

Zacks Small-Cap Research

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Innovus Pharmaceutical (INNV-OTC)

INNV: Solid results with a number of positive signals.

We base our \$0.42/share value for INNV on a ten-year DCF with a WACC of 15%. Our WACC reflects current high financing costs as well as its relatively recent transition from start up to true operating status. On a P/S basis, INNV trades at 0.9x 2018E, while its peers trade anywhere from 1.2-29x 2018 sales, averaging 12.6x.

OUTLOOK

Innovus Pharmaceutical beat its 3Q18 revenue estimate of \$7.0-7.1 million by reporting sales of \$7.4 million – the Company's fifth consecutive quarter of higher revenues.

There was a lot of good news in the quarter – higher subscription sales, strong growth in Canada and a slight decrease in absolute marketing spend. But the best news was a reduction in operating and investing cash spend from \$2.8 million in 2Q18 to \$2.1 million in 3Q18.

Current Price (11/20/18) \$0.10
Valuation **\$0.42**

SUMMARY DATA

52-Week High **\$0.21**
52-Week Low **\$0.08**
One-Year Return (%) **22.2**
Beta **4.93**
Average Daily Volume (sh) **693,000**

Shares Outstanding (mil) **214**
Market Capitalization (\$mil) **\$22**
Short Interest Ratio (days) **N/A**
Institutional Ownership (%) **0**
Insider Ownership (%) **16**

Annual Cash Dividend **\$0.00**
Dividend Yield (%) **0.00**

5-Yr. Historical Growth Rates

Sales (%) **N/A**
Earnings Per Share (%) **N/A**
Dividend (%) **N/A**

P/E using TTM EPS **N/A**

P/E using 2018 Estimate **N/A**

P/E using 2019 Estimate **N/A**

Zacks Rank **N/A**

Risk Level **High,**
Type of Stock **N/A**
Industry **Med-Drugs**
Zacks Rank in Industry **N/A**

Revenue

(in millions of \$)

| | Q1 | Q2 | Q3 | Q4 | Year |
|------|-------|-------|--------|-------|--------|
| | (Mar) | (Jun) | (Sep) | (Dec) | (Dec) |
| 2017 | 2.2 A | 2.0 A | 2.2 A | 2.4 A | 8.8 A |
| 2018 | 4.5 A | 7.3 A | 7.4 A | 7.4 E | 26.6 A |
| 2019 | 8.8 A | 9.5 A | 10.2 E | 9.9 E | 38.0 E |
| 2020 | | | | | 45.1 E |

| | Q1 | Q2 | Q3 | Q4 | Year |
|------|-----------|-----------|-----------|-----------|-----------|
| | (Mar) | (Jun) | (Sep) | (Dec) | (Dec) |
| 2017 | -\$0.02 A | -\$0.01 A | -\$0.01 A | -\$0.01 A | -\$0.04 A |
| 2018 | -\$0.01 A | -\$0.01 A | -\$0.01 A | -\$0.01 E | -\$0.04 E |
| 2019 | -\$0.01 E | \$0.00 E | \$0.00 E | -\$0.00 E | -\$0.01 E |
| 2020 | | | | | |

Zacks Projected EPS Growth Rate - Next 5 Years % **N/A**
N/A **N/A**

INVESTMENT UPDATE – 3Q18 results solid with positive signals

Innovus Pharmaceutical announced 3Q18 revenues of \$7.4million, up over 200% from \$2.2 million in the year earlier period, largely flat with down \$7.3 million posted in 2Q18. Product sales were largely flat on a sequential basis coming in at just under \$7.0 million. Management's comments were more focused than on the previous call and emphasized steps the INNV is taking to move to positive operating cash flow and, ultimately GAAP profitability.

Much of INNV's path to profitability relies on increasing its subscription persistency. Subscriptions create recurring revenue allowing the Company to focus its marketing dollars on new customer acquisition. In 3Q18, subscription revenues rose 31% on a sequential basis to \$0.9 million, or c. \$287K per month on average, up from c. \$218K per month in 2Q18. Subscriptions now make up 11.6% of product revenues, compared with 8.7% in 2Q18.

Another step is a more informed marketing program. We believe management took action based on its marketing data by reducing the number of products promoted in the quarter to 7 from 10 in 2Q18. In this way, the Company appears to be focusing on how to best deploy its marketing dollars.

Third, the Company reduced inventory on hand by \$20k (c.1%). We see this as a step towards improved cash flow management; however, it is unclear if inventories will climb in Q418 to support several product launches. In our initiation note we commented that INNV has typically carried six months of inventory on hand; however, we believe a three-month supply is a more normalized level. INNV used approximately \$2.1 million in operating cash in the third quarter, flat with 2Q18 operating cash spend.

Product gross margins contracted 200bp in the quarter to 78%. Management attributes approximately half the contraction to the decision to collect sales tax on many of its products regardless of where the products are shipped. Management has not implemented price increases or a separate sales tax charge to its customers, but is considering such a step. We believe the balance of the margin contraction stems from the increase in subscription revenues. INNV prices multiple unit orders at a discount to single unit purchases. For example, Diabesens is priced at \$39.95 per unit, but a three-month supply is \$29.98 per unit.

INNV notes that it is aiming for profitability in 4Q18. It may be possible for the Company to post positive operating income, however, we would rather see consistent improvement in operating metrics (sales, marketing expense, operating cash flow) than a quarter that "manages" to positive operating income in order to create a positive headline.

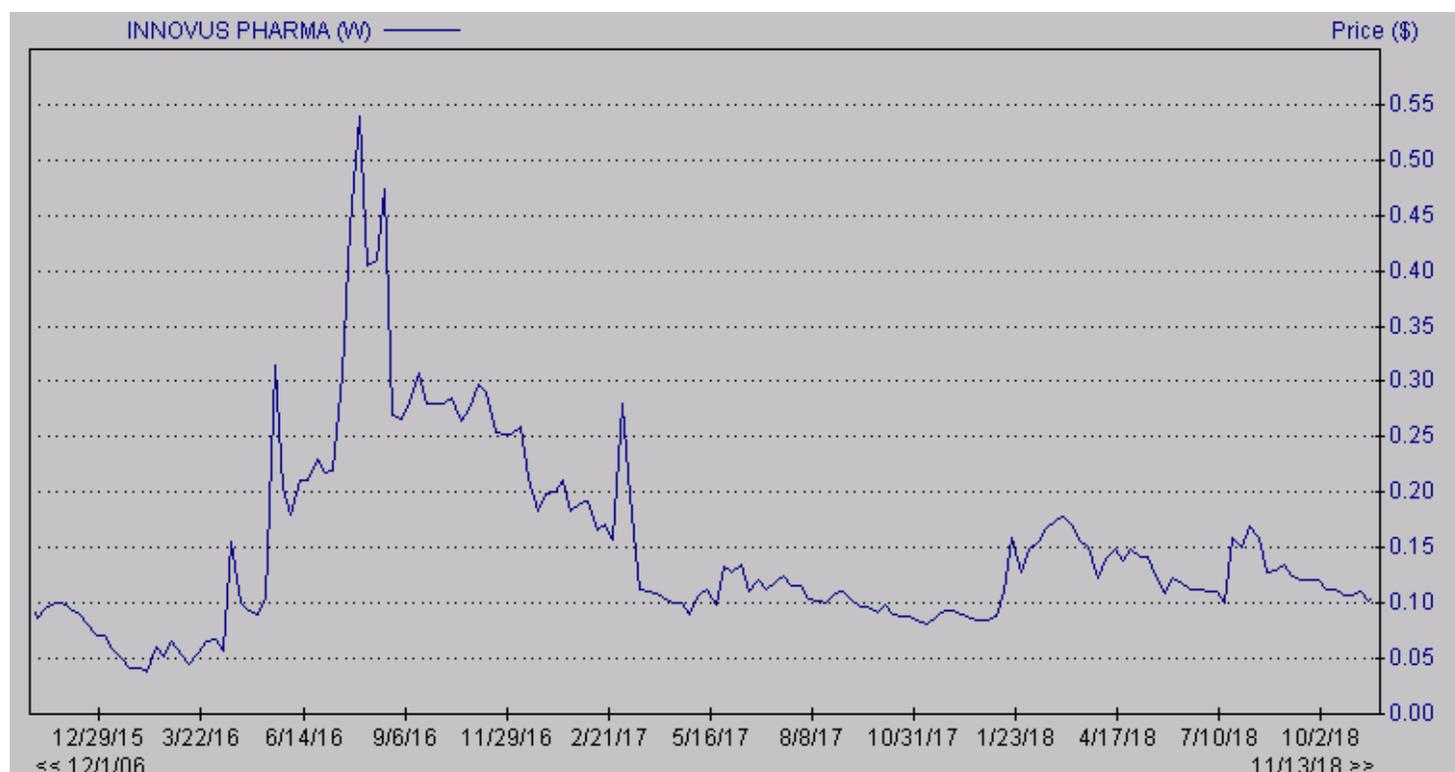
FINANCIALS AND VALUATION

We are trimming our 2018 revenue estimate from \$27.6 million, to \$26.6 million. The change is driven by more conservative 4Q product sales estimate of \$7.0 million, largely flat with 3Q18 and down from our previous estimate of \$7.8 million. Our decision is based off flat product sales between the second and third quarter; however, we our estimate could prove too low given plans to launch several new products in the quarter. As we've noted, we expect the Company to make another marketing push in 4Q18 to target customers who include "improving health" in their new year's resolutions and we anticipate that some of these revenues may book before year-end. Additionally, the Company appears close to releasing its GlucoGorx product/test strip bundle, which along with several other pipeline products may give the Company a 4Q revenue boost.

We value Innovus Pharmaceutical primarily using DCF techniques in large part because we expect much of the value in the Company will be unlocked over the next three to five years. The Company's recent results suggest a strong recent track record of product introductions and healthy gross margins of 80%+.

A 10-year DCF with a WACC of 15% on our forecast compound average annual revenue growth of 71% from 2017-2020 fading to terminal growth of 2% and a terminal EBIT margin of 15% yields a value of \$0.42 per share.

HISTORICAL STOCK PRICE



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