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## Strata Skin Sciences (Nasdaq/SSKN)

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**BUY**
**Turnaround well under way**

*Strata Skin Sciences is a medical technology company focused on the therapeutic and aesthetic dermatology market*

### Investment Highlights

1) SSKN reported excellent financial results for its Q2/2018 quarter, the first since the appointment of new top management and a major investment to fund growth, including quarter-over-quarter revenue growth of 17% to \$7.5 million, improved gross margins, and reduced net losses of \$1.4 million compared with a net loss of \$2.2 million in Q1/18. Leading the improvement in Q2/18 were higher utilization of the existing installed base of XTRAC systems in the US as well as growth in International markets for this product, fueled primarily by ramped-up direct-to-consumer advertising and other marketing and support programs.

2) In addition to the positive second quarter results, recent initiatives also bode well for Strata Skin going forward. Key recent developments at Strata Skin include an August strategic agreement with a large private equity-backed group of dermatology clinics for XTRAC excimer laser systems, with the first 10 clinics expected to be deployed before the end of this year. Other recent positive news for the Company includes an August FDA clearance of a 510(k) application for the new Multi Micro Dose tip accessory for the XTRAC, which is anticipated to help physicians design the optimal therapeutic dose treatment for each patient using the XTRAC system.

3) Recent strong quarterly earnings results as well as positive developments are expected to help Strata Skin continue its upward momentum for the rest of this year and into next, including projected revenue growth of 15% next year and potential break-even bottom line results in 2019E. With the forecasted reduction in operating cash burn going forward for the Company combined with a \$17 million financing completed earlier this year, SSKN is in solid shape financially, with \$14.4 million in cash on hand as of June 2018, enough operating capital to help the Company fuel its newly-implemented growth initiatives.

**Current Price \$2.47**
**Price Target \$5.00**

Estimates	F2016A	F2017A	F2018E
Revenues(\$000s)	\$31,457	\$31,644	\$30,000 E
1Q March	7,620	7,097	6,466 A
2Q June	7,739	8,471	7,533 A
3Q September	7,767	7,480	7,600 E
4Q December	8,331	8,596	8,401 E
EPS (diluted)	(\$1.44)	(\$4.94)	(\$0.14) E
1Q March	(1.29)	(1.03)	(0.13) A
2Q June	0.24	(0.52)	(0.06) A
3Q September	0.02	(3.32)	(0.03) E
4Q December	(0.41)	(1.08)	(0.01) E

EBITDA/Share	\$2.37	\$2.47	\$0.13
EV/EBITDA (x)	0.94 X	0.90 X	17.8 X

<b>Stock Data</b>	
52-Week Range	\$1.06-\$2.86
Shares Outstanding (mil.)	29.9
Market Capitalization (mil.)	\$73.9
Enterprise Value (mil.)	\$66.8
Debt to Capital (6/18)	18.1%
Book Value/Share (Pro Forma 6/18)	\$1.11
Price/Book	2.2 X
Average Trading Volume (3-month)	285,000
Insider Ownership	44.0%
Institutional Ownership	28.1%
Short interest	370,000
Dividend / Yield	\$0.00/0.0%



Price target and ratings changes over the past 3 yrs:  
 Initiated - September 4, 2018 - Buy - Price Target \$5.00

## Conclusion

SSKN shares currently trade at a considerable discount to other stocks and recent acquisitions in the dermatology product market, perhaps due to the Company's recent appointment of new management and completion of a major new financing just earlier this year. However, with a successful new growth strategy underway for a large installed base of customers, new contracts signed, recent new FDA approvals, recent expansion of international distribution, new large-customer contracts, and a recently bolstered balance sheet, we believe both long-term value-oriented and short-term event-focused investors will soon discover these undervalued shares, and thus we are initiating coverage on SSKN shares with a BUY rating and 12-18-month price target of \$5.00, based on a multiple of 5.0X estimated revenues of \$30.0 million for 2018E for the Company.

## Company Business/History

STRATA Skin Sciences ("Strata Skin" or "SSKN") is a medical technology company focused on the therapeutic and aesthetic dermatology market. Strata Skin markets and supports the following products:

- XTRAC laser and VTRAC excimer lamp systems utilized in the treatment of psoriasis, vitiligo and various other skin conditions; the
- STRATAPEN MicroSystems, a micropigmentation device; and
- Nordlys, a multi-technology aesthetic laser device for treating vascular and pigmented lesions, although as of May 2018 the company is no longer actively marketing this product.

Strata completed the acquisition of the XTRAC Excimer Laser and the VTRAC excimer lamp businesses from PhotoMedex in June 2015. The purchase price was \$42.5 million plus the assumption of certain business-related liabilities. Prior to this transaction, the Company's only product was the MelaFind system, a device for aiding dermatologists in the evaluation of clinically atypical pigmented skin lesions. The MelaFind system was to be used when the dermatologist chose to obtain additional information before making a final decision to biopsy in order to rule out melanoma. However, MelaFind did not achieve a significant enough level of acceptance by dermatologists to justify continued investment by the Company, and in March 2017 a notice was given to the 90 owners of MelaFind devices in the United States informing them that, effective September 30, 2017, the Company would no longer continue to support the device and that the inventory of spare parts was being offered for sale to them on a first-come, first-served basis. Strata has discontinued all research and development and sales and support activity related to MelaFind, however, the Company continues to maintain the patent portfolio for the related intellectual property, as it is believed these assets may have value to a potential developer of similar technology.

## XTRAC Systems and VTRAC Systems

The XTRAC excimer laser technology (shown in use in the photo to the right) emits highly concentrated Ultra Violet (UV) light to treat dermatological skin disorders. It received US Food and Drug Administration (FDA) clearance in 2000 and has since become a widely recognized treatment for psoriasis, vitiligo and other skin diseases. Psoriasis, vitiligo, atopic dermatitis, leukoderma and other skin diseases affect up to 35 million people in the US and over 190 million people worldwide.



VTRAC is a UV light lamp system that works in much the same way as the XTRAC. It

The XTRAC is marketed in the US mainly under a recurring revenue model in which the systems are placed in the physician's office for no upfront charge and generate revenue on a per-use basis. The Company estimates that there are roughly 1,000 XTRAC lasers in use in the US, of which approximately 750 systems have been actively placed in the recurring revenue model. The target US audience for XTRAC lasers comprises approximately 3,500 dermatologists who perform disease management. In markets outside the US, the XTRAC laser is marketed primarily as a capital sale through a master international distributor to distributors. The VTRAC is marketed exclusively in international markets through the same master distributor. The chart below outlines the Company's strategy to grow its revenues from XTRAC:



## *Psoriasis*

Studies have concluded that XTRAC treatment leads to significant improvement in psoriasis area and severity scores in as few as 6 to 10 treatments. Treatment protocols recommend that patients receive two treatments per week with a minimum of 48 hours between treatments. Data show that XTRAC has an 89% efficacy rate and produces only minimal side effects. In support of its clinical effect, the XTRAC Excimer Lasers have been cited in over 45 clinical studies and research programs, with findings published in peer-reviewed medical journals around the world. The products have also been endorsed by the National Psoriasis Foundation, and their use for psoriasis is covered by nearly all major insurance companies, including Medicare. XTRAC is a reimbursable procedure for psoriasis under three Current Procedural Terminology (CPT) codes, which differ based on area of treatment only. Insurance reimbursement to physicians varies based upon insurance company and geography. The national CPT code reimbursement established by the Center for Medicaid Services (CMS), which forms the basis for most insurance companies' reimbursement levels, ranges between \$150 per treatment to \$240 per treatment for the three codes.

## *Psoriasis Treatment Options*

There are essentially three main types of psoriasis treatments, as listed below:

1. **Topical therapies** - These can include corticosteroids, vitamin D3 derivatives, coal tar, anthralin and retinoids, among others, that are sold as a cream, gel, liquid, spray, or ointment. The efficacy of topical agents varies from person to person, although these products are commonly associated with a loss of potency over time as people develop resistance;
2. **Phototherapy** - This is the area in which the Company's products operate. Their XTRAC Excimer Systems are FDA-cleared, reimbursed by insurance, and exhibit none of the significant side-effects associated with some alternative therapies; and
3. **Systemic medications** - There are a number of prescription medications available for psoriasis, which are given either by mouth or as an injection. The popularity and use of these medications is growing significantly, notwithstanding their potentially severe side-effects.

The XTRAC Excimer Lasers are particularly significant and beneficial for moderate and severe psoriasis patients who prefer a noninvasive treatment approach without the side effects of invasive systemic agents, or to patients who have developed a resistance to topical agents. In many cases, patients treated with topical or systemic therapies are also candidates for phototherapy.

## *Vitiligo and Other Skin Diseases*

UV light therapy is considered to be an effective and safe treatment for many skin disorders beyond psoriasis. To this effect, the XTRAC technology is FDA cleared for the treatment of not only psoriasis but also vitiligo (a skin pigment deficiency), atopic dermatitis (eczema) and leukoderma, which is a localized loss of skin pigmentation that occurs after an inflammatory skin condition, such as a burn, intralesional steroid injection, or post dermabrasion. XTRAC technology for vitiligo patients typically requires more therapy sessions than for psoriasis, but this is dependent on the severity of the disease. In the treatment of vitiligo, the XTRAC functions to reactivate the skin's melanocytes (the cells that produce melanin), which causes pigment to return. To date, there is not sufficient data to confirm how long patients can expect their vitiligo to be in remission after XTRAC therapy. Based on anecdotal reports, the Company believes that re-pigmentation may last for several years.



Historically, vitiligo treatments had been considered cosmetic procedures by insurance companies, and as such were not reimbursed. However, over the past several years there has been a significant increase in insurance coverage for these procedures, and it is estimated that currently approximately 50% of insurers consider XTRAC treatments to be medically necessary for the treatment of vitiligo and therefore provide coverage.

Several factors may have limited the growth of the use of XTRAC treatments to those who suffer from psoriasis and vitiligo. Specifically, awareness of the positive effects of XTRAC treatments has not been high enough among both sufferers and providers. In addition, the treatment regimen requiring sometimes up to 12 or more treatments has limited XTRAC use to certain patient populations.

Therefore, to address the lack of knowledge issue, the Company has implemented a direct to patient advertising campaign aimed at motivating psoriasis and vitiligo patients to seek out XTRAC treatments from physician customers. Specific advertisements encourage prospective patients to contact the Company's patient advocacy center through telephone or web site, whereby information is provided on treatment and insurance coverage, and ultimately an appointment can be scheduled for the prospective patient to be evaluated by a physician in the customer network, convenient to their location, to determine if they would benefit from XTRAC treatments.

The graphic below depicts a number of examples of the Company's active and innovative direct-to-consumer advertisements:

## XTRAC DTC Advertising

The collage displays various direct-to-consumer (DTC) advertising materials for XTRAC treatments. At the top left is a large grid of 24 small portraits of diverse patients. To the right are several social media-style advertisements. These include:
 

- Ads for "XTRAC Psoriasis and Vitiligo Treatment" with text about FDA approval, insurance coverage, and patient testimonials.
- Visual aids showing hands with psoriasis and a person's head with vitiligo.
- Ads for "XTRAC Psoriasis Treatment" and "XTRAC Vitiligo Treatment" with specific claims about clearance rates and treatment duration.

 At the bottom are two larger informational ads:
 

- "Psoriasis Laser Treatment - XTRAC Covered by Insurance" with details on treatment areas (scalp, hands, face, feet) and insurance coverage.
- "XTRAC Vitiligo Laser Treatment - Dermatologist Recommended" with details on treatment results and insurance coverage.

 A common contact number, 800-874-8762, and website, consultations.xtraclear.com, are featured throughout the materials.

Source: Strata Skin Sciences

Strata Skin is in the process of a research and development effort to develop products to assist in the reduction of the number of treatments in the XTRAC treatment protocol, in order to make XTRAC treatments gain a wider appeal for those patients who cannot fit the current treatment regimen into their schedules. The graphic below outlines a proposed Optimal Therapeutic Dose regimen for use of the XTRAC system in treating patients with dermatological diseases, which has become part of a recent FDA 510(k) submission:

## Optimal Therapeutic Dose (“OTD”) – 510(k) Submitted for MMD The Path to Optimal Clinical Outcomes and Patient Retention



### MECHANISM

Tip applies 4 simultaneous doses of energy to the patient's plaque



### PURPOSE

To **minimize** number of treatments to clearance



### USE

Dose allows provider to determine blister threshold unique to each patient and each plaque. 510(k) submission **Filed**



### Clinical Studies

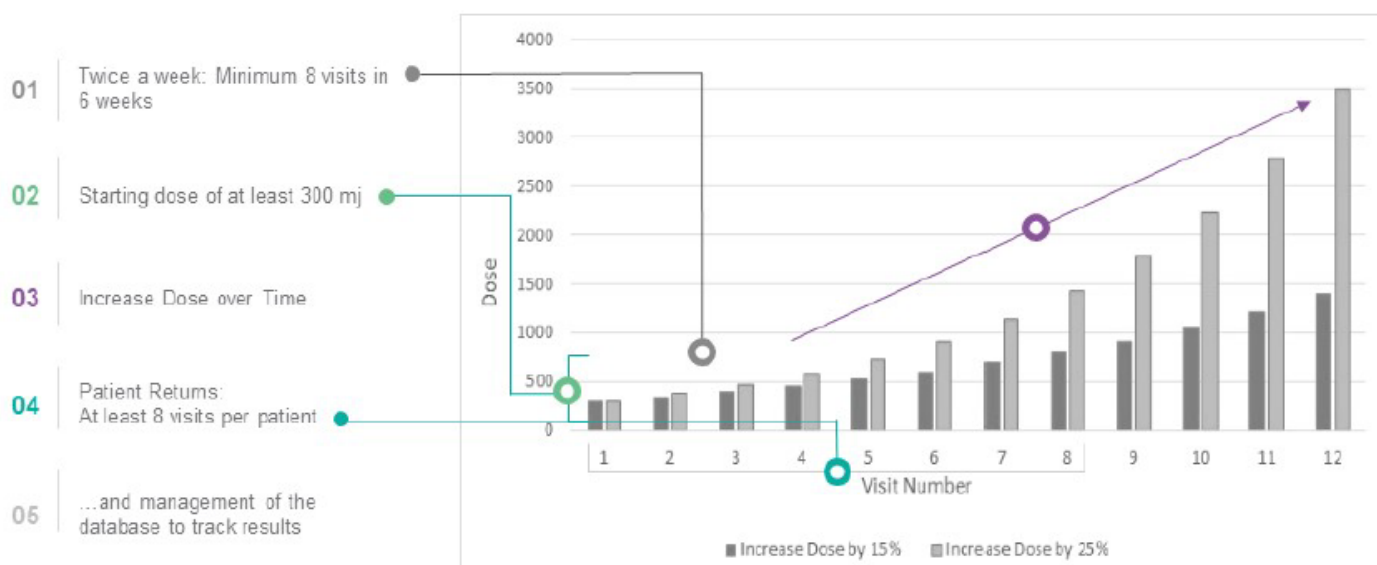


Source: *Strata Skin Sciences*

Further, the Company has developed the “8N6” protocol for optimal patient outcomes, which includes the following regimen which is depicted graphically below:

- 1) Twice a week – Minimum 8 visits in 6 weeks;
- 2) Starting dose of at least 300 millijoule;
- 3) Dose increased over time, by between 15%-25%;
- 4) Patient returns for at least 8 visits; and
- 5) The patient's database is managed to track results.

## Current Clinical Protocol For Optimal Patient Outcomes: 8N6 Protocol



Source: *Strata Skin Sciences*

## Sales and Marketing

The Company maintains an internal sales and marketing force in the US of 46 full-time personnel in order to create revenues from its dermatology devices and related products. This sales and customer service team includes:

- 22 sales territories;
- 4 field regions;
- 15 field service technicians;
- An in-house call center to qualify sales leads; and
- 750 XTRAC devices in partnership arrangements and 138 XTRAC devices sold directly.

The graphic below depicts the Company's US geographic dispersion of XTRAC installations and sales territories:



*Source: Strata Skin Sciences*

Internationally, the Company markets its VTRAC system exclusively through distributors on a sold and in service basis, rather than a recurring revenue or per-use model as in the US. Major markets currently for the Company include Japan, South Korea, Brazil, Russia, Australia, India, Saudi Arabia, the European Union and China, with 1,186 devices in service as of today. In most cases procedures are covered by applicable health insurance in the overseas territories served by the Company, and on average Strata's overseas units have higher utilization.

Recently, the Company has been focusing on new strategic agreements with large accounts. In August, the Company announced the signing of a strategic agreement with a large, private equity-backed group of dermatology clinics. The agreement includes use of the Company's XTRAC excimer laser in the group's network of "dozens of clinics" in the US, and will be installed on a pay per use basis with no upfront cost to the practices. Strata Skin will provide clinical training, direct to consumer (DTC) advertisement, and patient assistance programs and advocacy support for the centers, with the first 10 clinics in the network expected to be deployed before the end of 2018.

## **The Nordlys System**

In March 2017, the Company announced that it had become the US distributor for the Nordlys laser, a device representing the latest technology in non-ablative fractionated laser technology in the medical aesthetic field. This uniquely designed class of laser with patented Dual Mode Filtration is manufactured in Denmark by Ellipse Global A/S under the brand name Nordlys. Nordlys utilizes the latest advancements in cosmetic and medical technology and offers a superior patient, provider and practice experience. There is no requirement for medications or needles, and little to no downtime. The Nordlys system has 24 indications cleared to date by the FDA and has the ability to use a multitude of light based technologies all in one compact platform:

- SWT (Selective Waveband Technology: the latest evolution and advancements of Intense Pulsed Light);
- Nd:YAG; and the
- FRAX 1550 non-ablative fractionated technology.

Nordlys users include leading dermatologists, plastic surgeons and cosmetic physicians with over 6,000 placements worldwide. The Company's distribution agreement required certain minimum purchase commitments, however, in March 2018 the Company determined that it would no longer continue to market the Nordlys system.

## **STRATAPEN**

In January 2017 the Company entered into an OEM agreement with Esthetic Advisors, LLC to private label the STRATAPEN device. STRATAPEN MicroSystems is a micropigmentation device that provides advanced technology offering exceptional results. STRATAPEN offers the following differentiating technology and features:

- Patent-pending Biolock Cartridge;
- Gamma ray treated and sealed in individual packages;
- Incorporates seven-step safety system to prevent fluids from entering the motor;
- Multiple nose cones to facilitate more efficient patient flow;
- Ability to be reprocessed in autoclave after use;
- Adjustable speed and depth during the course of treatment; and
- Corded and cordless power options.

## **Manufacturing**

Strata Skin manufactures their XTRAC products at a 28,000 sq. ft. facility in Carlsbad, California. The California facility is ISO 13485 certified, which is an International standardization written by the International Organization for Standardization, which publishes requirements for a comprehensive quality management system for the design and manufacture of medical devices. Certification to the standard is awarded by accredited third parties.

## **Research and Development**

The Company's research and development team, including engineers, consists of approximately seven employees. Strata Skin's research and development activities are conducted at its facility located in Carlsbad, California. Currently, these research and development efforts are focused on the application of the XTRAC system to the treatment of inflammatory skin disorders. Most recently, in early August of this year, the Company announced US FDA clearance for the Multi Micro Dose tip accessory for its XTRAC 308nm excimer laser. The Multi-Micro Dose Tip accessory is indicated for use in conjunction with the XTRAC laser system to



filter the Narrow Band-UVB (NB-UVB) light at delivery in order to calculate and individualize the maximum non-blistering dose for a particular patient. The patent-pending MMD Tip simultaneously applies multiple level doses of energy to a specific area of the patient's psoriatic plaque, thereby identifying the maximum sub-blistering energy dose for a particular treatment zone. Utilizing the results from these test patches, the physician can design the optimal therapeutic dose treatment for each patient, which should result in a shorter treatment regimen to achieve patient improvement. Data have shown that higher doses of the XTRAC treatment achieved PASI-75 (reduction in the Psoriasis Area and Severity Index) clearance in as little as two to four weekly treatments, as compared to an average of 6.2 treatments in previously published studies.

## **Intellectual Property**

Currently, the Company has approximately 28 issued US patents on its technology in force, and many of these patents have foreign counterparts issued and pending. Of those issued, ten US patents and one German patent relate to the XTRAC and VTRAC product lines while eighteen US patents and several foreign patents relate to various aspects of the MelaFind technology. However, because the Company has discontinued its sales efforts for MelaFind, as these MelaFind related patents come up for the payment of periodic maintenance fees they will be assessed as to the need to continue to maintain their existence. Recently, in July 2018, Strata Skin announced a fully-paid exclusive and perpetual license agreement with a strategic entity for a de-identified image library of pigmented lesions and associated documentation related to the MelaFind device.

Strata Skin also relies on trade secrets and technical know-how in the manufacture and marketing of its products and requires its employees, consultants and contractors to execute confidentiality agreements with respect to proprietary information.

## **Recent Results and Balance Sheet/Cash Flow**

Strata Skin reported strong financial results for their Q2/18 quarter in August, including revenues of \$7.5 million, an increase of 17% above the previous quarter. Revenue growth in the second quarter was led by recurring XTRAC revenues of \$5.2 million, primarily in the US, an increase of 15% over the first quarter, as well as international XTRAC revenues of \$2.1 million, up 57% from Q1/18. Revenues in Q2/17 were \$8.5 million, however, Q2/18 was the first quarter reported following the appointment of new management earlier this year and the completion of a major financing which provided additional resources to the Company for marketing and support.

In Q2/18, the company also made progress on the bottom line, including improving gross margins to 54%, from 49% in the previous quarter, fueled by higher margins on recurring dermatology procedure revenues of 63.6%, an improvement of 6.9%. Net loss for the quarter was \$1.4 million or (\$0.06) per share, compared with a net loss of \$2.2 million or (\$0.13) per share in Q1/18. The net loss in Q2/18 included \$600,000 in severance and consulting costs and \$100,000 related to the write-down of the discontinued Nordlys product line. One key improved metric for Strata Skin this year has been average quarterly revenue per consigned US XTRAC system, which increased from \$6,000 to \$6,900 in Q2/18, or approximately 15%; this helps contribute to both revenue growth and gross margin improvement for the Company's installed base of XTRAC systems, which stood at 746 at the end of the second quarter. In addition, the Company related further that scheduled patient appointments in the US increased from 250 in Q1/18 to 870 in Q2/18. Net loss in Q2/17 was \$1.2 million or (\$0.52) per share. Non-GAAP adjusted EBITDA was approximately positive \$600,000 in Q2/18 for the Company, as compared to a negative amount in the first quarter of this year, and helped Strata Skin increase its cash on hand to \$14.4 million at the end of June from \$4.1 million at the start of the year.

The Company's balance sheets for the periods Q2/2018 ending June 30, 2018 and Q4/2017 ending December 31, 2017 are shown below:

<b><u>Balance Sheets</u></b>		
	(\$000s)	
<i>Assets:</i>	<b><u>12/31/17</u></b>	<b><u>6/30/18</u></b>
<b><u>Current Assets</u></b>		
Cash and equivalents	\$4,069	\$14,445
Accounts receivable, net	3,141	2,574
Inventory	3,009	2,413
Prepaid expenses and other current	<u>533</u>	<u>828</u>
Total current	10,752	20,260
Property, plant and equipment, net	7,703	6,271
Goodwill and intangibles, net	20,128	19,073
Other assets	<u>48</u>	<u>48</u>
<b>TOTAL ASSETS</b>	<b>\$38,631</b>	<b>\$45,652</b>
<i>Liabilities:</i>		
<b><u>Current liabilities</u></b>		
Note payable and current portion of LTD	\$2,744	\$51
Accounts payable	2,277	1,477
Other current liabilities	<u>2,651</u>	<u>2,723</u>
Total current	7,672	4,251
Long-term debt, net	7853	7,321
Non-current liabilities	<u>861</u>	<u>780</u>
Total liabilities	16,386	12,352
Stockholders' equity	<u>22,245</u>	<u>33,300</u>
<b>TOTAL LIAB &amp; EQ</b>	<b>\$38,631</b>	<b>\$45,652</b>

Source: DJSI estimates, Strata Skin Sciences

Strata Skin management did not provide specific financial guidance at the time of its most recent Q2/18 earnings release, except to the extent that “projected investments and growth in patient appointments (from higher advertising spend) are expected to deliver increased recurring revenue growth, system productivity, as well as higher gross margins in the coming quarters”. Thus, we are estimating that Strata Skin will continue to post quarter-over-quarter revenue growth, to \$7.6 million in Q3/18 and \$8.4 million in Q4/18, with improved gross margins, level operating expenses, and decreased quarterly net losses. For 2018E as a whole, we are estimating that Strata Skin will post annual revenues of \$30.0 million, as compared to \$31.5 million in 2017 when the Company was marketing additional products, but with decreased net losses of \$2.7 million or (\$0.14) per share as compared with net losses of \$18.8 million or (\$2.85) per share in 2017.

For 2019E, we are forecasting that Strata Skin will continue to post strong annual overall revenue growth of 15% to \$34.5 million and improved gross margins to 60.0%, fueled by higher utilization of existing systems in place in the US and to a lesser extent from new systems placed, for example those under a recent large dermatology group agreement. Combined with only slightly higher forecasted operating expenses, we estimate that the Company could post break-even operating income next year. With positive EBITDA forecast for the coming quarters and next year, as was evidenced in the most recent Q2/18 results, along with recently bolstered

cash on hand of \$14.4 million we also estimate that the Company will have adequate financial resources on hand to fund growth.

## Management

SSKN's management team, board of directors and scientific advisory board includes:

**Dolev Rafaeli** has served as Chief Executive Officer and member of the board since April 2018. Previously he served as a member of the board of directors and CEO of PhotoMedex, the company that founded the XTRAC business, as well as held executive positions with Radiancy and Motorola (MSI, Not Rated).

**Matthew Hill** joined the Company as CFO in March 2018. Prior to joining the Company, he held financial executive positions with SS White Dental, Velcera (now Perrigo, PRGP, NR), and EP Medsystems (now Abbott, ABT, NR).

In addition to CEO Dolev Rafaeli, SSKN's Board of Directors includes: **Uri Geiger**, currently Managing Partner of Accelmed; **David N. Gill**, formerly with EndoChoice, TransEnterix, and INC Research; **LuAnn Via**, appointed Chairperson in December 2017 and formerly with Christopher & Banks, Payless Shoe Source, and Charming Shoppes; **Nachum (Homi) Shamir**, currently President and CEO of Luminex (LMNX, NR); **Samuel Rubinstein**, currently CEO of Taro Pharmaceuticals (TARO, NR); and **Samuel E. Navarro**, currently Managing Partner at Gravitas Healthcare.

The Company's Scientific Advisory Board includes **Dr. R. Rox Anderson**, who was appointed head of the Company's advisory board in May 2017. Dr. Anderson is currently a professor at Harvard Medical School, an adjunct professor at MIT, a practicing dermatologist, and director of the Wellman Center for Photomedicine at Massachusetts General Hospital in Boston.

## Stock Valuation/Comparables

We have compiled a comparable four-company group for SSKN consisting of similar-sized commercial-stage dermatology stocks, including Biofrontera (BFRA, Buy), Sonoma Pharmaceuticals (SNOA, Buy), Sensus Healthcare (SRTS, NR), and NovaBay (NBY, NR). In addition, we have considered valuation multiples for a number of dermatology-oriented companies which have been recently acquired, including Medicis (\$2.6 billion purchase price in 2012), Zeltiq (\$2.5 billion, 2017), DUSA Pharmaceuticals (\$230 million, 2012), Stiefel Laboratories (\$2.9 billion, 2019) and Derma Sciences (\$200 million, 2017). On average, our comparable stock group shows valuation multiples of approximately 5.4X estimated revenues for calendar 2018, 4.0X estimated revenues for 2019, and 4.5X trailing twelve month revenues for the buy-out group, representing significant premiums to SSKN's current valuation metric of 2.5X estimated revenues for 2018E and 2.1X estimated revenues for 2019E. This discrepancy could perhaps be due to SSKN's relative lack of familiarity with investors following its recent change in management and new investment received earlier this year. However, we believe as SSKN continues to grow and increase its interest level with investors, valuation metrics for the Company will improve vis-à-vis its comparable stock group and as compared with recent industry buy-outs, and therefore, we are initiating coverage on SSKN shares with a Buy rating and 12-18 month price target of \$5.00 per share, based on average valuation metrics for comparable companies of 5.0X estimated revenues of \$30.0 million for SSKN for calendar year 2018E and 4.3X estimated revenues of \$34.5 million for SSKN for calendar year 2019E.

## Risk Factors

**In addition to normal economic and market risk factors that impact most equities and the common risks shared by Strata Skin Sciences with other companies in the industry, we believe an investment in SSKN involves the following risks:**

- **Reliance on key management** – At present, SSKN relies on several key members of its management team who have been in key executive positions for an extended period of time. Should one or more of these key executives leave the Company, SSKN could find it difficult to replace their long-standing knowledge of operations and industry expertise.
- **Reliance on future collaborations and partnerships** – To date, SSKN has signed large-volume sales agreements in the US as well as international distribution agreements for its products. Oftentimes in the case of distribution and sales agreements certain factors related to product sales or development may be determined by third parties and out of the control of Company management.
- **Limited stock liquidity** – Trading volume in SSKN on the Nasdaq exchange is comparatively light as these shares have a relatively limited history of trading compared with other healthcare stocks. As such, news regarding SSKN, its target market, partners and/or competitors could lead to significant volatility in the stock price.
- **Competitive markets** – The Company and its distribution partners compete in its target dermatology products market with a number of companies, many of which are considerably larger than the Company. There can be no assurance that the Company and its partners will be able to successfully compete and launch new products and services into these competitive markets in the future.
- **FDA and regulatory risks** – SSKN and its distribution partners are subject to regulatory review for ongoing research and development as well as manufacturing operations, including approval and review processes of the US Food and Drug Administration and other international regulatory agencies. Any negative correspondence from the FDA or other international regulatory agencies in the future could have an adverse effect on the ongoing operations of the Company.
- **Lack of historic profitability** – SSKN is currently not operating on a profitable basis, and according to our forecasts may not be expected to do so in the near future. Although the Company maintains adequate cash reserves at the present time, there can be no assurance the Company will not need to raise additional working capital in the future should operating losses continue.
- **Need to defend intellectual property** – SSKN currently relies on patents and other intellectual property on its technology and products to maintain its competitive position in the industry. The Company may be required to defend its trade secrets in the US and overseas in the future, and there can be no assurance these defenses will be successful.



**Strata Skin Sciences, Inc.**  
**Consolidated Statements of Income**  
 (In 000s, except per share data)

FYE December	2014	2015	2016	1Q17 March	2Q17 June	3Q17 September	4Q17 December	2017	1Q18 March	2Q18 June	3Q18E September	4Q18E December	2018E	2019E
Revenues	\$915	\$18,495	\$31,457	\$7,097	\$8,471	\$7,480	\$8,596	\$31,644	\$6,466	\$7,533	\$7,600	\$8,401	\$30,000	\$34,500
Cost of revenues	4,935	13,719	12,636	2,733	3,173	3,276	4,316	13,498	3,295	3,499	3,400	3,600	13,794	13,800
Gross profit	(4,020)	4,776	18,821	4,364	5,298	4,204	4,280	18,146	3,171	4,034	4,200	4,801	16,206	20,700
Operating Expenses														
Engineering and product development	1,641	2,029	1,929	475	423	411	402	1,711	338	269	300	330	1,237	1,300
Selling and marketing	3,140	9,194	12,852	2,975	2,846	2,687	2,936	11,444	2,871	2,378	2,500	2,550	10,299	10,500
General and administrative	7,821	10,028	7,637	1,601	1,720	1,678	2,402	7,401	1,803	2,333	2,000	2,050	8,186	8,000
Total operating expenses	12,602	21,251	22,418	5,051	4,989	4,776	5,740	20,556	5,012	4,980	4,800	4,930	19,722	19,800
Operating Income (loss) before other	(16,622)	(16,475)	(3,597)	(687)	309	(572)	(1,460)	(2,410)	(1,841)	(946)	(600)	(129)	(3,516)	900
Other income (expense), net														
Interest expense, net	(2,372)	(10,200)	(4,900)	(1,346)	(1,575)	(1,343)	(348)	(4,612)	(363)	(328)	(300)	(300)	(1,291)	(1,200)
Preferred expense						5,436		5,436	1,676	558			2,234	
Other income (expense), net	2,962	(1,115)	5,417	(132)	134	(11,718)	36	(11,680)	21	(41)	40	40	60	300
Total other (expense)	590	(11,315)	517	(1,478)	(1,441)	(7,625)	(312)	(10,856)	1,334	189	(260)	(260)	1,003	(900)
Income (loss) before tax	(16,032)	(27,790)	(3,080)	(2,165)	(1,132)	(8,197)	(1,772)	(13,266)	(507)	(757)	(860)	(389)	(2,513)	0
Income tax expense (benefit)	0	119	255	70	73	38	(52)	129	40	40	40	40	160	0
Net income (loss)	(16,032)	(27,909)	(3,335)	(2,235)	(1,205)	(8,235)	(1,720)	(13,395)	(547)	(797)	(900)	(429)	(2,673)	0
Basic income per share	(\$15.14)	(\$16.35)	(\$1.57)	(\$1.03)	(\$0.52)	(\$3.32)	(\$1.08)	(\$4.94)	(\$0.13)	(\$0.06)	(\$0.03)	(\$0.01)	(\$0.14)	\$0.00
Diluted income per share	(\$15.14)	(\$16.35)	(\$1.44)	(\$1.03)	(\$0.52)	(\$3.32)	(\$1.08)	(\$4.94)	(\$0.13)	(\$0.06)	(\$0.03)	(\$0.01)	(\$0.14)	\$0.00
Basic shares outstanding	1,059	1,707	2,119	2,177	2,327	2,478	1,587	2,714	4,371	13,734	29,900	30,100	19,526	31,000
Diluted shares outstanding	1,059	1,707	2,316	2,177	2,327	2,478	1,587	2,714	4,371	13,734	29,900	30,100	19,526	31,000
Key ratios:														
Revenue growth	N/A	1921.3%	70.1%	-6.9%	9.5%	-3.7%	3.2%	0.6%	-8.9%	-11.1%	1.6%	-2.3%	-5.2%	15.0%
Gross margins	N/A	25.8%	59.8%	61.5%	62.5%	56.2%	49.8%	57.3%	49.0%	53.6%	55.0%	57.0%	54.0%	60.0%
Engineering/revenue	N/A	11.0%	6.1%	6.7%	5.0%	5.5%	4.7%	5.4%	5.2%	3.6%	3.9%	3.9%	4.1%	3.8%
Selling/revenue	N/A	49.7%	40.9%	41.9%	33.6%	35.9%	34.2%	36.2%	44.4%	31.6%	32.9%	30.4%	34.3%	30.4%
G &A/revenue	N/A	54.2%	24.3%	22.6%	20.3%	22.4%	27.9%	23.4%	27.9%	31.0%	26.3%	24.4%	27.3%	23.2%
Tax Rate	0.0%	0.4%	8.3%	-3.2%	-6.4%	-0.5%	2.9%	1.0%	7.9%	5.3%	4.7%	10.3%	6.4%	0.0%
Deprec, amort & non-cash comp.	4,300	15,600	9,150	2,500	2,500	2,000	2,070	9,070	1,500	1,500	1,500	1,500	6,000	6,500
Cash Flow/share	(\$13.87)	(\$6.56)	\$0.17	\$0.18	\$0.50	\$2.21	\$0.20	\$2.71	\$0.21	\$0.05	\$0.02	\$0.03	\$0.17	\$0.21
EBITDA/share	(\$11.63)	(\$0.51)	\$2.37	\$0.80	\$1.18	\$0.56	\$0.42	\$2.47	(\$0.09)	\$0.04	\$0.03	\$0.04	\$0.13	\$0.25

**Balance Sheets**

(\$000s)

Assets:	12/31/17	6/30/18
<b>Current Assets</b>		
Cash and equivalents	\$4,069	\$14,445
Accounts receivable, net	3,141	2,574
Inventory	3,009	2,413
Prepaid expenses and other current	533	828
Total current	10,752	20,260
Property, plant and equipment, net	7,703	6,271
Goodwill and intangibles, net	20,128	19,073
Other assets	48	48
TOTAL ASSETS	\$38,631	\$45,652
<b>Liabilities:</b>		
<b>Current liabilities</b>		
Note payable and current portion of LTD	\$2,744	\$51
Accounts payable	2,277	1,477
Other current liabilities	2,651	2,723
Total current	7,672	4,251
Long-term debt, net	7853	7,321
Non-current liabilities	861	780
Total liabilities	16,386	12,352
Stockholders' equity	22,245	33,300
TOTAL LIAB & EQ	\$38,631	\$45,652

**Quarterly Earnings Comparisons**

	March	June	September	December	Total
<b>Revenues (in \$Mill)</b>					
2014					\$915
2015					18,495
2016	7,620	7,739	7,767	8,331	31,457
2017	7,097	8,471	7,480	8,596	31,644
2018E	6,466	7,533	7,600	8,401	30,000
<b>Earnings per Share (diluted)</b>					
2014					(\$15.14)
2015					(16.35)
2016	(1.29)	0.24	0.02	(0.41)	(1.44)
2017	(1.03)	(0.52)	(3.32)	(1.08)	(4.94)
2018E	(0.13)	(0.06)	(0.03)	(0.01)	(0.14)

**Revenues Breakdown**

	2015	2016	2017	2018E	2019E
<b>Revenues by Type</b>					
Dermatology Recurring Procedures (Per-Use)	\$14,616	\$23,508	\$22,640	\$21,000	\$25,000
Dermatology Procedures Equipment	3,591	7,065	8,792	9,000	9,500
Other revenues	288	134	17	0	0
Total revenues	\$18,495	\$30,707	\$31,449	\$30,000	\$34,500
<b>Revenues by Geographic Area</b>					
Domestic	\$14,724	\$24,486	\$26,178	\$23,500	\$27,000
International	3,771	6,221	5,271	6,500	7,500
Total	\$18,495	\$30,707	\$31,449	\$30,000	\$34,500

Source: Dawson James Securities, Inc. estimates; Company documents

## **Important Disclosures:**

### **Price Chart:**



### **Price target and ratings changes over the past 3 years:**

Initiated – Buy – September 4, 2018 – Price Target \$5.00

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- 1) **Buy:** the analyst believes the price of the stock will appreciate and produce a total return of at least 20% over the next 12-18 months;
- 2) **Neutral:** the analyst believes the price of the stock is fairly valued for the next 12-18 months;
- 3) **Sell:** the analyst believes the price of the stock will decline by at least 20% over the next 12-18 months and should be sold.

The following chart reflects the range of current research report ratings for all companies followed by the analysts of the Firm. The chart also reflects the research report ratings relating to those companies for which the Firm has performed investment banking services in the last twelve months.

	<b>Company Coverage</b>		<b>Investment Banking</b>	
<b>Ratings Distribution</b>	<b># of Companies</b>	<b>% of Total</b>	<b># of Companies</b>	<b>% of Totals</b>
Market Outperform (Buy)	26	90%	8	31%
Market Perform (Neutral)	3	10%	0	0%
Market Underperform (Sell)	0	0%	0	0%
<b>Total</b>	<b>29</b>	<b>100%</b>	<b>8</b>	<b>28%</b>

#### **Analyst Certification:**

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