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SPECIALTY
PHARMACEUTICALS

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**“BUCKETS OF CASH”: WILL BIG PHARMA REVIVAL LIFT ALL SHIPS?
STRONG Q1, SENATE BALKS PART D, AND ROTATION ARE BULLISH**

Summary: *We believe strong Q1 results are confirming the bullish sentiment by the now former Ex-AstraZeneca sales manager that “buckets of cash” are back (180 bp gross margin expansion among Merck, Schering-Plough Corp., Eli Lilly and Wyeth, which reported this week). Yes, Medicare Part D is now running on all cylinders, which means those checks we sent endorsed to the United States Treasury on Monday are being funneled (e.g. \$50B earmarked for Medicare Part D) into U.S. pharma sales, which thanks to the Senate’s blocking legislation to let the government negotiate drug prices from our tax dollars, is likely to produce the best industry earnings growth in years, in our view. Grandma will moan when benefits run dry this fall (or maybe she’s a smart old lady who knows TEVA (TEVA: Buy) can extend her budget), but investors seem downright giddy right now, which is what matters. Improving fundamentals, defensive rotation from slowing economy, and compelling valuations have fueled a revival in pharmaceutical stocks, with Big Pharma’s strong Q1 performance showcasing Merck and Schering-Plough rising back from their lowly abyss, reflected a combination of solid U.S. growth with the benefit of Medicare Part D spending that was very limited in Q1:06, a trough in new patent expirations, stronger international growth and cost cutting benefits of the painful shift to new pharmaceutical paradigm. And there was yesterday’s gift from Washington as the Senate could not muster the votes to amend Medicare Part D, which suggests to us this new windfall which was clearly evident in Q1 that should lift results over the balance of 2007, albeit we suspect Part D may be more of a H1 driver as the cap on spending could favor generics in H2 as seniors enter the donut hole. But no matter, investors should be delighted that the amending Part D which we expect will happen is now unlikely until 2009, which is dependent on the Democrats gaining additional seats in the Senate. While we don’t formally follow Big Pharma, but have been bearish for most of the past decade, Big Pharma appears to have its best visibility at least through 2008 in many years, in our view. Strategically, this window of opportunity (and that’s all it is, as long-term fundamentals remain very challenging, in our view), has powerful implications for industry executives and investors whose prospects may be impacted by the fortunes of Big Pharma. This should be good for Specialty Pharma stocks, most of which have struggled and underperformed the big guys so far this year. Sure, a more bearish view might argue that with Big Pharma delivering, who needs to waste time on the little guys? But Specialty Pharma emerged as a powerful force, while Big Pharma was falling on its sword and still represents higher growth prospects on their own and in many cases, represents the strategic solutions that Big Pharma still needs to survive beyond 2010, in our view.*

- **Trickle Down Pharamanomics?** Rotation may be the most significant force as funds flow into pharmaceutical stocks benefiting from strong fundamentals and the slowing economy. If we’re right about this, there is a lot more cash that needs to be put to work and “trickle down pharamanomics” should lift Specialty Pharma stocks. Offense and defense working at the same time. Powerful enough to render Q1 results meaningless? Not quite, but the case for buying stocks in front of results, even for those with less visibility, is compelling, in our view. So which are the rising ships? AMLN (AMLN: Buy) [and derivative Alkermes (ALKS: Buy)] already have, as a better Byetta outlook and increasing LAR visibility lifted these stocks. Barr Pharmaceuticals (BRL: Buy), Shire Pharmaceuticals (SHPGY: Buy) and TEVA (TEVA: Buy) top our list. Endo Pharmaceuticals (ENDP: Hold), Forest Laboratories (FRX: Sell) and Watson Pharmaceuticals (WPI: Hold) don’t, but may have limited downside and could benefit in this environment. Small caps that could rebound on improving sentiment and potential M&A down the road include Acusphere (ACUS: Buy) (our favorite), DepoMed (DEPO: Buy), Durect Corp. (DRRX: Buy), Emisphere (EMIS: Buy), and Nektar Therapeutics (NKTR: Buy), whose fortunes remain tied to Pfizer which reports results this morning.

Please see the [Important Disclosures Section](#) at the end of this report.

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- **Conclusion: Macro-environment Matters Less than Q1 Results to Lift Stocks, but TEVA Should Beat and is Undervalued, Making it Our Top Trading Idea in Front of Results out May 2.** So with the DRG up 7%YTD, boosting the performance of most fund managers higher than expected, investors who need to outperform should be putting more money to work in Specialty Pharma, which includes conservative large cap names from Allergan to Shire to TEVA; all the well to speculative pharma, where there is no shortage of attractive undervalued names, in our view. We highlight TEVA as most likely to beat estimates with recently launched respiratory brand, ProAir®, firmer U.S. generic pricing, and accelerating emerging market growth.
 - In short, this rising tide has lifted stocks, which along with improving balance sheets provide the currency for M&A activity that remains necessary for sustained growth in 2009 and beyond, in our view. We believe this is great news for specialty pharma stocks for several reasons:
 1. **Multiple Expansion: TEVA Cheap under \$40; BRL Cheap under \$50.** For the last several years, even the best growth stories were range-bound while Big Pharma's multiples compressed from the mid 20s down to the low teens, bottoming out in 2005. In the last 12 months, Big Pharma has enjoyed over 500 basis points P/E expansion. The opportunity now is for investors to identify stocks which are trading at relative discounts to Big Pharma which might not have looked cheap a few quarters ago, but now do. TEVA tops our list for P/E expansion potential, which has historically traded at a premium to Big Pharma, but now trades at 17x (Big Pharma's P/E a year ago) which if only expanded to 20x, Big Pharma's multiple on 2008E right now) and using management's early guidance of "at least \$2.50" for 2008, results in a \$50 stock price.
 2. **M&A: Shire Tops the List.** Big Pharma is more actively seeking alliances and M&A and can afford to pay greater premiums. At the margin, investors should consider overweighting stocks which have strong underlying fundamentals and have greater probability of being acquired. Shire (SHPGY) tops our list from this screen. Notably, SHPGY while a big winner in 2006, is up an anemic 2% so far in 2007, while the currency of the relatively short list of buyers is up 11%. At a minimum, it's hard for us to see where the downside is in SHPGY and one could make the case that SHPGY should be trading at \$70 if its ship rises. This suggests to us that strategic investors can take the other side of the trade for investors who might fret of Q1 EPS as management focuses on driving top-line growth as maximizing 2008 sales (the focus on a potential buyer) has more value than 2007 earnings.
 3. **Small Cap Strategic Solutions: More New Rivers? No, but New Creeks, Yes. ACUS, DEPO, DRRX, EMIS and NKTR.** While we would be hard pressed to find another small cap company that could go public at \$4 (August 2004 \$8 IPO pre-split) and be sold for \$64 30 months later producing returns that accelerated retirement dates for a few savvy investors, there are more than a few stocks which should outperform the market that we believe are likely to be acquired by 2010. We recommend investors own a portfolio of these stocks which look fundamentally cheap today, have meaningful catalysts over the balance of 2007 with upside M&A potential, in our view. Small cap fund managers with a three year time horizon should be well rewarded for owning the following: ACUS (our favorite idea right now), DEPO, DRRX, EMIS and NKTR (new CEO Howard Robin sold SRNA with no clinical data to Merck for what Nektar is worth right now).

- **TEVA Trades at 10% Discount to Big Pharma, but Has Superior CAGR Growth Potential over the Next Three Years and We Believe is the Best Pure Play on Medicare Part D Filling 1 out of 9 Rx More than Pfizer and Merck Combined.** Before we look at Specialty Pharma, let's take a look at Big Pharma's stellar performance thus far this year. Fred Hassan has proven he is the turnaround artist with Schering's rebound with a new 5-year high. Merck has come out of the woods on strong growth and fading Vioxx liability concerns. Wyeth keeps chugging along with its robust high margin biologics business supporting growth. Lilly's pipeline is bearing fruit with generic Zyprexa fears now over. And Abbott, now with Kos has reappeared as a player too. While it's a bit premature to reach conclusions, pricing power may be improving with Merck and Schering lifting the reporting companies thus far by 180 gross margin points which could reflect a dearth in patent expirations coupled with Medicare Part D growth. We only mention this trend to make the point that our favorite large cap idea which filled more Rx in Q1 than any two big pharma majors combined, TEVA, has pointed more favorable pricing across all its products including post exclusivity generic Zocor. So it just might be that pharmaceutical industry pricing power is also good for generics.

EXHIBIT 1: LARGE CAP PHARMA PERFORMANCE

Company	Sym	Price (\$) 1/1/2007	Price (\$) 4/19/2007	YTD % CHG	MKT Cap (mil)	Consensus EPS (\$)				P/E Ratio				Growth	PEG		
						2005A	2006A	2007E	2008E	2005A	2006A	2007E	2008E		2006E	2007E	2008E
Pfizer	PFE	\$25.90	\$26.78	3%	189,517	1.09	2.06	2.21	2.34	25x	13x	12x	11x	7%	2.0x	1.8x	1.7x
Johnson & Johnson	JNJ	\$66.02	\$64.43	-2%	186,523	3.46	3.74	3.91	4.29	19x	17x	16x	15x	7%	2.4x	2.3x	2.1x
GlaxoSmithKline	GSK	\$53.81	\$58.68	9%	166,040	1.60	0.96	1.01	1.09	37x	61x	58x	54x	7%	9.3x	8.8x	8.2x
Novartis	NVS	\$57.55	\$56.89	-1%	144,590	2.62	3.04	3.41	3.83	22x	19x	17x	15x	12%	1.5x	1.4x	1.2x
Sanofi-Aventis	SNY	\$46.12	\$46.14	0%	116,250	2.20	3.23	3.31	3.59	21x	14x	14x	13x	5%	2.6x	2.6x	2.4x
Merck	MRK	\$43.60	\$49.69	14%	107,826	2.10	2.53	2.61	2.74	24x	20x	19x	18x	4%	4.8x	4.7x	4.4x
Abbot	ABT	\$48.71	\$58.03	19%	89,545	2.16	2.51	2.80	3.20	27x	23x	21x	18x	13%	1.8x	1.6x	1.4x
AstraZeneca	AZN	\$53.55	\$57.67	8%	87,566	2.91	3.89	3.98	4.32	20x	15x	14x	13x	5%	2.8x	2.7x	2.5x
Wyeth	WYE	\$50.92	\$56.33	11%	75,633	2.70	3.18	3.50	3.85	21x	18x	16x	15x	10%	1.8x	1.6x	1.5x
Lilly	LLY	\$52.10	\$59.14	14%	67,067	1.81	3.15	3.34	3.67	33x	19x	18x	16x	8%	2.4x	2.2x	2.0x
Bristol	BMJ	\$26.32	\$28.26	7%	55,613	1.51	1.05	1.26	1.45	19x	27x	22x	20x	10%	2.7x	2.2x	2.0x
Schering	SGP	\$23.64	\$28.55	21%	42,475	0.12	0.84	1.07	1.29	NA	34x	27x	22x	NA	NA	NA	NA
TEVA	TEVA	\$31.08	\$37.29	20%	29,694	1.59	2.34	2.11	2.53	23x	16x	18x	15x	4%	4.1x	4.6x	3.8x
Large Cap Pharma Average*				9%	104,488	2.06	2.54	2.69	2.99	24x	24x	22x	19x	8%	3.3x	3.2x	2.9x
U.S. Large Cap Pharma Average*				9%	110,246	2.07	2.31	2.50	2.78	24x	28x	25x	22x	9%	3.46	3.22	2.94
S&P 500		1,418.30	1,472.50	4%													
Nasdaq		2,415.29	2,510.50	4%													
Dow Jones		12,463.15	12,803.84	3%													

Source: First Call, Capital IQ, WR Hambrecht + Co estimates

EXHIBIT 2: MAR 2007 QUARTERLY EARNINGS OUTLOOK

Company	Rating	Closing Price 4/19/07	YTD Perf.	WRH Target Price	2007 March Quarter Estimates				Market Cap (millions)	Catalysts	Q1 Earnings Date
					WRH		Consensus				
					Rev	EPS	Rev	EPS			
Teva	Buy	\$37.29	20%	\$50	\$2,035.0	\$0.45	\$2,091.3	\$0.39	\$29,694	ProAir sales, increased U.S. generic pricing, emerging markets	5/2/07
Forest Labs	Sell	\$54.89	8%	NE	\$805.2	\$0.70	\$867.0	\$0.71	\$17,447	Lexapro and Nemanda sales, competition and litigation events	4/24/07
Shire	Buy	\$64.45	4%	\$72	\$501.0	\$0.36	\$495.9	\$0.36	\$11,072	Finalizing NRPH acquisition & Vyvance launch,	4/25/07
Barr	Buy	\$49.08	-2%	\$63	\$587.0	\$0.63	\$617.0	\$0.68	\$5,386	Pлива integration, women's health products	5/9/2007
Endo	Hold	\$30.00	9%	NE	\$248.8	\$0.39	\$236.4	\$0.36	\$4,008	Lidoderm, Opana sales, pipeline development	
Watson	Hold	\$27.51	6%	NE	\$595.0	\$0.25	\$623.5	\$0.24	\$2,820	ADRX integration, manufacturing issues	
New River	Hold	\$63.96	17%	NE	NE	NE	\$37.9	\$0.33	\$2,370	Finalizing sale to Shire	
Alkermes	Buy	\$16.69	25%	\$24	\$56.2	\$0.03	\$60.3	\$0.01	\$1,685	Vivitrol Rx, Risperdal Consta revs, Exenatide LAR progress	
Nektar	Buy	\$12.62	-17%	\$22.50	\$51.5	(\$0.28)	\$57.6	(\$0.34)	\$1,153	Exubera visibility, CEO initiatives, pipeline update	
MannKind	Hold	\$14.30	-13%	NE	NE	NE	\$0.0	(\$0.99)	\$1,050	Cash burn, Technosphere progression	
Durect	Buy	\$4.74	7%	\$10	\$5.8	(\$0.11)	\$6.2	(\$0.12)	\$328	Remoxy, Posidur news, partnership updates	
Depomed	Buy	\$3.88	12%	\$12	NE	NE	\$2.6	(\$0.30)	\$164	Glumetza Rx trends, Gabapentin development	
Acusphere	Buy	\$4.02	65%	\$10	\$0.5	(\$0.38)	\$0.7	(\$0.31)	\$153	RAMP-2 Trial results coming in Q2:07	
Emisphere	Buy	\$3.97	-25%	\$8	\$2.5	(\$0.25)	\$2.0	(\$0.21)	\$112	Pipeline update, partnerships	
Buy Rating Average			10.5%								
S&P 500		1,472.50	3.8%								
Nasdaq Comp.		2,510.50	3.9%								
Dow Jones Ind.		128.04	2.7%								
AMEX Biotech		808.90	7.2%								
AMEX Drug Index		366.31	6.2%								

Source: First Call, Capital IQ, WR Hambrecht + Co estimates

TEVA PHARMACEUTICALS (TEVA - BUY, \$37.15, \$50 PRICE TARGET)

Best pure play on Medicare Part D: Q1 upside from U.S. respiratory, new & old Generics, emerging markets; multiple expansion story supported by shift in product mix

We believe TEVA should beat the Street for Q1. Our \$0.45 EPS estimate (raised from \$0.40 after our meetings with management at the end of month) compares to the consensus estimate of \$0.39. The source of "the beat" may come May 2? ProAir® HFA brand respiratory sales will be the headline, but as impressive is the stronger pricing power and volume gains including expanding (not declining as some expect) Rx share for the underlying U.S. generic business post Zocor and Zolofit exclusivities. The proof in the quarter should be higher gross margins (closer to 50% than the 48% guidance) with better operating and net margins, as TEVA continues to integrate IVAX shedding redundant and underperforming assets and moving to lower cost, lower tax regions. Our revenue estimate is \$2.04 billion and with the IVAX acquisition TEVA is breaking out revenue by generic, branded and API business segments. Our estimate for total generic revenues is \$1.6 billion where branded segment includes ProAir, QVar, Copaxone and Azilect revenues. We expect a healthy respiratory business as well as increased U.S. generic pricing and robust emerging markets growth to add to the upside in Q1, and suspect better than expected numbers. We forecast Copaxone sales for the quarter of \$395 million, up a robust 20% year over year. Our gross margin estimate is 49%, reflecting an improvement due to branded product mix; we expect margins to stay in this range for the year. We forecast SG&A spend of \$420 million, and R&D spend of \$140 million.

SHIRE PHARMACEUTICALS (SHPGY - BUY, \$64.97, \$72 PRICE TARGET)

Superior growth story supported by multiple new launches; on Our Big Pharma's short list

We believe Q1 should approach or reach a \$500M sales threshold with multiple growth drivers contributing to Adderall XR sales which we peg at \$243M with Daytrana (a Concerta patch) reaching \$20M and on track to reach \$100M in 2007. Elaprase, with just a few hundred patients but with each bringing in some \$350,000 should come in around \$25M which at an estimated 60% operating margin will be worth around \$0.06 in the quarter or about 16% of EPS from less than 5%

of sales. That's leverage. Other products, including Fosrenol which finally appears to be getting its legs, are making contributions and that's before Vyvanse launches. We forecast EPS of \$0.36, in line with consensus, and revenues of \$501 million compared to consensus estimate of \$496 million. This will be the first quarter after the introduction of Cash EPS for Shire, and the financial numbers should become clearer as the company clarifies the upcoming New River acquisition impact and provides more guidance. Shire expects to launch 6 products over the next year and a half and 2 PDUFA dates are expected in 2007. The aggregate impact of this major launch cycle will, with the exception of Elaprase, weigh on near-term EPS growth, but the view from the other side as a Shire shareholder looking at 2008 or just maybe a larger company such as Astra-Zeneca whose currency is up nearly 10% YTD and sports a \$87B market cap. Shire, which we have estimated would command at least \$80 per share today and \$100 a year from today, or \$15B to \$20B, would elevate Astra-Zeneca to the coveted top 5 status. But several others with newly found currency which need growth beyond 2008 might be snooping around including Merck, Eli Lilly, Wyeth and Abbott to name a few. And there's always Pfizer, which may remind investors how starved for growth they are today. So with this strategic context, do we really need to talk about Shire's quarter as a catalyst to buy the stock?

BARR PHARMACEUTICALS (BRL - BUY, \$49.33, \$63 PRICE TARGET)

BRL will need time to digest a big Pliva acquisition; positive strategic move in our view

While most investors may harp on the painful financial nuances of integrating Pliva and the shift to cash EPS guidance, at a certain level which we argue is below \$50 where we are today, BRL becomes a value story that has elements of what investors have always owned BRL for – the patent challenge leader whose guidance never counts the chickens before they hatch, a solid brand woman's health franchise, and a two new strategic stakes in the ground – a lower cost globalization footprint and biogenerics capability, neither of which will help Q1:07, but could provide substantial value in the 2008-2010 timeframe, in our view. At a minimum, Q1 should provide an anchor for investors to model which in itself could be a positive for the stock. So while we are holding our breath just a bit, we would still own BRL in front of Q1, but wouldn't chase the stock above \$50. Not yet. We expect another solid quarter for Barr, with its diversified business expected to show solid top line growth on continued strong performance of the brand business, relative stability in generic product sales. For the quarter, we forecast EPS of \$0.63, 5 cents below consensus estimate at \$0.68, on revenues of \$587 million, compared to consensus estimate of \$617 million. We estimate generic sales of \$430 million and branded segment revenues of \$115 million, although with Pliva products adding to the portfolio, we wait to see better breakout of revenue segments on the earnings call as well as more color on guidance. Our product gross margin follows the guidance where branded products are at 65% and generics at 50%. Our SG&A estimate of \$180 million is flat sequentially and we forecast R&D spend for the quarter of \$59 million, slightly down from Q4's \$68 million.

FOREST LABORATORIES (FRX - SELL, \$54.89)

F2007 comes to a close as investors turn to F2008 guidance. While we continue to believe FRX has difficult strategic issues in front of it, the bullish large cap pharma environment is keeping FRX afloat for now. We recommend FRX shareholders take profits and move into TEVA and SHPGY where we believe fundamentals are better and stocks are cheaper. We forecast FQ4 EPS of \$0.70, in line with \$0.71 consensus and our revenue estimate for the quarter is \$805 million, with \$563 million in Lexapro sales and \$188 million in Namenda sales, compared to consensus estimate of \$867 million in total revenues. Gross margin is estimated at 75.5%, slightly below 76.5% margins in FQ3. R&D spend is \$100 million, flat sequentially with SG&A spend of \$285 million compared to \$269 million in Q4. We maintain our Sell rating on this name due to heavy reliance on

anti-depressant Lexapro increasing risk and lack of visible pipeline in development picking up Lexapro's load.

ENDO PHARMACEUTICALS INC. (ENDP - HOLD, \$29.99)

Investors and our concerns with ENDP aren't related to the quarter, but the business mix and lack of visible growth drivers beyond Lidoderm®. We forecast EPS of \$0.39, three cents above consensus at \$0.36, on revenues of \$249 million, behind the consensus at \$236 million, where we forecast Lidoderm sales of \$162 million. Our gross margin estimate for Q1 is 78%, flat sequentially. R&D spend and SG&A spend is also flat sequentially at \$23 million and \$90 million, respectively. We do not anticipate any surprises for the quarter with nothing much changed, where Lidoderm is the engine that drives Endo with no pipeline supplanting this main product. Although in the short term Lidoderm seems solid, because of our concern with the reliance on one strong product with no visible diversification strategy in action, we maintain our Hold rating on this pain management company.

WATSON PHARMACEUTICALS, INC. (WPI - HOLD, \$27.31)

Messy Q4 numbers as well as cloudy 2007 outlook reinforce our caution

Watson's adoption of Cash EPS was somewhat forced on us as the numbers did not jive well unless using the newly guided Cash EPS in our analysis. We estimate Q1 EPS of \$0.25 compared to \$0.24 consensus and revenues of \$595 million compared to \$624 million consensus, although the Andrx acquisition and integration will keep estimates murky. Watson provided gross margin guidance for each segment of its expanded business, with generic at 38%, brand 76% and distribution business acquired from Andrx at 19%. With better guidance on SG&A where we estimate \$100 million and estimated \$39 million R&D spend, Watson provided more color than its last few earnings calls, but new Cash EPS keeps EPS numbers unsettled, in our view. We continue to see weak fundamentals and manufacturing compliance issues still not resolved, and we remain on the sidelines.

ALKERMES, INC. (ALKS - BUY, \$16.48, \$24 PRICE TARGET)

Amylin: Exenatide LAR, Johnson & Johnson: Risperdal Consta and Vivitrol provide three legs on the stool, although Vivitrol is up to a slow start

With Risperdal Consta® sales (\$260M, in line with our estimate) already reported by Johnson & Johnson and Amylin and Eli Lilly providing updates on Byetta LAR and AIR insulin, which improve 2008-2010 visibility, all that remains is Vivitrol® where expectations remain low. As the March quarter marks the end of Alkermes' fiscal year, this turn of the calendar should put Alkermes' F2008 guidance firmly in the black with upside to F2008 consensus (\$0.12 GAAP, but Non-GAAP or cash EPS likely to be closer to \$0.40), in our view. Viewed through the market lens which now embraces cash EPS and with ALKS stock still 30% below a year ago and Alkermes one of the few names moving into the black, and on the fringe of mid-cap status, Alkermes should benefit from the macro-environment which could move the stock back up above \$20 again this summer, in our view. For FQ4, our revenue estimate is \$56 million compared to \$60 million consensus and we forecast EPS of \$0.03, compared to \$0.01 consensus. Margins are expected to be 90 bp down sequentially at 79.5%. We forecast SG&A spend of \$28 million, sequentially flat, as the company keeps up the Vivitrol product launch. Our R&D spending estimate is \$7 million, down from FQ3's \$12 million, keeping it in line with \$45-\$50 million guidance. Although Vivitrol's first year was challenging, with better reimbursement and the benefit from Cephalon (CEPH: Not Rated) and Alkermes' learning curve, visibility has to improve. We see healthy Risperdal Consta sales sustaining the topline and

believe better visibility on Exenatide LAR should keep the company on an upswing in the short term.

NEKTAR THERAPEUTICS (NKTR - BUY, \$12.53, \$22.50 PRICE TARGET)

Today's Pfizer call with Exubera results and outlook may mean more for NKTR stock than what Nektar says in early May, which may have some details about the implications of its recently announced reorganization with cost cutting measures up to 20% of current SG&A and R&D spending a potential modest catalyst. For Q1:07, our total revenue forecast of \$52 million is slightly below consensus at \$58 million, and we forecast an EPS loss for the quarter of (\$0.28), six cents narrower than the consensus at (\$0.34) where we expect new CEO Howard Robin's cost cutting measures will be disclosed on the earnings call. Current weekly Exubera Rx trends run below 2000 Rx's per week, which is too low to be meaningful at this point, but we expect to see new management's efforts to be more transparent on the earnings call regarding Exubera's progress. Total product gross margins should improve slightly where our estimate is 30%, up from 27.9% sequentially, due to expected increased Exubera royalty revenues. We expect R&D and SG&A numbers to change if cost cutting initiatives began in Q1, where we estimate R&D spend at \$35 million, lower sequentially and SG&A spend remaining essentially flat at \$15 million.

ACUSPHERE (ACUS - BUY, \$4.01, \$8 PRICE TARGET)

Our top name for 2007; stock poised to move more despite recent 40% climb, in our view

Quarterly numbers have no impact financially, but we look for any clues regarding the second pivotal Phase 3 trial RAMP-2 for its Imagify product. With expected trial results coming in Q2:07 as soon as May, we believe the recent visibility could add more upside to the stock prior to the disclosure of data in the short term. Acusphere's management has taken necessary steps to ensure probability of the trial success as well as preparing for the all out launch of the product. IP protection has been fortified by paying GE & Bracco last year despite the Street's concern for cash burn, and with beefing up the management team with a well known cardiologist in Dr. Jaffe heading regulatory affairs and a new proven marketing head, as well as preparing the blinded readers in order to increase statistical probability for the second trial, we suspect that management believes that the product will have low probability of passing regulatory muster. Also, with the manufacturing side on track to meet expected NDA filing later this year, we see Acusphere well positioned for a successful launch pending FDA approval of Imagify.

DEPOMED, INC. (DEPO - BUY, \$3.89, \$12 PRICE TARGET)

Earnings call should show if Glumetza is picking up steam; Gabapentin Phase 3 top line data due in mid-2007

Glumetza's slow uptake makes our Q1 estimates less meaningful, in our view, with the focus on the potentially big Gabapentin pipeline indicated for 3 diseases, each targeting large markets as well as cash burn for the quarter. With ProQuin floundering and Glumetza not adding significantly to the topline yet, pipeline is more important than ever. The most visible pipeline, Gabapentin indicated for post herpetic neuralgia, is currently in Phase 3 trial, where we expect top line data by mid-2007 with NDA filing later this year. We don't expect too many changes to the numbers until the Gabapentin P3 results hit the tape, unless Glumetza's marketing efforts with aggressive 300,000 samplings per quarter driven by seasoned King's sales force translates into the top line.

DURECT CORP. (DRRX - BUY, \$4.75, \$10 PRICE TARGET)

Several pipelines in later clinical stages; Nycomed deal increases visibility.

We believe Durect is moving through its metamorphosis period and should emerge from the proverbial cocoon over the coming quarters with progress across all fronts. The stock has rebounded from lows and could be poised for a nice H2:07 run as investors realize that this \$1B 2010 story should be worth more than \$300M in 2007. As with most micro caps, we look for more color on the pipeline where quarterly financials have little impact in our view. Remoxy Phase 3 results and NDA filing by partners PIT/KG are the next catalysts to watch, with progress on Posidur, potential flagship product and Suragesic (licensed to Endo) moving into Phase 3. With cash burn of \$9.5 million in Q4, we watch closely for cash burn guidance for the quarter/year as well as any partnership updates on its pipeline. It's hard to see the downside in DRRX stock from here as it has lagged the market with internal progress moving ahead, albeit not at the pace we would like to see. Finally, the new CFO is a welcome addition to the management team which may mean more for DRRX stock in the short run. We're still big bulls, but ACUS, at half the valuation, may have great near-term appreciation, in our view.

EMISPHERE TECHNOLOGIES (EMIS - BUY, \$4.53, \$8 PRICE TARGET)

New heavy-hitting CEO lifts sentiment; expecting pipeline updates

The new sheriff in town with a few decades of big pharma operations under his belt and a clean slate after some tough years under his predecessor is providing a fresh look for investors and existing (Novartis) and potential partners, in our view. With Dr. Goldberg's departure, we suspect more will listen to the EMIS story and on the margin, the probability of management being able to extract whatever value lies in the business from getting oral calcitonin through Phase 3 (Novartis announced it is committed and paid Emisphere another milestone in Q1), finding a partner of Heparin and maybe insulin – can only be higher. While it's hard to get too excited about Emisphere right now, at these levels, we recommend investors consider the name as a bundling of micro-caps that have late stage programs and could be acquired in the 2008-2010 timeframe. After hitting 52 week lows post oral calcitonin results last year, the focus for the firm will be the strength and credibility of the new CEO as well as any development news regarding its oral heparin, oral insulin and oral calcitonin products, as well as key partnering of the drugs, as well as taking a closer look at Emisphere's cash burn expectations. We believe partner Novartis lends stability to this weakened stock where co-developed oral calcitonin is in Phase 3 trials with 4500 patients in a randomized 3 year study. Further, we await any FDA comments regarding oral heparin Phase 3 trial design which was submitted by Emisphere in late 2006.

NEW RIVER (NRPH – HOLD, \$63.98)

Epitaph salute to Virginia Tech

As New River fades from our screens, investors should remember the origins of the technology that gave us NRP104. It was a handful of peptide chemists, a small cadre who toiled in anonymity along the periphery of Virginia Tech in Blacksburg, Virginia that performed the synthesis of lysine and amphetamine among scores of others that resulted in the pioneering patents issued to New River. Sure, management and a few other cast of characters, us among them, played roles in exploiting the commercial value of this novel innovation, (this is the time to acknowledge the scientists in Blacksburg and the contributions of Virginia Tech which made the New River success story all possible in the New River valley that the country has come to know this week). They say that fortune favors the prepared mind, but as we learned this week, misfortune can find any of us in an instant. What's a bit troubling is the juxtaposition of New River's origins, with unimaginable fortunes (1600% return in 30 months after IPO) and unimaginable misfortune on the same campus.

For those of us who benefited at any point along the way – there were months with returns better than most years, let's give something back. Let's engage in discourse, support causes that will heal, issues that really matter that can help the most, the safety and nurturing of all our children. It is only the few of us on Wall Street that will remember New River flowing in green, but for Main Street, and the world at large, this place we first visited in early 2004 will be forever remembered as a sea of red. There's something wrong with this picture.

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