

Equity Research

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Evoke Pharma, Inc. (EVOK-\$9.96)

Rating: BUY

Target Price: \$19.00

Uneventful 4Q:13 Earnings; Moving Phase III Gastroparesis Trial Forward

<u>REV</u>	<u>1Q</u>	<u>2Q</u>	<u>3Q</u>	<u>4Q</u>
2013A	0.0A	0.0A	0.0A	0.0A
2014E	0.0E	0.0E	0.0E	0.0E
2015E	—	—	—	—
<u>EPS</u>	<u>1Q</u>	<u>2Q</u>	<u>3Q</u>	<u>4Q</u>
2013A	(0.32)A	(0.32)A	(0.41)A	(0.27)A
<i>Prev</i>	—	—	—	(0.21)E
2014E	(0.43)E	(0.59)E	(0.67)E	(0.82)E
2015E	—	—	—	—
<u>FY</u>	<u>2013A</u>	<u>2014E</u>	<u>2015E</u>	
REV	0.0A	0.0E	0.0E	
EPS	(1.20)A	(2.52)E	(1.30)E	
<i>Prev</i>	(1.18)E	(2.40)E	—	

- **4Q:13 earnings miss was irrelevant, in our view:** Evoke reported a net loss of (\$1.6M), which came in above our net loss estimate of (\$0.55M) due to higher operational expense (in both R&D and SG&A). With respect to per-share loss, the company reported a loss of (\$0.27), compared to our estimated loss of (\$0.21). This per-share performance also came in below FactSet consensus estimates of (\$0.13), which comprises forecasts from two analysts. The miss is therefore irrelevant, in our view. We have raised our 2014 expense run rates and updated our balance sheet/cash flow assumptions after reviewing the company's 10-K filing. We continue to view the opportunity as highly attractive and reiterate our BUY rating and \$19 PT, which is based on a 60% risk-adjusted, discounted 3x multiple of two potential peak revenue scenarios (\$230M weighted at 90% and \$415M weighted at 10%). We note that recent take-out multiples in the GI space were closer to 7x, possibly implying an even higher value for the company in the future.
- **We see positive trial progress:** Management indicated that it expects to enroll its first Phase III patient in 2Q:14. The company aims to utilize ~60 gastroenterology-focused sites to enroll 200 female gastroparesis patients. Management stated that it pre-selected sites based on the availability of potential patient lists which should speed enrollment, in our view. Evoke already held an "Investigator Meeting" for some of its sites and plans to train the rest via webinars and individual clinic visits. Management indicated that it is working on enrollment targets/time lines to track trial progress throughout the year. Any future indications of timely enrollment would be well-received by investors, in our view.
- **Why we like the story:** We believe that the EVK-001 program (intranasal metoclopramide for diabetic gastroparesis) is relatively low risk following the positive data in female patients from a recent Phase II trial, coupled with the well-characterized nature of metoclopramide. We also like the large commercial opportunity since there were over 3.5M metoclopramide prescriptions written in the last 12 months ending Feb 2014, and there are approximately 2 million patients already taking metoclopramide. We believe the company is adequately capitalized through its Phase III data in mid-2015 and, if results are positive, we believe that Evoke could get acquired. Catalysts for the stock over the next 12 months will primarily stem from updates on trial progress (which we expect to be provided during the quarterly earnings calls).

Current Statistics

Market Cap (\$Mil)	\$60.7	Float Shares (Mil):	6.100
Avg. Daily Trading Volume (3 mo.):	85,504		
Shares Out (Mil):	6.097		

ADDITIONAL DETAILS FROM THE EARNINGS CALL

We summarize our 4Q:13 Earnings estimates in Exhibit 1 below.

Exhibit 1: Evoke 4Q:13 Earnings

	4Q:13E	4Q:13A	% Variance	Y/Y Growth	Q/Q Growth	Comments
Revenues	0.00	0.00	NM	NM	NM	
Total Revenues	0.00	0.00	NM	NM	NM	
COGS	0.00	0.00	NM	NM	NM	
Gross Profit	0.00	0.00	NM	NM	NM	
SG&A	0.25	0.94	277.7%	174.9%	132.1%	
R&D	0.30	0.64	112.1%	99.9%	708.4%	
Other	0.00	0.00	NM	NM	NM	
EBIT	-0.55	-1.58	NM	NM	NM	
Interest and Other Income	0.04	-0.04	-192.5%	NM	NM	
Pre-tax income	-0.51	-1.62	NM	NM	NM	
Income tax expense	0.00	0.00	NM	NM	NM	
Net Income	-0.51	-1.62	NM	NM	NM	
Diluted shares	2.44	5.97	144.7%	428.6%	401.7%	
Operating EPS	(\$0.21)	(\$0.27)	NM	NM	NM	(\$0.13) Consensus

Source: Company reports, Cantor Fitzgerald estimates, and FactSet consensus

Valuation

We value Evoke using a weighted blend of the following two scenarios:

(1) **90% probability:** We apply a 3x multiple to discounted risk-adjusted peak sales of \$230 million (our most conservative peak sales estimate, which assumes only 20% penetration of today's generic, oral, 10 mg metoclopramide market; with 6% annual price increases), which yields a hypothetical price target of \$17.50. We employ a seven-year peak sales duration (assuming that peak sales are reached in 2023 after launch in 2H:16). We utilize a 13% discount rate, which is at the higher end of the risk rates we utilize in our space. We also risk adjust the sales estimate by 60% to incorporate clinical risk associated with a Phase III asset.

(2) **10% probability:** We apply a 3x multiple to discounted risk-adjusted peak sales of \$415 million (a more generous scenario, which assumes 16.6% penetration of prescriptions utilized by 2.2 million patients in 2023; with 6% annual price increases), which yields a hypothetical price target of \$31.60. We utilize a 13% discount rate, and risk-adjust the sales estimate by 60%. We include this scenario also since there could be potential upside to Evoke from capturing a small percentage of antiemetic prescriptions given the new concerns about serotonin syndrome in that drug class.

We therefore arrive at a blended price target of \$19.00 using these two calculations.

Risks

- (1) Clinical risk associated with intranasal metoclopramide. More specifically, we are concerned about the possibility of a strong placebo response in the pending Phase III trial of female patients.
- (2) Financing needs may pressure the stock if the company needs to raise cash ahead of the Phase III data release.
- (3) Potential volatility in the stock associated with a high percentage of insider shareholders (56% of the stock is held by insiders).
- (4) Progression of competitive products in gastroparesis.
- (5) Manufacturing risk.

Exhibit 2: Evoke Income Statement (dollars in millions)

	2011	2012	1Q:13A	2Q:13A	3Q:13A	4Q:13A	2013	1Q:14E	2Q:14E	3Q:14E	4Q:14E	2014E	2015E	2016E	2017E	2018E	2019E	2020E	2021E	2022E	2023E
Revenues:																					
Revenue	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	15.0	45.0	102.0	145.0	180.0	205.0	221.0	230.0
Total revenues	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	15.0	45.0	102.0	145.0	180.0	205.0	221.0	230.0
Operating expenses:																					
COGS	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.6	1.8	4.0	5.6	6.8	7.7	8.2	8.4
Gross Profit	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	14.4	43.2	98.0	139.4	173.2	197.3	212.8	221.6
R&D	1.8	1.2	0.1	0.1	0.1	0.6	1.0	1.5	2.5	3.0	4.0	11.0	5.0	4.0	4.2	4.4	4.6	4.9	5.1	5.4	5.6
SG&A	0.6	0.8	0.1	0.1	0.4	0.9	1.6	1.1	1.2	1.2	1.2	4.6	8.0	30.0	100.0	105.0	110.3	111.4	112.5	113.6	114.7
Other	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Total operating expenses	2.4	2.0	0.3	0.3	0.5	1.6	2.6	2.6	3.7	4.2	5.2	15.6	13.0	34.0	104.2	109.4	114.9	116.2	117.6	119.0	120.4
Operating income (Loss)	(2.4)	(2.0)	(0.3)	(0.3)	(0.5)	(1.6)	(2.6)	(2.6)	(3.7)	(4.2)	(5.2)	(15.6)	(13.0)	(19.6)	(61.0)	(11.4)	24.5	56.9	79.7	93.9	101.3
Interest income	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.1	0.2	0.1	0.1	0.1	0.2	0.3	0.6	1.0
Interest expense	(0.0)	(0.0)	(0.0)	(0.0)	(0.0)	(0.0)	(0.2)	(0.0)	(0.0)	(0.0)	(0.0)	(0.1)	(0.1)	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	(0.1)	(0.1)	0.0	0.0	(0.1)	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Other income, net	0.01	(0.0)	(0.1)	(0.1)	(0.0)	(0.0)	(0.2)	(0.0)	(0.0)	(0.0)	(0.0)	(0.1)	0.0	0.2	0.1	0.1	0.1	0.2	0.3	0.6	1.0
Pretax Income	(2.4)	(2.0)	(0.4)	(0.4)	(0.5)	(1.6)	(2.8)	(2.6)	(3.7)	(4.2)	(5.2)	(15.7)	(13.0)	(19.4)	(60.8)	(11.3)	24.6	57.1	80.1	94.5	102.3
Tax Rate	NA	NA	NA	NA	NA	0.0%	0.0	0.0%	0.0%	0.0%	0.0%	0%	0%	0%	0%	0%	15%	38%	38%	38%	38%
Tax expense	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	3.7	21.7	30.4	35.9	38.9
Net income	(2.4)	(2.0)	(0.37)	(0.37)	(0.5)	(1.6)	(2.8)	(2.6)	(3.7)	(4.2)	(5.2)	(15.7)	(13.0)	(19.4)	(60.8)	(11.3)	20.9	35.4	49.7	58.6	63.4
Weighted average common shares (diluted)	1.1	1.1	1.1	1.1	1.2	6.0	2.4	6.1	6.2	6.3	6.3	6.2	10.0	12.0	12.6	13.2	13.9	14.6	15.3	16.1	16.9
Diluted EPS	(\$2.18)	(\$1.79)	(\$0.32)	(\$0.32)	(\$0.41)	(\$0.27)	(\$1.20)	(\$0.43)	(\$0.59)	(\$0.67)	(\$0.82)	(\$2.52)	(\$1.30)	(\$1.62)	(\$4.83)	(\$0.86)	\$1.51	\$2.43	\$3.24	\$3.64	\$3.76
							Consensus Revenues					\$0.0	\$0.0	\$0.0	\$0.0	\$0.0	\$0.0	\$0.0	\$0.0	\$0.0	\$0.0
							Consensus EPS					(\$0.27)	(\$1.20)	(\$0.36)	(\$0.61)	(\$0.71)	(\$0.61)	(\$2.23)	(\$1.74)		
Margin Analysis	2011	2012	1Q:13A	2Q:13A	3Q:13A	4Q:13A	2013	1Q:14E	2Q:14E	3Q:14E	4Q:14E	2014E	2015E	2016E	2017E	2018E	2019E	2020E	2021E	2022E	2023E
Gross Margin	-	-	-	-	-	-	-	-	-	-	-	-	-	96.0%	96.1%	96.1%	96.2%	96.2%	96.3%	96.3%	96.4%
COGS	-	-	-	-	-	-	-	-	-	-	-	-	-	4.0%	4.0%	3.9%	3.9%	3.8%	3.8%	3.7%	3.7%
SG&A	-	-	-	-	-	-	-	-	-	-	-	-	-	200.0%	222.2%	102.9%	76.0%	61.9%	54.9%	51.4%	49.9%
R&D	-	-	-	-	-	-	-	-	-	-	-	-	-	26.7%	9.3%	4.3%	3.2%	2.7%	2.5%	2.4%	2.4%
Operating Margin	-	-	-	-	-	-	-	-	-	-	-	-	-	-130.7%	-135.5%	-11.2%	16.9%	31.6%	38.9%	42.5%	44.0%
Net Income Margin	-	-	-	-	-	-	-	-	-	-	-	-	-	-129.5%	-135.2%	-11.1%	14.4%	19.7%	24.2%	26.5%	27.6%
Growth (Y/Y)	2011	2012	1Q:13A	2Q:13A	3Q:13A	4Q:13A	2013	1Q:14E	2Q:14E	3Q:14E	4Q:14E	2014E	2015E	2016E	2017E	2018E	2019E	2020E	2021E	2022E	2023E
Net Sales	-	-	-	-	-	-	-	-	-	-	-	-	-	-	200%	127%	42%	24%	14%	8%	4%
SG&A	-	47%	-17%	-17%	189%	175%	97%	649%	683%	183%	22%	177%	76%	275%	233%	5%	5%	1%	1%	1%	1%
R&D	-	-37%	-53%	-53%	-77%	100%	-18%	1141%	1968%	3710%	529%	1049%	-55%	-20%	5%	5%	5%	5%	5%	5%	5%
EBIT	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	132%	40%	18%	8%
Interest income (expense)	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-
Tax	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	488%	40%	18%	8%
Net Income	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	69%	40%	18%	8%
Diluted EPS	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	61%	34%	12%	3%

Source: Company reports, Cantor Fitzgerald estimates, and FactSet Consensus

Company Description

Evoke Pharma is a small, development-stage specialty pharmaceutical company. Its key pipeline product is an intranasal formulation of metoclopramide, a well-known and widely used drug for the treatment of gastroparesis. The novel drug delivery approach developed by Evoke is expected to both enhance efficacy and tolerability, and therefore represents a meaningful improvement to current metoclopramide formulations, in our view.

Disclosures Appendix

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HOLD - denotes stocks that we suggest will provide a total return or total negative return of up to 15% over 12-month period. A HOLD rated stock is expected to perform in-line with the total average return of the analyst's industry coverage universe on a risk adjusted basis.

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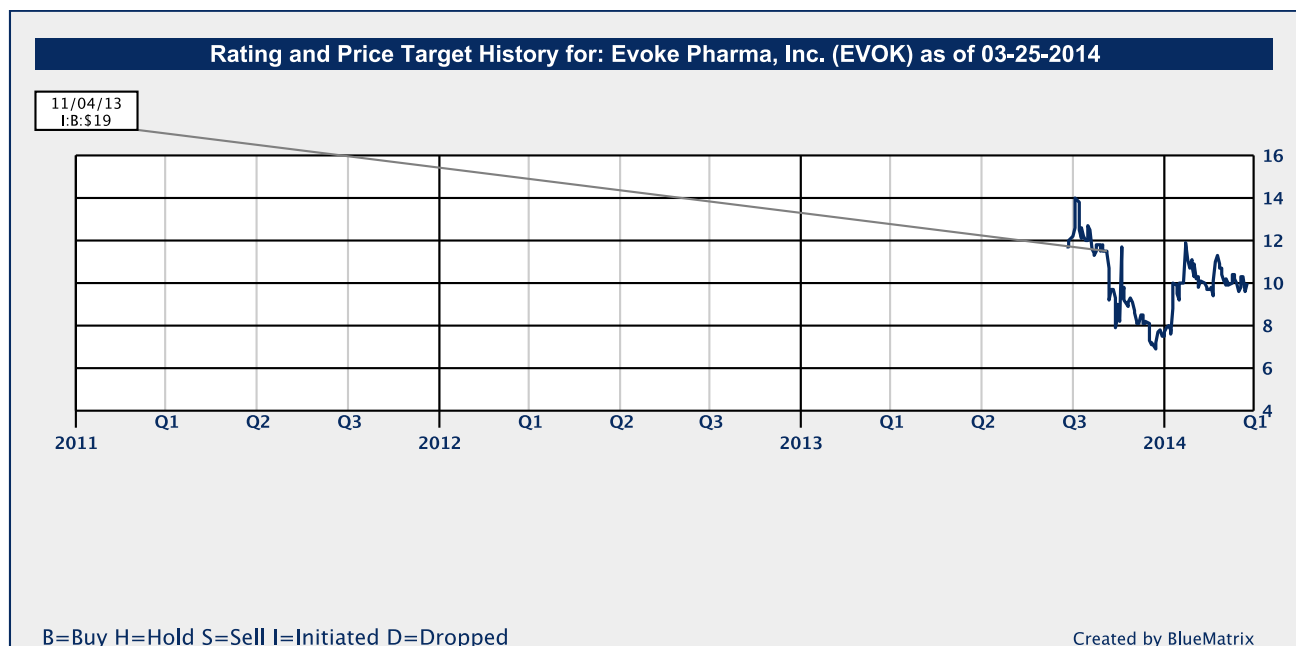
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Rating	Cantor		IB Serv./Past 12 Mos.	
	Count	Percent	Count	Percent
BUY [B]	74	52.11	18	24.32
HOLD [H]	56	39.44	8	14.29
SELL [S]	12	8.45	1	8.33