



May 3, 2012

ISTA

Price (May 2, 2012) \$9.05
Mkt. Cap. (mil.) \$460.6

Pharmaceuticals

Rating: **Neutral**
Previous: *Neutral*
Price Target: **NA**
Previous: *NA*
Risk Rank: **Speculative**
Previous: *Speculative*
Sector Rating: **Underweight**

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Market Data:

52-Week Range \$11.36-\$2.88
Shares Out. (mil.) 50.9
Float (mil.) 32.6
Avg. Daily Vol. (000) 664
Dividend/Yield \$0.00/0.0%

Financial Highlights:

Long-Term Debt (mil.) \$45.0
Debt/Cap. NA
Debt/EBITDA 6.0x
ROE NA
Book Value/Share NA
Free Cash Flow/Share NA
Net Cash/Share \$0.15
Shareholders' Equity (mil.) NA
Est. 5-Year EPS Growth 20%

Convertible No
Key Indices

EPS Est. Changes

	2012	2013
01/05/12	\$0.35	\$0.60
11/29/11	NA	\$0.75
11/01/11	\$0.50	NA

Ista Pharmaceuticals, Inc.

1Q Results Should Have No Impact on Bausch's \$9.10 Bid

Ista reported disappointing 1Q12 adjusted financial results with EPS of -\$0.15, which was below our forecast of -\$0.06. The Street mean was (\$0.11). We are adjusting our 2012 EPS to \$0.29 from \$0.35, but our \$0.60 EPS estimate for 2013 is unchanged.

Positives. Ista settled its litigation with Senju regarding Xibrom/Bromday royalties. Despite lower sales, adjusted gross margin was significantly greater than our forecast (79.3% vs. 75.5%). Ista took an 8% price increase on Bromday in early April. The Bromday twin-pack is growing prescription share, now at 11%.

Negatives. We adjusted down our sales forecast for all four marketed drugs for Ista, following a slower start to the year across the board. Bromday's sales were negatively impacted by \$1 million in Xibrom returns and higher-than-expected managed care rebates.

Pipeline. The phase II BepoSone (bepotastine + steroid) trial reported positive results with an adverse event profile similar to that of BepoMax. The phase III studies for both BepoMax and BepoSone are expected to start in 2013. Studies for T-Pred should begin in 2H12. Prolensa is on-track to file by the end of 2Q12.

Neutral. We do not view an additional bid as likely and are maintaining our Neutral rating.

FYE – Dec.	2011A		2012E		2013E	
EPS	Current	Previous	Current	Previous	Current	
1Q	-\$0.17A	-\$0.07E	-\$0.15A	\$0.05E	\$0.07E	
2Q	-\$0.11A	\$0.11E	\$0.11E	\$0.18E	\$0.19E	
3Q	\$0.09A	\$0.11E	\$0.11E	\$0.14E	\$0.13E	
4Q	\$0.25A	\$0.19E	\$0.19E	\$0.23E	\$0.21E	
Year	\$0.12A	\$0.35E	\$0.29E	\$0.60E	\$0.60E	
P/E	75.4x		31.2x		15.1x	
Mean EPS Estimate	\$0.08		\$0.33		\$0.65	
Revenue (mil.)	Current	Previous	Current	Previous	Current	
1Q	\$36.7A	\$39.6E	\$34.0A	\$51.0E	\$48.9E	
2Q	\$37.1A	\$54.1E	\$52.0E	\$71.3E	\$68.7E	
3Q	\$41.4A	\$46.8E	\$45.1E	\$53.4E	\$51.6E	
4Q	\$45.1A	\$54.9E	\$52.8E	\$61.1E	\$58.9E	
Year	\$160.3A	\$195.4E	\$183.9E	\$236.7E	\$228.1E	
EV/EBITDA	31.0x		18.2x		10.0x	
Operating Margin	6.2%	11.3%	10.4%	15.2%	15.8%	

Comments

Summary and Conclusion

Ista suspended guidance after the announcement of the acquisition by Bausch & Lomb.

Sales and Earnings Metrics for Ista – 1Q12

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

	1Q12			2012	
	STRH	Street Mean	Reported	STRH	Guidance
Product Sales					
Xibrom/Bromday	\$23.0		\$19.1	\$98.1	
Bepreve	\$6.6		\$6.1	\$43.2	
Istalol	\$6.7		\$5.8	\$26.3	
Vitrase	\$3.4		\$3.0	\$14.8	
Revenue	\$36.7	\$35.0	\$34.0	\$183.9	\$180-\$195
EPS	(\$0.07)	(\$0.08)	(\$0.15)	\$0.29	\$0.28-\$0.36

Source: Company Reports and SunTrust Robinson Humphrey estimates.

Quarter Comparison

Sales and Earnings Metrics for Ista – 1Q12

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

	Prior year	Forecast	Reported	vs Growth		vs Expectations		
				Actual	Percent	Actual	Percent	EPS
Net sales	\$36.7	\$39.6	\$34.0	(\$2.7)	(7.4%)	(\$5.6)	(14.2%)	(\$0.17)
Cost of products sold	\$9.2	\$9.7	\$7.0	(\$2.2)	(23.7%)	(\$2.7)	(27.6%)	\$0.08
Gross profit	\$27.5	\$29.9	\$27.0	(\$0.5)	(1.9%)	(\$3.0)	(9.9%)	(\$0.09)
Research and Development	\$10.1	\$9.9	\$9.0	(\$1.1)	(10.7%)	(\$0.9)	(8.9%)	\$0.03
SG&A expenses	\$21.9	\$22.6	\$23.4	\$1.5	6.9%	\$0.8	3.5%	(\$0.02)
Operating income	(\$4.5)	(\$2.6)	(\$5.4)	(\$0.9)	21.1%	(\$2.9)	111.2%	(\$0.09)
Interest expense	\$1.1	\$1.0	\$0.8	(\$0.3)	(31.2%)	(\$0.3)	(25.8%)	\$0.01
Interest income		(\$0.2)		\$0.0		\$0.2	(100.0%)	(\$0.01)
Other expense, net	\$0.0	\$0.0	\$0.0					
Income before taxes	(\$5.6)	(\$3.4)	(\$6.2)	(\$0.6)	10.8%	(\$2.8)	81.6%	(\$0.08)
Income tax								
Net income	(\$5.6)	(\$3.4)	(\$6.2)	(\$0.6)	10.8%	(\$2.8)	81.6%	(\$0.08)
Basic shares outstanding	33.7	42.3	41.8					
Diluted shares outstanding	33.7	48.0	41.8					
Basic E.P.S.	(\$0.17)	(\$0.08)	(\$0.15)					
Diluted E.P.S.	(\$0.17)	(\$0.07)	(\$0.15)					
EBITDA	(\$3.9)	(\$2.2)	(\$5.0)					

Margin Analysis

Gross margin	74.9%	75.5%	79.3%
Research and Development	27.5%	25.0%	26.6%
SG&A expenses	59.6%	57.0%	68.8%
EBITDA margin	(10.7%)	(5.5%)	(14.8%)
Operating margin	(12.2%)	(6.5%)	(16.0%)
Income before taxes	(15.2%)	(8.6%)	(18.2%)
Income tax			
Net margin	(15.2%)	(8.6%)	(18.2%)

Source: Company Reports and SunTrust Robinson Humphrey estimates.

Pipeline

Prolensa – Ista expects to file the Prolensa NDA during the second quarter of 2012. We maintain our forecast for approval in 1H13, giving time for Ista to replace Bromday.

BepoMax (Bepotastine Nasal) + BepoSone (Combination Bepo/Steroid) – Ista reported the results for a phase II trial with BepoSone in Mountain Cedar pollen. Statistically significant improvement was shown in patients' nasal allergy symptoms, with a sub group showing relief within 15 minutes of dosing. BepoSone was well tolerated with an adverse event profile similar to placebo and consistent with prior BepoMax trials. The phase III program is slated to begin in 2013.

Pipeline Summary

Product	Indication	Development Phase	Anticipated approval	Market size (\$ millions)
Prolensa	Inflammation (NSAID)	Phase III Complete	2013	\$400
Remura Vehicle (OTC)	Dry eye	Phase III	2012	\$350
T-PRED	Ocular Inflammation/Infection	Phase III	>2014	\$300
Bepotastine Nasal Spray	Allergic Rhinitis	Phase II	>2015	>\$250
Bepotastine Nasal/Combo	Allergic Rhinitis	Phase II	>2015	>\$2,000
Bromfenac & Lucentis Combo	AMD	Phase II	>2015	
Strong Steroid	Inflammation	Formulation	>2015	\$300

Source: Company Reports and SunTrust Robinson Humphrey estimates.

Ista Pharmaceuticals, Inc.

Historical and Projected Income Statement

(\$ millions)

	Historical results						Projections								
	2011						2012								
	Mar-11	Jun-11	Sep-11	Dec-11	Total	Mar-12	Jun-12E	Sep-12E	Dec-12E	Total	Mar-13E	Jun-13E	Sep-13E	Dec-13E	Total
Net sales	\$36.7	\$37.1	\$41.4	\$45.1	\$160.3	\$34.0	\$52.0	\$45.1	\$52.8	\$183.9	\$48.9	\$68.7	\$51.6	\$58.9	\$228.1
Cost of products sold	\$9.2	\$9.1	\$10.1	\$10.7	\$39.1	\$7.0	\$12.6	\$10.8	\$12.6	\$43.0	\$10.1	\$16.6	\$12.3	\$14.0	\$53.0
Gross profit	\$27.5	\$28.1	\$31.2	\$34.4	\$121.2	\$27.0	\$39.4	\$34.3	\$40.2	\$140.9	\$38.8	\$52.1	\$39.3	\$45.0	\$175.2
R&D expenses	\$10.1	\$8.5	\$7.4	\$4.3	\$30.3	\$9.0	\$10.7	\$8.3	\$9.8	\$37.8	\$11.2	\$15.1	\$9.8	\$10.6	\$46.8
SG&A expenses	\$21.9	\$22.7	\$18.9	\$17.6	\$81.0	\$23.4	\$22.1	\$18.9	\$19.5	\$84.0	\$23.5	\$25.4	\$21.7	\$21.8	\$92.4
Operating income	(\$4.5)	(\$3.1)	\$5.0	\$12.6	\$9.9	(\$5.4)	\$6.6	\$7.0	\$10.9	\$19.1	\$4.1	\$11.6	\$7.8	\$12.6	\$96.0
Interest expense	\$1.1	\$1.1	\$0.9	\$1.5	\$4.5	\$0.8	\$1.0	\$0.9	\$0.5	\$3.0	\$0.4	\$0.3	\$0.3	\$0.0	\$1.0
Interest income	\$0.0	(\$0.0)	\$0.0	(\$0.7)	(\$0.7)	\$0.0	(\$0.2)	(\$0.2)	(\$0.2)	(\$0.5)	(\$0.2)	(\$0.2)	(\$0.2)	(\$0.2)	(\$0.8)
Other expense, net	(\$5.6)	(\$4.2)	\$4.1	\$11.8	\$6.1	(\$6.2)	\$5.9	\$6.3	\$10.6	\$16.6	\$3.9	\$11.4	\$7.7	\$12.7	\$95.8
Income before taxes	(\$5.6)	(\$4.2)	\$4.1	\$11.8	\$6.1	(\$6.2)	\$0.3	\$0.3	\$0.5	\$1.1	\$0.3	\$0.8	\$0.5	\$0.9	\$2.5
Income tax							\$5.6	\$6.0	\$10.1	\$15.4	\$3.7	\$10.6	\$7.2	\$11.9	\$33.3
Net income							\$0.0	\$0.0	\$0.0	\$0.0	\$0.0	\$0.0	\$0.0	\$0.0	\$0.0
Basic shares	33.7	38.4	41.5	41.5	38.8	41.8	42.7	43.6	44.5	43.1	45.3	46.2	47.1	47.3	46.5
Diluted shares	33.7	38.4	47.9	47.3	50.0	41.8	51.8	52.7	53.6	52.7	54.5	55.3	56.2	56.4	55.6
Basic EPS	(\$0.17)	(\$0.11)	\$0.10	\$0.28	\$0.16	(\$0.15)	\$0.13	\$0.14	\$0.23	\$0.36	\$0.08	\$0.23	\$0.15	\$0.25	\$0.72
Diluted EPS	(\$0.17)	(\$0.11)	\$0.09	\$0.25	\$0.12	(\$0.15)	\$0.11	\$0.11	\$0.19	\$0.29	\$0.07	\$0.19	\$0.13	\$0.21	\$0.60
EBITDA	(\$3.9)	(\$2.6)	\$5.6	\$13.2	\$12.2	(\$5.0)	\$7.0	\$7.4	\$11.4	\$20.8	\$4.6	\$12.1	\$8.3	\$13.1	\$38.1
Margin Analysis															
Gross margin	74.9%	75.5%	75.5%	76.3%	75.6%	79.3%	75.8%	76.0%	76.2%	76.6%	79.4%	75.9%	76.1%	76.3%	76.8%
R&D expenses	27.5%	23.0%	17.9%	9.5%	18.9%	26.6%	20.5%	18.5%	18.5%	20.6%	23.0%	22.0%	19.0%	18.0%	20.5%
SG&A expenses	59.6%	61.0%	45.6%	38.9%	50.5%	68.8%	42.5%	42.0%	37.0%	45.7%	48.0%	37.0%	42.0%	37.0%	40.5%
EBITDA margin	(10.7%)	(7.0%)	13.4%	29.2%	7.6%	(14.8%)	13.5%	16.5%	21.6%	11.3%	9.4%	17.6%	16.1%	22.2%	16.7%
Operating margin	(12.2%)	(8.5%)	12.0%	27.9%	6.2%	(16.0%)	12.8%	15.5%	20.7%	10.4%	8.4%	16.9%	15.1%	21.3%	15.8%
Income before taxes	(15.2%)	(11.4%)	9.9%	26.2%	3.8%	(18.2%)	11.2%	14.0%	20.1%	9.0%	8.0%	16.6%	14.9%	21.6%	15.7%
Income tax							5.0%	5.0%	5.0%	6.9%	6.9%	6.9%	6.9%	6.9%	6.9%
Net margin	(15.2%)	(11.4%)	9.9%	26.2%	3.8%	(18.2%)	10.7%	13.3%	19.1%	8.4%	7.5%	15.5%	13.9%	20.1%	14.6%
Growth Analysis															
Net sales	29.7%	5.9%	(1.5%)	(11.8%)	2.4%	(7.4%)	40.1%	8.9%	17.1%	14.7%	43.8%	32.0%	14.5%	11.6%	24.0%
Cost of products sold	26.5%	10.6%	4.8%	(14.2%)	4.0%	(23.7%)	38.9%	6.7%	17.8%	10.0%	43.1%	31.4%	14.0%	11.2%	23.0%
Gross profit	30.8%	4.5%	(3.4%)	(11.1%)	1.9%	(1.9%)	40.5%	9.6%	16.9%	16.2%	44.0%	32.2%	14.7%	11.8%	24.3%
SG&A expenses	8.0%	17.5%	(0.1%)	(20.1%)	0.7%	6.9%	(2.4%)	0.3%	11.3%	3.7%	0.4%	14.9%	14.5%	11.6%	10.0%
EBITDA															
Operating income															
Income before taxes															
Net income															
Diluted EPS															

Source: Company Reports and SunTrust Robinson Humphrey estimates

Ista Pharmaceuticals, Inc.
Historical and Projected Revenue Breakout
(\$ millions)

Product/Revenue	Historical results						Projections									
	2011			2012			2013			Total						
	Mar-11	Jun-11	Sep-11	Dec-11	Total	Mar-12	Jun-12E	Sep-12E	Dec-12E	Total	Mar-13E	Jun-13E	Sep-13E	Dec-13E	Total	
Product Revenue																
Xibrom/Bromday	\$23.0	\$13.6	\$24.9	\$26.5	\$88.0	\$19.1	\$23.3	\$25.6	\$30.1	\$98.1	\$28.3	\$27.0	\$24.2	\$27.2	\$106.6	
growth	13.3%	(35.5%)	(15.9%)	(23.9%)	(16.8%)	(17.0%)	71.2%	2.9%	13.7%	11.5%	48.1%	15.8%	(5.4%)	(9.9%)	8.7%	
% of revenue	62.7%	36.7%	60.1%	58.8%	54.3%	56.2%	44.8%	56.8%	57.1%	53.4%	57.8%	39.3%	47.0%	46.1%	46.7%	
Istalol	\$6.2	\$7.9	\$7.0	\$6.8	\$27.9	\$5.8	\$7.1	\$6.8	\$6.6	\$26.3	\$6.4	\$7.8	\$7.5	\$7.3	\$29.0	
growth	14.8%	83.7%	32.1%	(2.9%)	26.8%	(6.5%)	(10.3%)	(2.3%)	(3.0%)	(5.7%)	10.0%	10.0%	10.0%	10.0%	10.0%	
% of revenue	16.9%	21.3%	16.9%	15.1%	17.4%	17.1%	13.6%	15.2%	12.5%	14.3%	13.0%	11.4%	14.6%	12.3%	12.7%	
Vitrase	\$3.3	\$3.4	\$4.1	\$4.7	\$15.5	\$3.0	\$3.4	\$3.9	\$4.5	\$14.8	\$3.1	\$3.5	\$4.0	\$4.6	\$15.2	
growth	57.1%	(2.9%)	28.1%	11.9%	19.2%	(9.1%)	0.0%	(5.0%)	(5.0%)	(4.8%)	3.0%	3.0%	3.0%	3.0%	3.0%	
% of revenue	9.0%	9.2%	9.9%	10.4%	9.7%	8.8%	6.5%	8.6%	8.5%	8.0%	6.3%	5.1%	7.8%	7.8%	6.7%	
Bepreve	\$4.2	\$12.2	\$5.4	\$7.1	\$28.9	\$6.1	\$18.3	\$8.2	\$10.6	\$43.2	\$9.2	\$27.4	\$12.3	\$15.9	\$64.8	
growth					84.1%	45.2%	49.6%	52.3%	49.6%	49.5%	50.1%	50.1%	50.1%	50.1%	50.1%	
% of revenue	11.4%	32.9%	13.0%	15.7%	18.0%	17.9%	35.1%	18.2%	20.1%	23.5%	18.7%	39.9%	23.9%	27.0%	28.4%	
T-Pred																
growth																
% of revenue																
OTC Dry Eye								\$0.5	\$1.0	\$1.5	\$2.0	\$3.0	\$3.5	\$4.0	\$12.5	
growth								1.1%	1.9%	0.8%	4.1%	4.4%	6.8%	6.8%	5.5%	
% of revenue																
License Revenue	\$0.0	\$0.0	\$0.0	\$0.0	\$0.0	\$0.0	\$0.0	\$0.0	\$0.0	\$0.0	\$0.0	\$0.0	\$0.0	\$0.0	\$0.0	
growth							0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	
% of revenue							0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	
Total Revenue	\$36.7	\$37.1	\$41.4	\$45.1	\$160.3	\$34.0	\$52.0	\$45.1	\$52.8	\$183.9	\$48.9	\$68.7	\$51.6	\$58.9	\$228.1	
growth	29.7%	5.7%	(1.4%)	(11.7%)	2.4%	(7.4%)	40.2%	8.9%	17.1%	14.7%	43.8%	32.0%	14.5%	11.6%	24.0%	

Source: Company Reports and SunTrust Robinson Humphrey estimates

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