

Emergent BioSolutions (EBS - \$34.43)

Hasta la vista BioSciences - spin-out is both immediately accretive, and long overdue, in our opinion. Raising PT to \$45

We believe that the decision to spin-out the Biosciences group represents a realistic appraisal of the cost-benefit of continuing the fund what has in reality been a massive cash drain on EBS for years. While we would prefer that EBS not send Biosciences off with the additional \$50M-\$70M (approximately 1 years' worth of operating expenses) if it stops our estimated ~\$50M per year cash drain on the business we see it as a money well spent. We estimate that EPS can improve 15%-20% immediately upon removing Biosciences from the P&L in 2016. EBS also reported a beat on the top & bottom line while reiterating full year guidance. Next catalysts for EBS are the spin-out of Biosciences in mid-2016, and the licensure of Building 55 in 1H16. Reiterate Buy rating, raising PT to \$45.

- **BioThrax strong sales drive top and bottom line beat.** EBS reported 2Q15 yesterday before the open with top line revenues of \$126M vs consensus \$124M and Laidlaw: \$119MM as BioThrax sales vastly exceeded our expectations. Although Operating expenses were slightly above our expectations, top line growth drove an adjusted-EPS beat of \$0.36 vs consensus: \$0.18 and Laidlaw: \$0.22.
- **Biosciences spin-out, \$40MM-\$50MM gain in annualized EBITDA.** We see the spin-out as the right move at the right time. EBS will seed the spin-out with \$50M-\$70M in cash and retain their \$250M convertible debt. The spin-out of the money-losing Biosciences division, which is estimated to have cost between \$100M-\$200M over the last ~ 5 years is a huge positive in our view. We believe this deal couldn't happen soon enough and we question why EBS needs to seed the spin-out with \$50M-\$70M when that cost savings can be realized by either a sale of the assets, or an outright shutting down of the Biosciences division. While management highlights the tax-neutral benefits of this spin-out structure, we think it could be even better yet if the cash "seed" were retained by EBS while capturing the EBITDA accretion as soon as possible.
- **Reiterate Buy rating, raising PT to \$45.** Our PT is based on a sum-of-the-parts with a base business DCF value of \$40/share, cash (net of debt) and accounts receivable at the end of 2016 of \$4/share, and a pipeline/tech value of \$1/share.

Adj-Earnings Estimates: (per share)

(Dec)	1Q	2Q	3Q	4Q	FY	P/E
FY16E	0.01	0.50	0.55	0.88	1.95	17.7x
FY15E	(0.50)A	0.36A	0.53	0.93	1.50	23.0x
FY14A	(0.40)	0.25	0.54	0.75	1.19	28.9x
FY13A	(0.19)	0.31	0.36	0.33	0.99	34.8x

Source: Laidlaw & Company estimates

Healthcare / Biotechnology

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

Trading Data:

Last Price (08/07/2015)	\$34.43
52-Week High (08/06/2015)	\$35.49
52-Week Low (10/15/2014)	\$19.31
Market Cap. (MM)	\$1,320
Shares Out. (MM)	38.36

Analyst

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Building 55 remains on track for early-2016 licensure. With Building 55 on-line in 1H16 (sBLA filing 3Q15) the focus turns to the next BioThrax procurement contract from the US Government (USG). Given the ~\$100MM that the USG has spent to help validate Bldg.55 we believe that a 20M dose/year contract (at a lower ~\$17/dose price point) is realistic. We anticipate the next USG contract is likely an early-mid 2016 event.

Additional acquisition continue to be likely in 2H15. EBS is targeting products, divisions, and entire companies in the CBRNE (chemical, biologic, radioactive, nuclear, explosive) space to bring in immediately accretive assets where EBS manufacturing expertise can improve margins.

Adjusting EPS upwards with Biosciences spin-out. We have adjusted our 2016-2018 EPS from \$1.95, \$2.45, and \$2.95 respectively to \$2.25, \$3.00, and \$3.50 respectively to account for the expected cost savings of the Biosciences spin out.

Figure 1: Valuation

Sum-of-the-parts valuation: EBS		
Segment	Valuation (000's)	Per share value
DCF of base business	\$1,985,468	\$40
Net Cash, end '16E	\$215,020	\$4
Technology value	\$50,000	\$1
SUM	\$2,250,487	\$45
Fully diluted shares out '16E (000)		48,985

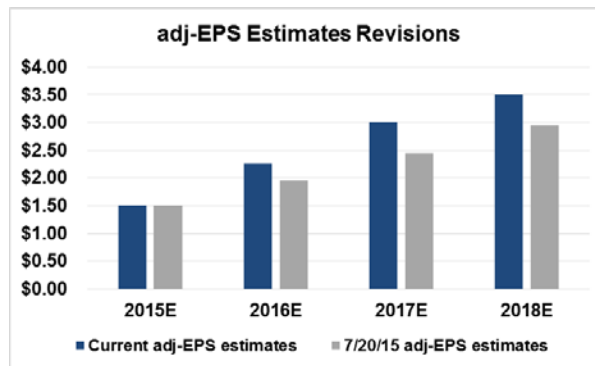
Source: Company reports; Laidlaw & Company estimates

Figure 2: Variance analysis

Emergent BioSolutions Quarterly Variance Analysis					
(\$000 except per share)	2Q14A	2Q15A	2Q15E	Variance	% Y/Y
BioThrax sales	\$67,500	\$72,200	\$55,000	\$17,200	7.0%
RSDL sales		0	3,000	(3,000)	NM
Contracts and Grants	22,869	35,230	33,000	2,230	54.1%
Total Revenue	\$110,325	\$126,112	\$118,750	\$7,362	14.3%
COGS	31,607	26,266	34,063	(7,797)	-16.9%
Gross Profit	78,718	99,846	84,688	15,159	26.8%
SG&A Expense	27,155	34,053	30,875	3,178	25.4%
R&D Expense	37,401	40,941	38,750	2,191	9.5%
Operating Income	14,162	24,852	15,063	9,790	75.5%
Interest Expense	3,621	1,628	1,750	(122)	
Int. & Inv. Income	31	273	150	123	780.6%
Other Inc./ (Exp)	1,322	300	500	(200)	NA
Pretax Income	11,894	23,797	13,963	9,835	100.1%
Tax exp/(benefit)	2,465	6,800	3,630	3,170	NA
Adj-Net Income	9,429	16,997	10,332	6,665	80.3%
Shares out (000)	38,333	47,410	46,949	461	23.7%
Adj-Earnings Per Share	\$0.25	\$0.36	\$0.22	\$0.14	45.8%
Margin Analysis					
Gross Profit Margin	63.9%	71.1%	60.3%	10.8%	11.3%
SG&A Expense	31.0%	37.5%	36.0%	1.5%	20.7%
R&D Expense	42.8%	45.0%	70.5%	-25.4%	5.3%
Operating Income	16.2%	27.3%	17.6%	9.8%	68.9%
Tax Rate	20.7%	28.6%	26.0%	2.6%	37.9%
Adj-Net Income	8.5%	13.5%	8.7%	4.8%	57.7%

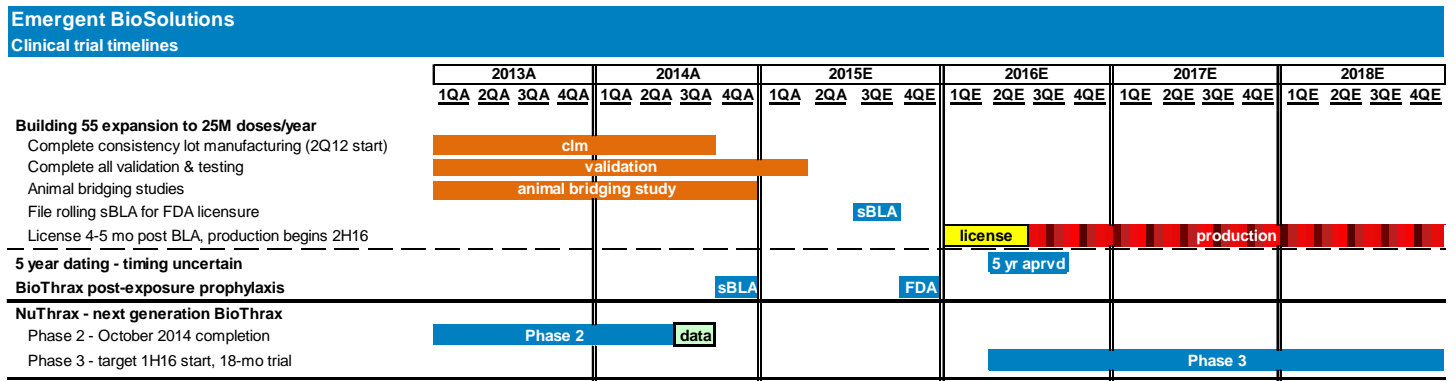
Source: Company reports; Laidlaw & Company estimates

Figure 3: Annual adj-EPS Revisions



Source: Company reports; Laidlaw & Company estimates

Figure 4: Clinical Trials Timeline



Source: Company reports and Laidlaw estimates

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

Figure 5: Quarterly Income Statement

Emergent BioSolutions Quarterly income statement										
(\$000 except per share)	2014A				2014A Year	2015E				2015E Year
	1QA	2QA	3QA	4QA		1QA	2QA	3QE	4QE	
BioThrax - US sales	\$24,544	\$67,500	\$66,000	\$87,900	\$245,944	\$0	\$72,200	\$85,000	\$126,000	\$283,200
BioThrax - OUS sales										
Other Biodefense	2,500	7,275	11,675	10,911	32,350	11,945	2,800	10,000	10,000	34,745
Total Biodefense	27,044	74,775	77,675	98,811	278,305	11,945	75,000	95,000	136,000	317,945
Total Biosciences	8,723	3,494	6,782	11,050	30,060	6,345	7,023	14,750	15,075	43,193
Contract manufacturing	2,726	9,187	9,433	9,589	30,935	12,243	8,859	9,500	9,500	40,102
Contracts & grants	15,391	22,869	44,064	28,525	110,849	33,099	35,230	33,000	33,000	134,329
Total revenues	\$53,884	\$110,325	\$137,954	\$147,975	\$450,138	\$63,633	\$126,112	\$152,250	\$193,575	\$535,570
Expenses										
COGS	16,997	31,607	30,423	29,185	108,212	16,048	26,266	39,593	42,242	124,148
Gross margin	36,887	78,718	107,531	118,790	341,926	47,585	99,846	112,658	151,334	411,422
% product sales	56%	64%	68%	76%	68%	47%	71%	67%	74%	69%
R&D	30,256	37,401	44,207	38,965	150,829	38,702	40,941	36,750	37,000	153,393
SG&A	24,089	27,155	27,692	28,705	107,641	33,393	34,053	39,585	50,700	157,731
Operating income	(17,458)	14,162	35,632	51,120	83,456	(24,510)	24,852	36,323	63,634	100,298
Interest expense	3,535	3,621	1,810	1,174	10,140	1,661	1,628	1,500	1,500	6,289
Interest income, net	40	31	59	190	320	82	273	150	175	680
Other income/(expense)	512	1,322	420	672	2,926	100	300	500	500	1,400
Pretax income (loss)	(20,441)	11,894	34,301	50,808	76,562	(25,989)	23,797	35,473	62,809	96,089
Tax exp/(benefit)	(5,805)	2,465	9,269	16,192	22,121	(7,169)	6,800	10,287	18,214	28,132
Loss to non-ctrl interest					-					
Adjusted Net Income	(14,636)	9,429	25,032	34,616	54,441	(18,820)	16,997	25,185	44,594	67,957
Non-cash charges	(5,600)	(4,400)	(3,200)	(4,500)	(17,700)	(2,700)	(2,900)	(2,000)	(2,000)	(9,600)
GAAP net income	(20,236)	5,029	21,832	30,116	36,741	(21,520)	14,097	23,185	42,594	58,357
EPS ex non-cash items	(\$0.40)	\$0.25	\$0.54	\$0.75	\$1.19	(\$0.50)	\$0.36	\$0.53	\$0.93	\$1.50
EPS as reported	(\$0.55)	\$0.13	\$0.47	\$0.65	\$0.80	(\$0.57)	\$0.30	\$0.49	\$0.89	\$1.29
Fully diluted shares (000)	36,854	38,333	46,557	46,391	45,803	37,949	47,410	47,760	48,110	45,308
Margin & expense analysis										
Gross Margin (% prod. sales)	56%	64%	68%	76%	68%	47%	71%	67%	74%	69%
Op margin (% prod. sales)	-45%	16%	38%	43%	25%	-80%	27%	30%	40%	25%
Taxes	28%	21%	27%	32%	29%	28%	29%	29%	29%	29%
Net margin	-27%	9%	18%	23%	12%	-30%	13%	17%	23%	13%
Year-over-year change										
Net revenue	25%	34%	55%	51%	44%	18%	14%	10%	31%	19%
R&D	5%	27%	53%	30%	26%	28%	9%	-17%	-5%	2%
SG&A	20%	36%	26%	59%	34%	39%	25%	43%	77%	47%
Operating income	54%	-12%	96%	83%	65%	40%	75%	2%	24%	20%
Net income	120%	-17%	86%	90%	50%	29%	80%	1%	29%	25%

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

Figure 6: Annual Income Statement

Emergent BioSolutions						
Annual income statement						
(\$000 except per share)	2014A	2015E	2016E	2017E	2018E	Comments
BioThrax - US sales	\$245,944	\$283,200	\$328,000	\$335,000	\$350,000	2015E guide: \$270M-\$285M
BioThrax - OUS sales				40,000	78,000	Excess Bldg 55 production sold OUS
Other Biodefense	<u>32,350</u>	<u>34,745</u>	<u>40,000</u>	<u>40,000</u>	<u>40,000</u>	RSDL, BAT, other Biodefense here
Total Biodefense	278,305	317,945	368,000	415,000	468,000	
Total biosciences	30,060	43,193	30,450	0	0	To be spun out mid-2016
Contract manufacturing	30,935	40,102	38,500	39,000	39,500	Acquired with Cangene 3Q13
Contracts & grants	110,849	134,329	127,000	122,000	126,000	Offset in R&D
Total revenues	\$450,138	\$535,570	\$563,950	\$576,000	\$633,500	2015E guide: \$510M-\$540M
Expenses						
COGS	108,212	124,148	135,623	119,550	122,893	
Gross margin	341,926	411,422	428,328	456,450	510,608	
% product sales	68%	69%	69%	74%	76%	Cangene impacts margins
R&D	150,829	153,393	140,500	135,000	139,000	
SG&A	107,641	157,731	128,000	103,500	110,500	
Operating income	83,456	100,298	159,828	217,950	261,108	
Interest expense	10,140	6,289	7,250	7,250	7,250	
Interest income, net	320	680	775	1,000	1,275	
Other inc/(exp)	2,926	1,400	2,000	2,000	2,000	
Pretax income	76,562	96,089	155,353	213,700	257,133	
Tax expense	22,121	28,132	45,052	61,973	74,568	
Loss to non-cont. int	0	0	0	0	0	
Adj-Net income	54,441	67,957	110,300	151,727	182,564	2015E adj-NI guide: \$60M-\$70M
Non-cash charges	(17,700)	(9,600)				
GAAP net income	36,741	58,357				2015E GAAP: \$50M-\$60M
EPS ex non-cash items	\$1.19	\$1.50	\$2.25	\$3.00	\$3.50	30% adj-EPS CAGR 2014-2018E
EPS as reported	\$0.80	\$1.29				
Fully diluted shares (000)	45,803	45,308	48,985	50,510	52,110	
Margin & expense analysis						
Gross Margin	68%	69%	69%	74%	76%	
Operating margin	25%	25%	37%	48%	51%	
Taxes	29%	29%	29%	29%	29%	Guide: high 20% range
Net margin	12%	13%	20%	26%	29%	
Year-over-year change						
Net revenue	44%	19%	5%	2%	10%	
R&D	26%	2%	-8%	-4%	3%	
SG&A	34%	47%	-19%	-19%	7%	
Operating income	65%	20%	59%	36%	20%	
Net income	50%	25%	62%	38%	20%	
EPS	21%	26%	50%	33%	17%	

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

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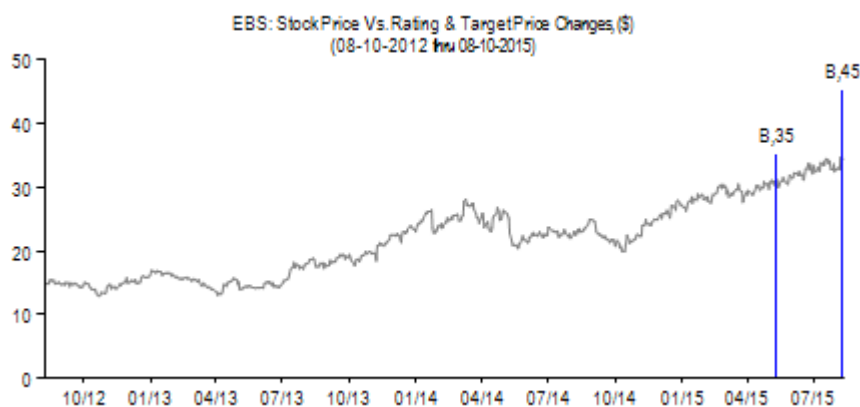
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3 Year Rating Change History

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

3 Year Price Change History

Date	Target Price (\$)	Closing Price, (\$)
05/11/2015	35.00	31.11
08/10/2015	45.00	34.43*

* Previous Close 8/7/2015

Source: Laidlaw & Company

Created by: Blue-Compass.net

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Buy (B)	Expected to outperform the sector average over 12 months.	75.00%	32.14%	7.14%
Hold (H)	Expected returns to be in line with the sector average over 12 months.	3.57%	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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