

Equity Research

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## Evoke Pharma, Inc. (EVOK-\$7.35)

**Rating: BUY**

**Target Price: \$20.00**

### Phase III Trial Enrollment Begins; Reiterate BUY and Raise PT to \$20 from \$19

<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	0.0A	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
2014E	(0.49)A	(0.85)E	(0.83)E	(0.82)E
Prev	(0.43)E	(0.59)E	(0.67)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	(3.00)E	(1.30)E	
Prev	—	(2.52)E	—	

- **1Q:14 expenses increase as Evoke prepares for Phase III trial:** Evoke reported a net loss of (\$2.96M), which came in above our net loss estimate of (\$2.63M). The company reported a per-share loss of (\$0.49), compared to our estimated loss of (\$0.43) and FactSet consensus of (\$0.36). R&D expenses increased to \$1.9M up from \$0.6M in 4Q:13 as Evoke prepared for initiation of its Phase III clinical trial for EVOK-001 (intranasal metoclopramide spray for gastroparesis). We reiterate our BUY rating and raise our PT to \$20 from \$19, which is based on a 60% risk-adjusted blend of two potential peak revenue scenarios (\$230M weighted at 90% and \$415M weighted at 10%). We used a 3x sales multiple in our valuation, though recent take-out multiples in the GI space have been as high as 7x, representing potential additional upside in the future.
- **Phase III gastroparesis trial enrollment begins:** Management announced on the call that the enrollment in its Phase III trial has commenced, with the first patients in the trial enrolled in April. We note the company will owe a \$0.5M payment to Questcor after the start of the trial and we raised our R&D estimates for the year. The Phase III will be modeled after the successful Phase IIb trial. The company has contracted with 40 sites to enroll the 200 female gastroparesis patients for the trial thus far. Management is actively interacting with study sites and plans to provide updates on enrollment in future earnings calls, which may serve as catalysts for the stock, in our view.
- **Other milestones to look out for:** Evoke will also be running a study of males, but data from this trial will not be needed to support the EVOK-001 NDA. Evoke will also run a QT study to ensure cardiac safety of the compound, with results expected by year-end. The company presented its Phase II data at Digestive Disease Week, and management indicated that many of the questions focused on the difference in efficacy between female and male patients, and we believe that physicians may require additional education on this issue upon commercialization.
- **M&A space in GI is heating up:** Recent high-profile acquisitions in the GI space, including Forest's recent bid to acquire Furiex for \$1.1 billion, bring attention to the space in general and bode well for later-stage companies like Evoke. Evoke reported \$21.8 million in cash at the end of the quarter, which should provide sufficient capital through its Phase III data in mid-2015. If Phase III data are positive, we would view Evoke as a prime take-out target in the GI space.

#### Current Statistics

Market Cap (\$Mil)	\$44.8	Float Shares (Mil):	6.100
Avg. Daily Trading Volume (3 mo.):	32,210		
Shares Out (Mil):	6.100		

## ADDITIONAL DETAILS FROM THE EARNINGS CALL

We summarize our 1Q:14 earnings estimates in Exhibit 1 below.

Exhibit 1: Evoke 1Q:14 Earnings (\$ in millions, except per share data)

	1Q:14E	1Q:14A	% Variance	Y/Y Growth	Q/Q Growth	Comments
Revenues	0.00	0.00	NM	NM	NM	
<b>Total Revenues</b>	<b>0.00</b>	<b>0.00</b>	<b>NM</b>	<b>NM</b>	<b>NM</b>	
COGS	0.00	0.00	NM	NM	NM	
<b>Gross Profit</b>	<b>0.00</b>	<b>0.00</b>	<b>NM</b>	<b>NM</b>	<b>NM</b>	
SG&A	1.1	1.07	-2.7%	629.1%	13.4%	
R&D	1.5	1.85	23.5%	1431.8%	191.0%	
Other	0.0	0.00	NM	NM	NM	
<b>EBIT</b>	<b>-2.60</b>	<b>-2.92</b>	<b>NM</b>	<b>NM</b>	<b>NM</b>	
Interest and Other Income	0.0	-0.03	NM	NM	NM	
Pre-tax income	-2.63	-2.96	NM	NM	NM	
Income tax expense	0.00	0.00	NM	NM	NM	
<b>Net Income</b>	<b>-2.63</b>	<b>-2.96</b>	<b>NM</b>	<b>NM</b>	<b>NM</b>	
Diluted shares	6.10	6.00	-1.6%	431.2%	0.5%	
<b>Operating EPS</b>	<b>(\$0.43)</b>	<b>(\$0.49)</b>	<b>NM</b>	<b>NM</b>	<b>NM</b>	<b>(\$0.36) Consensus</b>

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

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## 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 \$19 (up from \$17.50 previously). 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 \$34. 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 \$20 using these two calculations.

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## 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	2013	1Q:14A	2Q:14E	3Q:14E	4Q:14E	2014E	2015E	2016E	2017E	2018E	2019E	2020E	2021E	2022E	2023E
<b>Revenues:</b>																	
Revenue	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
<b>Total revenues</b>	<b>0.0</b>	<b>0.0</b>	<b>0.0</b>	<b>0.0</b>	<b>0.0</b>	<b>0.0</b>	<b>0.0</b>	<b>0.0</b>	<b>0.0</b>	<b>15.0</b>	<b>45.0</b>	<b>102.0</b>	<b>145.0</b>	<b>180.0</b>	<b>205.0</b>	<b>221.0</b>	<b>230.0</b>
<b>Operating expenses:</b>																	
COGS	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
<b>Gross Profit</b>	<b>0.0</b>	<b>0.0</b>	<b>0.0</b>	<b>0.0</b>	<b>0.0</b>	<b>0.0</b>	<b>0.0</b>	<b>0.0</b>	<b>0.0</b>	<b>14.4</b>	<b>43.2</b>	<b>98.0</b>	<b>139.4</b>	<b>173.2</b>	<b>197.3</b>	<b>212.8</b>	<b>221.6</b>
R&D	1.8	1.2	1.0	1.9	4.0	4.0	4.0	13.9	5.0	4.0	4.2	4.4	4.6	4.9	5.1	5.4	5.6
SG&A	0.6	0.8	1.6	1.1	1.2	1.2	1.2	4.5	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
<b>Total operating expenses</b>	<b>2.4</b>	<b>2.0</b>	<b>2.6</b>	<b>2.9</b>	<b>5.2</b>	<b>5.2</b>	<b>5.2</b>	<b>18.4</b>	<b>13.0</b>	<b>34.0</b>	<b>104.2</b>	<b>109.4</b>	<b>114.9</b>	<b>116.2</b>	<b>117.6</b>	<b>119.0</b>	<b>120.4</b>
<b>Operating income (Loss)</b>	<b>(2.4)</b>	<b>(2.0)</b>	<b>(2.6)</b>	<b>(2.9)</b>	<b>(5.2)</b>	<b>(5.2)</b>	<b>(5.2)</b>	<b>(18.4)</b>	<b>(13.0)</b>	<b>(19.6)</b>	<b>(61.0)</b>	<b>(11.4)</b>	<b>24.5</b>	<b>56.9</b>	<b>79.7</b>	<b>93.9</b>	<b>101.3</b>
Interest income	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)	(0.2)	(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)	0.0	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)	(0.2)	(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
<b>Pretax Income</b>	<b>(2.4)</b>	<b>(2.0)</b>	<b>(2.8)</b>	<b>(3.0)</b>	<b>(5.2)</b>	<b>(5.2)</b>	<b>(5.2)</b>	<b>(18.5)</b>	<b>(13.0)</b>	<b>(19.4)</b>	<b>(60.8)</b>	<b>(11.3)</b>	<b>24.6</b>	<b>57.1</b>	<b>80.1</b>	<b>94.5</b>	<b>102.3</b>
Tax Rate	NA	NA	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	3.7	21.7	30.4	35.9	38.9
<b>Net income</b>	<b>(2.4)</b>	<b>(2.0)</b>	<b>(2.8)</b>	<b>(3.0)</b>	<b>(5.2)</b>	<b>(5.2)</b>	<b>(5.2)</b>	<b>(18.5)</b>	<b>(13.0)</b>	<b>(19.4)</b>	<b>(60.8)</b>	<b>(11.3)</b>	<b>20.9</b>	<b>35.4</b>	<b>49.6</b>	<b>58.6</b>	<b>63.4</b>
Weighted average common shares (diluted)	1.1	1.1	2.4	6.0	6.1	6.3	6.3	6.2	10.0	12.0	12.6	13.2	13.9	14.6	15.3	16.1	16.9
<b>Diluted EPS</b>	<b>(\$2.18)</b>	<b>(\$1.79)</b>	<b>(\$1.20)</b>	<b>(\$0.49)</b>	<b>(\$0.85)</b>	<b>(\$0.83)</b>	<b>(\$0.82)</b>	<b>(\$3.00)</b>	<b>(\$1.30)</b>	<b>(\$1.62)</b>	<b>(\$4.83)</b>	<b>(\$0.86)</b>	<b>\$1.50</b>	<b>\$2.43</b>	<b>\$3.24</b>	<b>\$3.64</b>	<b>\$3.75</b>
<div> <div>\$0.0</div> <div>\$0.0</div> <div>\$0.0</div> <div>\$0.0</div> <div>\$0.0</div> <div>\$6.9</div> </div> <div> <div>(\$0.61)</div> <div>(\$0.75)</div> <div>(\$0.76)</div> <div>(\$2.56)</div> <div>(\$1.30)</div> <div>(\$1.51)</div> </div>																	
<b>Margin Analysis</b>	<b>2011</b>	<b>2012</b>	<b>2013</b>	<b>1Q:14A</b>	<b>2Q:14E</b>	<b>3Q:14E</b>	<b>4Q:14E</b>	<b>2014E</b>	<b>2015E</b>	<b>2016E</b>	<b>2017E</b>	<b>2018E</b>	<b>2019E</b>	<b>2020E</b>	<b>2021E</b>	<b>2022E</b>	<b>2023E</b>
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%
<b>Growth (Y/Y)</b>	<b>2011</b>	<b>2012</b>	<b>2013</b>	<b>1Q:14A</b>	<b>2Q:14E</b>	<b>3Q:14E</b>	<b>4Q:14E</b>	<b>2014E</b>	<b>2015E</b>	<b>2016E</b>	<b>2017E</b>	<b>2018E</b>	<b>2019E</b>	<b>2020E</b>	<b>2021E</b>	<b>2022E</b>	<b>2023E</b>
Net Sales	-	-	-	-	-	-	-	-	-	-	200%	127%	42%	24%	14%	8%	4%
SG&A	-	47%	97%	629%	683%	183%	22%	175%	77%	275%	233%	5%	5%	1%	1%	1%	1%
R&D	-	-37%	-18%	1432%	3208%	4981%	529%	1347%	-64%	-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%
<b>Diluted EPS</b>	-	-	-	-	-	-	-	-	-	-	-	-	-	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.

## Companies Mentioned:

Forest Laboratories, Inc. (FRX - NYSE): HOLD

Furiex Pharmaceuticals, Inc. (FURX - NASDAQ): NC

Questcor Pharmaceuticals, Inc. (QCOR - NASDAQ): NC

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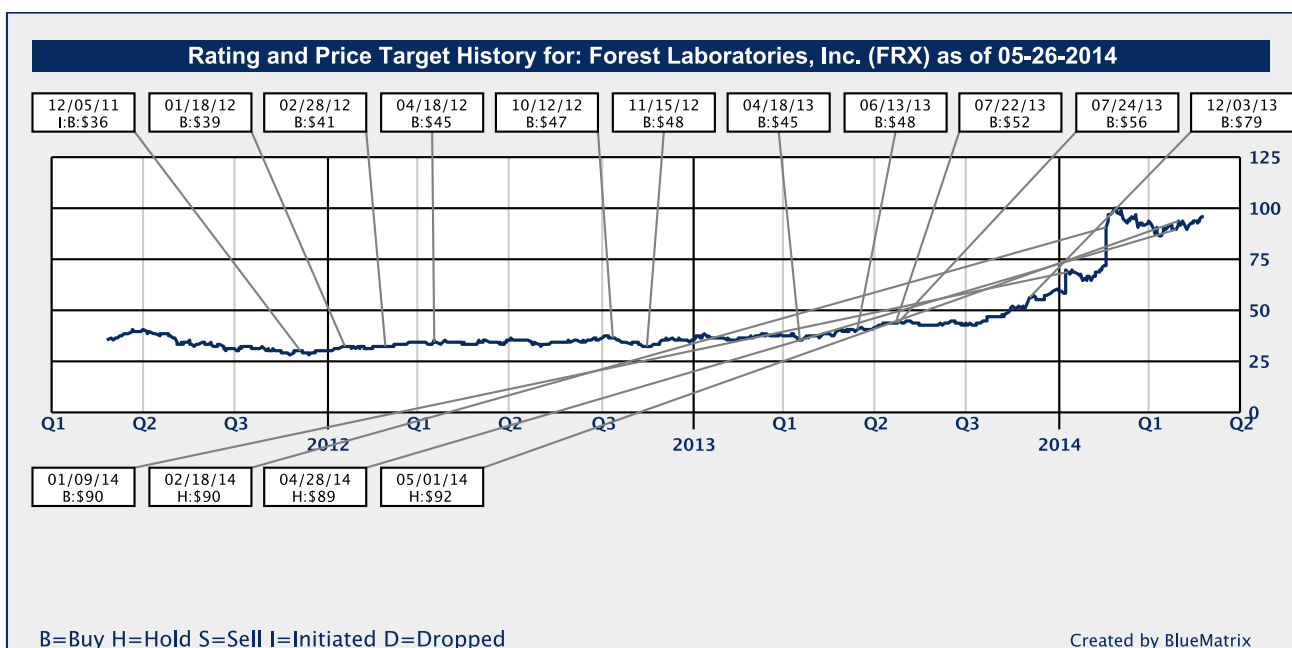
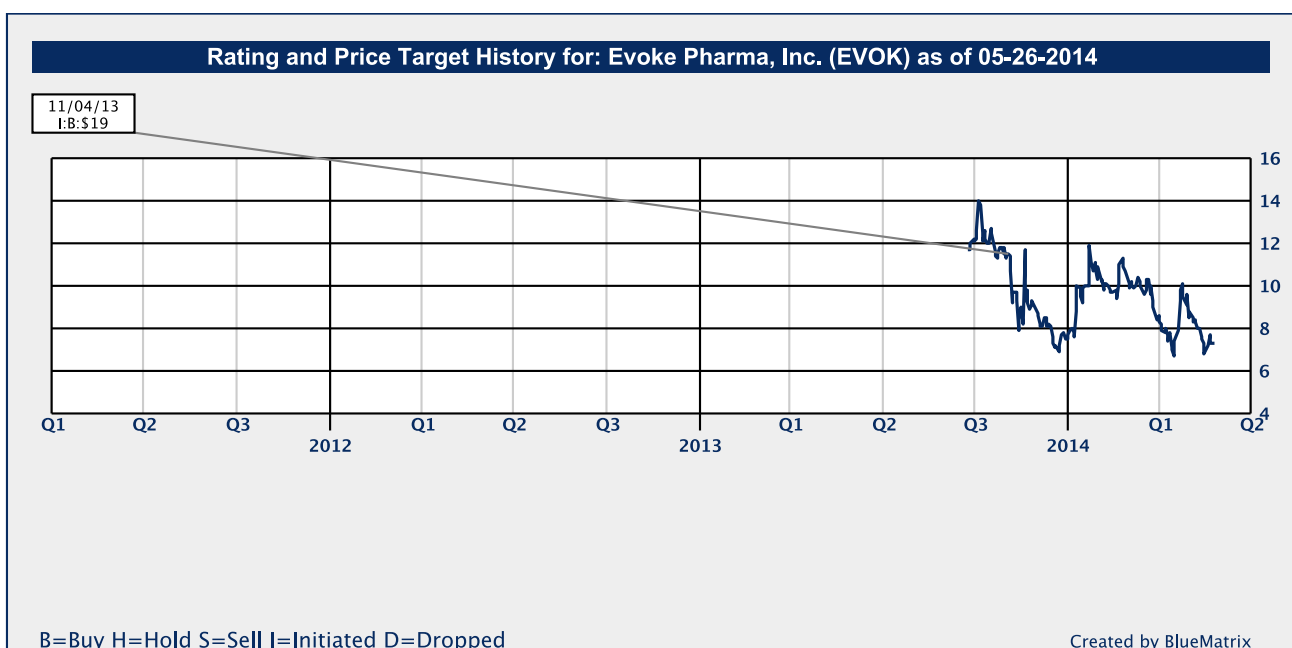
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**Cantor**

Rating	Count	Percent	IB Serv./Past 12 Mos.	
			Count	Percent
BUY [B]	83	57.24	20	24.10
HOLD [H]	50	34.48	8	16.00
SELL [S]	12	8.28	1	8.33