

NovaBay Pharmaceuticals (NBY - \$ 0.66)

4Q14: Avenova and NeutroPhase Skin and Wound Cleanser Commercialization Are Underway

NBY reported 4Q14 financial results yesterday with net losses of (\$4.7MM) and net losses per share of (\$0.09). With an addition of \$4.9MM from recent financing, we estimate the company currently has cash of ~\$8MM (pro forma), enough to support their operation into 2016, in our opinion.

- **Avenova U.S. commercialization is underway.** The company started its Avenova marketing and sales campaign in the U.S. late last year by targeting optometrists (60%) and ophthalmologists (40%). NBY already has 35 sales reps in place and expects to expand the team to a total of 50. Management indicated that the sales in February were twice the level of January and the March sales have further increased. NBY did not provide revenue guidance given the commercialization effort is still in early stage. NBY is developing longer-acting Avenova in the form of cream and ointment with the possibility of reaching the market in 2H16 if the drug receives FDA clearance.
- **NeutroPhase skin and wound cleanser sales in China started in March.** Pioneer Pharma Holdings has launched and started promotion activities for NeutroPhase skin and wound cleanser in China in March 2015. Given the vast market and un-met medical needs in China, long term NeutroPhase sales potentially could reach \$300MM, in our estimate.
- **Highlights from optometrist/ophthalmologist KOL dinner.** Last night, we attended a KOL dinner and presentation by Dr. Eric Donnenfeld and his colleagues. Dr. Donnenfeld is a leading refractive and cataract surgeon and clinical professor at NYU Medical Center. He suggested that Avenova could be an effective and non-toxic drug to manage the ocular surface in patients with blepharitis, or prior to starting various surgical procedures. He views substantial unmet needs in managing meibomian gland dysfunction (MGD or posterior blepharitis); and Avenova would be a logical solution given the drug's anti-bacterial and anti-inflammatory activities and the lack of elucidating resistance. It is well recognized that bacteria play an important role in developing MGD.
- **Action.** Based on the encouraging advancements of its commercialization effort, we view NBY has a more balanced overall risk/reward portfolio. We are reiterating our Buy rating and \$1.90 target price, which is supported by our peer comparable and risk-adjusted cash flow sum-of-the-parts analyses.

Earnings Estimates: (per share)

(Dec)	1Q	2Q	3Q	4Q	FY	P/E
FY-15E	-0.05	-0.05	-0.04	-0.03	-0.18	NM
FY-14A	-0.08	-0.06	-0.08	-0.09	-0.31	NM
FY-13A	-0.11	-0.11	-0.10	-0.10	-0.42	NM
FY-12A	-0.09	-0.08	0.00	-0.07	-0.24	NM

Source: Laidlaw & Company estimates.

Healthcare/Biotechnology

Ticker:	NBY
Rating:	Buy
Price Target:	\$ 1.90

Trading Data:

Last Price (03/27/2015)	\$ 0.66
52-Week High (8/18/2014)	\$ 1.30
52-Week Low (2/27/2015)	\$ 0.42
Market Cap. (MM)	\$ 42
Shares Out. (MM)	61

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Anticipated milestones in 2015 and beyond

Product	Indication	Partner	Event	Timing
Avenova	Blepharitis		Expand sales force	1H15
NeuroPhase	Chronic non-healing wounds	Pioneer Pharma	Potential launch in China	March, 15
Consumer lens care product			Commercial launch	2015
Auriclosene (NVC-422)	Prevention of urinary catheter blockage and encrustation (UCBE) (0.2%)		Potentially to outlicense for further development	2015

Source: Laidlaw & Company estimates and company presentation.

Major Risks

Failures of current and upcoming clinical programs. Although auriclosene demonstrated promising efficacy and a satisfactory safety profile from the Phase II studies in several indications, NBY subsequently announced that the auriclosene in viral conjunctivitis Phase IIb study did not meet the primary and secondary endpoints; and the company does not intend to initiate any new studies of auriclosene for this indication

Maintaining current and expanding future partnerships are not guaranteed. One of major validations of NovaBay's technologies and significant near-term revenue prospects derive from the company's collaborative partners, such as Galderma. Should a partner decide to terminate collaboration with NovaBay, shareholder value could be substantially impacted, due to the potential loss of future revenue and concerns about the company's technology for generating effective therapeutic products. In addition, there is no assurance that the company can forge additional collaborations for generating revenue.

Product may not reach anticipated sales. Although NeutroPhase has illustrated promising efficacy and safety profiles, and has received FDA approval, the sales potential for the product could miss our forecasts. Although NeutroPhase is approved to be used in wound care in the U.S., it is not guaranteed that the product could receive approval in China and can successfully launch in China and Southeast Asian markets. In addition, NovaBay may not generate projected revenue from its own in-house pipeline.

Additional financing could dilute shareholder value. Regardless of whether or not the company forges additional collaborations with partners to generate non-dilutive revenue to support operation, it is likely that NovaBay may need to provide offerings to raise cash from investors to fund its operations. As such, the share value for existing investors could be diluted. Further, if the company cannot raise equity capital at more favorable terms, the share value of current shareholder could be further impaired.

Limited trading liquidity limits shareholder options. Given daily trading volume and name recognition of NBY shares are relatively modest, some investors could be hesitant to own the shares as relatively illiquid trading volume could impose constraints if they want to increase or reduce their positions in a volatile stock market.

DISCLOSURES:

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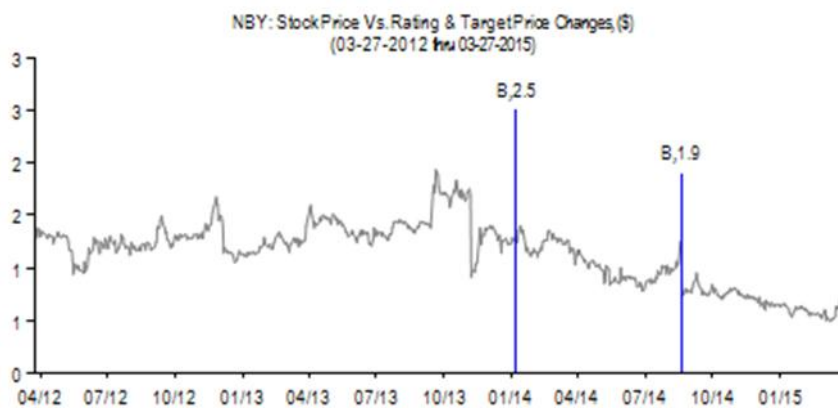
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Additional information available upon request.

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RATINGS INFORMATION

Rating and Price Target Change History



Date	Rating	Closing Price (\$)
01/07/2014	Buy (B)	1.28

Date	Target Price (\$)	Closing Price, (\$)
01/07/2014	2.50	1.28
08/20/2014	1.90	0.81

Source: Laidlaw & Company

Created by: Blue-Compass.net

Laidlaw & Company Rating System*		% of Companies Under Coverage With This Rating	% of Companies for which Laidlaw & Company has performed services for in the last 12 months	
			Investment Banking	Brokerage
Strong Buy (SB)	Expected to significantly outperform the sector over 12 months.	0.00%	0.00%	0.00%
Buy (B)	Expected to outperform the sector average over 12 months.	81.82%	36.36%	9.09%
Hold (H)	Expected returns to be in line with the sector average over 12 months.	4.55%	0.00%	0.00%
Sell (S)	Returns expected to significantly underperform the sector average over 12 months.	0.00%	0.00%	0.00%

ADDITIONAL COMPANIES MENTIONED

China Pioneer Pharma Holdings, Ltd: HK 01345 – Not Rated

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