

## NovaBay Pharmaceuticals (NBY - \$ 0.61)

### 1Q15: Avenova Commercialization Continued

NBY reported 1Q15 financial results late last week with a net loss of (\$4.6MM) or (\$0.09) per share. With an additional \$4.5MM from a recent financing, NBY ended 1Q15 with \$5.6MM cash, enough to support their operation into late 2015, in our opinion. NBY hosted an Analyst and investor event last night and highlights include:

- Optometrist/ophthalmologist KOLs are bullish on the potential of Avenova in multiple indications.** All five optometrist/ophthalmologist KOLs presented at the event expressed their bullish view on Avenova's potential to be used in multiple conditions such as: anterior blepharitis; dry eye; meibomian gland diseases (MGD); pre- and post-surgical preparation (such as cataract, LASIK and oculoplastic); and ocular rosacea (posterior blepharitis) and in contact lens wearers. With the availability of Avenova, many KOLs suggested the concept of practicing eye lid hygiene currently could become a very effective new paradigm in eye care.
- Presence of unmet needs is obvious but more time may be needed for Avenova to gain greater penetration for managing multiple conditions.** We are very encouraged by Avenova sales in 1Q15 and expect sales to continue to expand in 2015 and beyond. We also recognize optometrists /ophthalmologists are rather conservative in prescribing new medications. As such, we believe it might require sufficient time and deeper knowledge before they start to prescribe a new drug. We currently model modest but significant Avenova revenue growth in 2015, and project sales could expand more substantially in 2016 and beyond. Strong endorsements by KOLs and NBY's marketing and sales effort are important factors propelling Avenova's sales.
- Potential positive Phase IV post market clinical study results could increase physician buy-in.** We believe NBY is preparing to conduct relatively inexpensive Phase IV studies to further demonstrate the effectiveness of Avenova. Positive outcomes from such studies could be a valuable tool to gain further physician buy-in in addition to the current peer-to-peer discussions on the benefits of Avenova.
- Action.** Based on the encouraging advancements of its commercialization effort, we view NBY has a more balanced overall risk/reward portfolio. We are reiterating our Buy rating and \$1.90 target price, which is supported by our peer comparable and risk-adjusted cash flow sum-of-the-parts analyses.

### Earnings Estimates: (per share)

(Dec)	1Q	2Q	3Q	4Q	FY	P/E
<b>FY-15E</b>	-0.09A	-0.07	-0.05	-0.05	-0.25	NM
<b>FY-14A</b>	-0.08	-0.06	-0.08	-0.09	-0.31	NM
<b>FY-13A</b>	-0.11	-0.11	-0.10	-0.10	-0.42	NM
<b>FY-12A</b>	-0.09	-0.08	0.00	-0.07	-0.24	NM

Source: Laidlaw & Company estimates.

Healthcare/Biotechnology

Ticker: **NBY**  
Rating: **Buy**  
Price Target: **\$ 1.90**

### Trading Data:

Last Price (05/19/2015)	\$ 0.61
52-Week High (8/18/2014)	\$ 1.30
52-Week Low (2/27/2015)	\$ 0.42
Market Cap. (MM)	\$ 37
Shares Out. (MM)	61

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- The optometrist/ophthalmologist KOLs in the panel include Eric Donnenfeld, M.D, Clinical Professor of Ophthalmology NYU; Henry D. Perry, M.D., Chief of the Cornea Service at Nassau University Medical Center; Katherine M. Mastrota, O.D., Center Director of Omni Eye Surgery; Brian D. Rosenblatt, O.D., Rosenblatt Family Eye Care Associates; and Ivan Mac, MD., Metrolina Eye Associates.

### Anticipated milestones in 2015 and beyond

Product	Indication	Partner	Event	Timing
Avenova	Blepharitis		Expand sales force	1H15
Consumer lens care product			Potential FDA clearance	2015
			Commercial launch	1H16
Auriclosene (NVC-422)	Prevention of urinary catheter blockage and encrustation (UCBE) (0.2%)		Potentially to outlicense for further development	2015
Avenova Cream / Ointment	Blepharitis		Commercial launch	2016

Source: Laidlaw & Company estimates and company presentation.

## Major Risks

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**Failures of current and upcoming clinical programs.** Although auriclosene demonstrated promising efficacy and a satisfactory safety profile from the Phase II studies in several indications, NBY subsequently announced that the auriclosene in viral conjunctivitis Phase IIb study did not meet the primary and secondary endpoints; and the company does not intend to initiate any new studies of auriclosene for this indication

**Maintaining current and expanding future partnerships are not guaranteed.** One of major validations of NovaBay's technologies and significant near-term revenue prospects derive from the company's collaborative partners, such as Galderma. Should a partner decide to terminate collaboration with NovaBay, shareholder value could be substantially impacted, due to the potential loss of future revenue and concerns about the company's technology for generating effective therapeutic products. In addition, there is no assurance that the company can forge additional collaborations for generating revenue.

**Product may not reach anticipated sales.** Although NeutroPhase has illustrated promising efficacy and safety profiles, and has received FDA approval, the sales potential for the product could miss our forecasts. Although NeutroPhase is approved to be used in wound care in the U.S., it is not guaranteed that the product could receive approval in China and can successfully launch in China and Southeast Asian markets. In addition, NovaBay may not generate projected revenue from its own in-house pipeline.

**Additional financing could dilute shareholder value.** Regardless of whether or not the company forges additional collaborations with partners to generate non-dilutive revenue to support operation, it is likely that NovaBay may need to provide offerings to raise cash from investors to fund its operations. As such, the share value for existing investors could be diluted. Further, if the company cannot raise equity capital at more favorable terms, the share value of current shareholder could be further impaired.

Figure 1: Income Statement

NovaBay – Income Statement								
(\$'000)	2013	2014	1Q15	2Q15E	3Q15E	4Q15E	2015E	2016E
<b>Revenue</b>								
Product royalty revenue	223	684	492	667	857	1,088	3,104	6,776
Cost of goods sold	162	486	148	164	197	197	706	1,015
Gross profit	61	198	344	503	660	891	2,398	5,761
Revenue (upfront, milestone, etc.)	3,045	158	6	15	20	15	56	56
Others	209	212	40	35	32	40	147	147
Total non-product revenue	3,254	370	46	50	52	55	203	203
Research and development	12,461	9,511	1,641	985	709	603	3,937	1,808
Sales, General and administrative	6,340	7,935	3,410	3,512	3,618	3,726	14,266	16,691
<b>Total Operating Expenses</b>	18,801	17,446	5,051	4,497	4,327	4,329	18,203	18,499
Operating Incomes (losses)	(15,486)	(17,076)	(4,661)	(3,944)	(3,615)	(3,383)	(15,603)	(12,536)
Non-cash gain on decrease in fair value of warrants	(555)	1,664	34	28	29	40	131	131
Total Other Income, net	1	22	(11)	3	3	3	(2)	(2)
<b>Income before tax</b>	(16,040)	(15,390)	(4,638)	(3,913)	(3,583)	(3,340)	(15,474)	(12,407)
Tax Rate	(16,039)							
Tax	(2)	(2)	(2)	(2)	(2)	(2)	(8)	(8)
<b>Net Income (Loss)</b>	(16,042)	(15,392)	(4,640)	(3,915)	(3,585)	(3,342)	(15,482)	(12,415)
Net Income (Loss) Applicable to Common Shareholders	(\$16,044)	(\$15,392)	(4,639)	(3,914)	(3,584)	(3,341)	(\$15,482)	(\$12,414)
Net Earnings (Losses) Per Share—Basic and Diluted	(\$0.42)	(\$0.31)	(\$0.09)	(\$0.07)	(\$0.05)	(\$0.05)	(\$0.25)	(\$0.18)
Shares outstanding—basic and diluted	38,183	49,626	54,371	59,371	65,371	66,371	61,371	68,371
	38,183	49,626	54,371	59,371	65,371	66,371	61,371	68,371
<b>Margin Analysis (% of Sales/Revenue)</b>								
COGS		71.1%	30%	25%	23%	18%	23%	28%
R&D	376%	1674%	421%	178%	100%	64%	151%	30%
MG&A	191%	1397%	874%	635%	508%	394%	549%	280%
Operating Income (loss)	-467%	-3006%	-1195%	-713%	-508%	-358%	-600%	-210%
Net Income	-484%	-2710%	-1189%	-708%	-504%	-353%	-595%	-208%
<b>Financial Indicator Growth Analysis (YoY%)</b>								
Revenue (upfront, milestone, etc.)	-56%	-95%	-84%	-61%	-13%	-75%	-65%	0%
Other revenue	127%	1%	-35%	-45%	-18%	-15%	-31%	0%
Total Revenue	-53%	-89%	-54%	-51%	-16%	-48%	-45%	0%
R&D	34%	-24%	-35%	-56%	-69%	-75%	-59%	-54%
SG&A	6%	25%	100%	112%	89%	40%	80%	17%
Operating Loss	86%	10%	14%	4%	-12%	-31%	-9%	-20%
Total Other Income, net	-101%	2100%	57%	-95%	-250%	-112%	-109%	0%
Net Income	128%	-4%	30%	33%	-15%	-25%	1%	-20%
EPS - Diluted	76%	-26%	9%	14%	-34%	-42%	-19%	-28%
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Source: Bloomberg LP; Company reports; Laidlaw &amp; Company estimates.

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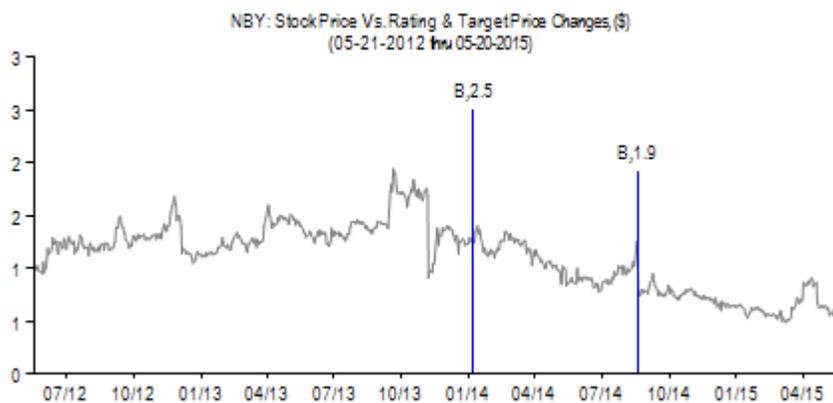
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#### Rating and Price Target Change History



#### 3 Year Rating Change History

Date	Rating	Closing Price (\$)
01/07/2014	Buy (B)	1.28

#### 3 Year Price Change History

Date	Target Price (\$)	Closing Price, (\$)
01/07/2014	2.50	1.28
08/20/2014	1.90	0.81

Source: Laidlaw & Company

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			Investment Banking	Brokerage
<b>Strong Buy (SB)</b>	Expected to significantly outperform the sector over 12 months.	0.00%	0.00%	0.00%
<b>Buy (B)</b>	Expected to outperform the sector average over 12 months.	73.08%	30.77%	7.69%
<b>Hold (H)</b>	Expected returns to be in line with the sector average over 12 months.	3.85%	0.00%	0.00%
<b>Sell (S)</b>	Returns expected to significantly underperform the sector average over 12 months.	0.00%	0.00%	0.00%

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