

January 20, 2006

SPECIALTY
PHARMACEUTICALS

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NASDAQ: NRPH
PRICE: \$32.71
RATING: BUY

NRPH: ADDERALL XR GENERICS APPEARING LESS LIKELY; RAISING PRICE TARGET TO \$36

Investment Conclusion: We are raising our price target on New River Pharmaceuticals from \$30 to \$36, as yesterday's announced litigation settlement between Shire (SHPGY: Buy) and Impax suggests to us that the likelihood of generic erosion of Adderall XR prior to an NRP104 launch is significantly diminishing, resulting in an increase to our probability adjusted NRP104 forecasts. Based on the Impax deal, which removes a potential legal strategy for Barr (BRL: Buy) to work with Impax, we expect Barr to settle with Shire rather than go to court, allowing Shire to effectively remove the risk of generic competition, facilitating the rotation of patients from Adderall XR to NRP104 upon a product launch. We now forecast a faster and more robust ramp for NRP104, with sales surpassing \$1B by 2010, compared to our previous estimate of \$887M. As a result, our 2007 and 2008 EPS estimates are raised from \$0.35 and \$1.36, to \$0.41 and \$1.60, respectively. In arriving at our new price target, we use our same valuation methodology, 35x our 2008 EPS estimate of \$1.60, discounted annually 25%. We continue to believe that NRP104 has a best in class clinical profile and blockbuster market potential, given its improved safety profile compared to other stimulants, and possibility for a less restrictive schedule. As such, we reiterate our Buy rating.

- **Impax Deal with Shire on Adderall XR Announced Yesterday.** Yesterday, Shire announced that it had entered into an agreement with Impax to settle all pending litigation around Adderall XR exclusivity. As part of the settlement, Impax confirmed that its proposed generic products infringe Shire's patents and that Shire's patents are valid and enforceable. As part of the settlement, Impax may enter the market as an authorized generic upon the launch of other generics, and Impax will also co-promote Shire's Carbatrol for three years beginning in July 2006.
- **Shire-Barr Deal Appears Highly Likely, Positive for NRP104.** Shire also announced yesterday that settlement discussions with Barr are ongoing, and with the Impax deal with Shire, we believe the likelihood of a near-term Shire deal with Barr is high, as it eliminates a potential legal strategy for Barr to strengthen its case through working together with Impax (refer to our Shire note out this morning for a full discussion of our view of the ongoing litigation between Barr and Shire and potential settlement). With Barr's hand strategically weakened, a settlement appears to be an increasingly likely scenario and represents a win-win scenario for both companies, as Shire would avoid generic erosion of sales for its lead product, during a critical time during which it is seeking to rotate patients to NRP104, with an approval and launch expected later this year. With delayed generic entry, Shire can rotate patients without the risk of

Stock Data

12-Month Price Target	\$36.00
52-Week Range	\$31.19 - 10.24
10-Day Avg. Daily Volume	299,535

Revenues

FY ends December	2004A	2005E	2006E
Revenue (MM)	\$0.0	\$25.0	\$25.0
Previous Estimate (MM)	-	NC	NC
Price/Revenue	NA	46.6x	46.6x
EV/Revenue	NA	44.3x	44.3x
Secular Growth Rate			NM

Capitalization

Shares Outstanding (MM)	35.6
Market Capitalization (MM)	\$1,163.8
Enterprise Value (MM)	\$1,107.2
Debt/Total Cap. (10/02/05)	0.0%
Cash (10/02/05) (MM)	\$56.6
Cash/Share (10/02/05)	\$1.59

Earnings Per Share*

	2004A	2005E	2006E
Q1	(\$0.07)	(\$0.19)A	NE
Q2	(\$0.04)	(\$0.18)A	NE
Q3	(\$0.14)	(\$0.25)A	NE
Q4	(\$0.23)	\$0.02	NE
Fiscal Year EPS	(\$0.48)	(\$0.59)	(\$0.91)
Previous Estimate	-	NC	NC
P/E	NM	NM	NM

*Earnings Per Share before extraordinary charges

NC indicates no change from current estimate. NE indicates no estimate. NM indicates not meaningful.

Sources: WR Hambrecht + Co estimates and company reports

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losing them to generic Adderall XR, allowing NRP104 to establish itself in the market without a competing Adderall XR generic. For Barr, the risk of losing on litigation and not having anything to show for its Adderall XR challenge is the downside scenario which a deal avoids, and a potential deal provides a steady earnings stream from Adderall XR.

- **Raising Estimates and Price Target.** Incorporating the larger projected Adderall XR market with the increased probability of better case scenarios for NRP104 into our new sales forecast (lowering probability of 2006 generic entry from 25% to 5%) results in our 2007-2008 EPS estimates rising from \$0.35 and \$1.36, to \$0.41 and \$1.60, respectively; applying a 25% annual discount and 35x P/E multiple to our new 2008 estimate, our new price target is \$36.

2010 PROBABILITY ADJUSTED SALES RISE BY 19% TO \$1 BILLION

Our upward adjustments to our NRP104 forecasts are driven by our reevaluation of our assumptions surrounding NRP104 under different scenarios. Based on our view that the likelihood of a deal between Barr and Shire is increasing, we are assigning a lower probability to generic competition for Adderall XR complicating an NRP104 launch in 2006. We continue to assume a 2007 product launch, though New River Pharmaceuticals has indicated that it is targeting a 2006 product launch (we estimate an October 6 PDUFA date), presenting some upside to our estimates.

EXHIBIT 1: NRP104 SALES MODEL – PROBABILITY WEIGHTED

	CY04E	CY05E	CY06E	CY07E	CY08E	CY09E	CY10E
Estimated U.S. ADHD market							
Total U.S. Sales in \$ millions	\$2,000	\$2,240	\$2,509	\$2,710	\$2,980	\$3,129	\$3,286
Shire's Adderall Franchise Sales	\$536	\$635	\$750	\$544	\$202	\$83	\$50
Market share	27%	28%	30%	20%	7%	3%	2%
Base Case: Safety Only; Generics in 1H'06: Launch in 2007 (5% prob)			0%	2%	6%	8%	10%
Implied Sales (\$MM)	\$0	\$54	\$179	\$250	\$329		
Case 2: Better Label, Generics later: (65% probability)			0%	8%	15%	25%	30%
Implied Sales (\$MM)	\$0	\$217	\$447	\$782	\$986		
Case 3: Best Case: Great Label, Late Generics (30% probability)			0%	10%	25%	35%	40%
Implied Sales (\$MM)	\$0	\$271	\$745	\$1,095	\$1,314		
Probability adjusted NPR104 Sales Forecast (\$MM)			\$0	\$225	\$523	\$850	\$1,052
Previous Forecast			\$0	\$187	\$440	\$712	\$887
Probability adjusted NRP104 Market share			0%	8%	18%	27%	32%

Source: WR Hambrecht + Co estimates

Base Case: From 25% to 5% Probability. This scenario assumes generic Adderall XR enters in Q2:06, NRP104 approved in Q4:06, launched in H1:07. Generics have a 6-12 month lead time which prevents Shire from maximizing its rotation strategy. As a result, Rx penetration is slower with maximum penetration reaching just 10%, only a third of Shire's current share. This would clearly be a disappointment for Shire, but would still result in an estimated \$330 million in sales in 2010. With the recent Impax settlement suggesting a Barr settlement is nearing, we are lowering our weighting of this scenario from 25% to 5%, as we believe that the likelihood of generic entry is significantly diminished.

Case 2: From 55% to 65% Probability. This scenario assumes a label that provides a modest advantage with a DEA schedule of III vs. current stimulants, which are schedule II, and limited erosion of Adderall XR by generics. NRP104 prescription share growth is fairly rapid with Shire achieving its 30% share by 2010. With a larger brand ADHD market compared to our base case, NRP104 sales could approach blockbuster status, with sales of \$986 million in year four post launch. We are increasing our weighting of this scenario from 55% to 65%. While this scenario

does factor in some impact from generic entry during a product launch, its primary weighting in our scenario analysis is based on the assumption of only a slightly improved label compared to other stimulants (compared to a significantly improved label in Case 3). This is likely the scenario that Shire management is targeting, but has hope for the upside assumed in our Case 3, should NRP104 Phase 3 trials have an improved side effect profile vs. Adderall XR as we discuss below.

Case 3: From 20% Probability to 30% Probability - Blockbuster Scenario. Shire launches NRP104 with no generic erosion on Adderall XR at time of launch, maximizing its ability to successfully execute a switching strategy. The FDA approves a labeling which supports a better side effect profile (lower addiction, abuse, and overdose potential) and the assigned DEA Schedule is a best case schedule IV, which allows Shire to sample NRP104 as well as allow patient refills, driving faster uptake and market penetration. This allows prescription share to reach 25% in NRP104's second year on the market and reach an unprecedented 40% share in year four. In this scenario, U.S. sales reach \$1.3 billion in 2010.

Combining these new probability weightings, our new projected sales adjusting the weighting of all three scenarios, we arrive at a probability adjusted sales estimate of \$1.05 billion or about 19% higher potential sales for NRP104 by 2010.

Reiterating Buy Rating. We continue to believe NRP104 is poised to be a significant product in the multi-billion dollar ADHD market, offering a differentiated and improved safety profile compared to current agents, with the potential for a more favorable DEA schedule. Upcoming catalysts expected before an estimated October 6 PDUFA date for NRP104 include a settlement deal between Barr and Shire, presentation of clinical data for NRP290 at an investor meeting on February 7, and the presentation of comprehensive safety results for NRP104 following completion of a third clinical abuse liability study.

New River Pharmaceuticals

Profit and Loss Statement

(\$ in millions, except per-share data)

	2003	2004	2005E	2006E	2007E	2008E	2009E	CAGR '03-'08E
NRP End Product Sales U.S. (prob. adj.)				0.0	224.9	523.1	849.7	
NRP End Product Sales Ex-U.S.				0.0	10.0	35.0	66.5	
NRP W.W. End Product Sales				0.0	234.9	558.1	916.2	
NRP104 Amphetamine - Revenues to New River					24.7	89.2	218.4	
NRP290 Sales to New River						2.6	13.3	
NRP369 Sales to New River						2.7	15.0	
Research Revenue & License Fees			25.0	25.0	25.0	25.0	0.0	
Total Revenues	0.0	0.0	25.0	25.0	49.7	119.5	246.7	NM
Cost of Sales	0.0	0.0	0.0	0.0	0.0	1.6	8.5	
Gross Profit	0.0	0.0	25.0	25.0	49.7	117.9	238.2	
R&D and Scale Up	3.1	10.2	34.0	50.0	12.0	14.5	22.0	
SG&A	1.5	5.9	12.0	12.0	12.2	15.0	26.0	
Depreciation and amortization	0.1	0.1	0.2	0.3	0.4	0.5	0.6	
Operating Income (loss)	(4.8)	(16.3)	(21.2)	(37.3)	25.1	87.9	189.6	NM
Other Income	(0.0)	2.0	0.0	0.0	0.0	0.0	0.0	
Pretax Income	(4.8)	(14.3)	(21.2)	(37.3)	25.1	87.9	189.6	NM
Income Taxes	0.0	0.0	0.0	0.0	7.5	17.6	56.9	
Net Income before Extraord. Chrgs	(4.8)	(14.3)	(21.2)	(37.3)	17.6	70.3	132.7	NM
Average Shares Fully Diluted (millions)	23.6	29.7	37.2	41.0	42.8	44.0	45.6	
Earnings Per Share before Extraord. Chrgs	(0.20)	(0.48)	(0.59)	(0.91)	0.41	1.60	2.91	NM
Growth Analysis								
Total Revenues		NM	NM	0.0%	99.0%	140.3%	106.3%	
Gross Profit		NM	NM	0.0%	99.0%	137.0%	102.0%	
R&D		226.1%	232.2%	47.1%	-76.0%	20.8%	51.7%	
SG&A		288.1%	102.3%	0.0%	1.7%	23.0%	73.3%	
Operating Income		-238.8%	-30.2%	-75.9%	167.4%	249.6%	115.6%	
Pretax Income		-197.6%	-47.9%	-75.9%	167.4%	249.6%	115.6%	
Net Income before Extraord. Chrgs		-197.6%	-47.9%	-75.9%	147.2%	299.6%	88.6%	
Earnings Per Share before Extraord. Chrgs		-136.5%	-22.0%	-54.5%	145.2%	288.7%	82.0%	
Margin Analysis								
Gross Profit Margin	NM	NM	100.0%	100.0%	100.0%	98.7%	96.6%	
R&D	NM	NM	136.0%	200.0%	24.1%	12.1%	8.9%	
SG&A	NM	NM	48.0%	48.0%	24.5%	12.5%	10.5%	
Operating Margin	NM	NM	-84.8%	-149.2%	50.6%	73.6%	76.9%	
Pretax Margin	NM	NM	-84.8%	-149.2%	50.6%	73.6%	76.9%	
Net Income before Extraord. Chrgs	NM	NM	-84.8%	-149.2%	35.4%	58.8%	53.8%	
Tax Rate	0.0%	0.0%	0.0%	0.0%	30.0%	20.0%	30.0%	

Source: Company reports, WR Hambrecht + Co estimates

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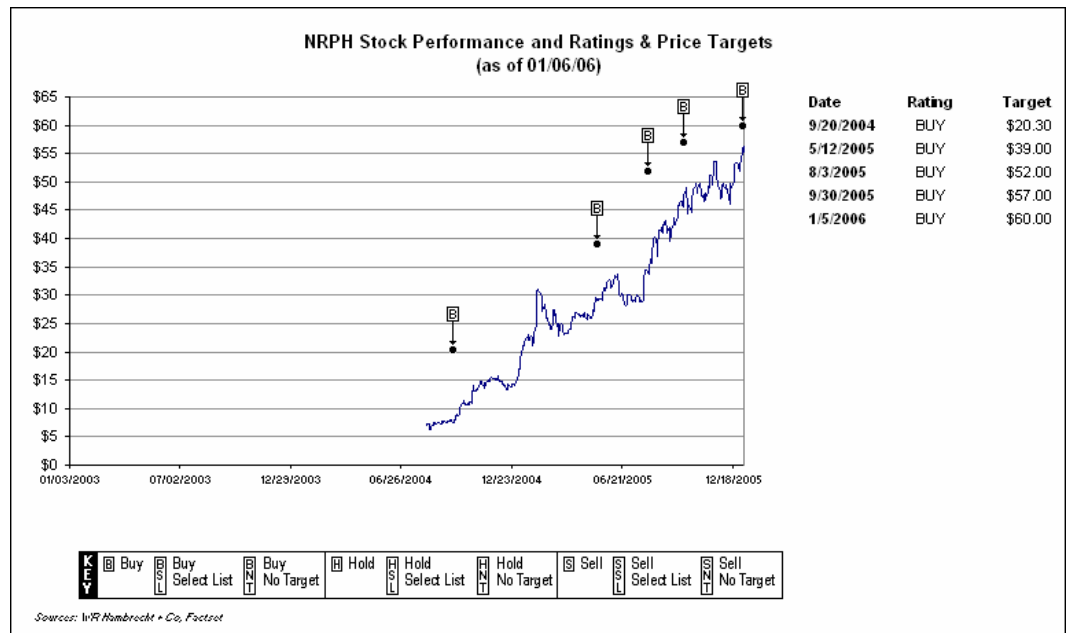
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VALUATION METHODS TO DETERMINE PRICE TARGET

In arriving at our new \$36 price target, we use our same valuation methodology, 35x our 2008 EPS estimate of \$1.60, discounted annually 25% for New River Pharmaceuticals (NRPH).

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