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## Sorrento Therapeutics (Nasdaq: SRNE)

April 6, 2021

### BUY: Acquires Oncology Company ACEA Therapeutics

Sorrento announced the acquisition of ACEA Therapeutics for \$38M in stock. ACEA brings to Sorrento Abivertinib (oral), a next generation, dual EGFR mutant and BTK inhibitor (BTKi) with a completed NSCLC registrational/Phase 3 trial. The compound is also in a Phase 1 B-cell lymphoma study, ongoing Phase 2 trials in COVID-19 patients with ARDS, and Phase 2 studies for prostate cancer, systemic lupus erythematosus and the ultra-orphan indication of hairy cell leukemia. We also note that ACEA brings a state-of-the-art cGMP facility located in Quzhou, China, on a 23-acre campus with five buildings. In many ways, ACEA reminds us of BeiGene Pharma (BGNE-Not rated) - \$32B market capitalization today.

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**What Does Sorrento Get?** The acquisition brings to Sorrento Abivertinib, AC0058, preclinical stage candidate AC0939, and ACEA's extensive proprietary library of small molecules (over 1,000,000 compounds), which potentially have applications for numerous human disease indications, including non-small cell lung cancer (NSCLC), B cell lymphomas, systemic lupus, rheumatoid arthritis, multiple sclerosis and viral infections.

**The Gem in the Portfolio: Abivertinib** is a small molecule tyrosine kinase inhibitor (TKI) that selectively targets both a mutant form of the epidermal growth factor receptor (EGFR) and Bruton's tyrosine kinase (BTK); it was originally identified from ACEA's compound library. Abivertinib has the potential to improve outcomes in resistant prostate cancer, systemic lupus erythematosus, and various B cell lymphomas in addition to NSCLC, an indication for which a registrational/Phase 3 trial has been completed. It is currently being studied as a Phase 2 treatment for COVID-19-induced respiratory compromise in the US and Brazil. A second clinical candidate, AC0058, is a next generation BTK inhibitor, currently in a Phase 1b trial for Lupus patients in the US, which could potentially be expanded to other autoimmune diseases such as multiple sclerosis.

**A Presence in China:** The acquisition will also include ACEA's state-of-the-art cGMP facility located in Quzhou, China, on a 23-acre campus with five buildings. This facility has successfully manufactured multiple batches of the active pharmaceutical ingredient (API) and final product in capsules for Abivertinib and AC0058 for clinical studies. The ACEA facility currently has capacity to manufacture up to 5,000 kg/year of APIs and 50,000,000 capsules of final drug product.

**Valuation.** We have not yet factored in the ACEA acquisition to our model. We assume Sorrento develops COVI-SHIELD (and non-opioid Pain Medication, RTX). We apply a probability of success of just 50%, but given the size of the indication, the valuation potential for COVID alone is significant. For Sorrento, we additionally apply a 30% discount rate. Our valuation conclusion is an equally weighted average of our FCFE, EPS, and sum-of-the-parts analysis rounded to the nearest whole number. We use an estimated fully diluted end-year share count (we assume a capital raise). The conclusion of this method is a \$19.00 price target.

**Risks to our thesis** include the following: (1) commercial; (2) regulatory; (3) clinical; (4) manufacturing; (5) financial; (6) liability; and (7) intellectual property. We review these and other risks in the risk section of this report.

Current Price				\$8.23
Price Target				\$19.00
<b>Estimates</b>	<b>F2020A</b>	<b>F2021E</b>	<b>F2022E</b>	
Expenses (\$000s)	\$ 284,504	\$ 1,122,550	\$ 826,961	
1Q March	\$ 50,884	\$ 258,187	\$ 190,201	
2Q June	\$ 56,735	\$ 269,412	\$ 198,471	
3Q September	\$ 93,823	\$ 291,863	\$ 215,010	
4Q December	\$ 83,062	\$ 303,089	\$ 223,279	
	<b>F2020A</b>	<b>F2021E</b>	<b>F2022E</b>	
EPS (diluted)	\$ (1.30)	\$ 6.02	\$ 3.54	
1Q March	\$ (0.36)	\$ 1.38	\$ 0.81	
2Q June	\$ (0.36)	\$ 1.44	\$ 0.85	
3Q September	\$ (0.35)	\$ 1.56	\$ 0.92	
4Q December	\$ (0.24)	\$ 1.62	\$ 0.96	
EBITDA/Share	(\$1.35)	\$7.52	\$4.72	
EV/EBITDA (x)	-6.7	1.1	1.7	
<b>Stock Data</b>				
52-Week Range	\$1.39	-	\$19.39	
Shares Outstanding (mil.)			255.1	
Market Capitalization (mil.)			\$2,098	
Enterprise Value (mil.)			\$2,076	
Debt to Capital			0%	
Book Value/Share			\$2.41	
Price/Book			7.2	
Average Three Months Trading Volume (K)			48,303	
Insider Ownership			20.3%	
Institutional Ownership			30.6%	
Short interest (mil.)			21.2%	
Dividend / Yield			\$0.00/0.0%	



## Risk Analysis

**Clinical and regulatory risk.** There is no assurance that any of the company's products will be approved for any additional indications and, even if approved, will be reimbursed by insurance, or successfully commercialized.

**Commercial risk.** The focus of the company is on successfully developing its products and eventually bringing them to the mass market. It is important to note that the market opportunity in COVID is a race against time. Others may develop a vaccine that could reduce the need for the company's therapy.

**Financial risk.** The company may need to raise capital in the marketplace relatively soon, and there can be no assurances that the company will be able to successfully raise capital and do so on favorable terms.

**Intellectual property risk.** The company may have to defend its patents and technical know-how, and there can be no assurances that the patents will not be infringed or will be held as valid if challenged, and the company may infringe on third parties' patents.

**Reimbursement and insurance payment risk.** Insurance payment for products may be an additional hurdle for adoption.

**Exhibit 1. Income Statement.**

Sorrento Income Statement (\$ '000)															
SRNE	1Q20A	2Q20A	3Q20A	4Q20A	2020A	2021	2022	2023	2024	2025	2026	2027	2028	2029	2030
COVID19 USA *						1,500,000	1,000,000	800,000	600,000	400,000	200,000	200,000	200,000	200,000	200,000
COVID 19 ROW *						1,500,000	1,000,000	800,000	600,000	400,000	200,000	200,000	200,000	200,000	200,000
Non - Opioid Pain Relief U.S.						-	-	51,515	106,142	164,021	211,218	217,596	224,168	307,917	396,520
Non - Opioid Pain Relief ROW						-	-	128,788	265,354	410,052	528,044	543,991	560,419	769,792	991,300
Service Revenues	2,473	3,213	3,879	3,793	13,358	13,492	13,626	13,763	13,900	14,039	14,180	14,322	14,465	14,609	14,756
Revenues	5,248	5,794	7,874	7,712	26,628	3,000,000	2,000,000	1,780,303	1,571,496	1,374,072	1,139,261	1,161,587	1,184,587	1,477,709	1,787,820
Total Revenues (Product Sales, Service and Therapeutics)	7,721	9,007	11,753	11,505	39,986	3,013,492	2,013,626	1,794,065	1,585,396	1,388,112	1,153,441	1,175,909	1,199,052	1,492,318	1,802,575
<b>Expenses</b>															
COGS	2,439	2,249	2,671	2,581	9,940	904,047	604,088	538,220	475,619	416,433	346,032	352,773	359,716	447,695	540,773
% COGS	31.6%	32%	32%	32%	25%	30%	30%	30%	30%	30%	30%	30%	30%	30%	30%
R&D	21,154	29,031	66,887	37,260	154,332	100,000	102,000	104,040	106,121	108,243	110,408	112,616	114,869	117,166	119,509
Intangible	992	992	1,034	1,035	4,053										
SG&A (net)	26,299	24,463	24,265	41,152	116,179	118,503	120,873	123,290	125,756	128,271	130,836	133,453	136,122	138,845	141,622
Total costs & expenses	50,884	56,735	93,823	83,062	284,504	1,122,550	826,961	765,550	707,495	652,948	587,277	598,842	610,706	703,706	801,903
Operating Income (Loss) EBIT	(43,163)	(47,728)	(83,104)	(70,523)	(244,518)	1,890,942	1,186,666	1,028,516	877,901	735,164	566,164	577,067	588,346	788,612	1,000,672
Oper Margin															
(Loss) or Gain on Securities	(59)	2	0	50	(7)										
Loss on Partial Debt	(23,645)	(28,294)	(1)	51,941	1										
Gain (loss) on derivate liabilities	4,920	1,980	0	(6,901)	(1)										
Loss gain on Fx	(147)	124	(2,563)	2,586											
Interest Expense	(6,825)	(8,297)	(0)	15,102	(20)										
Interest Income	19	2													
Other Income expenses - Financial Expenses (net)	(25,737)	(34,483)	50	8,231	(51,939)										
Pre-tax income	(68,900)	(82,213)	(86,398)	(73,069)	(310,580)	1,890,942	1,186,666	1,028,516	877,901	735,164	566,164	577,067	588,346	788,612	1,000,672
Taxes	(276)	(6,618)	(421)	(543)	(7,858)	378,188	296,666	287,984	263,370	242,604	186,834	190,432	194,154	260,242	330,222
Tax Rate	0%	0%	0%	0%	3%	20%	25%	28%	30%	33%	33%	33%	33%	33%	33%
Net Income (loss)	(69,180)	(84,993)	(87,109)	(73,128)	(314,410)	1,512,753	889,999	740,531	614,530	492,560	379,330	386,635	394,192	528,370	670,450
Net Loss attributable to noncontrolling interests	(3,985)	(7,253)	(3,086)	(1,625)	(15,949.00)	(5,022.88)	(5,226.83)	(5,439.06)	(5,659.91)	(5,889.73)	(6,128.87)	(6,377.73)	(6,636.69)	(6,906.17)	(7,187)
Net Gain / Loss to Sorrento	(65,195)	(77,740)	(84,023)	(71,503)	(298,461)	1,169,843	690,526	575,648	478,848	385,161	298,213	304,086	310,164	413,751	663,263
Basic EPS	(0.36)	(0.36)	(0.35)	(0.24)	(1.30)	6.02	3.54	2.94	2.44	1.96	1.51	1.54	1.57	2.10	2.66
Basic Wght Average Shares Outstanding (thousands)	182,609	216,956	251,211	251,462	229,823	251,462	251,462	251,462	251,462	251,462	251,462	251,462	251,462	251,462	251,462
Fully Diluted Wgtd Avg Shrs outstanding (Thousands)	182,609	216,956	257,670	257,928	229,823	251,462	251,462	251,462	251,462	251,462	251,462	251,462	251,462	251,462	251,462

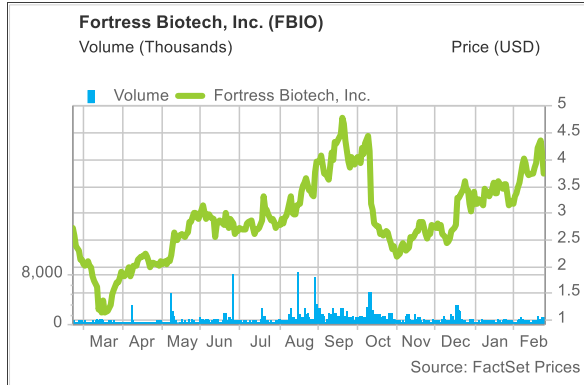
Source: Dawson James estimates, company reports

Companies mentioned in this report:

BeiGene Pharma (BGNE-Not rated)

Important Disclosures:

**Price Chart:**



Price target and ratings changes over the past three years:

- Initiated – Buy – May 26, 2020 – Price Target \$24.00
- Update – Buy – June 2, 2020 – Price Target \$24.00
- Update – Buy – June 5, 2020 – Price Target \$24.00
- Update – Buy – June 10, 2020 – Price Target \$24.00
- Update – Buy – July 2, 2020 – Price Target \$24.00
- Update – Buy – July 20, 2020 – Price Target \$24.00
- Update – Buy – July 29, 2020 – Price Target \$24.00
- Update – Buy – August 26, 2020 – Price Target \$21.00
- Update – Buy – August 28, 2020 – Price Target \$21.00
- Update – Buy – September 17, 2020 – Price Target \$21.00
- Update – Buy – September 24, 2020 – Price Target \$21.00
- Update – Buy – September 29, 2020 – Price Target \$21.00
- Update – Buy – October 5, 2020 – Price Target \$21.00
- Update – Buy – November 9, 2020 – Price Target \$21.00
- Update – Buy – December 10, 2020 – Price Target \$21.00
- Update – Buy – December 23, 2020 – Price Target \$21.00
- Update – Buy – April 6, 2021 – Price Target \$19.00

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	# of Companies	% of Total	# of Companies	% of Totals
Market Outperform (Buy)	20	69%	6	30%
Market Perform (Neutral)	9	31%	0	0%
Market Underperform (Sell)	0	0%	0	0%
Total	29	100%	6	21%

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