

## **BioSpecifics (NASDAQ: BSTC) \$63.25**

With royalty cash flows that are growing at a 20%+ clip, over \$100 million in cash on the balance sheet and on the cusp of approval for “botox for women’s butts and legs”, BioSpecifics is an unfollowed and mispriced stock with a lot of upside potential.

### **BioSpecifics is a Royalty Cash Machine with Only Seven Employees**

BioSpecifics owns the patent rights to an FDA approved branded drug called Xiaflex. BioSpecifics doesn’t make the drug, conduct research on the drug, market or sell it. It simply collects royalty checks from its licensing partner Endo Pharmaceuticals (NYSE: ENDP) every quarter equivalent to approximately 11% of net sales.

The company only has seven employees including a newly hired CEO, following the death of the previous CEO. As far as I can tell the company has been on autopilot since 2015 with little activity besides accumulating cash from its licensed drug, Xiaflex. BioSpecifics’ cash balance in the last four years has grown by almost \$70 million on an almost 70% increase in annual royalties.

### **BioSpecifics’s Drug Xiaflex is the Only Treatment of its Kind**

Xiaflex treats two conditions: Peyronie’s disease and Dupuytren’s Contracture. And Xiaflex is the only approved pharmaceutical treatment for either condition.

Peyronie’s disease (from Webmd) is a penis problem caused by scar tissue, called plaque, that forms inside the penis. It can result in a bent, rather than straight, erect penis. Most men with Peyronie’s disease can still have sex. But for some, it can be painful and cause erectile dysfunction.

Alternative treatments for Peyronie’s are a splint (ouch) or surgery. These alternatives are not only painful, but can cause serious problems from incontinence to impotence.

According to Endo Pharmaceuticals, there is only a 3% diagnosis rate for Peyronie’s. Of this diagnosis rate, Endo estimates that 14% decide to treat and that Xiaflex has close to a 60% market share of those treatments. There appears to be a lot of runway for Xiaflex to continue to grow with such a small diagnosis rate and the fact that the odds of getting Peyronie’s grows with age, and the populations in the markets Endo is selling into continue to get older.

Dupuytren’s Contracture is the other condition that Xiaflex treats. From Webmd: Dupuytren’s (du-pwe-TRANZ) contracture is a condition that gradually causes connective tissue (fascia) under the skin of your palm to thicken and become scar-like. Although Dupuytren’s isn’t always painful, it does restrict movement. The thickened tissue forces several fingers -- usually your ring and pinky fingers -- to curl in toward your palm. The bending caused by the thick tissue is called contracture.

Again just like Peyronie’s, the diagnosis rate of Dupuytren’s (according to Endo Pharmaceuticals) is a low 3%. Endo estimates that treatment decisions are 30% and that Xiaflex has a 25% market share.

In August, John Elway, the famous, now retired, Denver Broncos quarterback became a spokesman for Xiaflex after the drug helped him with his Dupuytren's contracture.

The very low diagnosis and treatment rates equal upside potential for Xiaflex, which now does approximately \$332 million in annualized revenue, and in the last reported quarter showed 29% year-over-year revenue growth. The next reported quarter will be the fourth quarter numbers and will be announced by Endo on February 26th.

There are additional potential applications for Xiaflex including Adhesive Capsulitis, Uterine Fibroids and Plantar Fibromatosis. But while those are definitely future niche opportunities, none shows the enormous promise of the treatment of cellulite in women's butts and legs.

### **Xiaflex is on the Cusp of FDA Approval for the Treatment of Cellulite on July 6th**

Endo Pharmaceuticals has applied for FDA approval for Xiaflex for the treatment of cellulite in women's butts and legs. They have conducted all of the necessary trials including a Phase 3 trial showing it is effective and safe. The FDA has let Endo know that a decision will be given on July 6th of this year on whether to approve this new indication. This would be the first pharmaceutical treatment for cellulite ever approved.

The good news is that we know Xiaflex is well tolerated and has been safely used by patients for years with Peyronie's and Dupuytren's contracture. Also, from all indications, Endo went above and beyond in reporting data and endpoints in their Phase 3 trial to ensure there would be no problems with approval.

So how big could this market be? Cellulite is present in 80% to 90% of all post-pubertal women. The aesthetics market is obviously an enormous one clocking in at \$16.5 billion.

Botox, which temporarily smooths out wrinkles, has been a homerun drug by Allergan (NYSE: AGN). In fact, this is why Abb-Vie (NYSE: ABBV) is merging with Allergan. Botox sales are currently running at a run rate of over \$2 billion a year in sales in an anti-wrinkle market worth almost \$3.5 billion.

Another data point to consider is that in 2018, Botox and other botulism treatments were done over 1.8 million times in the US.

But what about the demand for how butts look? Consider that Buttock Augmentation is one of the fastest growing plastic surgeries, with growth up 61% in the past five years.

[https://www.surgery.org/sites/default/files/ASAPS-Stats2018\\_0.pdf](https://www.surgery.org/sites/default/files/ASAPS-Stats2018_0.pdf)

It is obvious that the cellulite approval could make Xiaflex a billion-dollar drug, and none of this potential is priced into BioSpecifics' stock.

## BioSpecifics Valuation is Too Low

With 7.4 million shares outstanding and a stock price of \$63.25 per share, BioSpecifics sports a market capitalization of approximately \$468 million. BioSpecifics should end 2019 with cash and accounts receivable of \$122 million or \$16.50 per share. Cash on the balance sheet is 26% of the company's market cap. Its enterprise value is only \$346 million or 12.8 times 2019 EBIT.

By the end of 2020, EV/EBIT should only be 9.7 times, assuming a 20% growth in Xiaflex and no royalties from cellulite.

Play around with Net Present Value of cash flows through 2028, assume 15%-20% revenue growth, no terminal value for the drug and no cellulite approval and BSTC is worth somewhere around \$55 a share, not too far from its current share price.

Little if any of the of the cellulite optionality is in the stock, nor is higher growth or any terminal value for its treatment. Finally, this assumes they do nothing with the cash and don't do anything to earn a higher return.

Following is an analysis of what BioSpecifics could be worth:

Stock price	\$63.25		
Shares out	7,400,000		
Market Cap	\$468,050,000		
Cash (EOY 2019)	\$122,000,000	\$	16.49
% of market cap in cash	26%		
EV	\$346,050,000		
		<u>YE Cash Balance</u>	<u>Year End EV</u>
2019 EBIT	\$27,000,000	\$122,000,000	\$346,050,000
2020 EBIT	\$33,000,000	\$146,750,000	\$321,300,000
2021 EBIT	\$40,000,000	\$176,750,000	\$291,300,000
2022 EBIT	\$55,000,000	\$218,000,000	\$250,050,000
	<u>Multiple</u>	<u>EBIT yield</u>	
2019 EV/EBIT	12.8	7.80%	
2020 EV/EBIT	9.7	10.27%	
2021 EV/EBIT	7.3	13.73%	
2022 EV/EBIT	4.5	22.00%	
<u>Valuation case</u>	<u>Low</u>	<u>Base*</u>	<u>Bull*</u>
Peyronies & Dupreynes	\$400,000,000	\$350,000,000	\$500,000,000
CCH (cellulite)	\$0	\$500,000,000	\$1,000,000,000
Total	\$400,000,000	\$850,000,000	\$1,500,000,000
Royalty	\$42,000,000	\$89,250,000	\$157,500,000
Expenses	\$7,000,000	\$7,000,000	\$9,000,000
EBIT	\$35,000,000	\$82,250,000	\$148,500,000
Taxes	\$8,750,000	\$20,562,500	\$37,125,000
FCF	\$26,250,000	\$61,687,500	\$111,375,000
Per share	\$3.55	\$8.34	\$15.05
Multiple	12.5	15	18
Share target	\$44.34	\$125.04	\$270.91
Adding back in cash	<u>\$16.49</u>	<u>\$16.49</u>	<u>\$16.49</u>
Total price	<b>\$60.83</b>	<b>\$141.53</b>	<b>\$287.40</b>

\* with CCH approval, pricing may have to go down for existing indications

## **Biggest Risk is Endo Pharmaceuticals' Woes**

Endo Pharmaceuticals (the company that licenses Xiaflex from BioSpecifics) is struggling under a mountain of litigation from opioid problems. The company is also embroiled in litigation from a faulty vaginal mesh product as well. All of these woes have caused the stock to tank from an all-time high of over \$90 per share in 2015 to as low as \$2 per share last year. And this means there is a risk that Endo goes bankrupt.

It is important to note that recently, Endo, has rebounded strongly from a low of \$2 per share to over \$6 per share on positive litigation news. The state of Oklahoma settled for only \$8.75 million, a very positive indication of future liability. Endo's bonds currently trade for 77 cents on the dollar, but this is up quite a bit from last year's low of 60 cents on the dollar.

What that means for BioSpecifics is unclear. It would seem self-defeating for Endo or its creditors to jeopardize the license of one of its most valuable and its fastest growing drugs. But you never know. In bankruptcy, a valuable growing drug is likely to be a very valuable asset. This could be a blessing in disguise as the drug could be sold to a better suited company such as Allergan. Or it could put BioSpecifics in a position to renegotiate its royalty rate or advance some research into other indications that have been put on ice such as uterine fibroids.

On a separate note, Endo's presentations on its investor relations website is a fountain of information on Xiaflex. It is worth the time to research Endo and get comfortable with its prospects to be an investor in BioSpecifics.

## **Patent Risk**

BioSpecifics' patent on Xiaflex ends in 2028, giving the company nine years of runway without competition. What is unclear is what FDA approval for cellulite may do in terms of extending the patent protection.

What is interesting is that Botox has no patent, only a trademark. This has not stopped the company from growing the drug and wildly succeeding in the brand of the drug.

<https://thehustle.co/allergan-evolus-botox-anti-aging-pharma-biotech/>

It is unclear what competition will emerge in 2029 or later and how that will impact sales. This is a risk to consider. At current prices, the market appears to be valuing Xiaflex with a terminal value of zero, which seems extreme.

## **What Does BioSpecifics Do with Its Growing Cash Hoard?**

BioSpecifics is undervalued and a strong case exists that the company should be aggressively buying back its cheap stock. However, in light of the company's patent expiration in 2028, and its reliance on one drug, the new CEO, J. Kevin Buchi is likely to embark on a strategy to grow the company and not take advantage of the company's low valuation.

His strategy includes utilizing the company's growing cash pile to invest in new drugs or other companies. While the cash on the balance sheet is clearly not being valued by investors, despite growing by \$70 million in the last 4 years, there is a clear risk that this money may be wasted on unnecessary investments and drugs at time when most asset prices are at all time highs.

### **An Activist May Emerge After Company Has Been Flat for Years**

The stock has been flat for years, despite superior sales growth, cash flow and new indications on the cusp of approval.

BioSpecifics is an odd company to be public. It really doesn't do anything besides collect royalty checks. If the company doesn't articulate a clear and coherent strategy and explain how that strategy will benefit shareholders, it could be inviting an activist who will force the company's hand.

PDL BioPharma (NASDAQ: PDLI) tried to pursue a similar strategy of acquiring drugs and companies and came under significant fire. Activists entered the situation to force the company to return money to shareholders.

Many private equity investors, activists and other institutions have access to cheap capital and BioSpecifics presents an attractive candidate to take private.

### **Summary**

With a lucrative royalty stream, monster cash balance, low valuation and a clear catalyst this summer, BioSpecifics represents real value with a low downside risk.

### **Catalysts**

Cellulite approval on July 6, 2020  
Increase in share buyback/ return of capital  
Activist/Acquisition interest