

Emergent BioSolutions (EBS - \$39.43)

October Contract Likely \$1B+ Size, Multi-Year

EBS recently reported a surprisingly profitable 1Q16, handily beating us and consensus on both the top & bottom line. The EPS beat was driven by lower than expected COGS and significantly lower R&D expenses in the quarter. Offsetting this positive news EBS has removed their FY16 guidance of \$600M-\$630M in sales and adjusted net income of \$90M-\$100M due to the U.S. Government announcing that they will not buy EBS full production from Bldg. 12 in 2Q/3Q, and instead will wait for lower-priced production from Bldg. 55, which should be FDA approved in August-September of this year. Positively, the Government also put an October 1st deadline for when they will award the next procurement contract for BioThrax, which we believe will be similar to the current contract at over \$1B in value and going out multiple years. While we have adjusted our FY16 numbers to reflect the lower than anticipated USG BioThrax buys, we haven't changed our out year numbers as we have modeled those years to be fully supplied by the lower cost Bldg. 55 BioThrax production. We continue to recommend EBS here and we are reiterating our Buy rating and our \$45 price target.

- **October 1 contract award a big milestone.** We continue to believe that the FDA will approve the sBLA for Bldg. 55 in the August-September timeframe 4 months post the mid-April filing. Currently the USG procures BioThrax for ~\$28/dose from Bldg. 12, and we anticipate this will drop to the ~\$17/dose range post-Bldg. 55 licensure. We estimate 2017-2018 BioThrax sales of \$350M each year, with the potential for ex-US sales starting in 2017 as capacity expands with the new manufacturing facility.
- **Aptevo spin-out on track for mid-2016.** We model in EBS ex-Aptevo starting in 3Q16 which should significantly improve operating margins. We model in EBS shedding ~\$40M in annual SG&A expense and the operating margin improving from 29% in 2015 to 40%-43% in 2017-2018.
- **Another solid cash generating quarter.** EBS ended 1Q16 with \$341M in cash & equivalents (and \$70M in AR), generating \$38M in cash from operations in 1Q16. We continue to expect additional acquisitions in 2016.
- **Reiterate Buy rating \$45 price target.** Our price target is based on a sum-of-the-parts analysis, with a base business DCF value of \$40/share, cash (net of debt) and tech value of \$5/share.

Adj-Earnings Estimates: (per share)

(Dec)	1Q	2Q	3Q	4Q	FY	P/E
FY17E	0.22	0.61	0.89	0.93	2.65	14.9x
FY16E	0.16A	0.03	0.50	1.25	1.94	20.3x
FY15A	(0.50)	0.36	0.83	0.78	1.60	24.6x
FY14A	(0.40)	0.25	0.54	0.75	1.19	33.1x

Source: Laidlaw & Company estimates

Healthcare / Biotechnology

Ticker:	EBS
Rating:	Buy
Price Target:	\$45.00

Trading Data:

Last Price (05/10/2016)	\$39.43
52-Week High (04/26/2016)	\$40.96
52-Week Low (10/07/2015)	\$27.68
Market Cap. (MM)	\$1,570
Shares Out. (MM)	39.83

Analyst

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Figure 1: Variance analysis

Emergent BioSolutions Quarterly Variance Analysis					
(\$000 except per share)	1Q15A	1Q16A	1Q16E	Variance	% Y/Y
BioThrax sales	\$0	\$59,100	\$35,000	\$24,100	NM
Contracts and Grants	33,099	31,709	35,000	(3,291)	-4.2%
Total Revenue	\$63,633	\$111,002	\$108,700	\$2,302	74.4%
COGS	16,048	25,803	37,960	(12,157)	60.8%
Gross Profit	47,585	85,199	70,740	14,459	79.0%
SG&A Expense	33,393	37,484	29,500	7,984	12.3%
R&D ex-ctrcs & grnts	5,603	2,445	15,750	(13,305)	-56.4%
R&D Expense	38,702	34,154	50,750	(16,596)	-11.8%
Operating Income	(24,510)	13,561	(9,510)	23,071	-155.3%
Interest Expense	1,661	1,524	1,750	(226)	-8.2%
Int. & Inv. Income	82	186	175	11	126.8%
Other Inc./(Exp)	100	116	500	(384)	NA
Pretax Income	(25,989)	12,339	(10,585)	22,924	-147.5%
Tax exp/(benefit)	(7,169)	4,818	(3,070)	7,888	NA
Adj-Net Income	(18,820)	7,521	(7,515)	15,036	-140.0%
Shares out (000)	37,949	48,360	48,493	(134)	27.4%
Adj-Earnings Per Share	(\$0.50)	\$0.16	(\$0.15)	\$0.31	-131.4%
Margin Analysis					
Gross Profit Margin	47.4%	67.5%	48.5%	19.0%	42.2%
SG&A Expense	109.4%	47.3%	40.0%	7.2%	-56.8%
R&D Expense	126.8%	43.1%	68.9%	-25.8%	-66.0%
Operating Income	-80.3%	17.1%	-12.9%	30.0%	-121.3%
Tax Rate	27.6%	39.0%	29.0%	10.0%	41.6%
Adj-Net Income	-29.6%	6.8%	-6.9%	13.7%	-122.9%

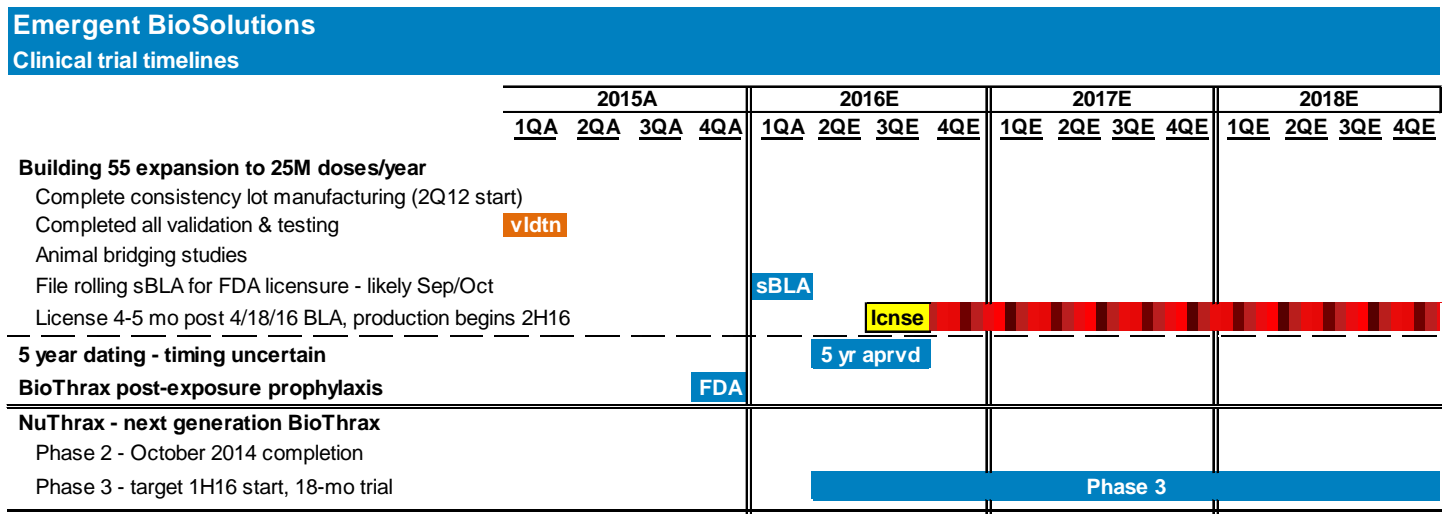
Source: Company reports; Laidlaw & Company estimates

Figure 2: Valuation

Sum-of-the-parts valuation: EBS		
Segment	Valuation (000's)	Per share value
DCF of base business	\$1,932,416	\$40
Net Cash, end '16E	\$185,258	\$4
Technology value	\$50,000	\$1
SUM	\$2,167,674	\$45
Fully diluted shares out '16E (000)		48,885

Source: Company reports; Laidlaw & Company estimates

Figure 3: Clinical Trials Timeline



Source: Bloomberg LP; Company reports; Laidlaw & Company estimates

Quarterly Income Statement

Emergent BioSolutions
Quarterly income statement

(\$000 except per share)	2015A				2015A Year	2016E				2016E Year
	1QA	2QA	3QA	4QA		1QA	2QE	3QE	4QE	
BioThrax - US sales	\$0	\$72,200	\$109,800	\$111,900	\$293,900	\$59,100	\$50,000	\$65,000	\$125,000	\$299,100
OUS Biodefense sales										
Other Biodefense	11,945	2,800	7,700	12,549	34,994	4,700	5,000	6,500	7,500	23,700
Total Biodefense	11,945	75,000	117,500	124,449	328,894	63,800	55,000	71,500	132,500	322,800
Total Biosciences	6,345	7,023	6,500	8,200	28,068	7,906	15,750	-	-	23,656
Contract manufacturing	12,243	8,859	11,341	10,525	42,968	7,587	11,000	12,500	14,000	45,087
Contracts & grants	33,099	35,230	29,646	24,930	122,905	31,709	32,500	36,500	38,000	138,709
Total revenues	\$63,633	\$126,112	\$164,987	\$168,104	\$522,789	\$111,002	\$114,250	\$120,500	\$184,500	\$530,252
Expenses										
COGS	16,048	26,266	36,161	37,070	112,895	25,803	30,003	21,470	30,513	107,788
Gross margin	47,585	99,846	128,826	131,034	409,894	85,199	84,248	99,030	153,988	422,464
% product sales	47%	71%	73%	74%	72%	67%	63%	74%	79%	72%
R&D	38,702	40,941	41,868	32,486	153,997	34,154	38,250	38,750	40,750	151,904
SG&A	33,393	34,053	29,806	42,756	141,758	37,484	43,000	25,000	25,000	130,484
Operating income	(24,510)	24,852	57,152	55,792	114,139	13,561	2,998	35,280	88,238	140,076
Interest expense	1,661	1,628	1,635	1,600	6,523	1,524	1,750	1,750	2,000	7,024
Interest income, net	82	273	104	113	572	186	200	225	225	836
Other income/(expense)	100	300	602	(524)	(319)	116	500	500	500	1,616
Pretax income (loss)	(25,989)	23,797	56,223	53,781	107,869	12,339	1,948	34,255	86,963	135,504
Tax exp/(benefit)	(7,169)	6,800	16,434	16,334	32,299	4,818	565	9,934	25,219	40,536
Loss to non-ctrl interest										
Adjusted Net Income	(18,820)	16,997	39,789	37,447	75,570	7,521	1,383	24,321	61,743	94,968
Non-cash charges	(2,700)	(2,900)	(1,847)	(4,100)	(12,700)	(3,530)	(3,500)	(3,500)	(3,500)	(14,030)
GAAP net income	(21,520)	14,097	37,942	33,347	62,870	3,991	(2,117)	20,821	58,243	80,938
EPS ex non-cash items	(\$0.50)	\$0.36	\$0.83	\$0.78	\$1.60	\$0.16	\$0.03	\$0.50	\$1.25	\$1.94
EPS as reported	(\$0.57)	\$0.30	\$0.79	\$0.69	\$1.33	\$0.08	(\$0.04)	\$0.42	\$1.18	\$1.66
Fully diluted shares (000)	37,949	47,410	47,785	48,143	47,256	48,360	48,710	49,060	49,410	48,885
Margin & expense analysis										
Gross Margin (% prod. sales)	47%	71%	73%	74%	72%	67%	63%	74%	79%	72%
Op margin (% prod. sales)	-80%	27%	42%	39%	29%	17%	4%	42%	60%	36%
Taxes	28%	29%	29%	30%	30%	39%	29%	29%	29%	30%
Net margin	-30%	13%	24%	22%	14%	7%	1%	20%	33%	18%
Year-over-year change										
Net revenue	18%	14%	20%	14%	16%	74%	-9%	-27%	10%	1%
R&D	28%	9%	-5%	-17%	2%	-12%	-7%	-7%	25%	-1%
SG&A	39%	25%	8%	49%	32%	12%	26%	-16%	-42%	-8%
Operating income	40%	75%	60%	9%	37%	-155%	-88%	-38%	58%	23%
Net income	29%	80%	59%	8%	39%	-140%	-92%	-39%	65%	26%

Source: Bloomberg LP; Company reports; Laidlaw & Company estimates

Annual Income Statement

Emergent BioSolutions						
Annual income statement						
(\$000 except per share)	2014A	2015A	2016E	2017E	2018E	Comments
BioThrax - US sales	\$245,944	\$293,900	\$299,100	\$355,000	\$350,000	2016E guide was: \$305M-\$320M
OUS Biodefense sales				27,000	65,500	Excess Bldg 55 production sold OUS
Other Biodefense	32,350	34,994	23,700	40,000	40,000	RSDL, BAT, other Biodefense here
Total Biodefense	278,305	328,894	322,800	422,000	455,500	
Total biosciences	30,060	28,068	23,656	0	0	To be spun out mid-2016
Contract manufacturing	30,935	42,968	45,087	60,000	60,000	Acquired with Cangene 3Q13
Contracts & grants	110,849	122,905	138,709	170,000	180,000	Offset in R&D
Total revenues	\$450,138	\$522,789	\$530,252	\$652,000	\$695,500	'16 guide was: \$600M-\$630M
Expenses						
COGS	108,212	112,895	107,788	141,100	134,425	
Gross margin	341,926	409,894	422,464	510,900	561,075	
% product sales	68%	72%	72%	71%	74%	Cangene impacts margins
R&D	150,829	153,997	151,904	218,000	235,500	
SG&A	107,641	141,758	130,484	100,250	105,500	
Operating income	83,456	114,139	140,076	192,650	220,075	
Interest expense	10,140	6,523	7,024	7,250	7,250	
Interest income, net	320	572	836	1,100	1,500	
Other inc/(exp)	2,926	(319)	1,616	2,000	2,000	
Pretax income	76,562	107,869	135,504	188,500	216,325	
Tax expense	22,121	32,299	40,536	54,665	62,734	
Loss to non-cont. int	0	0	0	0	0	
Adj-Net income	54,441	75,570	94,968	133,835	153,591	16E adj-NI was: \$90M-\$100M
Non-cash charges	(17,700)	(12,700)				
GAAP net income	36,741	62,870				'16E GAAP was: \$75M-\$85M
EPS ex non-cash items	\$1.19	\$1.60	\$1.94	\$2.65	\$2.95	25% adj-EPS CAGR 2014-2018E
EPS as reported	\$0.80	\$1.33				
Fully diluted shares (000)	45,803	47,256	48,885	50,410	52,010	
Margin & expense analysis						
Gross Margin	68%	72%	72%	71%	74%	
Operating margin	25%	29%	36%	40%	43%	
Taxes	29%	30%	30%	29%	29%	Guide: high 20% range
Net margin	12%	14%	18%	21%	22%	
Year-over-year change						
Net revenue	44%	16%	1%	23%	7%	
R&D	26%	2%	-1%	44%	8%	
SG&A	34%	32%	-8%	-23%	5%	
Operating income	65%	37%	23%	38%	14%	
Net income	50%	39%	26%	41%	15%	
EPS	21%	35%	21%	37%	11%	

Source: Bloomberg LP; Company reports; Laidlaw & Company estimates

Major Risks

Exogenous events could impact our outlook. We believe pharmaceutical companies have the least control over competitive, political, and regulatory risks. Although we have incorporated competitive assumptions into our forecasts, there may be other risks beyond the scope of our analysis. Changes in the drug reimbursement system, as well as any political or regulatory amendments, may significantly influence the earnings power of these companies.

Actual clinical results and the FDA's conclusions may deviate from expectations. Many of our assumptions are based on a review of incomplete clinical trial data available in the public domain. Often, our conclusions are drawn from early stage data, which may not be reflected by pivotal studies. Furthermore, the FDA's conclusions may not coincide with our own, materially changing our revenue and earnings assumptions.

Compliance issues, product recalls, and other mandates by regulatory authorities could materially change our expectations. Regulatory compliance issues, ranging from accounting irregularities to defective manufacturing practices, could materially change our assumptions and earnings outlook. Unanticipated product recalls and labeling changes could also have adverse consequences on our earnings assumptions.

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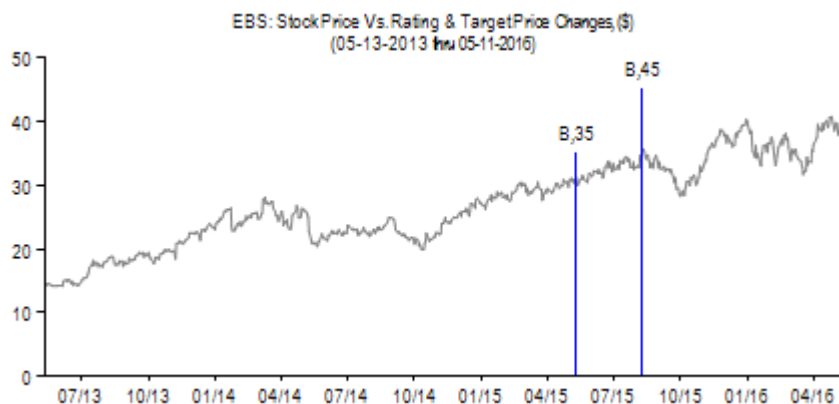
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Date	Rating	Closing Price (\$)
05/11/2015	Buy (B)	31.11

Date	Target Price (\$)	Closing Price, (\$)
05/11/2015	35.00	31.11
08/10/2015	45.00	35.29

Source: Laidlaw & Company

Created by: Blue-Compass.net

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			Investment Banking	Brokerage
Strong Buy (SB)	Expected to significantly outperform the sector over 12 months.	0.00%	0.00%	0.00%
Buy (B)	Expected to outperform the sector average over 12 months.	66.67%	27.78%	2.78%
Hold (H)	Expected returns to be in line with the sector average over 12 months.	0.00%	0.00%	0.00%
Sell (S)	Returns expected to significantly underperform the sector average over 12 months.	0.00%	0.00%	0.00%

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