

**St. John's University**  
**Student Managed Investment Fund**  
**Presents:**  
**Impax Labs, Inc.**



***Analysts:***

**Shreya Bansal, ([shreya.bansal@gmail.com](mailto:shreya.bansal@gmail.com))**  
**Ridwan Mahmood, ([rwmahmood23@gmail.com](mailto:rwmahmood23@gmail.com))**  
**Danielle Buonfrisco, ([dbuonfrisco@gmail.com](mailto:dbuonfrisco@gmail.com))**  
**Morgan McCarthy, ([morgan.mccarthy08@gmail.com](mailto:morgan.mccarthy08@gmail.com))**  
**Marcial Zebaze, ([mzebaze@gmail.com](mailto:mzebaze@gmail.com))**

**RECOMMENDATION: Purchase 250 shares**

**Company Data (as of 12/12/2011):**

<b>Price:</b>	\$18.90	<b>Beta (10 year):</b>	1.088
<b>52 Week Range:</b>	\$14.46–\$28.75	<b>Dividend Yield:</b>	0
<b>Shares Outstanding:</b>	66.43M	<b>Market Capitalization:</b>	1.26B



## I. Executive Summary

---

Impax Laboratories, Inc. is a specialty pharmaceutical company that focuses on producing controlled drug-release products. A technology based company, Impax was formed in December 1999 by the reverse merger of the publicly owned Global Pharmaceutical Corporation and the privately held Impax Pharmaceuticals, Inc.

With the pending release of its internally developed products that focus on central nervous system disorders (CNS) as well as the production of high margin first-to-file, first-to-market generic products, the firm has significant potential future revenue streams. In addition, its management has taken an aggressive stance towards global expansion through partnerships and the purchase of new manufacturing plants. From our analyses, we have found the stock of the firm to be undervalued in the market and thus recommend buying 250 shares of the stock. We suggest buying the stock at market at a price below \$19.00.

**Recommendation: BUY (250 Shares)**

## II. Company Overview

---

### 1. Operating Structure of the Firm:

Impax Laboratories, Inc. is a specialty pharmaceutical company that focuses on producing controlled drug-release products. A technology based company, Impax was formed in December 1999 by the reverse merger of the publicly owned Global Pharmaceutical Corporation and the privately held Impax Pharmaceuticals, Inc. This move combined the advanced drug research and technology of Impax with the strong marketing and distribution benefits of Global Pharmaceutical.

As a result of this, Impax is organized into two divisions. The first is the Global Pharmaceutical division that produces generic bioequivalent products. The second is Impax which produces branded internally produced products. There are also research and partner agreements between Impax and other established pharmaceuticals that provide an added source of revenue for the firm.

The Global division focuses on technologically advanced control release drug products which imbibe a unique drug delivery mechanism. Through this, the drug is delivered at a specific time to a specific part of the body in certain dosages. Such technology is limited to a few pharmaceuticals and thus reduces competition to only those that have the resources to create these drugs. The Global division takes advantage of first-to-file, first-to-market, high margin opportunities and currently manufactures 102 products with 79 under development. It further has 39 pending Abbreviated New Drug Applications (ANDAs – applications for bioequivalent generic products). With a commendable drug pipeline in tow, this division had its largest product launch to date in 2Q, 2010 with the introduction of the generic drug Flomax. Its major clients are five of the top pharmaceutical giants in the industry and accounted for a sizable amount in profits in 2010: McKesson Corporation – 20%, Cardinal Health – 14%, Amerisource-Bergen – 14%, Walgreens – 7%, Medco – 3%. This highlights that the firm has wide industry recognition but also showcases their dependency on influential clients (for the time being).

The Impax division was launched in 2006 and is neurology focused - it specializes on drugs that treat Central Nervous System (CNS) disorders. With a large R&D team and 7 New Drug Applications (NDAs), it holds potential for enormous business growth. Currently, their leading product (IPX066) that focuses on relieving symptoms of Parkinson's disease has passed through preliminary Phase III trials and is on track to complete approval by the end of 2012. The drug would improve the dosage, efficacy, and convenience of treatment for patients ailing from the disease. In addition, the firm signed a lucrative agreement with GlaxoSmithKline (GSK) to develop and commercialize the product outside the United States and Taiwan.

In addition, Impax Labs, Inc. has partner agreements with unrelated third party pharmaceuticals for research and product manufacturing partners. The firm receives royalties for the sale of products sold by some of these partners which provide an added source of revenue. Below is a breakdown of revenues for the firm from 2005-2010 (in millions).

	30-Dec-05	29-Dec-06	31-Dec-07	31-Dec-08	31-Dec-09	31-Dec-10
<b>Sales/Revenue</b>	<b>112.400</b>	<b>135.246</b>	<b>273.753</b>	<b>210.071</b>	<b>358.409</b>	<b>879.509</b>
<b>Global Product sales, net</b>	--	78.201	87.978	96.006	287.079	622.889
<b>Private Label Product sales</b>	--	--	--	2.596	5.513	2.074
<b>Rx Partner</b>	--	36.809	161.114	81.778	33.835	217.277
<b>OTC Partner</b>	--	13.782	11.866	15.946	6.842	8.888
<b>Research Partner</b>	--	--	--	0.833	11.680	14.308
<b>Promotional Partner</b>	--	6.434	12.759	12.891	13.448	14.073
<b>Other</b>	--	0.020	0.036	0.021	0.012	--

From the above data, it is clear that the Global division responsible for generic products and some of the partnerships have been key drivers of revenue for the firm. The Private Label Product sales are projected to increase once the branded IPX066 drug from the Impax division is released. The Private Label sales will also be key drivers to growth in the years to come because of the pending approval of various internally developed products in the drug pipeline.

## 2. Corporate Structure of the Firm:

The executive team of the firm consists of the individuals below. Their biographies are also presented here as found on the corporate website (impaxlabs.com).

a.) **Larry Hsu, Ph.D.**

*President, Chief Executive Officer and Director*

“Larry Hsu, Ph.D. has been President and Chief Executive Officer since October 1, 2006. Prior to holding these positions, Dr. Hsu served as President and Chief Operating Officer beginning in 1999. Dr. Hsu co-founded Impax Pharmaceuticals, Inc. in 1994 and served as its President, Chief Operating Officer and a member of the board from its inception until its merger with us. From 1980 to 1995, Dr. Hsu worked at Abbott Laboratories, where, during his last four years, he served as Director of Product Development in charge of formulation development, process engineering, clinical lot manufacturing and production technical support of all dosage forms, managing a staff of approximately 250 people. Dr. Hsu obtained his Ph.D. in pharmaceuticals from the University of Michigan.”

b.) **Carol Ben-Maimon, M.D.**

*President, Global Pharmaceuticals*

“Dr. Ben-Maimon comes to Impax with a broad base of executive experience in the pharmaceutical industry. She was most recently senior vice president, corporate strategy consulting to the president, chief executive officer and investors at Qualitest Pharmaceuticals, Inc. Prior to her role at Qualitest, she held executive positions with Barr Pharmaceuticals, including president and chief operating officer of Duramed Research (formerly known as Barr Research), a subsidiary of Barr Pharmaceuticals Inc. and with Teva Pharmaceuticals USA where she was senior vice president, Science and Public Policy. From 1996 to 2000, she served as senior vice president, Research and Development at Teva. She has also served as president and chief executive officer of Alita

Pharmaceuticals, Inc. – a company which she founded. She served as the chairman of the board of the Generic Pharmaceutical Association from 2000 to 2003, and is also a published author of numerous scientific and clinical articles. Dr. Ben-Maimon is a graduate of Thomas Jefferson Medical College and received a bachelor of arts in biology from The University of Pennsylvania where she graduated magna cum laude. She is board certified in internal medicine, and completed clinical and research training in nephrology at Thomas Jefferson University.”

c.) **Michael J. Nestor**

*President, Impax Pharmaceuticals*

“Michael J. Nestor joined us in March 2008 as the President of our newly formed branded products division, Impax Pharmaceuticals. Before joining us he was Chief Operating Officer of Piedmont Pharmaceuticals, a specialty pharmaceutical company. Prior to Piedmont, Mr. Nestor was CEO of NanoBio, a start-up biopharmaceutical company, prior to which he was employed by Alpharma, initially as President of its generic pharmaceutical business and later as President of its branded pharmaceutical business. Before this he was President, International business at Banner Inc., a global contract manufacturing concern. Mr. Nestor spent 16 years at Lederle Laboratories/ Wyeth holding increasing positions of responsibility including Vice President, Cardiovascular business, Vice President/ General Manager of Lederle-Praxis Biologics, and Vice President/ General Manager of Wyeth-Lederle Vaccines and Pediatrics. Mr. Nestor has experience in a number of pharmaceutical therapeutic areas including vaccines, cardiovascular products, anti-infectives, dermatologics, CNS, generics and analgesics. Mr. Nestor has a bachelor of Business Administration degree from Middle Tennessee State University and an MBA from Pepperdine University.”

d.) **Arthur A. Koch, Jr.**

*Executive Vice President, Finance, and Chief Financial Officer*

“Mr. Koch has served as the Company's SVP and CFO since April 2005. Prior to joining the Company, he had been with Strategic Diagnostics Inc. (NASDAQ:SDIX), a company that develops, manufactures and markets immunoassay-based diagnostic test kits, including six years as Chief Operating Officer, five months as interim Chief Executive Officer and five years as Chief Financial Officer and Vice President. At Strategic Diagnostics, his most recent responsibilities included responsibility for all P&L activities and leadership of the research, manufacturing and financial functions. He also was involved in several acquisitions and developed the company's investor relations campaign. Mr. Koch has held further CFO positions at Paracelsian Inc., IBAH Inc., Liberty Fish Company and Premier Solutions Ltd. In addition, he has served as a corporate finance and operations consultant for numerous private companies, and spent the first eight years of his career at KPMG LLP, rising to the rank of senior manager. Mr. Koch holds a Bachelor of Business Administration from Temple University and has been a Certified Public Accountant since 1977.”

e.) **Mark A. Schlossberg**

*Senior Vice President and General Counsel*

“Mr. Schlossberg brings over 25 years of legal experience to Impax, including more than 11 in the healthcare industry. He joins Impax from Amgen Inc., where he served

as Vice President, Associate General Counsel, responsible for the areas of corporate governance and securities law, licensing, mergers and acquisitions, sales and marketing and global operations. Prior to joining Amgen, he held legal and business positions at Medtronic, Inc., and legal positions at Diageo plc, RJR Nabisco, Inc. and Mudge Rose Guthrie Alexander & Ferdon. He earned a Bachelor of Sciences in business administration and finance from the University of Southern California and a Juris Doctor degree from Emory University.”

### **3. Geographic Operations:**

Impax Laboratories, Inc. has three facilities located in Philadelphia, New Britain, and Taiwan with its headquarters in Hayward, California. As mentioned on the firm’s corporate website, each facility takes on specific roles:

- Hayward, California: “Has a full range of capabilities including research and development and commercial manufacturing. Hayward can produce approximately 1.2 billion units of oral, solid dosage forms annually.”
- Philadelphia, Pennsylvania: “Serves as the primary packaging facility for products produced both domestically and internationally.”
- New Britain, Pennsylvania: “Serves as the primary commercial center, housing accounting, sales and marketing, warehousing and distribution.”
- Taiwan: “Manufacturing facility completed in early 2010 with production capacity of approximately 450 million units of oral, solid dosage forms annually. In April 2011, announced expansion to double facility’s square footage and initially increase annual capacity to approximately 700 million tablets and capsules. The two-year project is scheduled for completion in the fourth quarter of 2012. The expanded facility has been designed with the superstructure and infrastructure to install additional equipment capable of supporting annual production of 1.5 billion tablets and capsules as necessary to support future growth.”

The establishment of the Taiwan facility along with the viewpoint toward increased growth in the future highlights the positive growth trends envisioned by the firm’s management.

### **4. Business Risks and Future Outlook:**

Impax Laboratories, Inc. faces business risks that include fluctuations in revenues and operating expenses (affected by FDA approvals, raw materials, protection of intellectual property, business competition, etc.), need for innovation, and legal and political risk from international operations. The firm is prudently aware of all of these and others and has taken combative steps towards them. It has invested extensive money and resources towards research and has come up with business strategies for both divisions.

For the Global division, firm management is looking to expand through a.) strategic acquisitions, partnerships, or mergers, b.) new forms of products – creams, ointments, etc., and c.) international market penetration.<sup>1</sup>

---

<sup>1</sup> [http://www.impaxlabs.com/our\\_company/future\\_directions](http://www.impaxlabs.com/our_company/future_directions)



**Global Division Business Outlook**

For the Impax division of the firm, management is looking to continually invest in research and development along with collaborations in the commercialization and acquisition of market products.<sup>2</sup> This will ensure promotion of long-term brand strategies and provide near-term revenue.<sup>3</sup>



**Impax Division Business Outlook**

Furthermore, despite competing with formidable competitors like Mylan and Teva, Impax Labs has a significant competitive edge. This is because of three main reasons:

<sup>2</sup> [http://www.impaxlabs.com/our\\_company/future\\_directions](http://www.impaxlabs.com/our_company/future_directions)

<sup>3</sup> [http://www.impaxlabs.com/our\\_company/future\\_directions](http://www.impaxlabs.com/our_company/future_directions)

- a.) the firm focuses on a special control-release technology that limits competitors to those who have the required resources while reducing dosage and increasing convenience for the consumer,
- b.) the Impax division focuses on the CNS market. This market accounted for \$77 billion in prescriptions in 2010 which constituted 21% of the \$367billion pharmaceutical market. CNS prescription volume grew at 5% in 2010 consistent with market growth.<sup>4</sup>In addition, some of the major CNS market participants are losing patent expirations in 2012-2013 giving generic drug producers and smaller firms (like Impax) to breach the niche CNS market.<sup>5</sup>
- c.) the firm has wide partnership agreements and alliances and is recognized in the industry.

Overall, the prospects for the company are noteworthy, especially with the release of their upcoming branded products and aggressive expansion strategies.

---

<sup>4</sup> Impax Annual Report 2010

<sup>5</sup> [http://www.bourne-partners.com/FileLib/CNS%20Outlook%20\(October%202010\).pdf](http://www.bourne-partners.com/FileLib/CNS%20Outlook%20(October%202010).pdf)



## III. Industry Analysis

---

### 1. Overview:

Impax Laboratories, Inc. falls squarely within the healthcare sector. As a firm, Impax is still in the early growth stage of its business cycle and as shown in the last section, holds a potential for high returns as it matures.

The healthcare sector as a whole has performed relatively well with positive projections for the future. Healthcare enjoyed added job growth in the past recession and has done well compared to other sectors. This is because it requires a degree of skilled human capital and is also a necessary resource in the economy. During the quasi-recessions of 2008 and 2010, healthcare was one of the few sectors that still maintained growth, albeit slowed growth, instead of dealing with a blanket fall. In 2008, it accounted for \$2.3 trillion and 16.2% of the US economy.<sup>6</sup> In the wake of the recession, there were fewer people with private insurance, but ObamaCare (for better or for worse), has led to an increase in insurance subscriptions and spending. Besides insurance, pharmaceuticals are expected to grow by 4-6% with stronger near term growth in the US accompanied by an expansion of markets in emerging economies.<sup>7</sup> The expected growth in US markets is because of price increases, tighter inventory control and management<sup>8</sup>, and because of the aging US demographic. While investing in this sector, it will be important to be cognizant of patent expiries, payer mechanisms, insurance policies, and levels of patient access. This holds significance as quite a few pharmaceutical giants are losing patent expirations in the next two years<sup>9</sup> which will prove quite useful for the Global division of Impax which aggressively aims for first-to-file, first-to-market products.

### 2. Trends:

Below is a graph that compares the performance (using total returns) of Impax Labs to that of the SP500, NASDAQ, and a few of its competitors (Teva, Eli Lilly, Par Pharmaceuticals, and Endo Pharmaceuticals) in the last five years. As can be seen, this industry peer group and the market as a whole have experienced growth (except for a few shortfalls in 2008). Impax, on the other hand, has maintained a significantly positive and upward trend until 2010. It shows a decrease in 2011 because of the uncharacteristically high sales in 2010 of the firm's generic products (for which they enjoyed an 8 week exclusivity period). Market comparisons have been undertaken from 2006 and onward because that is when the firm opened the Impax branded product division which will be a key source of revenue in the future.

<sup>6</sup> <http://www.reuters.com/article/2010/01/05/us-usa-healthcare-spending-idUSTRE6040MP20100105>

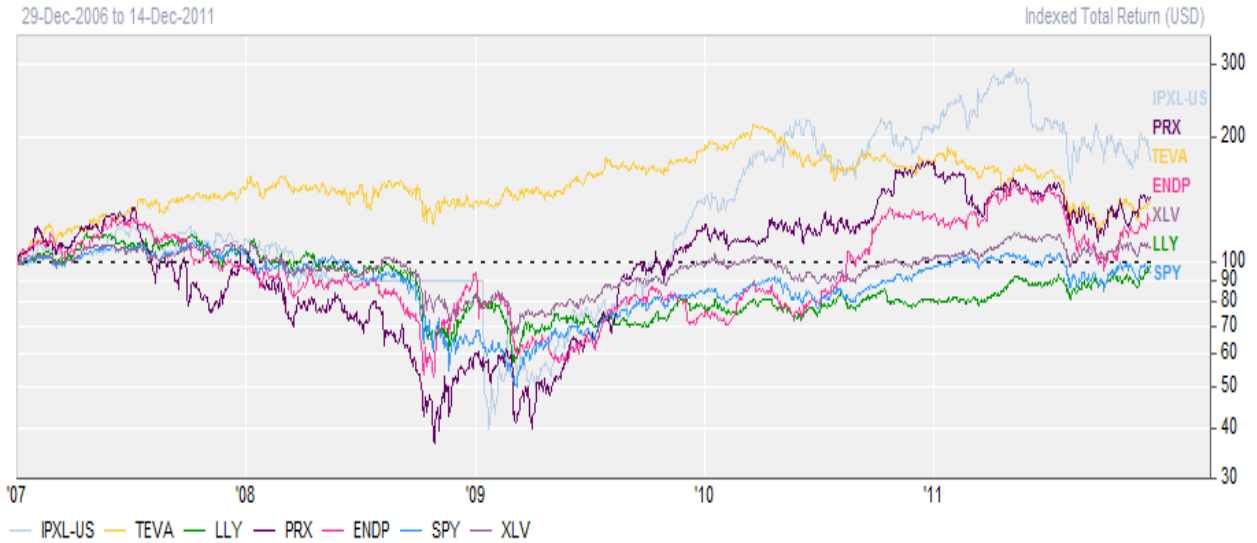
<sup>7</sup> IMS Health:

<http://www.imshealth.com/portal/site/imshealth/menuitem.a46c6d4df3db4b3d88f611019418c22a/?vgnnextoid=500e8fabedf24210VgnVCM10000ed152ca2RCRD&cpsexcurrchannel=1>

<sup>8</sup> IMS Health:

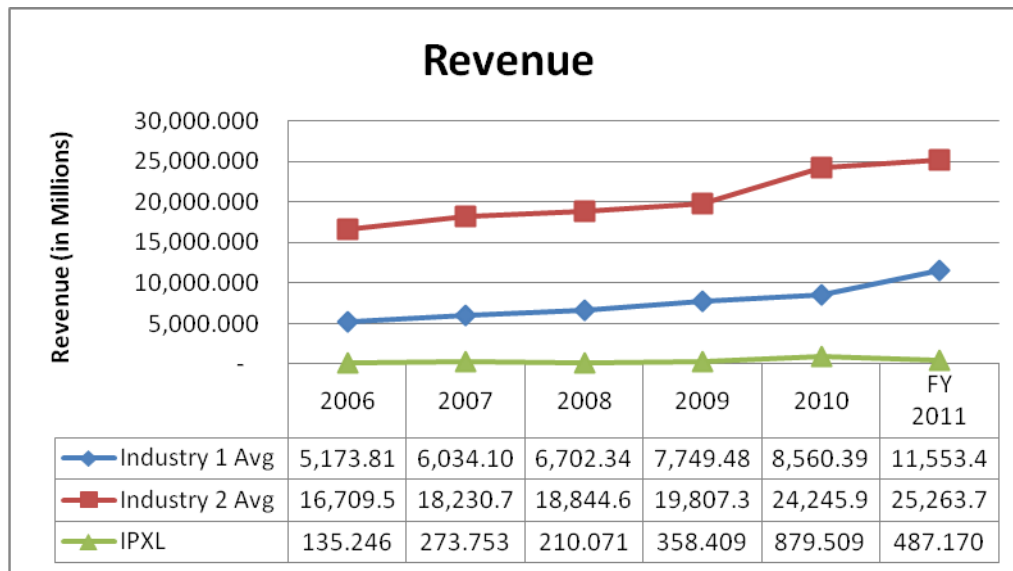
<http://www.imshealth.com/portal/site/imshealth/menuitem.a46c6d4df3db4b3d88f611019418c22a/?vgnnextoid=500e8fabedf24210VgnVCM10000ed152ca2RCRD&cpsexcurrchannel=1>

<sup>9</sup> <http://money.usnews.com/money/blogs/the-best-life/2011/04/29/blockbuster-drugs-that-will-go-generic-soon>



### 3. Revenue:

In order to evaluate Impax Laboratories, Inc. in a fair manner, two custom industry peer groups were formed. Industry 1 consisted of five firms<sup>10</sup> (including Impax), some of which are in



the in the early stages of their business cycles. Industry 2 was a more comprehensive nine firm group<sup>11</sup> (including Impax) consisting of large pharmaceuticals as well. Their revenue streams (in millions) from 2006-2011 are depicted in the graph.

As can be seen, the industry has had growing revenue streams in the past 5 years.

<sup>10</sup> Teva Pharmaceuticals ADR (TEVA), Eli Lilly & Co. (LLY), Par Pharmaceutical Companies, Inc. (PRX), Endo Pharmaceuticals (ENDP), Impax Laboratories, Inc. (IPXL)

<sup>11</sup> The five firms of the previous group, Johnson and Johnson (JNJ), Pfizer, Inc. (PFE), Merck & Co, Inc. (MRK), Enzon Pharmaceuticals, Inc. (ENZN)

#### 4. Analysis of Competitive Forces:

##### a. *Rivalry Amongst Existing Competitors* –

Currently, Impax does face significant competition in the generic drug market but is limited to those who have the resources to produce control-release drug delivery products. Principal competitors (as mentioned in the annual report of 2010) include Teva Pharmaceutical Industries, Ltd. , Mylan, Inc. , Lannett Company, Inc. , Zydus Pharmaceuticals USA Inc. , and Watson Pharmaceuticals, Inc. Impax does not currently market its internally produced products but will face competition from established companies and CNS focused specialty pharmaceuticals when it does.

##### b. *Threat of New Entrants* –

Impax is a new entrant into the CNS market itself and is a reputable firm in the generic drug industry. New entrants would be considered as peers to Impax as they would be in the same stage of the life cycle as the firm. In addition, Impax has significant partnerships with bigger players of the industry (e.g. Teva, GlaxoSmithKline) that give it a major competitive edge over potential new entrants. Unless the new entrant has significantly better technology than Impax, the firm should be able to hold its own as it is recognized industry wide.

##### c. *Threat of Substitute Products* –

Impax is a producer of substitute products (i.e., generic drugs) and will benefit significantly from the patent expirations of established firms in the next two years. The company intends to hold patents and licenses for the products (like IPX066) that the company develops internally and will hold these for the normal patent period thereby eliminating chances of substitute generic versions of the drug for the near future.

##### d. *Bargaining Power of Suppliers and Buyers* –

As stated in the firm's 2010 annual report, "The active chemical raw materials, essential to our business, are generally readily available from multiple sources in the U.S. and throughout the world. Certain raw materials used in the manufacture of our products are, however, available from limited sources and, in some cases, a single source." The sole-source suppliers for some of the ingredients they require are Formosa Laboratories, Ltd. and a division of Ashland, Inc. However, the firm has faced no problems with these suppliers in the past and is looking to expand its supply chain so as to establish a stronger global presence.

Impax's source of revenue from its generic drug business is dependent on five of its strongest clients which accounted for a large amount of revenue in 2010. These include McKesson Corporation – 20%, Cardinal Health – 14%, Amerisource-Bergen – 14%, Walgreens – 7%, Medco – 3%. Revenue would be significantly impacted if any of these firms suddenly pulled out of its client base but the firm does not expect this to happen anytime in the near future. Furthermore, with the development of internal products, Impax is aggressively seeking to increase its client base and global presence.

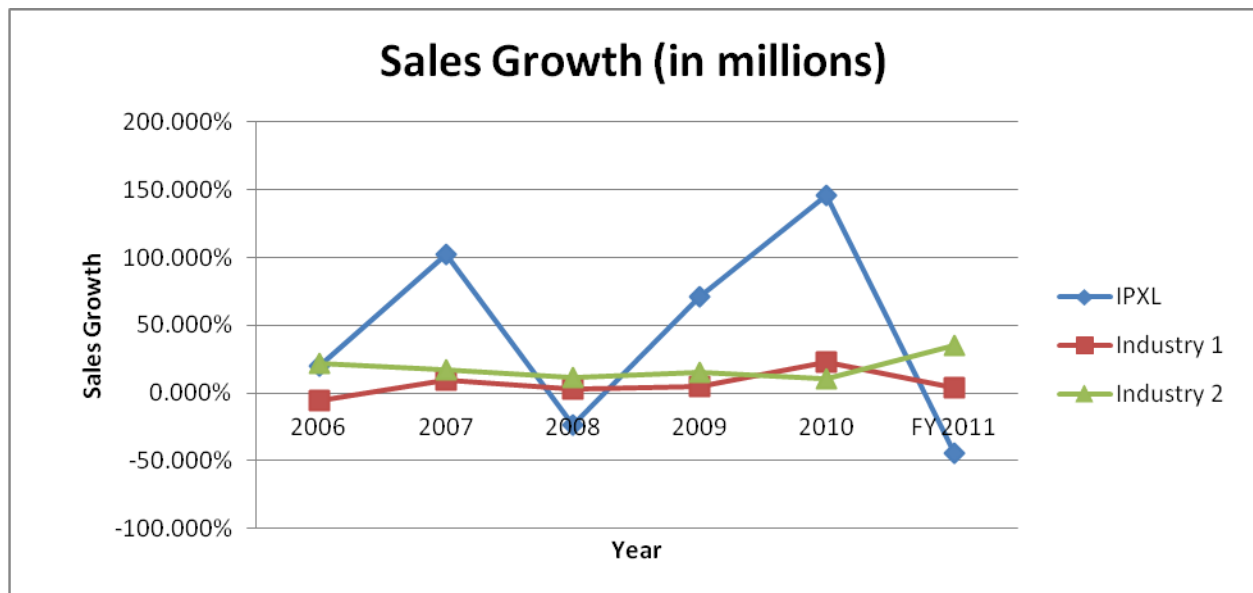
## IV. Fundamental Analysis

Impax Laboratories, Inc. has been compared to two industry groups (as mentioned in the last section) and has been evaluated using different performance indicators. These are highlighted below. Most of the numbers for 2011 consist of the actual numbers from the first three quarters of the year and estimates for the last quarter. In some cases, only YTD 2011 or LTM numbers have been used and have been noted as such in the analysis.

### 1. Financial Performance:

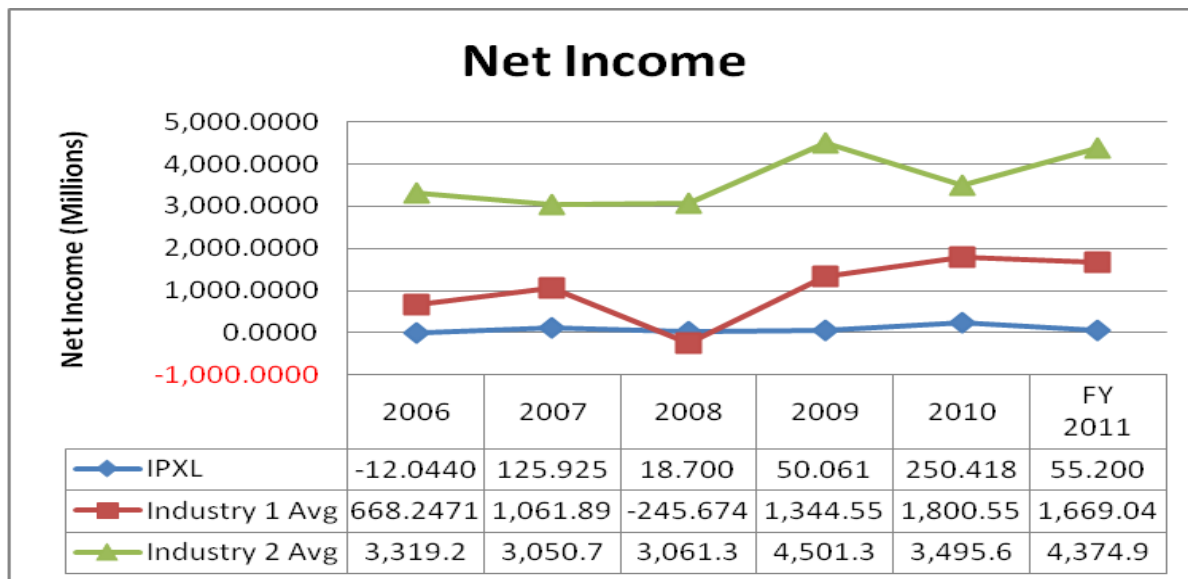
#### a. Sales Growth -

The graph below depicts sales growth for the two industry groups compared to Impax. It is apparent that they have had volatile growth rates but there have been significant reasons behind each. The actual revenue streams for the firm can be seen in section II.3. They have had positive revenues but with varied growth rates. In 2010, sales skyrocketed from \$358.4 million to \$789.5 million due to the introduction of the generic drug Adderall XR and Flomax. Compared to the average Industry 1 growth rate of 17.43% and the Industry 2 rate of 8.62%, Impax has had a better average growth rate of 29.21%.

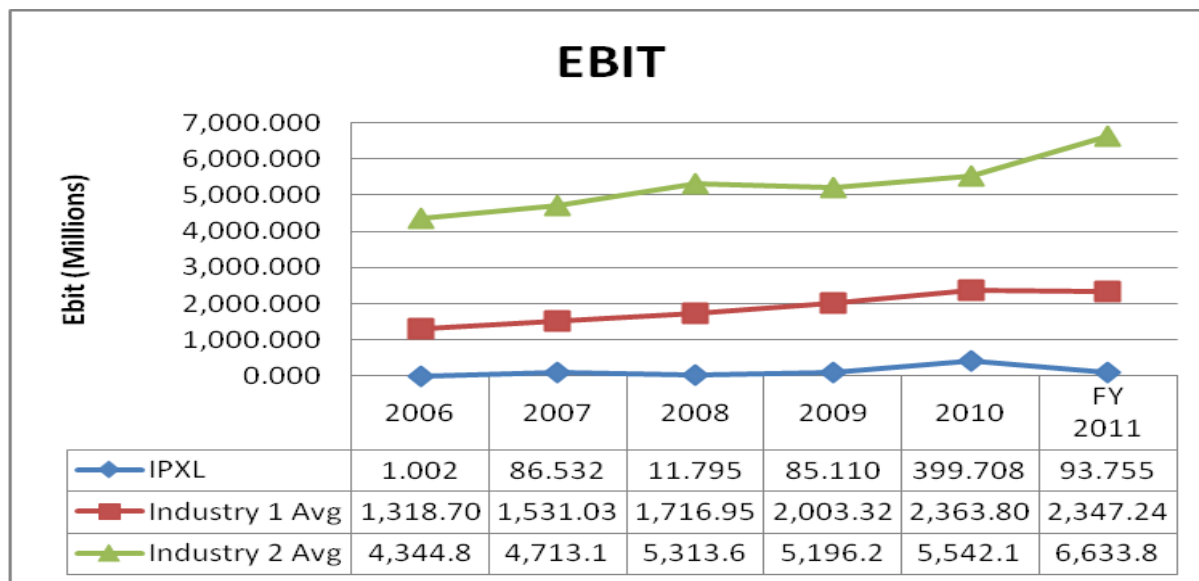


#### b. Net Income and Earnings Before Income and Taxes (EBIT) -

There has been a significant increase in net income from 2006 to 2011 for Impax. Net income increased from \$-12.44 million in 2006 to \$250.4 million in 2010. The 2011 YTD shows net income to be \$43.7 million. In 2010, Industry 1 average was \$2188 million while Industry 2 average was \$3496 million.



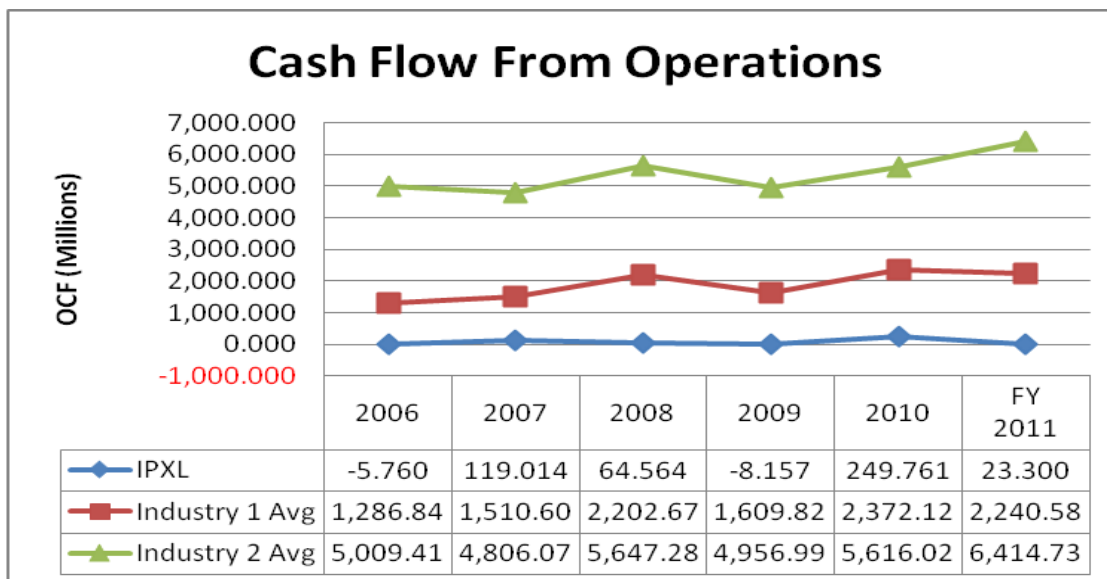
EBIT has been low compared to its competitors due to its smaller size. However, it has been following an upward trend since 2006. The growth rates for both net income and EBIT have been volatile from 2006 to 2010. This is attributed to changing cash flows due to



investments in research and facilities.

#### *c. Cash Flow from Operations -*

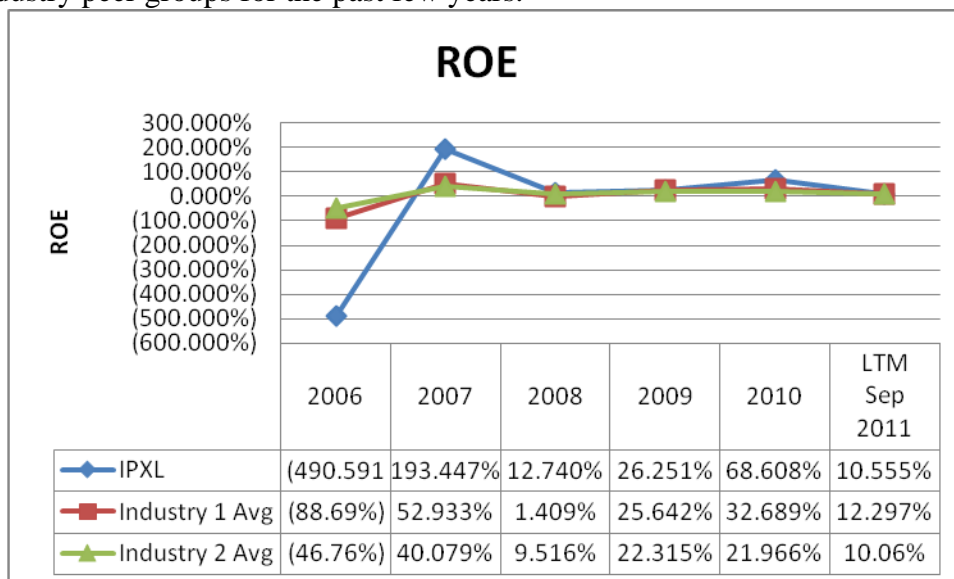
The Cash Flow from Operations has been volatile since 2006 and quite small compared to the industry groups. Once again, this can be attributed to the smaller size of the firm. In 2010, the cash flow jumped up to \$249.76 million and the FY 2011 is expected to be \$23.3 million. The lower figures can be attributed to its small size while the volatility is due to the expenses the firm has faced due to research and the new Taiwan plant.



## 2. Profitability Margins:

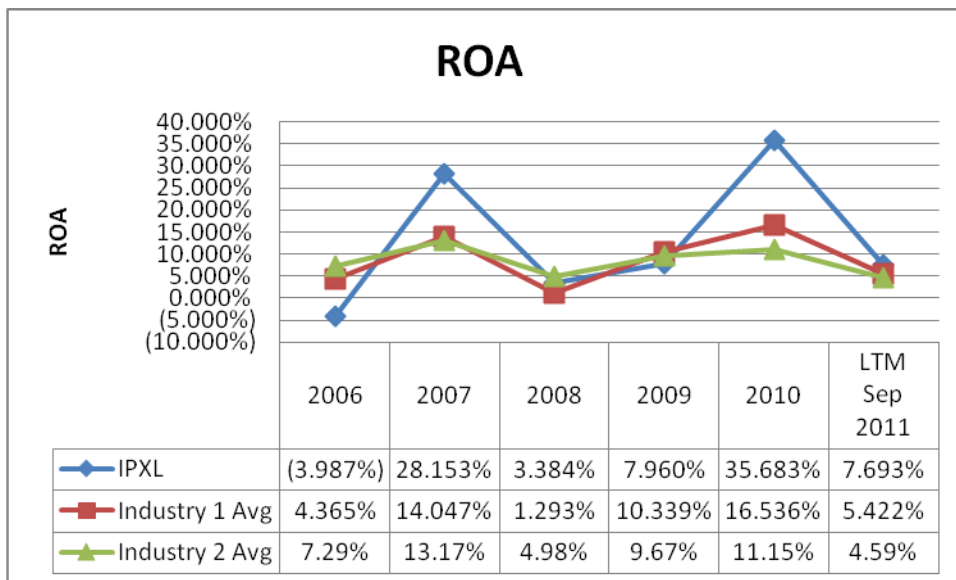
### a. Return on Equity (ROE) -

The ROE for the firm followed an upward trend until 2008 after which it slowed down. However, the ROE figures for the firm have remained stable throughout and beat the Industry peer groups for the past few years.



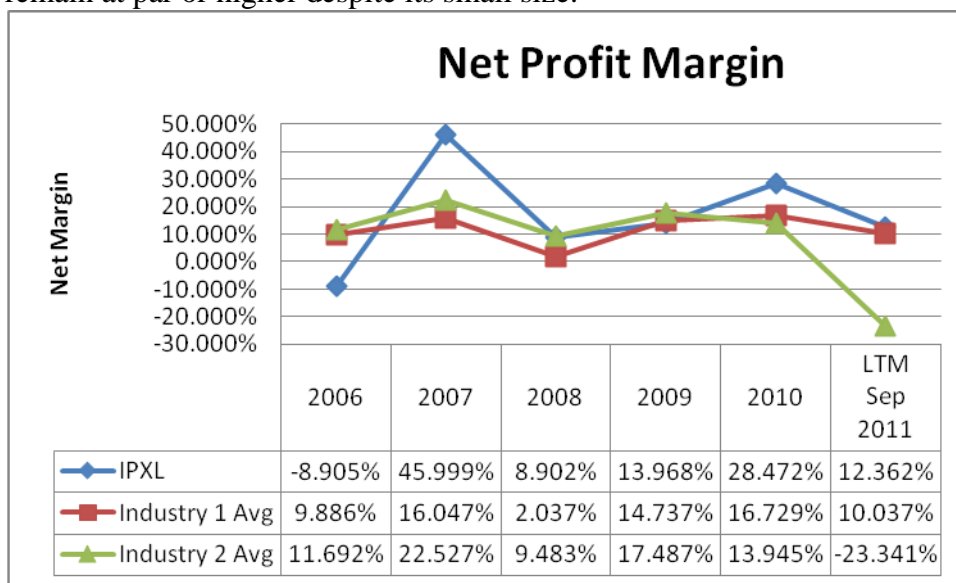
### b. Return on Assets (ROA) -

Impax had a high ROA in 2007. Compared to the industry, Impax has close ROA values. However, in 2007 and in 2010, Impax had higher ROA values than its competitors. Impax tends to manage its assets well to generate income.



c. **Net Margin** –

Impax started out with negative net margins back in 2006 since they faced expenses with the launch of the branded division of the firm. Since then, the net profit margin rose to positive growth numbers though it has been volatile year to year. That being said, it has still performed significantly better than competitors and has managed to remain at par or higher despite its small size.

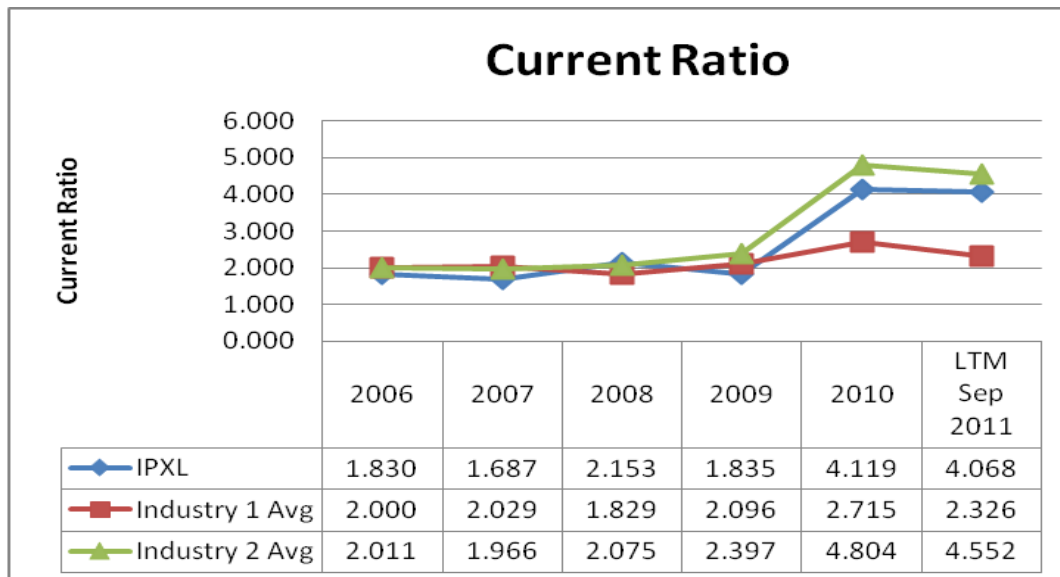


### 3. Short-Term Liquidity

a. **Current Ratio** -

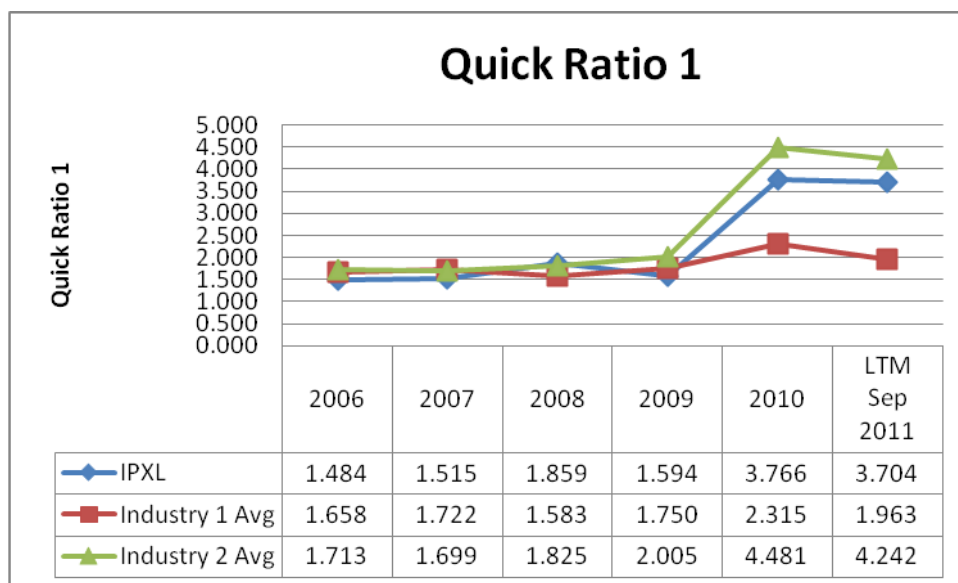
The current ratio was calculated by dividing total current assets by total current liabilities. Impax has maintained a current ratio in the range of 1.65 to 2.2 since 2006.

2010 witnessed a very prominent jump of current ratio when it rose from 1.84 to 4.12. This ratio has remained lower than that of the industry.



**b. Quick Ratio 1 -**

This ratio was calculated by subtracting inventory from the firm's total current assets and dividing by the total current liabilities. Quick Ratio 1 increased steadily from 2006 – 2008. The number rose in 2010 due to high revenue growth.

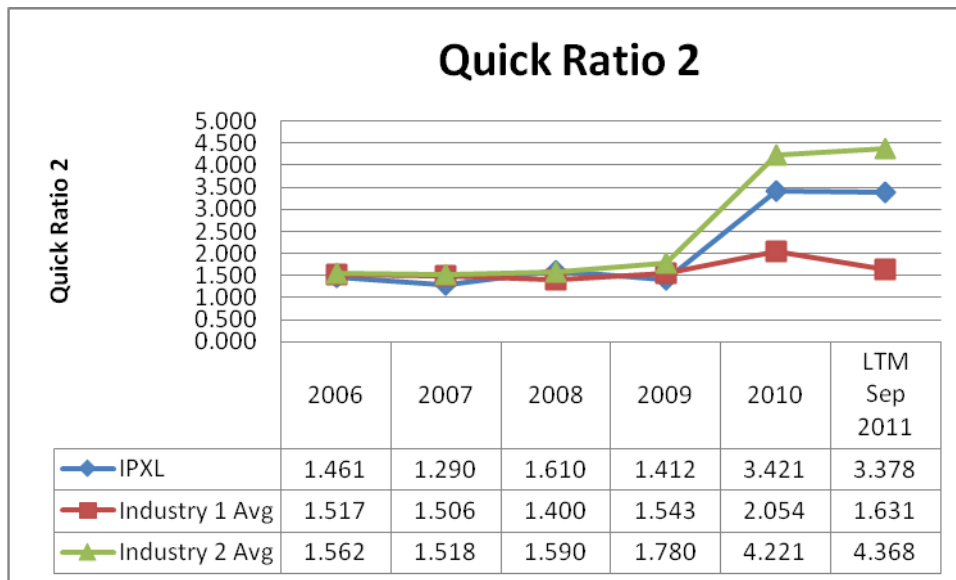


**c. Quick Ratio 2 -**

This ratio is measured by dividing the firm's cash, short term investments, and accounts receivable by its total current liabilities. Quick Ratio 2 measures the company's



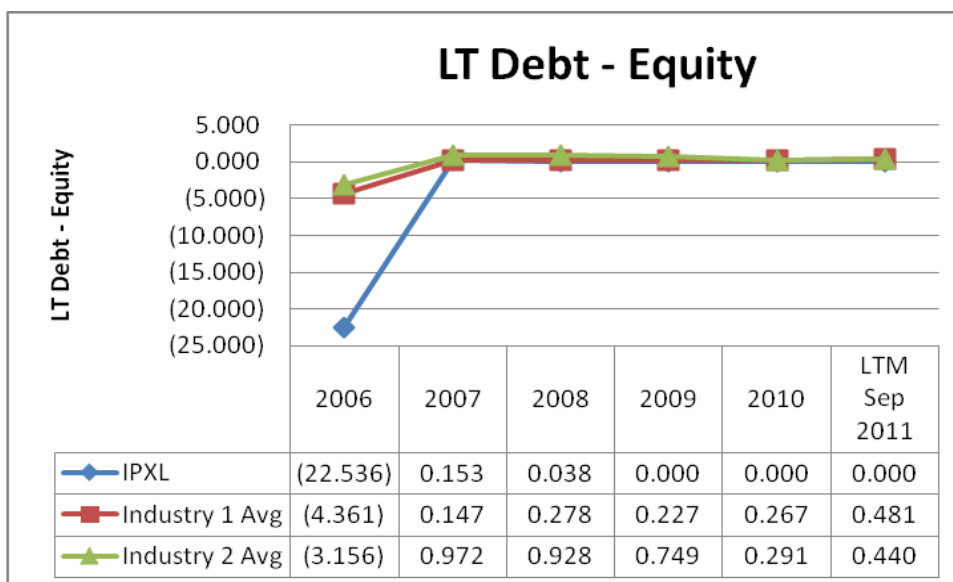
ability to meet short-term obligations with the most liquid assets. This number has been more volatile depending on the inventory that was available on hand but has been satisfactorily up to par when compared with industry groups.



#### 4. Long-Term Solvency and Debt Capacity:

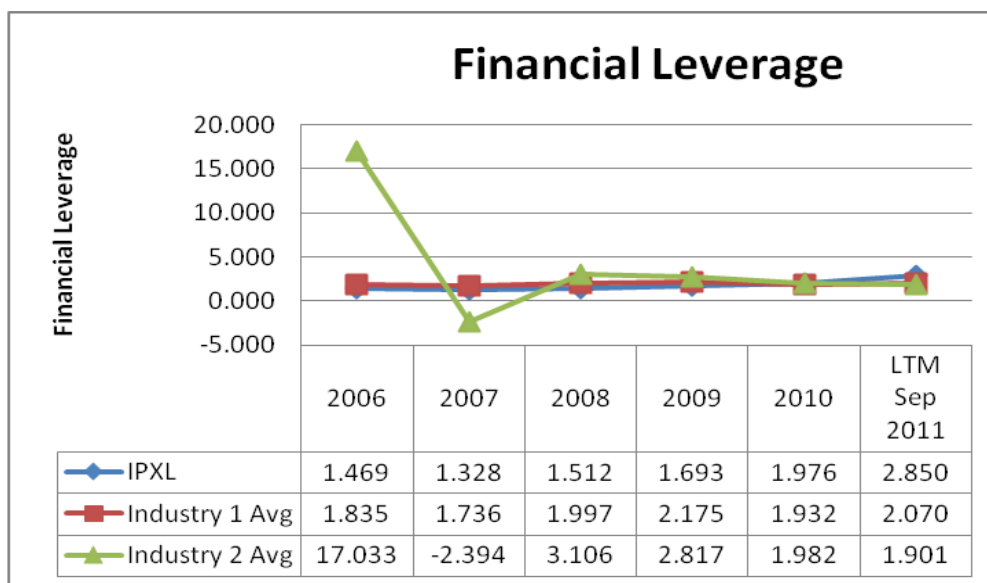
a. *Long-Term Debt To Equity* –

There has been no outstanding debt since 2009 which explains the absent ratios since then.



**b. Financial Leverage –**

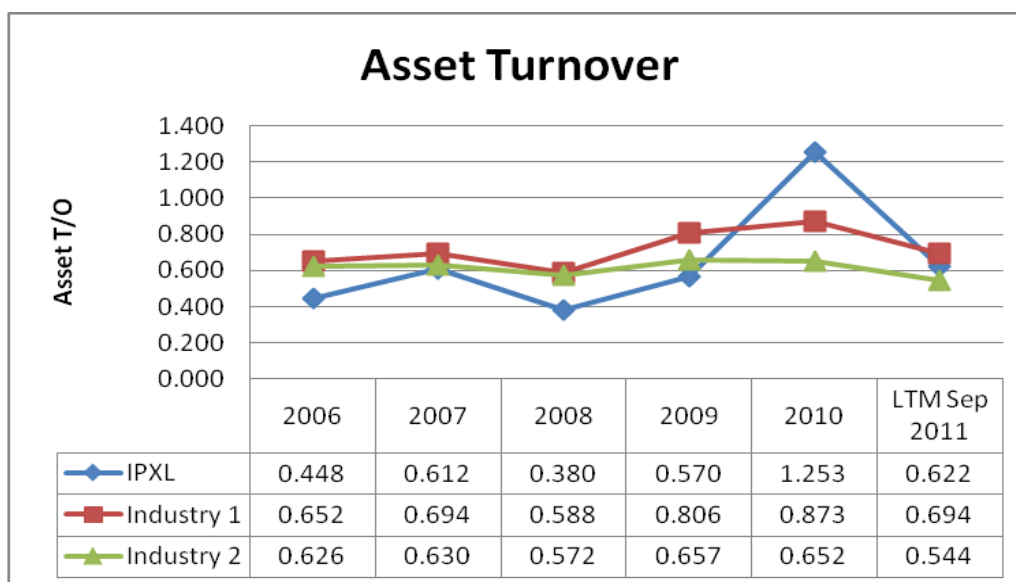
Financial Leverage has decreasing since 2006. The company's use of leverage is significantly less than that of its competitors.



**5. Operating Efficiency:**

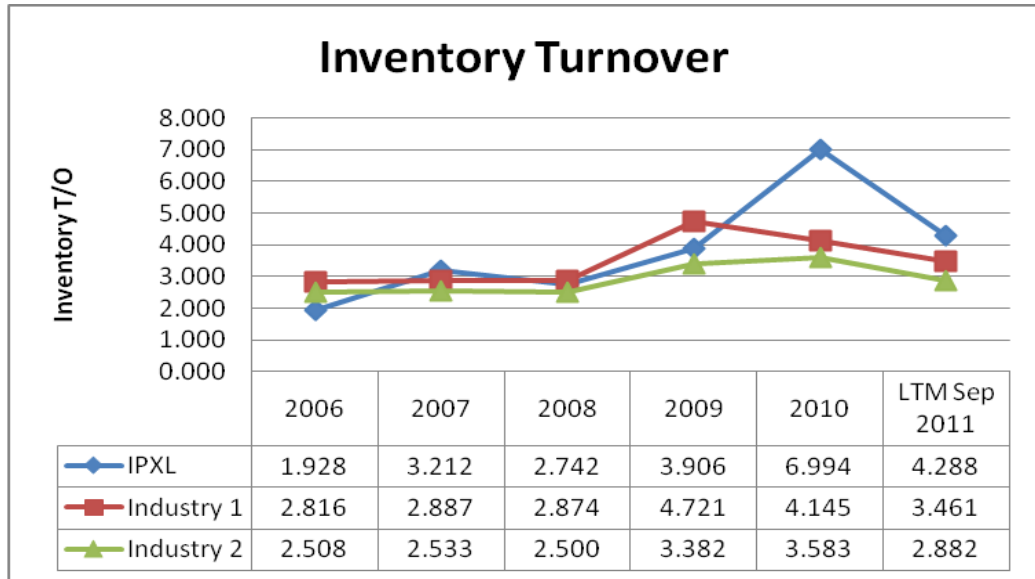
**a. Asset Turnover –**

Asset turnover was high in 2010 because of high revenue streams from the sale of generic products. Compared to the industry, Impax has been slightly below industry levels but this can be explained by large amounts of assets vested in research. This figure is expected to change once they start marketing internally developed products.



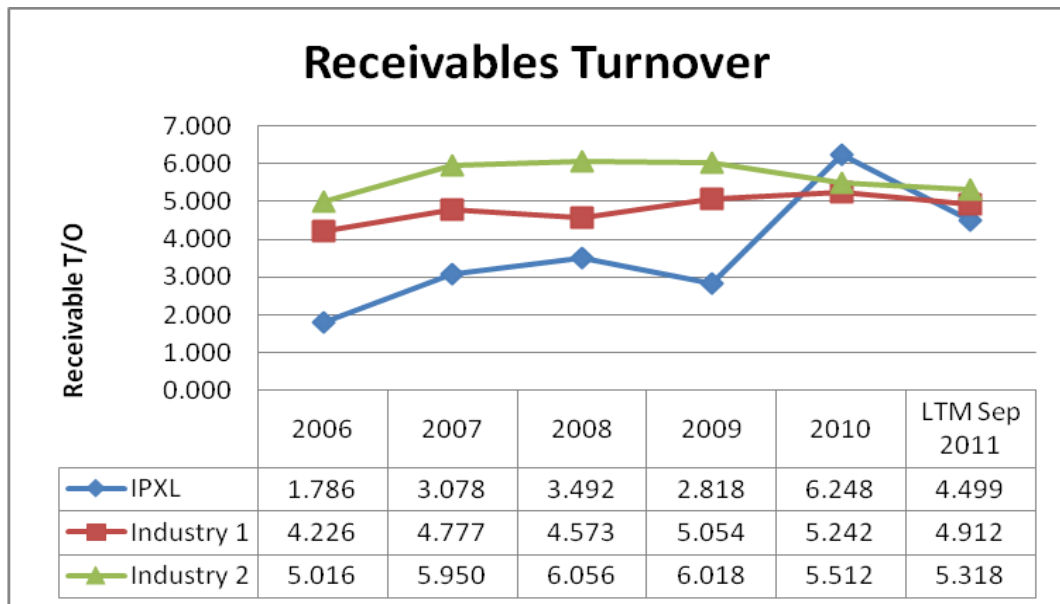
**b. Inventory Turnover –**

The inventory turnover for Impax is proficient. The metric has seen steady growth since 2006 and has been significantly higher than its competitors. This is important as it highlights the demand for the products for the firm and the quick turnover is a positive sign for current operations. It also brings forth the possibility of even better revenues upon adding internally developed products to the firm’s portfolio.



**c. Receivables Turnover –**

Impax has had a generally upward trend for receivables turnover reflecting a positive relationship with clients. The numbers have been below the industry in all periods shown except for 2010.



## 6. DuPont Analysis:

The DuPont Analysis provides further insight to the ROE. It is important to note that Impax's main source of capital comes from Common Shareholder's Equity, since it does not issue company debt any longer.

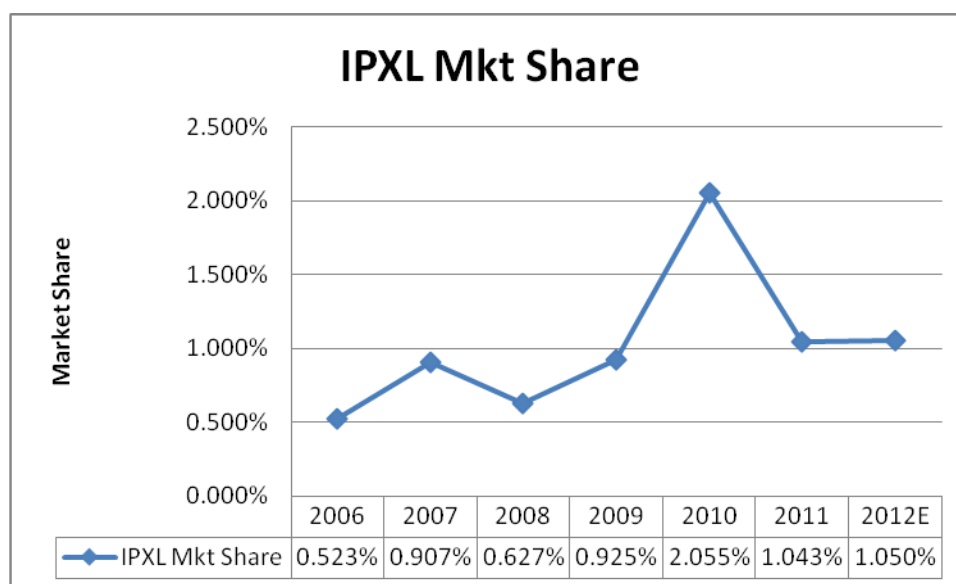
$$ROE = \text{Net profit margin (NPM)} \times \text{asset utilization (AU or asset turnover)} \times \text{Financial Leverage}$$

Based on the DuPont Analysis, Impax's financial leverage and asset turnover are the two drivers in the composition of the ROE in 2007 and 2008. 2006 suffered with a negative ROE due to a negative net margin and high financial leverage. The ROE rose significantly in 2010, driven primarily by significantly higher asset turnover and net margin for the year. This is because of the sale of the firm's generic drugs in 2010 that greatly increased revenues. The ROE stabilized at 10.55% for the period LTM Sept 2011 primarily because of lower asset turnover and net margin, with lower financial leverage.

<b>IPXL</b>	<b>2006</b>	<b>2007</b>	<b>2008</b>	<b>2009</b>	<b>2010</b>	<b>LTM Sept 2011</b>
<b>Financial Leverage (Avg)</b>	123.049	6.871	3.765	3.298	1.923	1.372
<b>Asset T/O</b>	0.448	0.612	0.380	0.570	1.253	0.622
<b>Net Margin</b>	-0.089	0.460	0.089	0.140	0.285	0.124
<b>ROE</b>	-490.591%	193.447%	12.740%	26.251%	68.608%	10.555%

## V. Income Forecasts and EPS

A market share approach was used in order to forecast growth trends and income figures for Impax Laboratories, Inc. By using Industry 1 as the peer group, the historical market shares of IPXL were calculated and were used to forecast market share numbers for 2012 and 2013. For 2013, two scenarios with different market share figures were calculated. One reflects a higher market share in case the drug IPX066 is released and distributed in time while the other is a more conservative estimate in case of delays in approvals or distribution. As seen in the graph below, the Impax market share as relative to this industry group, has grown consistently up until 2011. The spike in 2010 is because of the release of new generic drugs. Based on these figures, we estimated the 2012 market share to be 1.05%. We used an estimate of 1.25% and 1.6% for 2013 to reflect different scenarios that get affected by when the actual drug release and distribution of IPX066 takes place.



Based on the above market shares, the sales projections for 2012 and 2013 were estimated. The cost of goods sold (COGS) was calculated as a percentage of the revenue. Depreciation, amortization, selling, general, and administrative expenses (SG&A), interest expenses, and legal expenses were estimated based on historical trends and management indications for future trends found in the 2010 annual report and the 3Q 2011 quarterly reports.

Based on the estimates shown below, the EPS (basic) estimate for 2012 is \$1.037. EPS (basic) estimate for 2013 is \$2.270 (for higher market share scenario) and \$1.531 (for lower market share scenario). Compared to the YTD 2011 EPS (basic) of \$0.68, EPS estimates for the future point to positive growth.

<b>Yearly Market Share of IPXL</b>	<b>1.043%</b>	<b>1.050%</b>	<b>1.600%</b>	<b>1.250%</b>
<b>Custom Industry Revenues</b>	<b>46,701.114</b>	<b>49,338.375</b>	<b>51,382.524</b>	<b>51,200.409</b>
	<b>YTD 2011</b>	<b>2012 E - Market Share Estimate</b>	<b>2013E - Market Share Estimate</b>	<b>2013E - Market Share Estimate</b>
	<b>Final</b>			
<b>Sales/Revenue</b>	354.360	518.053	822.120	640.005

<b>Cost of Goods Sold (COGS) incl. D&amp;A</b>	173.467	240.290	369.588	292.148
<b>COGS excluding D&amp;A</b>	161.584	220.290	349.588	272.148
<b>Depreciation &amp; Amortization Expense</b>	11.883	20.000	20.000	20.000
<b>Depreciation</b>	11.883	20.000	20.000	20.000
<b>Amortization of Intangibles</b>	0.000	0.000	0.000	0.000
<b>Gross Income</b>	180.893	277.763	452.533	347.858
<b>SG&amp;A Expense</b>	110.714	162.708	205.318	178.001
<b>Research &amp; Development</b>	62.308	85.000	82.000	82.000
<b>Other SG&amp;A</b>	48.406	77.708	123.318	96.001
<b>EBIT (Operating Income)</b>	70.179	115.055	247.214	169.857
<b>Nonoperating Income (Expense) - Net</b>	0.409	0.500	0.663	0.663
<b>Nonoperating Interest Income</b>	0.879	1.100	1.263	1.263
<b>Other Income (Expense)</b>	-0.470	-0.600	-0.600	-0.600
<b>Interest Expense</b>	0.081	0.130	0.100	0.100
<b>Gross Interest Expense</b>		0.130	0.100	0.100
<b>Interest Capitalized</b>	0.000	0.000	0.000	0.000
<b>Legal Claim Expense</b>	6.097	10.000	10.000	10.000
<b>Patent Litigation</b>	6.097	8.000	8.000	8.000
<b>Litigation Settlement</b>	0.000	2.000	2.000	2.000
<b>Pretax Income</b>		105.425	237.777	160.420
<b>Income Taxes</b>	20.844	37.953	85.600	57.751
<b>Realized tax rate</b>				
<b>After-tax Adjustments - Net</b>	0.067	-0.072	-0.072	-0.072
<b>Minority Interest Expense</b>	-0.067	-0.072	-0.072	-0.072
<b>Net Income</b>	43.633	67.400	152.106	102.597
<b>Net Income available to Common</b>	43.633	67.400	152.106	102.597
<b>EPS (recurring)</b>	0.712			
<b>EPS (basic)</b>	0.680	1.037	2.270	1.531
<b>EPS (diluted)</b>	0.648	0.971	2.142	1.445
<b>EBITDA</b>	82.062	135.055	267.214	189.857
<b>EBIT</b>	70.179	115.055	247.214	169.857
<b>Depreciation &amp; Amortization Expense</b>	11.883	20.000	20.000	20.000

## V. Relative Valuation

To perform a relative valuation for Impax, two adjustment factors were used. Factor 1 is based on the mean historical relationship between Impax and the peer company while Factor 2 is based on the median historical relationship between Impax and the peer company. The average prices below exclude TEVA as it is an outlier. The prices with TEVA included are below in red. As per this valuation, Impax is valued between **\$12.12 to \$12.54**.

Relative Valuation						
Company	2012 Comparable P/E	Adjusment Factor	Adjustment Factor 2	IPXL EPS 2012	Price 1	Price 2
<b>VRX</b>	11.300	1.363	0.904	1.037	15.974	10.594
<b>GSK</b>	10.900	1.058	1.103	1.037	11.963	12.466
<b>JNJ</b>	11.900	1.072	1.134	1.037	13.230	13.992
<b>TEVA</b>	6.700	0.998	0.464	1.037	6.937	3.222
<b>ABT</b>	10.500	0.884	1.135	1.037	9.624	12.355
<b>XLV</b>	10.700	1.194	1.211	1.037	13.252	13.435
<b>SPY</b>	11.270	0.963	0.847	1.037	11.251	9.893
<b>Average Price</b>					<b>12.549</b>	<b>12.123</b>
					<b>11.045</b>	<b>10.436</b>

## VI. Absolute Valuation

To perform an absolute valuation, the k value was calculated using the CAPM model.

- $R_f = .031168$  (30-Yr Strip)
- $R_{mkt} = .11655^{12}$
- Beta = 1.088 (10-Yr beta)
- **K = 12.49**

Next, the Free Cash Flow to Equity was calculated since 2005.

	2005	2006	2007	2008	2009	2010	FY2011
<b>Net Operating Cash Flow</b>	(8.979)	(5.868)	118.761	(0.670)	(21.044)	249.761	23.354
<b>Capital Expenditures</b>	14.764	21.475	18.836	25.863	14.417	16.267	24.577
<b>Debt</b>	0	0	0	0	0	0	0
<b>FCFE</b>	(23.743)	(27.343)	99.925	(26.533)	(35.461)	233.494	(1.233)

Since the FCFE's have been volatile for various reasons, we chose to estimate a FCFE of 60 for 2012 (we took the consensus estimate of 60 for 2012 and no additional borrowing) and chose 4 different possible FCFEs for 2013 – 60, 100, 150, 200. A near-term growth rate of either 2%, 5%, or 10% was used for the years 2013-2016 and then terminal growth rates of 1%-9% were used for post 2016 cash flows. The 120 scenario analyses results are shown below.

2013 FCFE of 60				
		Growth Rate: 2013-2016		
		2.0%	5.0%	10.0%
Terminal Growth Rate	1.0%	\$8.00	\$8.53	\$9.48
	2.0%	\$8.50	\$9.07	\$10.10
	3.0%	\$9.10	\$9.73	\$10.86
	4.0%	\$9.85	\$10.55	\$11.80
	5.0%	\$10.80	\$11.58	\$12.99
	6.0%	\$12.03	\$12.93	\$14.54
	7.0%	\$13.72	\$14.77	\$16.66
	8.0%	\$16.16	\$17.43	\$19.72
	9.0%	\$20.00	\$21.62	\$24.53

2013 FCFE of 100				
		Growth Rate: 2013-2016		
		2.0%	5.0%	10.0%
Terminal Growth Rate	1.0%	\$12.80	\$13.68	\$15.26
	2.0%	\$13.63	\$14.59	\$16.30
	3.0%	\$14.63	\$15.69	\$17.57
	4.0%	\$15.88	\$17.04	\$19.13
	5.0%	\$17.46	\$18.76	\$21.10
	6.0%	\$19.52	\$21.01	\$23.69
	7.0%	\$22.33	\$24.08	\$27.22
	8.0%	\$26.40	\$28.52	\$32.32
	9.0%	\$32.80	\$35.50	\$40.35

From this analysis, Impax is valued from \$8 per share to \$80 per share. Below are possible buy scenarios for the stock:

- a.) 2013 FCFE – 60, 2013-2016 growth rate - 10%, post 2016 growth rate – 8%: The stock would be fairly valued under this condition. To make it worth buying, a post 2016 growth rate of more than 8% would be required.

<sup>12</sup> Bloomberg



- b.) 2013 FCFE – 100, 2013-2016 growth rate - 10%, post 2016 growth rate – 4%: The stock would be fairly valued under this condition. To make it worth buying, a post 2016 growth rate of more than 4% would be required.
- c.) 2013 FCFE – 150, 2013-2016 growth rate - 5%, post 2016 growth rate – 1%: The stock would be fairly valued under this condition. To make it worth buying, a post 2016 growth rate of more than 1% would be required.
- d.) 2013 FCFE – 200: All scenarios show the stock undervalued and a worthy buy.

2013 FCFE of 150				
		Growth Rate: 2013-2016		
		2.0%	5.0%	10.0%
Terminal Growth Rate	1.0%	\$18.79	\$20.12	\$22.49
	2.0%	\$20.04	\$21.48	\$24.05
	3.0%	\$21.55	\$23.12	\$25.95
	4.0%	\$23.42	\$25.16	\$28.29
	5.0%	\$25.78	\$27.74	\$31.25
	6.0%	\$28.87	\$31.12	\$35.13
	7.0%	\$33.10	\$35.72	\$40.43
	8.0%	\$39.20	\$42.38	\$48.08
	9.0%	\$48.80	\$52.85	\$60.12

2013 FCFE of 200				
		Growth Rate: 2013-2016		
		2.0%	5.0%	10.0%
Terminal Growth Rate	All	\$24.78	\$26.55	\$29.71
	1.0%	\$24.78	\$26.55	\$29.71
	2.0%	\$26.45	\$28.37	\$31.80
	3.0%	\$28.46	\$30.56	\$34.33
	4.0%	\$30.95	\$33.28	\$37.45
	5.0%	\$34.11	\$36.72	\$41.40
	6.0%	\$38.23	\$41.22	\$46.58
	7.0%	\$43.86	\$47.36	\$53.64
	8.0%	\$51.99	\$56.23	\$63.84
9.0%	\$64.79	\$70.19	\$79.89	

## VII. Recommendation

---

The firm has positive business prospects. The release of their internally developed IPX066 product should boost revenues by 2013 and 2014. Below is the summary of the various analyses performed on the company.

- a.) Ratio Analysis: Volatile ratios that have stabilized over the past few years to give a stable ROE of 10.55% for LTM September 2011
- b.) Income Statement and EPS forecasts: Profits expected to increase with an expected EPS of \$1.531 (conservative view) or \$2.27 (optimistic view)
- c.) Relative Valuation: Stock valued at around \$12 (when taking in the different scenarios)
- d.) Absolute Valuation: Depending on growth rate and scenario, stock valued between \$8 and \$80. The different scenarios that would make the stock worth buying are summarized below:

2013 FCFE	2013-2016 growth rate	Post 2016 growth rate	Worth Buying
60	10%	>8%	Yes
100	10%	>4%	Yes
150	5%	>1%	Yes
200	Any	Any	Yes

Based on broker opinions (obtained from FactSet), the 2013 FCFE may range from 100 to 150. From these analyses, we believe the stock to be a good buy and have positive recommendations for the stock. Our recommendation matches with that of major institutions like Piper Jaffray and ThinkEquity.

We thus recommend buying 250 shares of the stock at market if the share price is below \$19.00. This is because we believe that our valuation model is quite conservative and that actual growth might be much higher.

## Bibliography

1. *Impax Labs*. Web. 10 Dec. 2011. <<http://www.impaxlabs.com/>>.
2. "Ownership Summary." *Impax Labs*. Web. 10 Dec. 2011. <<http://phx.corporate-ir.net/phoenix.zhtml?c=67240&p=irol-ownershipSummary>>.
3. "Piper Jaffray (PJC) Analysts Reiterate an "Overweight" Rating on Impax Laboratories (IPXL)." *Localized USA*. 1 Dec. 2011. Web. 10 Dec. 2011. <<http://localizedusa.com/2011/12/01/piper-jaffray-pjc-analysts-reiterate-an-overweight-rating-on-impax-laboratories-ipxl/>>.
4. "UPDATE 1-GSK, Impax Drug Works in Second Parkinson's Study." *Reuters*. 15 Aug. 2011. Web. 10 Dec. 2011. <<http://www.reuters.com/article/2011/08/15/glaxosmithkline-impax-idUSL5E7JFOPT20110815>>.