

Mast Therapeutics (MSTX - \$ 0.12)

Corporate Update Points Out AIR001 Is the Leading Asset With Strategic Options Contemplated

Yesterday, MSTX provided an update regarding business strategy and the clinical development of its product candidate.

- Details.** MSTX provided a corporate update yesterday with highlights that included: 1) Management reiterated that MSTX will focus on clinical development of AIR001 (inhaled sodium nitrite) as a potential heart failure with preserved ejection fraction (HFpEF) treatment. MSTX will continue supporting the three investigator-sponsored Phase II studies in 2016 and 2017; 2) MSTX will evaluate the opportunities for partnering out AIR001 and possibly vepoloxamer; 3) Vepoloxamer development activities to be wound down and this is likely to be completed by 4Q16; 4) MSTX will repay the \$10MM debt facility in early October with additional repayment of the remaining \$3.5MM in equal monthly installments through January 1, 2019; and 5) MSTX's 2017 operating expenses is estimated to be in the range of \$9 to \$10MM.
- Implications.** We were disappointed with the negative outcome of the EPIC study, even given that enriched pediatric and hydroxyurea (HU) treated patients were included in the study, and the significant impairment of the vepoloxamer value. Nevertheless, we believe AIR001 (an intermittent inhaled sodium nitrite) in HFpEF is still promising given nitrite is well known as a vasodilator and reducing inflammation. We view MSTX's decision to continue the AIR001 Phase II study (with potential patient enrollment completion by YE2017 and top-line results potentially in 2018), and explore a partnering opportunity is prudent to potentially maximize shareholder value under the current circumstances.
- Action.** We are reiterating our Neutral rating looking for more visibility for the development of AIR001. Although we believe AIR001 in HFpEF could be very promising, we believe MSTX shares are likely be range bound for a while before completion and data reporting from the ongoing AIR001 in HFpEF Phase II study. We have adjusted our financial model to reflect MSTX's guidance.

Healthcare/Biotechnology

Ticker: **MSTX**
Rating: **Neutral**
Price Target:

Trading Data:

Last Price (09/26/2016)	\$ 0.12
52-Week High (9/6/2016)	\$ 0.71
52-Week Low (9/21/2016)	\$ 0.10
Market Cap. (MM)	\$ 26
Shares Out. (MM)	212

Earnings Estimates: (per share)

(Dec)	1Q	2Q	3Q	4Q	FY	P/E
FY-16E	-0.06A	-0.05A	-0.04	-0.03	-0.18	N.A.
FY-15A	-0.06	-0.06	-0.06	-0.06	-0.25	N.A.
FY-14A	-0.06	-0.06	-0.06	-0.05	-0.23	N.A.
FY-13A	-0.12	-0.09	-0.05	-0.06	-0.28	N.A.

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Source: Laidlaw & Company estimates

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Anticipated milestones in 2016 and beyond

Product	Indication	Event	Timing	Importance
AIR001	PH associated with heart failure with preserved ejection fraction (HFpEF)	Potentially complete patient enrollment	4Q17	***
		Potentially report Phase II (INDIE-HFpEF) top-line results	2018	****

**** / ***** Major catalyst event that could impact share price very significantly while *** event is more informative

Source: Laidlaw & Company and company presentation

Major Risks

Risks of clinical study failure could have a major impact on MSTX share value. Given the clinical development focus rests entirely on AIR001 and as such the upside for MSTX shares is based on the assumption that a positive AIR001 in Phase II (INDIE-HFpEF) study outcome could progress clinical development of AIR001 potentially to a pivotal stage; a failure of the INDIE-HFpEF study would have significant impact on MSTX share value.

Limited product diversity could increase overall risk. Given the MSTX product portfolio is limited to mid-stage AIR001, majority of the product pipeline value mainly resides on AIR001 in HFpEF development. As such, we believe the company at the current stage has very limited diversification potential in its product pipeline.

Additional financing could dilute shareholder value. Although the company ended 2Q16 with ~\$35MM cash and we estimate the company's cash might reach \$15MM by end of 3Q16, MSTX could potentially need more financial resources going forward if they want to expand and further develop its pipeline. Should AIR001 show a positive outcome in Phase II study the company might need to increase its financial resources, which includes issuing new equity to raise additional cash. Under such a scenario, the share value of existing shareholders could be diluted.

Figure 1: Income Statement

Mast Therapeutics – Income Statement										
(\$'000)	2012	2013	2014	2015	1Q16	2Q16	3Q16E	4Q16E	2016E	2017E
Revenue										
Net sales	0	0	0	0	-	-	-	-	0	0
Licensing revenue	0	0	0	0	-	-	-	-	0	0
Grant revenue	0	0	0	0	-	-	-	-	0	0
Total revenue	0	0	0	0	-	-	-	-	0	0
Costs of goods	0									0
Research and development	8,088	12,902	19,436	28,264	7,875	7,752	5,581	3,070	24,278	8,255
Selling, general and administrative	7,519	8,518	9,487	10,963	2,835	2,439	2,512	1,959	9,746	2,242
Marketing and sales										0
Transaction-related expenses	(70)	80	271	0					0	0
Depreciation and amortization	90	40	84	146	32	30	30	30	122	122
Total Operating Expenses	15,628	21,539	29,279	39,373	10,742	10,221	8,124	5,059	34,146	10,618
Operating Incomes (losses)	(15,628)	(21,539)	(29,279)	(39,373)	(10,742)	(10,221)	(8,124)	(5,059)	(34,146)	(10,618)
Reduction of fair value of warrants	0	0	0	0	0	0	0	-	0	0
Investment income	74	60	67	47	39	0	0	0	39	43
Interest expense	0	0	0	0	(519)	(485)	(485)	(485)	(1,974)	(2,171)
Other income/(expense), net	(5)	(1)	511	(516)	15		2	2	19	(20)
Loss before cumulative effect of change in accounting principle	(15,559)	(21,480)	(28,701)	(39,842)	(11,207)	(10,706)	(8,607)	(5,542)	(36,062)	(12,767)
Cumulative effect of change in accounting principle	0	0	0	0	0	0	0	-	0	0
Income before tax	(15,559)	(21,480)	(28,701)	(39,842)	(11,207)	(10,706)	(8,607)	(5,542)	(36,062)	(12,767)
Tax	0	0	0	0	0	0	0	-	0	0
Net Income (Loss)	(15,559)	(21,480)	(28,701)	(39,842)	(11,207)	(10,706)	(8,607)	(5,542)	(36,062)	(12,767)
Net Income (Loss) Applicable to Common Shareholders	(15,559)	(21,480)	(28,701)	(39,842)	(11,207)	(10,706)	(8,607)	(5,542)	(36,062)	(12,767)
Net Earnings (Losses) Per Share—Basic and Diluted	(\$0.33)	(\$0.28)	(\$0.23)	(\$0.25)	(\$0.06)	(\$0.05)	(\$0.04)	(\$0.03)	(\$0.18)	(\$0.06)
Shares outstanding—basic	47,641	76,586	122,409	162,204	178,115	196,554	211,554	212,554	199,694	200,694
Shares outstanding—diluted	47,641	76,586	122,409	162,204	178,115	196,554	211,554	212,554	199,694	200,694
Margin Analysis (% of Sales/Revenue)										
Costs of goods									9%	9%
R&D	NA	NA	NA	NA	NA	NA	NA	NA	NA	NA
MG&A	NA	NA	NA	NA	NA	NA	NA	NA	NA	NA
Operating Income (loss)	NA	NA	NA	NA	NA	NA	NA	NA	NA	NA
Pretax	NA	NA	NA	NA	NA	NA	NA	NA	NA	NA
Tax Rate										37%
Net Income	NA	NA	NA	NA	NA	NA	NA	NA	NA	NA
Financial Indicator Growth Analysis (YoY%)										
Licensing revenue				0%					0%	0%
Grant revenue				0%					0%	0%
Total Revenue	NA	NA	NA	NA	NA	NA	NA	NA	NA	NA
R&D	40%	60%	51%	45%	30%	0%	-24%	-59%	-14%	-66%
SG&A	5%	13%	11%	16%	-21%	1%	2%	-22%	-11%	-77%
Marketing and sales										
Operating Income (Losses)	17%	38%	36%	34%	11%	0%	-17%	-48%	-13%	-69%
Net Income	17%	38%	34%	39%	17%	5%	-13%	-45%	-9%	-65%
EPS	-31%	-14%	-16%	5%	4%	-20%	-33%	-58%	-26%	-65%
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Source: Bloomberg LP; Company reports; Laidlaw & Company estimates

DISCLOSURES:

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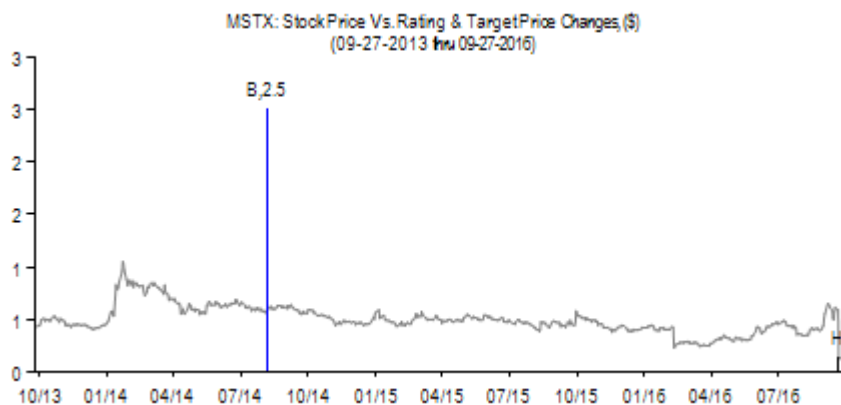
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Rating and Price Target Change History



3 Year Rating Change History

Date	Rating	Closing Price (\$)
08/06/2014	Buy (B)	0.60
09/21/2016	Hold (H)	0.12

3 Year Price Change History

Date	Target Price (\$)	Closing Price, (\$)
08/06/2014	2.50	0.60
09/21/2016		0.12

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.	60.53%	28.95%	2.63%
Hold (H)	Expected returns to be in line with the sector average over 12 months.	5.26%	0.00%	0.00%
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