BLUE ORCA CAPITAL

"Don't bet on science – bet on management."

- Motto of Michael Pearson, CEO of Valeant Pharmaceuticals

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COMPANY: Corcept Therapeutics | NASDAQ: CORT
INDUSTRY: Biotechnology

PRICE (AS OF CLOSE 2/4/19)
$10.20

MARKET CAP:
$1.17 BILLION

30 DAY AVG VOLUME:
1.8 MM SHARES

BLUE ORCA VALUATION
$5.42 PER SHARE

Corcept Therapeutics (NASDAQ: CORT) ("Corcept" or the "Company") is a pharmaceutical company which derives 100% of its revenues from a single drug, Korlym. The active ingredient in the drug is mifepristone, colloquially known as the 'abortion drug' because of its effectiveness in terminating pregnancies.

Although mifepristone was discovered in France, Corcept garnered FDA approval to use the compound to treat a small subset of patients suffering from endogenous Cushing's syndrome, an extremely rare disease. Based on the incidence rate of Cushing's reported in academic literature (1-2.4 per million), an American is almost as likely to get **struck by lightning** (~500 per year/1.5 per million) than fall into the category of newly diagnosed Cushing's patients for whom Korlym is appropriate.

On January 25, 2019, Roddy Boyd's Southern Investigative Reporting Foundation published a report on Corcept focusing on the questionable efficacy of Korlym, the notable flaws in the Phase III study (e.g., no placebo or control group), Corcept's history of price gouging, and most notably, the suspicion that Corcept engages physicians in pay-for-play. SIRF highlighted that many physicians who frequently prescribed Korlym also received nebulous *honaria* payments directly from the Company. Such payments are not illegal. But they raise the specter that Corcept is inappropriately incentivizing physicians to prescribe an expensive drug of questionable efficacy beyond the extremely narrow set of circumstances for which Korlym was approved.

We do not want to rehash these arguments because we present **new evidence** showing Corcept has a much bigger problem.

- 99% of Corcept's revenues are derived from sales of Korlym through its sole and exclusive specialty pharmacy, Optime Care ("Optime").
- Not only does Optime appear to be a captured specialty pharmacy, deriving most if not substantially all of its revenues from Corcept, but when we called Optime, its representative told us over a recorded phone call that **Corcept and Optime were one and the same**. We were then transferred to a second representative, introduced as a specialty pharmacy care coordinator, who reiterated that we had reached Corcept. We placed a **recording of the call on YouTube (here)** for any interested investor to listen.
- **We believe, based on this evidence, that Corcept's sole specialty pharmacy and exclusive distributor is an undisclosed related party**. If Optime's employees believe that Corcept and Optime are one and the same, then it creates the material risk that the Company is using its captured pharmacy to boost sales, hide losses or engage in other financial shenanigans. We can't know for sure because Optime's financials are not publicly available.
- At a **minimum**, if Corcept's ties to Optime are so close that Optime's representatives believe the companies are one and the same, then we believe that Corcept must **restate its financials to consolidate its specialty pharmacy**.
- This is reminiscent of Valeant, whose collapse was precipitated by revelations of undisclosed ties between Valeant and its supposedly independent specialty pharmacy, Philidor. Although not a perfect comparison, in some ways this is more material. Philidor accounted for only $80 million of Valeant's $2.8 billion sales, whereas here, 99% of Corcept's revenues are derived from Korlym sales through Optime.

Furthermore, if Corcept has control over Optime, this raises the distinct possibility that a captured pharmacy is under undue pressure to inappropriately facilitate the prescription of Korlym in situations where insurance companies, PBMs or Medicare/Medicaid would not otherwise approve the drug. Once payers get wise, we would expect them raise the bar, making it harder to get Korlym approved in the future.

There is market precedent indicating that scrutiny of the relationship between a drug company and a captured specialty pharmacy of questionable independence should have a negative effect on future prescription volumes and drug sales.

In 2016, Horizon Pharma's (NASDAQ: HZNP) shares fell precipitously when it disclosed a subpoena from the U.S. attorney's office questioning its patient access program and the independence of its specialty pharmacies. Horizon was never charged (to our knowledge), civilly or criminally, with any wrongdoing, but because of heightened scrutiny on its pharmacy and patient access program from regulators, PBMs and payers, revenues from two of Horizon's drugs which appear to be subject of the inquiry **declined at a CAGR of -20% and -41%, respectively, in the two years following the subpoena**.

We found a similar trend with respect to Valeant, which used its influence and control over undisclosed related specialty pharmacy, Philidor, to aggressively push the growth of two drugs: Jublia, a toenail fungus treatment, and Solodyn, an acne treatment. Prescription volumes for Jublia and Solodyn **declined at a CAGR of -29% and -11%, respectively**, in the two years following the revelations of Valeant's relationship with its specialty pharmacy.

Corcept is in many ways **more vulnerable** than either Valeant or Horizon, because 100% of its revenues are from one drug, 99% of which is distributed exclusively through a specialty pharmacy which appears, at least according to Optime's employees, to be an undisclosed related party.

Like Horizon and Valeant, we predict that once Corcept's relationship with its specialty pharmacy comes under scrutiny, Optime will be far less aggressive in pushing prescriptions and payers and PBMs should make it more difficult to fill prescriptions, which together will lead to a contraction in Corcept's revenues.

Accordingly, we project a decline in Korlym revenues of **-22% in 2019 and -15% in 2020**, which would be in line with the rate of decline in prescription volumes incurred by the two Horizon and two Valeant drugs in the two years following either a subpoena or revelations questioning the independence of their respective specialty pharmacies.

We may have just seen the canary in the coal mine suggesting that such a decline has already begun. Corcept's stock fell as much as 13.7% on February 1, 2019, after it announced Q4 results revealing it missed Korlym revenue targets by **6%**. More notably, Corcept's initial guidance for FY 2019 was only $300 million, well below the consensus street estimates of $328 million for this year. This miss was so significant that previously bullish sell-side analysts Cantor Fitzgerald and B. Riley downgraded their price targets by 30% and 45%, respectively.

Our model values Corcept at $5.42 per share, based on the sell side valuation of its pipeline at $3.00 per share[1] and our DCF analysis of Korlym, which values the drug at $2.42 per share. Our DCF of Korlym is driven by our expectation of a significant contraction in revenues from Corcept's only drug. Our predicted rate of drug revenue decline would be consistent with the contraction experienced by other drug companies whose relationship with their specialty pharmacy became the focus of investor or regulatory scrutiny.

[1] Bank of America Merrill Lynch Analyst Note on Corcept, October 23, 2018.

NPV of Korlym cash flows	**$97.3**
Plus: net cash at 4Q18	$206.8
Korlym value	**$304.1**
Shares out	125.7
Korlym value per share	**$2.42**
Pipeline value per share (BofA estimate)	$3.00
Blue Orca target price	**$5.42**

Source: Blue Orca

Note: See detailed model and DCF calculation at the end of this report.

Ultimately, we feel this valuation is conservative given the multitude of governance concerns we identified and the material risk of financial restatements to consolidate sales through a specialty pharmacy we believe is not independent.

SPECIALTY PHARMACY APPEARS TO BE UNDISCLOSED RELATED PARTY

Corcept is a pharmaceutical company which derives 100% of its revenues from a single drug, Korlym. The active ingredient in the drug is mifepristone, colloquially known as the 'abortion drug' because of its effectiveness in terminating pregnancies. Although discovered in France, Corcept garnered FDA approval to use mifepristone to treat a small subset of patients suffering from endogenous Cushing's syndrome, an extremely rare disease. Based on the incidence rate of endogenous Cushing's reported in academic literature (1-2.4 per million), an American is almost as likely to get struck by lightning (~500 per year/1.5 per million) than fall into the category of newly diagnosed Cushing's patients for whom Korlym is appropriate.[2]

On January 25, 2019, Roddy Boyd's Southern Investigative Reporting Foundation published a report on Corcept focusing on the questionable efficacy of Korlym, the notable flaws in the Phase III study (e.g., tiny sample size and no placebo or control group), Corcept's history of price gouging, and most notably, the suspicion that Corcept engages physicians in pay-for-play. SIRF pointed out that many of doctors who most frequently prescribe Korlym to Medicare patients also receive nebulous *honaria* payments directly from Corcept. Such payments are not illegal. But they raise the specter that Corcept is inappropriately incentivizing physicians to prescribe an expensive drug of questionable efficacy beyond the extremely narrow set of cases for which Korlym was approved.

We do not want to rehash these arguments because in our view, Corcept has a much bigger problem. 99% of Corcept's revenues are derived from sales of Korlym through its sole and exclusive specialty pharmacy, Optime Care ("Optime"). Not only does Optime appear to be a captured specialty pharmacy, deriving most if not substantially all of its revenues from Corcept, but when we called Optime its representative told us over a recorded phone call that **Corcept and Optime were one and the same**.

1) From Dohmen to Optime: Corcept Trades Down

Because the active ingredient in Korlym is an abortifacient (a drug used to terminate pregnancies) and its use is closely regulated by the Food and Drug Administration ("FDA"), Corcept distributes its drug through a specialty pharmacy. Specialty pharmacies play a unique and important role for drugs like Korlym because the drug is expensive and approved for use in only a very narrow set of circumstances, meaning payers require a lot of tests and paperwork in order to authorize a prescription. Moreover, the drug is typically prescribed for a chronic illness, meaning patients require extensive support over time.[3]

In 2013, Corcept contracted Dohmen Life Science Services ("Dohmen") to serve as its specialty pharmacy and exclusive distributor. Dohmen is a legitimate specialty pharmacy with hundreds of employees and which was recently sold to JLL Partners and Water Street for over $385 million. Dohmen serves more than 300 of the industry's top pharmaceutical and medical device companies.

Even though Corcept renewed its distribution agreement with Dohmen in 2016, Corcept soon had a change of heart. In July 2017, Corcept moved to terminate the contract, alleging material breach. Dohmen denied it was in breach and sued Corcept arguing that the alleged breach was a fabricated pretext for Corcept to switch to Optime.[4] The parties sued each other for breach of contract, and although the litigation is sealed, each party's initial complaint is available under Bloomberg's law function. Corcept and Dohmen settled, the terms of which are not publicly disclosed.

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[2] Cushing's syndrome is a horrible disease, but thankfully it is quite rare. Academic literature states that Cushing's has an incidence rate of only 0.7-2.4 per million of the population per year and a prevalence rate of 39.1 cases per million. Surgery is the first line treatment, effective in 60-90% of cases. *See* Sharma ST, Nieman LK, Feelders RA et al: *Cushing's syndrome: epidemiology and developments in disease management*. Clinical Epidemiology 2015:7 281-293.

Korlym was only approved for Cushing's patients who are diabetic (hyperglycemic) and for whom surgery was ineffective or is inappropriate. Corcept, unsurprisingly, would like investors to believe the market for its drug is much broader, but we have found no evidence in the academic literature to support such self-serving claims.

[3] Initial Complaint, Corcept Therapeutics vs. Dohmen Life Science Services, Case 1:17-cv-01332-JEJ, filed September 28, 2017.
[4] Initial Complaint, Dohmen Life Science Services v. Corcept Therapeutics, Delaware Chancery Court 2017-0567-TMR, filed August 10, 2017.

We see two potential narratives. One is that Dohmen wasn't fulfilling its duties under the contract, which is of course possible. The other potential narrative, however, is far less charitable: that Dohmen was unwilling to push for approval of an increasingly expensive drug only appropriate in a tiny set of circumstances, and Corcept wanted to replace Dohmen with a bucket shop pharmacy completely dependent on Korlym and thus more vulnerable to the Company's influence in facilitating the proliferation of the drug.

Even from the limited publicly available filings, the Dohmen lawsuits reveal interesting details to support our suspicion that switching from Dohmen to Optime was driven by Corcept's desire to increase its influence and control over its specialty pharmacy.

In its complaint, Corcept alleged that Dohmen lacked sufficient information management systems to maintain "accurate and reliable financial reporting" and "key accounting controls."[5] Corcept also alleged that Dohmen failed in its duty to provide accurate and reliable reporting on inventory, billing and receivables. Corcept claimed that it was forced to make over $350,000 in negative adjustment to its financial records due to Dohmen's reporting errors.

Corcept Lawsuit Allegations

b. On July 14, 2016, Corcept Director of IT Patrick Glenn explained to Dohmen Client Executive, Diann Johnson, and Dohmen Director of IT Services, Joe Federer, that as the parties had "discussed on several occasions," Corcept "need[ed] transactional information" generated by Dohmen's LPM system, as well as the "ability to audit and trace" that information, so that its "auditors [could] have confidence" that it was the "right information." Dohmen, however, failed to provide the requested information.

Source: Initial Complaint, Corcept Therapeutics vs. Dohmen Life Science Services, Case 1:17-cv-01332-JEJ, filed September 28, 2017.

Dohmen vigorously denied these accusations, and alleged that Corcept was simply fabricating a pretext to switch to Optime. Dohmen alleged in its complaint that Corcept was **Optime's first ever customer**, and that Corcept had worked behind the scenes with Optime for some time to design Optime's claims and inventory reporting systems.[6]

The odd thing is that Dohmen was a medium-sized enterprise with hundreds of employees, a roster of over 300 pharmaceutical and medical device customers, and a valuation of over $385 million. By comparison, Optime looks like a bucket shop.

Dohmen vs. Optime

	Dohmen*	Optime Care
Date of incorporation	2004	2015
Years in business at time of switch	**13.0**	**2.0**
Start of CORT relationship	2013	2017
Employees on LinkedIn	**329**	**32**
Dohmen/Optime Care	*10.3x*	

*Note: *Dohmen here refers to Dohmen Life Science Services (DLSS), which as Centric Health Resources was acquired by the Dohmen Company in 2011. DLSS was sold to JLL Partners and Water Street Healthcare Partners in 2018.*
Sources: https://www.biztimes.com/2018/industries/banking-finance/dohmen-completes-sale-of-life-science-services-division/
https://www.businesswire.com/news/home/20110809006224/en/Dohmen-Company-Acquires-St.-Louis-Based-Centric-Health

[5] Initial Complaint, Corcept Therapeutics vs. Dohmen Life Science Services, Case 1:17-cv-01332-JEJ, filed September 28, 2017.
[6] Amended Complaint, Dohmen Life Science Services v. Corcept Therapeutics, Delaware Chancery Court 2017-0567-TMR, filed September 27, 2017.

If Dohmen's internal systems were antiquated, how could a small specialty pharmacy like Optime afford the appropriate reporting systems? **If Optime was formed to serve Corcept, and Corcept allegedly helped design Optime's systems, how did Optime get the money to build such systems? Did Corcept or parties connected to it fund the initial investment?**

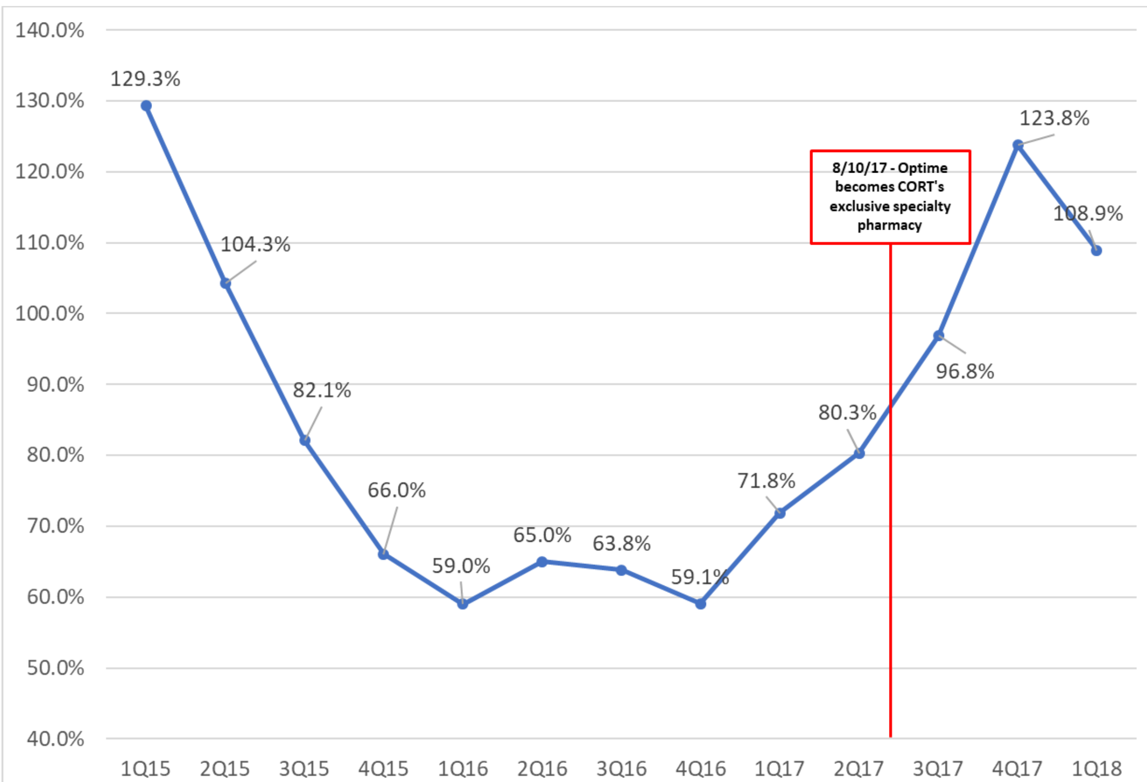
Perhaps the counterargument is that Optime, with one customer, could devote the necessary time and attention to better manage the prescription process and to better serve Corcept, patients and payers. But this relies on the presumption that a startup specialty pharmacy could invest in better systems than a much bigger business (Dohmen) with more employees, experience and relationships.

There is circumstantial evidence to support our thesis that Optime was far more pliable to push prescriptions at the margins than Dohmen.

The growth rate in Corcept revenues, driven exclusively by Korlym prescriptions, accelerated significantly in Q3 and Q4 2017, immediately following the switch from Dohmen to Optime, which formally took place in August 2017.

Quarterly Growth in Corcept Revenues

	1Q16	2Q16	3Q16	4Q16	1Q17	2Q17	3Q17	4Q17	1Q18
Revenue	$16,061	$19,724	$21,725	$23,811	$27,599	$35,559	$42,763	$53,280	$57,659
% yoy	59.0%	65.0%	63.8%	59.1%	71.8%	80.3%	96.8%	123.8%	108.9%



Source: Corcept Annual and Quarterly Reports

In our view, this acceleration in sales growth is suspicious. Corcept will no doubt argue that the growth was attributable to increasing popularity of its drug among physicians, and Optime's superior efficiency and level of service. But this data could also support the competing narrative, that Optime was a captured pharmacy that was so dependent on Corcept that it was significantly more aggressive in pushing Korlym through the approval process.

In its complaint, Dohmen described the claims approval process for Corcept as "exacting and intense." This process was only getting harder because PBMs and relevant payers were imposing "increasingly complex requirements" for approval.[7]

If payers and PBMs were making it harder to approve Korlym, how did revenue growth accelerate so materially when Optime took over? Was Optime that much better than Dohmen?

The crux of the short case against Corcept, as outlined by SIRF, is that Corcept is financially incentivizing physicians with direct payments to prescribe Korlym beyond the narrow set of circumstances for which the drug was approved and in which the drug is appropriate. This is extremely costly to the health care system, in part because Corcept has raised prices on Korlym since FDA approval. Yet pay-for-play with physicians is only half the thesis, because such prescriptions have to clear an increasingly high bar set by PBMs and payers.

That is why the specialty pharmacy is so important. A specialty pharmacy like Dohmen with hundreds of clients and a large book of business would have no incentive to push Korlym through the approval process in situations where the drug would not be appropriate or merited. But the same cannot be said of Optime, whose first and we think only major client is Corcept and thus has direct financial incentive to match the Company's aggressive tactics.

Notably, right before Corcept switched from Dohmen to Optime, the Company **increased guidance** substantially.[8]

Date	Event	FY guidance Low	FY guidance Mid	FY guidance High	Change in mdpt from previous
3/6/2017	4Q16 results; FY guidance increased to 120-130MM from 115-125MM	$120.0	$125.0	$130.0	$5.0
5/1/2017	1Q17 results; FY guidance increased to 125-135MM	$125.0	$130.0	$135.0	$5.0
8/1/2017	2Q17 results; FY guidance increased to 145-155MM	$145.0	$150.0	$155.0	$20.0
11/2/2017	3Q17 results; FY guidance increased to 157-162MM	$157.0	$159.5	$162.0	$9.5
2/22/2018	4Q17 results; FY18 guidance to 275-300MM	$275.0	$287.5	$300.0	
5/8/2018	1Q18 results; reaffirmed guidance	$275.0	$287.5	$300.0	$0.0
8/9/2018	2Q18 results; guidance reduced to 250-270MM	$250.0	$260.0	$270.0	($27.5)
11/1/2018	3Q18 results; reaffirmed guidance	$250.0	$260.0	$270.0	$0.0

Source: Corcept Earnings Releases

We think this is evidence that Corcept knew Optime would be far more aggressive in pursuing claim approvals.

Again, the narrative could be that Optime did a better job of record keeping and working with physicians and payers, which may explain the growth in prescriptions. But the alternative explanation could be that Optime was willing to do whatever Corcept asked to get prescriptions filled. To us, it comes down to whether Optime is sufficiently independent. Our due diligence shows that, in our opinion, it's not.

2) Optime's Questionable Independence

On paper, Optime and Corcept may be separate. Without access to Optime's shareholder records or formation documents, we do not know Optime's shareholder structure or whether it ever received capital or investment from Corcept or any of its directors or officers. However, our research indicates that in practice, the two companies appear far from independent.

In order to examine the independence of Optime, we dialed Optime's main phone number (888-287-2017) to ask about the pharmacy's relationship with Corcept. The following is a transcript. Note that **we called Optime**, not **Corcept**, yet according to Optime's representatives, Corcept and Optime **are one and the same**.

[7] Amended Complaint, Dohmen Life Science Services v. Corcept Therapeutics, Delaware Chancery Court 2017-0567-TMR, filed September 27, 2017.
[8] Corcept formally switched to Optime on 8/10/2017.

Due Diligence Phone Call: January 2019

*Optime Representative: **Optime Care**, this is XXXX.*

*Blue Orca: **Hi, I'm looking for Corcept Therapeutics please.***

*Optime Representative: **Yes, you have reached it, is there anyone in particular you need to speak with**.*

Blue Orca: I'm a physician, an endocrinologist in the Austin area, and I was wondering if there was a Corcept sales representative that covered the area?

Optime Representative: Um yep, hold on, I will let you speak with the director of the Spark program and they can certainly tell you. Okay?

Blue Orca: Thank you.

Optime Representative: You're welcome.

…. (on hold)

*Optime Representative: Sir, I'm going to transfer you over to XXX and XXX is one of **our care coordinators** and he can find a sales rep in your area for you.*

… (call transferred internally)

Optime Representative #2: Thank you for holding, this is XXX, how can I help you?

*Blue Orca: **Hi, is this Corcept**?*

*Optime Representative #2: **It is**.*

Blue Orca: Ok, great. I'm a physician endocrinologist in the Austin Texas area and I was actually wondering if there was a sales rep that covers this area to learn more about the Korlym Treatment?

Optime Representative #2: Yeah, let me find out who your sales rep would be for that area…

…

Optime Representative #2 places us on hold, then retrieves the Corcept sales representative's number for the Austin area.

We placed a **recording of the call on YouTube** (**here**) for any interested investor to listen.

This simple phone call, in our opinion, is nothing short of a bombshell. Optime is supposed to be an **independent third-party pharmacy**, yet when we called Optime and asked for Corcept, an Optime representative told us that Optime and Corcept were one and the same.

To confirm, we asked the second representative, introduced as a specialty pharmacy care coordinator, if we had reached Corcept? He replied, "**it is**."

In our opinion, this phone call indicates that far from being an independent third party, Corcept's only distributor and specialty pharmacy is an undisclosed related party. After all, Optime's representatives believe the two companies are one and the same. We think this creates a massive problem for Corcept, for three reasons: (a) related parties must be consolidated, meaning Corcept should, in our opinion, restate its financial statements; (b) payers and PBMs who question the independence of the specialty pharmacy should raise the bar for future prescription approvals, and (c) there is an enhanced risk of regulatory scrutiny of the relationship between the drug company and its specialty pharmacy.

a. Restating Financials Because Sole Distributor is an Undisclosed Related Party

If Optime's employees believe that Corcept and Optime are one and the same, then it creates the material risk that the Company is using its captured pharmacy to boost sales, hide losses or engage in other financial shenanigans. We can't know for sure because Optime's financials are not publicly available.

At a minimum, we think Corcept must restate its financials to consolidate Optime, raising the possibility that there are significant off-balance sheet liabilities or receivables.[9]

Related party transactions are subjected to a higher degree of scrutiny by auditors and investors because the lack of independence between company and distributor creates a much higher risk of financial impropriety.[10] In this case, we think this risk is multiplied because 99% of Corcept's revenues are derived from sales through a pharmacy whose representatives are acting as if the two companies are one and the same.

Citron called out Valeant for improperly inflating sales through Philidor, an entity Citron correctly identified as an undisclosed related pharmacy. Although the comparison is not perfect, in some ways this is more material. Philidor accounted for only $80 million of Valeant's $2.8 billion sales, whereas here, 99% of Corcept's revenues are derived from Korlym sales through Optime.

But it's not just the specter of inflated sales and hidden liabilities. It's also profitability. Corcept reports a 98% gross margin and, in 2017, a 33% operating margin. How could its profitability not be impacted, if as we believe, its undisclosed related party pharmacy is consolidated? Of course, without insight into Optime's financials, which we don't have, it's hard to know. But we suspect that the Company's purported financial performance would look substantially less attractive once it properly consolidates its sole distributor.

b. Pushback from Payers

Second, it raises questions about the pharmacy's role in getting prescriptions approved. According to Dohmen and confirmed by our expert calls, it has become increasingly difficult to get Korlym approved because of the drug's high and increasing cost. This makes sense because Cushing's syndrome is a very rare disease and even among those patients, Korlym is only approved for use in a very narrow set of circumstances.

But PBMs and insurance companies rely on Optime to manage the prescription process. If Optime is not truly independent, then PBMs and insurance companies should question whether Corcept exercises undue influence over the approval process. This influences how investors think about both Corcept's past and its future.

With respect to the robust growth it has reported in the past, if its specialty pharmacy was not truly independent, then we think it calls into question the propriety of prescriptions, especially at the margin.

Our suspicion is that Corcept has used direct financial incentives to encourages doctors to over-prescribe Korlym even when its appropriateness is questionable. This is a significant cost to payers and the health care system. The pharmacy is a critical independent gate keeper facing payers and patients. But if the pharmacy is not independent, then we think it raises the material risk that prescriptions were, at the margins, pushed to approval in circumstances that may not warrant the drug.

We believe there is certainly a very narrow limited place for Korlym. The question is whether the Company's growth is driven by an expanding patient universe, or as we believe, questionable Company behavior which is by definition unsustainable.

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[9] Under the Distribution Services Agreement ("DSA") between Corcept and Optime, Corcept provides Korlym to Optime for dispensing to patients. Optime does not take title to the product. Rather title passes directly from Corcept to patients at the time the drugs are received by patients.

[10] We have no visibility into Optime's financials, so we cannot say definitively that any such shenanigans are taking place.

But this also raises questions about Corcept's **future**. If Optime is not truly independent, then PBMs and insurance companies should subject the approval process to even greater scrutiny. If payers like PBMs and insurers raise the bar, we would expect a significant decline in prescription volumes and pricing.

c. Regulatory Risk

Third, there are regulatory implications. Although we are by no means experts, we see parallels with other drug companies whose share price reflected growing investor concerns over undisclosed related party ties with supposedly independent specialty pharmacies.

The most famous case is Valeant, which was first subject to scrutiny for acquiring antiquated but life-saving drugs and jacking up their prices. Akin to Valeant, Corcept did not discover the active compound in its drug. But that has not stopped Corcept from raising prices an estimated 106% since FDA approval.[11]

But the similarities do not end there. A good summary of the Valeant timeline can be found here, but the first investor to publicly mention Philidor was actually Bronte Capital's inimitable John Hempton. After a comprehensive series of posts scrutinizing Valeant's accounting, Hempton put up a cryptic post (his words) referencing the film *The Graduate* and the word "Philidor." After more great work by Roddy Boyd and Citron, it was revealed that Philidor was an undisclosed related party, a captured specialty pharmacy which was controlled by Valeant.

The relationship between specialty pharmacies and drug companies is clearly in the crosshairs of politicians and regulators alike, particularly in cases like Corcept where a Company has raised drug prices rapidly. Undisclosed ties have clearly been a potential regulatory issue for other drug companies, and we think they could be an issue here.

[11] Based on wholesale cost of prescriptions as reported by Symphony Health.

VALUATION: SCRUTINY OF PHARMACY RELATIONSHIP LEADS TO REVENUE DECLINE

There is market precedent indicating that scrutiny of a relationship between a drug company and a specialty pharmacy of questionable independence should have a negative impact on prescriptions and drug sales.

In 2016, Horizon Pharma (NASDAQ: HZNP)'s stock dropped significantly when it announced that it received a subpoena from the U.S. Attorney's Office for the Southern District of New York requesting documents and information related to its patient access programs and its relationships with its specialty pharmacies. Horizon was never charged (to our knowledge), civilly or criminally, with any wrongdoing, but the subpoena and scrutiny had a noticeable impact on sales of its drugs which were likely the focus of the inquiry.

According to securities litigation, the two drugs under scrutiny for Horizon's links to specialty pharmacies and patient access programs were Duexis and Vimovo.[12] Notably, Horizon's revenues from these two drugs declined at a CAGR of -20% and -41% respectively in the two years following the subpoena.

Horizon Drug Price and Prescription Volume Declines in Years Following Subpoena

	2015	2016	2017	CAGR
HZNP				
TRx count at retail				
Duexis	643,542	558,275	537,626	-8.6%
Vimovo	486,835	345,141	281,054	-24.0%
TRx count at retail %yoy				
Duexis		-13.2%	-3.7%	
Vimovo		-29.1%	-18.6%	
Product revenue				
Duexis	$190,357	$173,728	$121,161	-20.2%
Vimovo	$166,672	$121,315	$57,666	-41.2%
Product revenue %yoy				
Duexis		-8.7%	-30.3%	
Vimovo		-27.2%	-52.5%	
Implied yoy px change				
Duexis		5.2%	-27.6%	
Vimovo		2.7%	-41.6%	

Source: Symphony Health Prescription Data; Horizon Annual Reports

Horizon's two drugs Duexis and Vimovo, which we believe were the focus of scrutiny from federal prosecutors and securities lawyers, showed a marked drop off in sales in the two years after falling under scrutiny. This was driven in both cases by an immediate and significant contraction in **retail** prescription volumes and a significant drop in drug pricing.

[12] Rayos was also named in the securities litigation as a focus of inquiry, but sales volumes were so small that we excluded it. We focused on Duexis and Vimovo, which because of their maturity make for a better comparison to Korlym.

DUEXIS. Net sales decreased $52.6 million, or 30%, to $121.2 million during the year ended December 31, 2017, from $173.8 million during the year ended December 31, 2016. Net sales decreased by approximately $59.4 million due to lower net pricing, as further described after the next table, partially offset by an increase of $6.8 million resulting from prescription volume growth.

VIMOVO. Net sales decreased $63.6 million, or 52%, to $57.7 million during the year ended December 31, 2017, from $121.3 million during the year ended December 31, 2016. Net sales decreased by approximately $47.1 million due to lower net pricing, as further described after the next table, and approximately $16.5 million resulting from lower prescription volume.

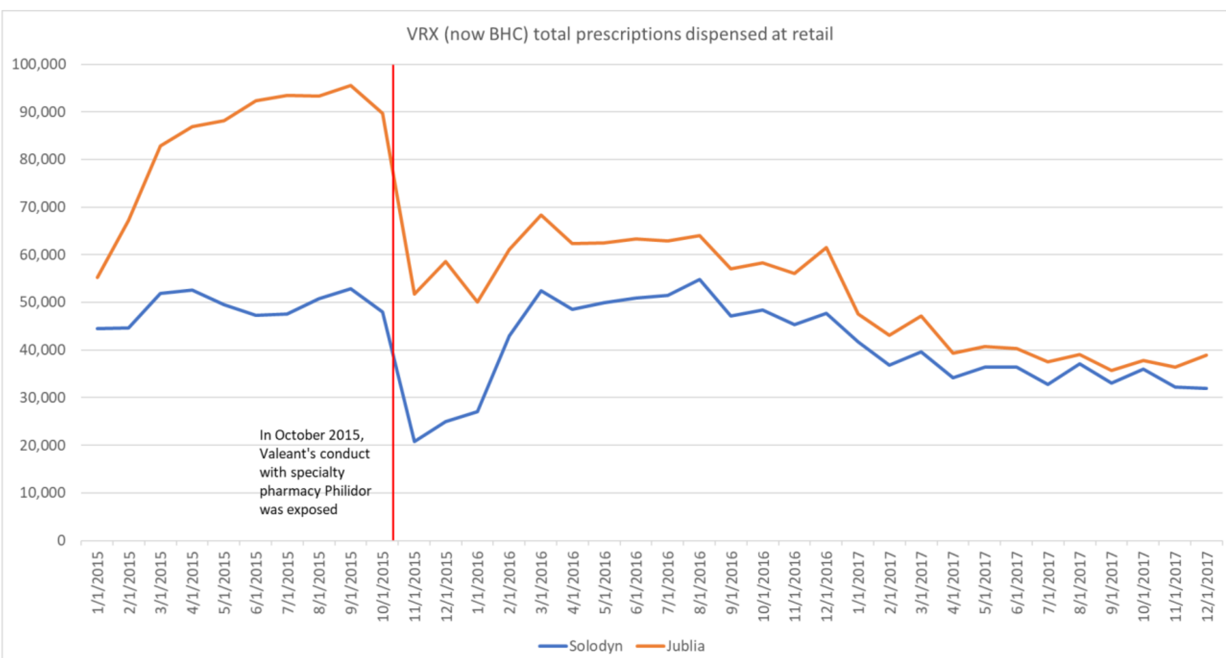
Source: Horizon 2017 Annual Report

We think that there are two reasons that Horizon's revenues declined for the two drugs presumably at the epicenter of the inquiry. First, because of the scrutiny regarding Horizon's patient access program and the independence of its specialty pharmacy, we suspect that its pharmacies were likely far less aggressive in pushing prescriptions through the approval process. Second, we suspect that once PBMs and payers were alerted by the subpoena to the potential conduct of patient access programs and specialty pharmacies, they more thoroughly scrutinized the approval process or aggressively renegotiated pricing and rebates.

We found a similar trend with respect to Valeant, which used its influence and control over undisclosed related specialty pharmacy, Philidor, to aggressively push the growth of two drugs: Jublia, a toenail fungus treatment, and Solodyn, an acne treatment.

Sales of Solodyn had been declining for years as generics entered the market but jumped 56% in Q1 2015 as Valeant pushed sales through Philidor. Sales of Jublia were up 188% that quarter (compared to Q1 the previous year).[13]

Yet this growth was unsustainable. When Valeant fell under scrutiny for its ties to Philidor, prescriptions volumes for the two drugs fell at a CAGR of -10.6% and -28.9%, respectively, in the two years following the revelations.



Source: Symphony Prescription Data Available through Bloomberg

[13] We have seen no evidence that Corcept is engaged in a kickback scheme to increase prescriptions, so Valeant is therefore not a perfect comparison. But Valeant remains illustrative in showing what happens to prescription volumes and drug sales when the relationship between a specialty pharmacy and a drug company comes under scrutiny for questionable independence, which we believe will happen with Corcept and Optime.

Valeant: Drug Price and Prescription Volume Declines in Years Following Subpoena

	2015	2016	2017	CAGR
VRX				
TRx count at retail				
Solodyn	535,345	566,883	428,311	-10.6%
Jublia	955,123	727,535	483,420	-28.9%
TRx count at retail %yoy				
Solodyn		5.9%	-24.4%	
Jublia		-23.8%	-33.6%	

Source: Symphony Prescription Data Available through Bloomberg

Valeant and Horizon are illustrative because both cases show a material decline in prescription volumes following scrutiny from the markets (and regulators) of the drug company's relationship with its specialty pharmacy.

Corcept is in many ways **more vulnerable** than either Valeant or Horizon, because 100% of its revenues are from one drug, of which 99% is distributed exclusive through a specialty pharmacy which appears, at least according to Optime's representatives, to be an undisclosed related party.

In our model, we therefore predict that Korlym will see a similar decline in prescription volumes in the next two years. We predict that once the relationship comes under scrutiny, Optime will be far less aggressive in pushing prescriptions and payers and PBMs should make it more difficult to fill prescriptions, which together will lead to a contraction in Corcept's revenues.

Neither Valeant nor Horizon were able to maintain pricing once their respective relationships with specialty pharmacies came under scrutiny. We would expect the pricing of Korlym to come under similar pressure from payers and PBMs.

Accordingly, we project a decline in Korlym revenues of **-22% in 2019 and -15% in 2020**, which would be in line with the rate of decline in prescription volumes incurred by the two Horizon and two Valeant drugs in the two years following either a subpoena or revelations questioning the independence of their respective specialty pharmacies.

We may have just seen the canary in the coal mine suggesting that such a decline has already begun. Corcept's stock fell as much as 13.7% on February 1, 2019, after it announced Q4 results revealing it missed Korlym revenue targets by **6%**. More notably, Corcept's initial guidance for FY 2019 was only $300 million, well below the consensus street estimates of $328 million for that year. This miss was so significant that previously bullish sell-side analysts Cantor Fitzgerald and B. Riley downgraded their price targets by 30% and 45%, respectively.

With respect to Korlym, our DCF uses the only sell-side estimates for sales in 2022 and 2023, when competition from generics is expected to drive down revenues. Our model makes other assumptions favorable to Corcept, including the exclusion of research and development costs which presumably will be incurred for Relacorilant.

Blue Orca DCF					B. Riley rev estimates	
(MM)	**2018**	**2019**	**2020**	**2021**	**2022**	**2023**
Korlym revenue	$251.2	$194.7	$165.5	$157.2	$69.3	$10.4
		-22%	*-15%*	*-5%*	*-56%*	*-85%*
Gross margin	98%	98%	98%	98%	98%	98%
Gross profit	$246.2	$190.8	$162.2	$154.1	$67.9	$10.2
SG&A excluding R&D for Relacorilant (sell side)		$80.7	$86.3	$103.6	$109.8	$129.5
EBITDA		$110.1	$75.9	$50.5	($41.9)	($119.4)
Changes in WC		($2.0)	($2.0)	($2.0)	($2.0)	($2.0)
Estimated Korlym FCF		**$108.1**	**$73.9**	**$48.5**	**($43.9)**	**($121.4)**
NPV at 16% Bloomberg WACC		$93.1	$54.8	$31.0	($24.1)	($57.5)
NPV of Korlym cash flows		**$97.3**				
Plus: net cash at 4Q18		$206.8				
Korlym value		**$304.1**				
Shares out		125.7				
Korlym value per share		**$2.42**				
Pipeline value per share (BofA estimate)		$3.00				
Blue Orca target price		**$5.42**				

Source: Blue Orca model and calculations

Note: Model values Korlym cashflows and excludes costs of Relacorilant R&D

Our model values Corcept at $5.42 per share, based on the sell side valuation of its pipeline at $3.00 per share[14] and our DCF analysis of Korlym, which values the drug at $2.42 per share. Our DCF of Korlym is driven by our expectation of a significant contraction in revenues from Corcept's only drug. Our predicted rate of drug revenue decline would be consistent with the contraction experienced by other drug companies whose relationship with their specialty pharmacy became the focus of investor or regulatory scrutiny.

But there are reasons to believe that this valuation is too generous to the Company. Notably, the Company's Chief Medical Officer, Dr. Fishman, announced his resignation in November 2018. He had been CMO for three years. Dr. Fishman was leading Corcept's drug development pipeline, so his resignation is hardly a vote of confidence in the Company's future, especially at the beginning of its critical Phase III trial for Relacorilant.

We believe that at a minimum, Corcept must restate its financials to consolidate Optime. This brings the material risk of off-balance sheet liabilities, revenue recognition pitfalls and ballooning receivables.

Pharmaceutical companies with undisclosed ties to specialty pharmacies are a hot button issue for investors and regulators, especially when such relationships accompany price gouging like it does here. Concerns regarding Corcept's governance and potential restatements of the Company's financials may therefore warrant a much lower valuation.

[14] Bank of America Merrill Lynch Analyst Note on Corcept, October 23, 2018.

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