

Emergent BioSolutions (EBS - \$26.36)

BioThrax Clarity Expected in 4Q16, Likely a Choppy Year End

EBS reported 3Q16 last night after the close, handily beating top & bottom line, but leaving the impression that 4Q16 could be “lumpy” as EBS & the US Government finalize the pricing & size for the BioThrax procurement contract that will carry over until NuThrax supply can start in 2019. With ~\$30M left in the current BioThrax contract (and that already shipped) it seems likely to us that there will be a significant production shortfall in 4Q16 before returning to a more normalized run-rate in 2017. Positively, EBS continues to make tremendous strides in reducing R&D and SG&A to match the lower top line, with operating expenses coming in ~\$17.5M below our estimates for the quarter. At this lower OpEx run rate we believe EBS can continue to deliver EPS growth in the outer years despite top-line headwinds. EBS also highlighted the outside the US opportunities for sales growth, which we estimate could constitute 5%-8% of product sales going forward. We continue to expect clarity on the follow-on BioThrax contract should be a positive catalyst for EBS in 4Q16, and we are reiterating our Buy rating, \$45 PT.

- **Surprise beat in the quarter nice to see.** EBS’ \$143M top line handily beat both Laidlaw: \$121M, and consensus: \$112M sales estimates, but we anticipate a significant reversion in 4Q16 as the delay in finalizing the BioThrax procurement contract likely leads to little more being shipped than the remaining \$30M in the current contract. We model in \$40M BioThrax sales in 4Q16, with top line growth returning in 2017 as the follow-on contract goes into effect.
- **Final weeks for BioThrax contract.** Management guided that they were in the final weeks of the BioThrax procurement contract, which should cover top line for EBS until they begin shipping NuThrax in 2019 (by our estimate).
- **OUS sales & acquisitions on target for 2017.** EBS highlighted the OUS opportunities for Biodefense sales, but we continue to see US sales dominating the top line for the near term, with OUS sales comprising 5%-8% of total sales. Acquisitions remain a top priority for EBS, but as always with acquisitions there’s nothing done until it’s inked. We have not modeled in any acquisition revenue in our estimates, but EBS will need to add \$400M-\$500M top line to hit their aspirational guidance of \$1B in sales by 2020.
- **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 \$37/share, cash (net of debt) and tech value of \$8/share.

Adj-Earnings Estimates: (per share)

(Dec)	1Q	2Q	3Q	4Q	FY	P/E
FY17E	0.37	0.41	0.53	0.68	2.00	13.2x
FY16E	0.16A	(0.18)A	0.58A	0.22	0.85	31.0x
FY15A	(0.50)	0.36	0.83	0.78	1.60	16.5x
FY14A	(0.40)	0.25	0.54	0.75	1.19	22.2x

Source: Laidlaw & Company estimates

Healthcare / Biotechnology

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

Trading Data:

Last Price (11/07/2016)	\$26.36
52-Week High (06/07/2016)	\$44.38
52-Week Low (11/03/2016)	\$24.47
Market Cap. (MM)	\$1,070
Shares Out. (MM)	40.46

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Figure 1: Variance Analysis

Emergent BioSolutions					
Quarterly Variance Analysis					
<i>(\$000 except per share)</i>	3Q15A	3Q16A	3Q16E	Variance	% Y/Y
BioThrax sales	\$109,800	\$94,100	\$70,000	\$24,100	-14.3%
Contracts and Grants	29,646	31,504	36,500	(4,996)	6.3%
Total Revenue	\$164,987	\$142,914	\$127,000	\$15,914	-13.4%
COGS	36,161	38,460	24,950	13,510	6.4%
Gross Profit	128,826	104,454	102,050	2,404	-18.9%
SG&A Expense	29,806	27,388	35,000	(7,612)	-8.1%
<i>R&D ex-ctrcs & grnts</i>	12,222	(4,316)	500	(4,816)	-135.3%
R&D Expense	41,868	27,188	37,000	(9,812)	-35.1%
Operating Income	57,152	49,878	30,050	19,828	-12.7%
Interest Expense	1,635	2,049	1,750	299	25.3%
Int. & Inv. Income	104	358	200	158	244.2%
Other Inc./(Exp)	602	(134)	125	(259)	NA
Pretax Income	56,223	48,053	28,625	19,428	-14.5%
Tax exp/(benefit)	16,434	19,565	8,301	11,264	NA
Adj-Net Income	39,789	28,488	20,324	8,164	-28.4%
Shares out (000)	47,785	49,440	48,453	987	3.5%
Adj-Earnings Per Share	\$0.83	\$0.58	\$0.42	\$0.16	-30.8%
Margin Analysis					
Gross Profit Margin	73.3%	65.5%	72.4%	-7.0%	-10.6%
SG&A Expense	22.0%	24.6%	38.7%	-14.1%	11.6%
R&D Expense	30.9%	24.4%	40.9%	-16.5%	-21.1%
Operating Income	42.2%	44.8%	33.2%	11.6%	6.0%
Tax Rate	29.2%	40.7%	29.0%	11.7%	39.3%
Adj-Net Income	24.1%	19.9%	16.0%	3.9%	-17.3%

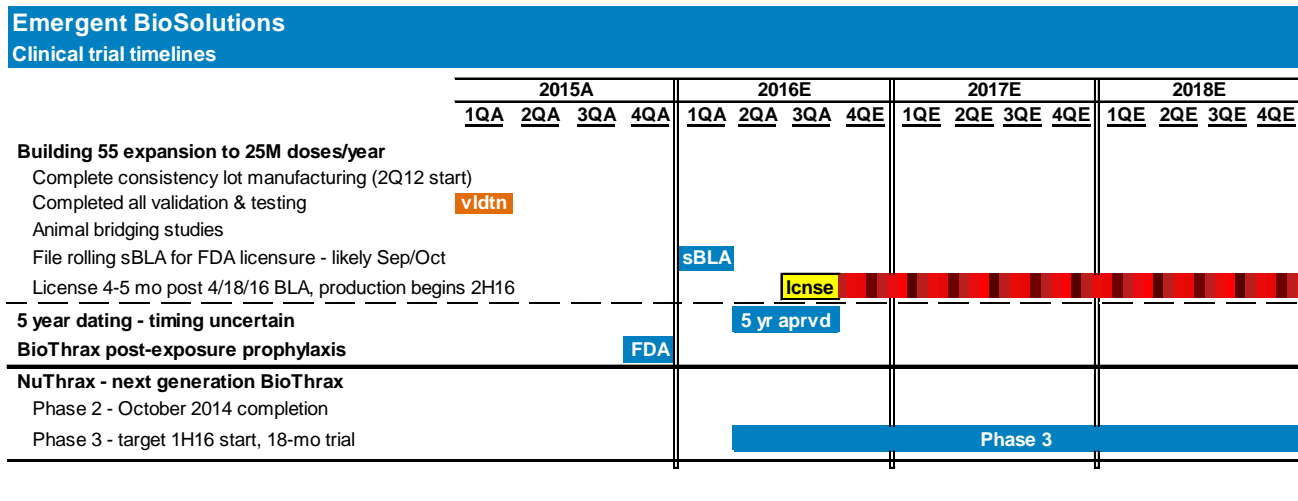
Source: Company reports; Laidlaw & Company estimates

Figure 2: Valuation

Sum-of-the-parts valuation		
Segment	Valuation (000's)	Per share value
DCF of base business	\$1,863,421	\$37
Net Cash, end '16E	\$303,560	\$6
Technology value	\$100,000	\$2
SUM	\$2,266,981	\$45
Fully diluted shares out '16E (000)		50,690

Source: Company reports; Laidlaw & Company estimates

Figure 3: Clinical Trial Timeline



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

Figure 4: Quarterly Income Statement

Emergent BioSolutions										
Quarterly income statement										
	2015A				2015A Year	2016E				2016E Year
	1QA	2QA	3QA	4QA		1QA	2QA	3QA	4QE	
(\$000 except per share)										
BioThrax - US sales	\$0	\$72,200	\$109,800	\$111,900	\$293,900	\$59,100	\$40,000	\$94,100	\$40,000	\$233,200
OUS Biodefense sales										
Other Biodefense	11,945	2,800	7,700	12,549	34,994	4,658	8,300	2,598	8,000	23,556
Total Biodefense	11,945	75,000	117,500	124,449	328,894	63,758	48,300	96,698	48,000	256,756
Total Biosciences	6,345	7,023	6,500	8,200	28,068	7,948	10,200	-	-	18,148
Contract manufacturing	12,243	8,859	11,341	10,525	42,968	7,587	10,200	14,712	14,000	46,499
Contracts & grants	33,099	35,230	29,646	24,930	122,905	31,709	32,787	31,504	38,000	134,000
Total revenues	\$63,633	\$126,112	\$164,987	\$168,104	\$522,789	\$111,002	\$101,487	\$142,914	\$100,000	\$455,403
Expenses										
COGS	16,048	26,266	36,161	37,070	112,895	25,803	35,612	38,460	25,600	125,475
Gross margin	47,585	99,846	128,826	131,034	409,894	85,199	65,875	104,454	74,400	329,928
% product sales	47%	71%	73%	74%	72%	67%	48%	65%	59%	61%
R&D	38,702	40,941	41,868	32,486	153,997	34,154	33,947	27,188	29,000	124,289
SG&A	33,393	34,053	29,806	42,756	141,758	37,484	40,148	27,388	28,000	133,020
Operating income	(24,510)	24,852	57,152	55,792	114,139	13,561	(8,220)	49,878	17,400	72,619
Interest expense	1,661	1,628	1,635	1,600	6,523	1,524	1,509	2,049	2,200	7,282
Interest income, net	82	273	104	113	572	186	220	358	200	964
Other income/(expense)	100	300	602	(524)	(319)	116	17	(134)	125	124
Pretax income (loss)	(25,989)	23,797	56,223	53,781	107,869	12,339	(9,492)	48,053	15,525	66,425
Tax exp/(benefit)	(7,169)	6,800	16,434	16,334	32,299	4,818	(2,345)	19,565	4,502	26,540
Loss to non-ctrl interest										
Adjusted Net Income	(18,820)	16,997	39,789	37,447	75,570	7,521	(7,147)	28,488	11,023	39,885
Non-cash charges	(2,700)	(2,900)	(1,847)	(4,100)	(12,700)	(3,530)	(3,800)	(8,100)	(3,500)	(18,930)
GAAP net income	(21,520)	14,097	37,942	33,347	62,870	3,991	(10,947)	20,388	7,523	20,955
EPS ex non-cash items	(\$0.50)	\$0.36	\$0.83	\$0.78	\$1.60	\$0.16	(\$0.18)	\$0.58	\$0.22	\$0.85
EPS as reported	(\$0.57)	\$0.30	\$0.79	\$0.69	\$1.33	\$0.08	(\$0.27)	\$0.41	\$0.15	\$0.45
Fully diluted shares (000)	37,949	47,410	47,785	48,143	47,256	48,360	40,203	49,440	49,690	46,923
Margin & expense analysis										
Gross Margin (% prod. sales)	47%	71%	73%	74%	72%	67%	48%	65%	59%	61%
Op margin (% prod. sales)	-80%	27%	42%	39%	29%	17%	-12%	45%	28%	23%
Taxes	28%	29%	29%	30%	30%	39%	25%	41%	29%	40%
Net margin	-30%	13%	24%	22%	14%	7%	-7%	20%	11%	9%
Year-over-year change										
Net revenue	18%	14%	20%	14%	16%	74%	-20%	-13%	-41%	-13%
R&D	28%	9%	-5%	-17%	2%	-12%	-17%	-35%	-11%	-19%
SG&A	39%	25%	8%	49%	32%	12%	18%	-8%	-35%	-6%
Operating income	40%	75%	60%	9%	37%	-155%	-133%	-13%	-69%	-36%
Net income	29%	80%	59%	8%	39%	-140%	-142%	-28%	-71%	-47%

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

Figure 5: 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	\$233,200	\$295,000	\$300,000	2016E guide was: \$305M-\$320M
OUS Biodefense sales				14,250	24,000	OUS sales here ~10% of US sales
Other Biodefense	<u>32,350</u>	<u>34,994</u>	<u>23,556</u>	<u>34,000</u>	<u>40,000</u>	RSDL, BAT, other Biodefense here
Total Biodefense	278,305	328,894	256,756	343,250	364,000	
Total biosciences	30,060	28,068	18,148	0	0	Spun out mid-2016
Contract manufacturing	30,935	42,968	46,499	60,000	60,000	Acquired with Cangene 3Q13
Contracts & grants	110,849	122,905	134,000	170,000	180,000	Offset in R&D
Total revenues	\$450,138	\$522,789	\$455,403	\$573,250	\$604,000	'16 guide was: \$600M-\$630M
Expenses						
COGS	108,212	112,895	125,475	133,700	130,000	
Gross margin	341,926	409,894	329,928	439,550	474,000	
% product sales	68%	72%	61%	67%	69%	Cangene impacts margins
R&D	150,829	153,997	124,289	175,000	185,500	
SG&A	107,641	141,758	133,020	115,750	117,000	
Operating income	83,456	114,139	72,619	148,800	171,500	
Interest expense	10,140	6,523	7,282	7,275	7,275	
Interest income, net	320	572	964	950	1,300	
Other inc/(exp)	2,926	(319)	124	400	400	
Pretax income	76,562	107,869	66,425	142,875	165,925	
Tax expense	22,121	32,299	26,540	41,434	48,118	
Loss to non-cont. int	0	0	0	0	0	
Adj-Net income	54,441	75,570	39,885	101,441	117,807	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	\$0.85	\$2.00	\$2.25	~20% adj-EPS CAGR 2014-2018E
EPS as reported	\$0.80	\$1.33				
Fully diluted shares (000)	45,803	47,256	46,923	50,690	52,290	
Margin & expense analysis						
Gross Margin	68%	72%	61%	67%	69%	
Operating margin	25%	29%	23%	37%	40%	
Taxes	29%	30%	40%	29%	29%	Guide: high 20% range
Net margin	12%	14%	9%	18%	20%	
Year-over-year change						
Net revenue	44%	16%	-13%	26%	5%	
R&D	26%	2%	-19%	41%	6%	
SG&A	34%	32%	-6%	-13%	1%	
Operating income	65%	37%	-36%	105%	15%	
Net income	50%	39%	-47%	154%	16%	
EPS	21%	35%	-47%	135%	13%	

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

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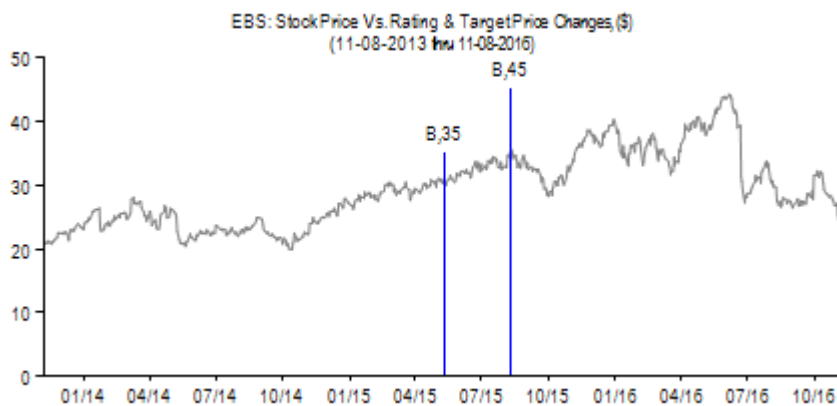
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Date	Rating	Closing Price (\$)
05/11/2015	Buy (B)	31.11

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.	2.56%	2.56%	0.00%
Buy (B)	Expected to outperform the sector average over 12 months.	58.97%	28.21%	2.56%
Hold (H)	Expected returns to be in line with the sector average over 12 months.	5.13%	0.00%	0.00%
Sell (S)	Returns expected to significantly underperform the sector average over 12 months.	2.56%	0.00%	0.00%

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