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Biotechnology — Company Update

Synergy Pharmaceuticals (SGYP)

June 29, 2012

Management Update; Reiterating BUY

Recommendation: BUY
Price Target: $9.00

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Source: StockCharts.com

Stock Data – (NASDAQ:SGYP)

Price:	$4.61
52-week high:	$7.08
52-week low:	$1.86
Shares out:	64.31MM

Valuation Metrics

Market cap:	$296.5MM
Enterprise value:	$290.3MM

Financial Highlights (March:2012)

Cash/equivalents (pro forma):	$57.8MM
Debt:	$0

	1Q12A	2Q12E	2012E	2013E
Revs	--	--	--	--
Prior	--	--	--	--
EPS	($0.12)	($0.12)	($0.49)	($0.47)
Prior	--	*($0.15)*	*($0.61)*	*($0.57)*
P/E	--	--	--	--

Company Description

Synergy Pharmaceuticals, Inc., is a New York-based biopharmaceutical company focusing on the development of drugs to treat gastrointestinal disorders and diseases. Its leading compound, plecanatide, is being evaluated in a phase II/III trial (ongoing) in patients with chronic idiopathic constipation and in patients with constipation-predominant irritable bowel syndrome (phase IIb planned). The second compound, SP-333, a second-generation GC-C receptor analog, expects to have an IND submitted for treating ulcerative colitis in 3Q12.

- ***Management update.*** We recently met with SGYP management to obtain an update on the company's clinical programs. The phase II/III trial evaluating plecanatide in patients with chronic idiopathic constipation (CIC) is on track to complete enrollment by 3Q12 and report topline data by YE12. Additionally, SGYP recently met with the FDA and is finalizing the protocol for a phase IIb trial of plecanatide in patients with irritable bowel syndrome with constipation (IBS-C) with the potential to initiate patient enrollment in 3Q12.

- ***Plecanatide phase II/III CIC enrollment on track; we expect positive data to drive upside.*** In April SGYP announced the ongoing phase II/III CIC trial of plecanatide had enrolled half of the target patients (800 patients screened, 440 patients randomized and enrolled, out of 880 targeted enrolled patients to achieve 800 evaluable patients). To date, the trial has enrolled more than 700 patients. Management is very confident it will complete patient enrollment in 3Q12 and report topline data by 4Q12. We expect the data to be positive, based on the promising preliminary efficacy of plecanatide demonstrated in a randomized, placebo-controlled phase IIa trial in CIC, a validated mechanism of action by competitor plecanatide, and a potentially improved safety profile over competing drug linaclotide with minimal diarrhea. Data from previously completed phase I and phase I/II trials is being prepared for manuscripts to be published in peer reviewed journals.

- ***Plecanatide phase IIb IBS-C trial update.*** SGYP recently met with the FDA to discuss the protocol for the planned phase IIb trial evaluating plecanatide in patients with IBS-C. It is currently finalizing the protocol and is on track for trial initiation in 3Q12. The FDA has informed SGYP to use the questionnaire for patient-reported symptoms under the current FDA guidance in the phase IIb trial. The FDA will develop a uniform/industry-wide questionnaire for several diseases, including IBS-C, which will be used in future plecanatide phase III trials. We believe this is favorable for SGYP because it will save costs/time and reduce risks as opposed to developing and validating the questionnaire on its own. Given the validated mechanism of action of this class of compound in IBS-C and the preliminary efficacy of plecanatide in improving abdomen symptoms/discomfort in the phase IIa trial in CIC patients, we believe there is great potential for plecanatide to demonstrate proof of concept in phase IIb IBS-C patients as well.

- ***Recent financing significantly strengthens balance sheet.*** SGYP raised gross proceeds of ~$51.75MM via a public offering of 11,500,000 common shares at $4.50 per share, which significantly improved the balance sheet. The current cash position should be sufficient to fund operations through 2013.

REPORT SUMMARY

We recently met with management to obtain an update on SGYP's clinical programs. The phase II/III trial evaluating plecanatide in patients with chronic idiopathic constipation (CIC) is on track to complete enrollment by 3Q12 and report topline data by YE12. We continue to expect potentially positive data to drive significant upside. Additionally, SGYP recently met with the FDA to discuss and is currently finalizing the protocol for a phase IIb trial of plecanatide in IBS-C with the potential to initiate patient enrollment in 3Q12. The FDA will form a uniform/industry-wide questionnaire for patient-reported symptoms for several diseases, including IBS-C, which will be used in future plecanatide phase III trials. We believe this is favorable for SGYP because it will save costs/time and reduce risks as opposed to developing and validating the questionnaire on its own. SGYP raised gross proceeds of ~$51.75MM via a recent public offering, which significantly improved the balance sheet. We reiterate the BUY rating and 12-month price target of $9.

VALUATION

We use a sum-of-the parts analysis to value SGYP shares. Our 12-month target price of $9 is derived by summing up SGYP's development programs: the risk-adjusted NPV of plecanatide at ~$477MM, SP-333 at $35MM, and the company's technology and discovery engine at $80MM (Figure 1).

Figure 1. Sum-of-the-Parts Analysis

Plenacatide	$	476,984
SP-333	$	35,000
Technology	$	80,000
Fair value	**$**	**591,984**
Fair value / share	**$**	**9.2**

INVESTMENT RISKS

- **Clinical risks associated with plecanatide:** We assign a significant proportion of our projected value to plecanatide. Therefore, if the ongoing phase II/III trial in CIC or future clinical trials in CIC or IBS-C fail to deliver positive results, it would have a negative impact on our projections and target price.
- **Regulatory risks associated with plecanatide:** Plecanatide may not obtain regulatory approval even if it demonstrates positive clinical data. Our model factors in the risk-adjusted sales of plecanatide in CIC and IBS-C. If the drug does not obtain regulatory approval, it will negatively impact our target price.
- **Liquidity and financing risk:** We estimate SGYP's cash position should be sufficient to fund operations through 2013. There are risks associated with obtaining sufficient funding to sustain operations. The company may need to raise additional capital via equity financing, potentially causing dilution.
- **Commercialization risk:** The market potential of plecanatide in CIC and IBS-C may not be as large as we project.
- **High stock price volatility:** High stock price volatility is common among developmental companies in the biotechnology sector.

CATALYSTS/UPCOMING MILESTONES

- Complete patient enrollment in the pivotal phase II/III trial of plecanatide in CIC (3Q12)
- Potential to initiate a randomized, placebo-controlled phase IIb trial evaluating plecanatide in patients with IBS-C (3Q12)
- File an IND for SP-333 in patients with ulcerative colitis (3Q12)
- Potential for competitor linaclotide to obtain regulatory approval for CIC and IBS-C in the US (3Q12/September PDUFA date)
- Report topline results from a phase II/III trial of plecanatide in CIC (4Q12)
- Potential to report topline data from the phase IIb trial of plecanatide in patients with IBS-C (3Q13)

PIPELINE

Figure 2. SGYP's Pipeline

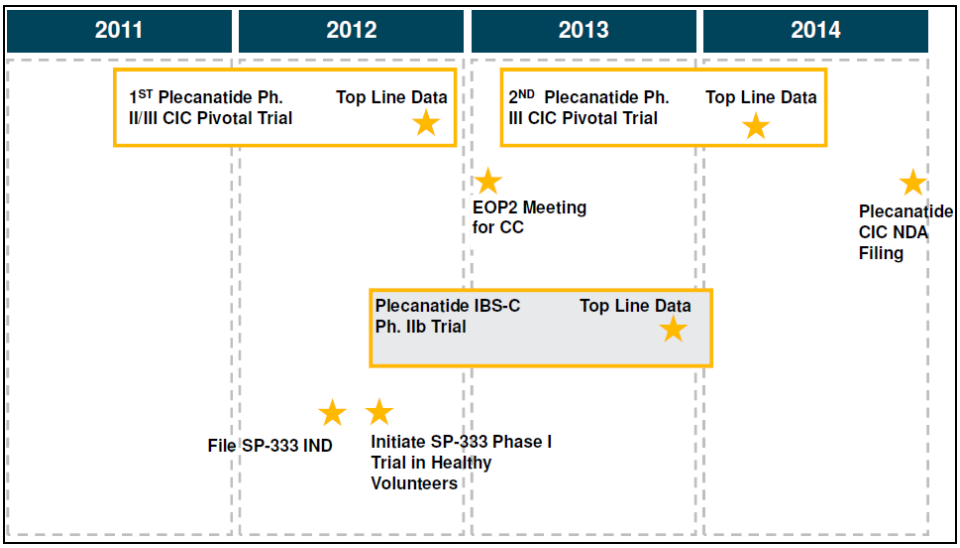

Figure 3. Income Statement and Financial Projections

Synergy Pharmaceuticals, Inc.

Income Statement

Fiscal Year Ends December

(in 000, except per share amounts)

	2009A	2010A	1Q11A	2Q11A	3Q11A	4Q11A	2011A	1Q12E	2Q12E	3Q12E	4Q12E	2012E	2013E
Revenue	-	-											
Total Revenues	-	-	-	-	-	-	-	-	-	-	-	-	
Operating Expenses:													
Cost of goods sold	-	-	-	-	-	-	-	-	-	-	-	-	
Research and development	3,733	9,559	1,478	2,355	3,883	5,703	13,419	5,338	5,700	5,800	5,900	22,738	25,012
General and administrative	4,467	6,563	1,897	1,524	1,103	2,222	6,746	1,731	2,100	2,200	2,300	8,331	8,748
Total Operating Expenses	**8,200**	**16,121**	**3,375**	**3,879**	**4,986**	**7,925**	**20,165**	**7,069**	**7,800**	**8,000**	**8,200**	**31,069**	**33,760**
Loss from operations	**(8,200)**	**(16,121)**	**(3,375)**	**(3,879)**	**(4,986)**	**(7,925)**	**(20,165)**	**(7,069)**	**(7,800)**	**(8,000)**	**(8,200)**	**(31,069)**	**(33,760)**
Other income (expense):													
Interest and Investment Income	75	108	24	20	20	26	90	39	20	20	20	99	70
Interest expense			(12)				(12)						
Other income (expense):		494				362	363						
Change in fair value of derivative instruments - warrants		297	(339)	(698)	4,383	1,911	5,257	8					
Net loss before income taxes	**(8,125)**	**(15,222)**	**(3,702)**	**(4,557)**	**(583)**	**(5,626)**	**(14,467)**	**(7,023)**	**(7,780)**	**(7,980)**	**(8,180)**	**(30,971)**	**(33,690)**
Income tax benefit – principally from sale of New Jersey tax benefits in 2010 and 2008													
Net loss	**(8,125)**	**(15,222)**	**(3,702)**	**(4,557)**	**(583)**	**(5,626)**	**(14,467)**	**(7,023)**	**(7,780)**	**(7,980)**	**(8,180)**	**(30,971)**	**(33,690)**
Basic and diluted net loss per share	$ (0.22)	$ (0.34)	$ (0.08)	$ (0.10)	$ (0.01)	$ (0.12)	$ (0.30)	$ (0.13)	$ (0.12)	$ (0.12)	$ (0.12)	$ (0.49)	$ (0.47)
Weighted average number of shares outstanding – basic and diluted	36,641	44,875	46,167	46,643	47,309	48,657	47,587	54,298	65,048	65,373	65,700	62,605	72,270

Important Disclosures and Disclaimers — Second Quarter 2012

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Investment Rating Distribution for the Period 1/1/12 through 3/31/12:

Rating	Count	Percentage
BUY	34	81%
NEUTRAL	7	17%
SELL	1	2%
Companies under coverage at 3/31/12	**42**	**100%**

We have assigned an investment rating for at least one year for the following subject companies mentioned in this report:

SGYP

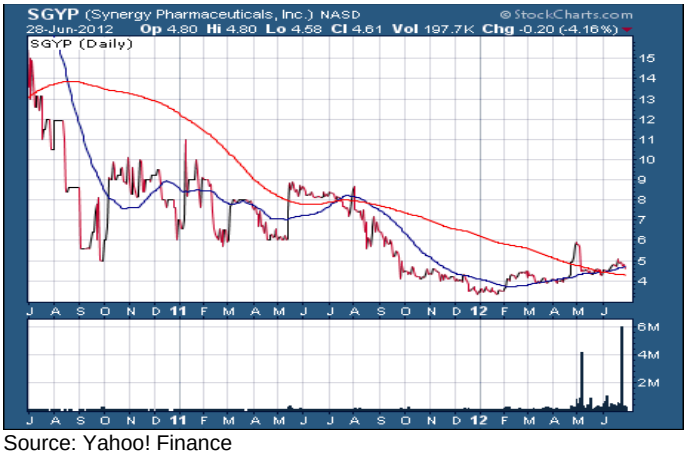
Ratings History

Date	Rating	Share Price	Price Target
3/22/12	BUY	$4.15	$9.00

SGYP Investment Risks

- **Clinical**: If the ongoing phase II/III trial of plecanatide in CIC or future clinical trials in CIC or IBS-C fail to deliver positive results, it would have a negative impact on our projections and target price.
- **Regulatory**: Plecanatide may not obtain regulatory approval even if it demonstrates positive clinical data.
- **Commercialization**: The market potential of plecanatide in CIC and IBS-C may not be as large as we project.
- **High stock price volatility**: High stock price volatility is common among developmental companies in the biotechnology sector.

Valuation Method for Price Target: Sum of the parts



Source: Yahoo! Finance