November 26, 2013

OUTPERFORM

Reason for report:

EARNINGS

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HEALTHCARE EQUITY RESEARCH

ENANTA PHARMACEUTICALS, INC.

F4Q:13 Call Highlights Multiple Shots on Goal

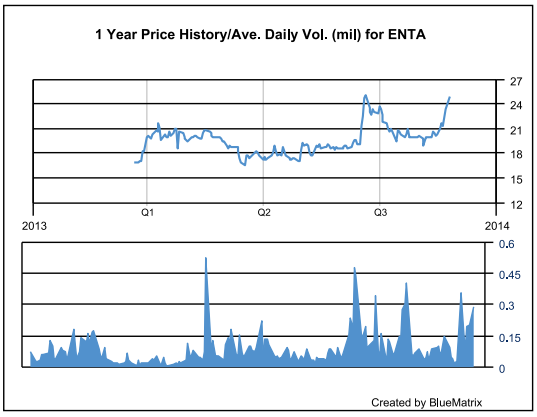
• **Bottom Line:** Yesterday, ENTA reported F4Q:13 results and ended the fiscal year with a cash balance of $112M. Following strong top-line data from the SAPPHIRE I trial, results from five remaining ABT-450 studies continue to be expected in late 2013 and early 2014. As we stated in our 11/18 note, we believe the first Phase III results further de-risk the program and set a valuation floor with available cash and ~ $195M in regulatory and approval milestone payments from ABBV. We continue to see ENTA as a de-risked small cap play to participate in what we anticipate to be a large hepatitis C market. Beyond ABT-450-based regimens, we believe a number of other shots on goal including second-gen combo ABT-493/530, partnered NS5A program, antibiotic program, and nuc / cyclophilin inhibitor program could increasingly factor in the valuation in 2014/15 time frame. Due to the positive outcome of SAPPHIRE I, we are slightly adjusting the assumed probability of success of ABT-450 from 85% to 90% which increases our price target on ENTA from $28 to $29.

• **HCV pipeline continues to progress**. ENTA provided an update on the status of the two-drug (protease inhibitor + NS5A inhibitor) HCV regimens, with ABT-450/r+ABT-267 expected to begin Phase III trials in both Japan and the West in 2014. The next-generation PI ABT-493 will start patient dosing in combination with ABBV's NS5A inhibitor ABT-530 by the end of 2013, likely as single agents first in short-term studies followed by combination. Partner NVS (OP) is advancing NS5A inhibitor EDP-239 (Phase Ib) and presumably will combine it with cyclophilin inhibitor alisporivir. Recent AASLD data have highlighted the synergy for an NS5A inhibitor and a cyclophilin inhibitor. Management also plans select and advance candidates in the company's internal nucleotide polymerase and cyclophilin inhibitor programs in 2014.

• **The economics to ENTA on a second-generation combo could improve in two aspects**. While ENTA has a similar royalty arrangement with ABT-493 as ABT-450, the ENTA retains the option to pay for 40% of development and commercialization costs in exchange for a 40% profit share and intends to make a decision on this prior to Phase IIb. Unlike the first-generation combination which required a large number of studies to optimize the regimen, the development program on the second-gen combo will likely be much more focused and ENTA will also be in a stronger financial position to co-develop the combination with proceeds from ABT-450. In addition, the second-gen 2-drug combo like ABT-450r/+ABT-267 could also improve ENTA's economics from 1/3 to 1/2 due to the reduction of number of direct antiviral agents.

Key Stats:	**(NASDAQ:ENTA)**
S&P 600 Health Care Index:	**1,273.91**
Price:	**$23.40**
Price Target:	$29.00 from $28.00
Methodology:	DCF, 12% discount rate
52 Week High:	$26.39
52 Week Low:	$14.00
Shares Outstanding (mil):	17.9
Market Capitalization (mil):	$418.9
Cash Per Share:	$6.26
Net Debt to Total Capital:	0%
Dividend (ann):	$0.00
Dividend Yield:	0.0%

General: IPO was priced at $14 on March 20, 2013.



Sep Yr	1Q	2Q	3Q	4Q	FY Rev	1Q	2Q	3Q	4Q	FY EPS	P/E
2013A	**$27.9**	**$1.2**	**$1.6**	**$1.3**	**$32.1**	**$1.61**	**($2.28)**	**($0.23)**	**($0.25)**	**($0.67)**	**NM**
2014E - New	**--**	**--**	**--**	**--**	**$40.0**	**--**	**--**	**--**	**--**	**$0.90**	**26.0x**
2014E - Old	--	--	--	--	$40.0	--	--	--	--	$0.91	NM
2015E	--	--	--	--	$256.1	--	--	--	--	$8.39	2.8x

Source: Company Information and Leerink Swann LLC Research
Revenues in $M; GAAP presentation

INVESTMENT THESIS

ENTA offers an opportunity to participate in the multi-billion HCV market for IFN-free regimen as a small-cap but late-stage player. ENTA is partnered with ABBV on ABT-450, which is the protease inhibitor (PI) in ABBV's all-oral HCV treatment regimen, which is one of the only two late-stage regimens that have broad genotype-1 activity and is anticipated to reach the market in 2015. We are more bullish than the Street on the size of the HCV market. ENTA's valuation is based primarily on the initial market for IFN-free regimens, thus ENTA represents a way to participate in the market upside without taking long-term market risks, in our view. We believe our market share assumption of 70:30 split for GILD:ABBV in GT-1 patients is supported by the most recent example of HCV protease inhibitor market. Though we believe GILD will be a fierce competitor, the market is large enough for multiple players. In comparison to the current HCV protease inhibitor market, which is split approximately 70:30 between VRTX's (OP) Incivek and MRK's (MP) Victrelis, the efficacy and convenience advantage for Incivek over Victrelis is arguably bigger than the difference between GILD and ABBV regimens although there does not appear to be a safety/tolerability advantage for ABBV over GILD as Victrelis is at least perceived to hold over Incivek. We believe ENTA's valuation is well supported by potential ABBV milestone payments and royalties on early ABT-450 sales. ENTA is entitled to tiered double-digit royalties on sales attributable to ABT-450, and we believe there is upside to the stock as ABBV HCV numbers rise to reflect the overall market potential. Several upside scenarios exist. We conservatively model no sales for ABT-450 post-2020. The biggest upside for ENTA would be if GILD's HCV program somehow stumbles, although we think this is unlikely. However, the scenario that earlier-stage competitors experience a setback is realistic, in our view. Furthermore, ABBV/ENTA's next-gen PI (in Phase I) could extend the HCV franchise into the next decade. ENTA has a 40% profit share option on this agent. In addition, ENTA is entitled to economics on EDP-239, its NS5A inhibitor partnered with NVS, in Phase I development. We currently attribute limited value to these programs; however, successful advancement and development could create significant royalty and milestone payments for ENTA. Productive medicinal chemistry platform could continue to advance clinical candidates. ENTA currently has three interesting pre-clinical programs that could potentially advance to the clinic in the 2014 timeframe. A MEDACorp key opinion leader (KOL) highlighted the cyclophilin inhibitor (for hepatitis C) as an interesting agent to watch. In addition, given the scarcity in the class, ENTA's nucleotide HCV polymerase inhibitor could generate investor interest as it advances.

Phase I trials of EDP-788 expected to initiate in 1H:14. In September, the National Institute of Allergy and Infectious Disease (NIAID) awarded ENTA an additional $9.2M to develop the bridged bicyclic antibiotics EDP-788. Total funding to date is $23.5M and could reach $42.7M based on various milestone and NIAID options.

Model updates. We are updating our financial model to reflect reported F4Q:13 and full year results. Fourth quarter revenues were slightly lower than our expectations ($1.3M vs. $1.6M), due the accounting for milestone payments and other collaboration revenue. R&D spend was somewhat lower ($4.3M vs. $4.6M) and SG&A was slightly higher ($1.8M vs. $1.2M) than our estimates.

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ENTA – Expected Events

Timing	Event
ABT-450/r (protease inhibitor)	
late'13/early'14	Phase III data from remaining 5 trials in GT1
2Q:14	NDA filing for IFN-free regimen containing ABT-450
Early '14	Initiation of Phase III trials of ABT-450+ABT-297
2015	Potential approval
ABT-493 (Next-Gen protease inhibitor)	
4Q:13	Initiation of Phase II combination study with ABT-530
2017	Potential approval
EDP-239 (NS5A inhibitor)	
2H:13	Possible Phase I and proof of concept data
Cyclophilin inhibitor program	
2H:13	Expect to advance into preclinical studies
Nucleotide polymerase program	
2H:13	Expect to advance into preclinical studies
EDP-788 (Bicyclolide antibiotic)	
1H:14	Expect to initiate Phase I

Source: Company Reports and Leerink Swann

ENTA – Product Pipeline

Candidate	Mechanism	Indication	Status	Partner
ABT-450	NS3/4A protease inhibitor	Hepatitis C	Phase III	AbbVie
ABT-493	NS3/4A protease inhibitor (next generation)	Hepatitis C	Phase I	AbbVie
EDP-239	NS5A inhibitor	Hepatitis C	Phase I	Novartis
Cyclophilin inhibitor	Cyclophilin inhibitor	Hepatitis C	Preclinical	
Nucleotide polymerase inhibitor	Nucleotide polymerase inhibitor	Hepatitis C	Preclinical	
EDP-788	Biocyclolide antibiotic	MRSA	Preclinical	

Source: Company reports and Leerink Swann research

VALUATION

Our $29/share 12-month valuation is derived from a probability-adjusted DCF analysis of ABT-450 royalties as well as expected pre-commercialization milestone payments and platform value. We model >$3B in worldwide sales for ABBV's HCV regimen from 2016 to 2018, with declining revenues in 2019 and 2020 and no revenues afterwards. We model a blended royalty rate of 15-16% for the 1/3 of sales attributable to ABT-450, and apply at 90% probability adjustment. We assume $195M in milestone payments from ABBV, $135M in YE:14 cash and $60M platform value. We use a 12% discount rate on after-tax cash flows as the royalty payments are already probability adjusted.

RISKS TO VALUATION

- ABBV's Phase III HCV regimen may fail due to either efficacy or safety concerns.
- ABBV's HCV program faces competition from GILD (OP), VRTX, BMY (OP), Roche, MRK and other players in the field.
- Ritonavir boosting may limit the usage of ABBV's regimen due to drug-drug interactions.
- Treatment rates for all oral treatments in HCV may be lower than we and the market anticipate.
- Pricing and reimbursement pressures are high in the US, Europe and other geographies and may be a headwind to sales.
- Dependent on partners in clinical development and commercialization and in assembling a portfolio of agents to have a competitive IFN-free regimen.

Enanta Pharmaceuticals, Inc.

All figures in millions of U.S. Dollar, except per share items.

	FY12A	1QA	2QA	3QA	4QA	FY13A	FY14E	FY15E
	Sep '12A	Dec '12A	Mar '13A	Jun '13A	Sep '13E	Sep '13E	Sep '14E	Sep '15E
Net Sales	41.7	27.9	1.2	1.6	1.3	32.1	40.0	256.1
SG&A	5.3	1.2	1.5	1.8	1.8	6.2	4.6	5.0
R&D	15.1	4.8	3.7	4.0	4.3	16.8	19.2	20.0
Operating Income	21.3	21.9	(4.0)	(4.2)	(4.7)	9.0	16.2	231.1
Interest income	0.1	0.0	0.0	0.1	0.3	0.4	0.0	0.0
Interest expense	0.0	(0.0)	(0.0)	(0.0)	0.0	(0.0)	0.0	0.0
Change in fair value of warrant liability	(0.0)	0.0	0.2	(0.0)	0.0	0.2	0.0	0.0
Pretax Income	21.4	22.0	(3.7)	(4.1)	(4.4)	9.6	16.2	231.1
Taxes		0.0	0.0	0.0	0.0	0.0	0.0	80.9
Income After Taxes	21.4	22.0	(3.7)	(4.1)	(4.4)	9.6	16.2	150.2
Accretion of redeemable convertible preferred to redemption value	(5.4)	(1.3)	(1.2)	0.0	0.0	(2.5)	0.0	0.0
Net income attributable to participating securities	(14.7)	(13.7)	0.0	0.0	0.0	(13.7)	0.0	0.0
Net income to common shares	1.4	7.0	(5.0)	(4.1)	(4.4)	(6.6)	16.2	150.2
EPS								
Basic	$1.26	$6.05	($2.28)	($0.23)	($0.25)	($0.67)	$0.90	$8.39
Diluted	$1.13	$1.45	($2.28)	($0.23)	($0.25)	($0.67)	$0.90	$8.39
Common shares								
Basic	1.1	1.2	2.2	17.8	17.9	9.8	17.9	17.9
Diluted	2.5	1.2	2.2	17.8	17.9	9.8	17.9	17.9

Source: Company information, Leerink Swann estimates

Disclosures Appendix

Analyst Certification

I, Howard Liang, Ph.D., certify that the views expressed in this report accurately reflect my views and that no part of my compensation was, is, or will be directly related to the specific recommendation or views contained in this report.

Distribution of Ratings/Investment Banking Services (IB) as of 09/30/13				
			IB Serv./Past 12 Mos.	
Rating	Count	Percent	Count	Percent
BUY [OP]	111	64.90	27	24.00
HOLD [MP]	60	35.10	0	0.00
SELL [UP]	0	0.00	0	0.00

Explanation of Ratings

Outperform (Buy): **We expect this stock to outperform its benchmark over the next 12 months.**

Market Perform (Hold/Neutral): **We expect this stock to perform in line with its benchmark over the next 12 months.**

Underperform (Sell): **We expect this stock to underperform its benchmark over the next 12 months.The degree of outperformance or underperformance required to warrant an Outperform or an Underperform rating should be commensurate with the risk profile of the company.**

For the purposes of these definitions the relevant benchmark will be the S&P 600® Health Care Index for issuers with a market capitalization of less than $2 billion and the S&P 500® Health Care Index for issuers with a market capitalization over $2 billion.

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