**18,507**	**17,031**	**31,718**	**21,287**	**91,116**	**125,899**	**107,086**	**124,832**
Operating income (EBIT)	**(11,872)**	**(4,140)**	**373**	**(164)**	**(3,039)**	**(6,970)**	**(5,025)**	**(6,771)**	**(3,921)**	**(7,453)**	**(23,169)**	**(1,451)**	**(230)**	**(15,147)**	**(9,231)**	**(28,632)**	**(45,808)**	**(345)**	**26,650**
Interest income	11	4	4	2	3	12	9	8	10	3	14	6	6	6	6	15	17	25	37
Grant income	-					-					-					-	-	-	
Interest expense	(4,273)		(1,688)	(1,990)	(1,882)	(5,560)	(1,512)	(1,317)	(1,450)	(1,875)	(6,154)	(1,875)	(1,875)	(1,875)	(1,875)	(7,500)	(7,500)	(7,500)	(1,875)
Income before taxes	**(16,134)**	**(4,136)**	**(1,311)**	**(2,152)**	**(4,918)**	**(12,518)**	**(6,528)**	**(8,080)**	**(5,361)**	**(9,325)**	**(29,310)**	**(3,320)**	**(2,099)**	**(17,016)**	**(11,100)**	**(36,117)**	**(53,292)**	**(7,820)**	**24,813**
Provision for income taxes/(income tax bene	-				(15,551)	(15,551)	11	195	(18)		188					-	-	(782)	7,444
Net income, GAAP	**(16,134)**	**(4,136)**	**(1,311)**	**(2,152)**	**10,633**	**3,033**	**(6,517)**	**(7,885)**	**(5,379)**	**(9,325)**	**(29,122)**	**(3,320)**	**(2,099)**	**(17,016)**	**(11,100)**	**(36,117)**	**(53,292)**	**(7,038)**	**17,369**
Accretion of redeemable convertible preferr	(1,270)					-													
Net income to common shareholders	**(17,404)**	**(4,136)**	**(1,311)**	**(2,152)**	**10,633**	**3,033**	**(6,517)**	**(7,885)**	**(5,379)**	**(9,325)**	**(29,122)**	**(3,320)**	**(2,099)**	**(17,016)**	**(11,100)**	**(36,117)**	**(53,292)**	**(7,038)**	**17,369**
EPS basic	$ (2.79)	$ (0.53)	$ (0.17)	$ (0.24)	$ 1.15	$ 0.36	$ (0.70)	$ (0.83)	$ (0.50)	$ (0.86)	$ (2.88)	$ (0.30)	$ (0.19)	$ (1.55)	$ (1.00)	$ (3.29)	$ (4.76)	$ (0.62)	$ 1.49
EPS diluted, GAAP	$ (2.79)	$ (0.53)	$ (0.17)	$ (0.24)	$ 1.03	$ 0.21	$ (0.70)	$ (0.83)	$ (0.50)	$ (0.86)	$ (2.88)	$ (0.30)	$ (0.19)	$ (1.55)	$ (1.00)	$ (3.29)	$ (4.76)	$ (0.62)	$ 1.27
Basic shares outstanding	6,239	7,769	7,830	9,119	9,247	8,491	9,252	9,545	10,781	10,835	10,103	10,889	10,943	10,998	11,053	10,971	11,190	11,414	11,642
Diluted shares outstanding	6,239	7,769	7,830	9,119	10,280	8,749	9,252	9,545	10,781	10,835	10,103	10,835	10,835	10,835	10,835	10,971	11,190	13,414	13,642

Source: Company documents and Aegis Capital estimates

Required Disclosures

Price Target

$21

Valuation Methodology

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Risk Factors

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Aegis Capital Corp. makes a market in Recro Pharma, Inc..

Rating	Percent	Investment Banking Services/Past 12 Mos. Percent
BUY [BUY]	88.89	42.50
HOLD [HOLD]	11.11	30.00
SELL [SELL]	0.00	0.00

Meaning of Ratings

A) A Buy rating is assigned when we do not believe the stock price adequately reflects a company's prospects over 12-18 months.

B) A Hold rating is assigned when we believe the stock price adequately reflects a company's prospects over 12-18 months.

C) A Sell rating is assigned when we believe the stock price more than adequately reflects a company's prospects over 12-18 months.

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