BI Research®

Celebrating our 33rd year!

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Year 33, No. 2

DJIA- 14,001
S&P 500- 1,516

InVivo Therapeutics

(NVIV $1.75, OTC BB)*

With the stock market probing all-time highs, and up every week for the past 7, one can argue that a correction is overdue. So I thought I'd feature one of our best existing stocks rather than serve up something new into a likely correction. And as I look through our stable I find the stock I am most enthusiastic about at today's price is InVivo. We've been up on this one and down and up and now we're down a little as investor enthusiasm waxes and wanes … often due to a misunderstanding of the situation. InVivo finally really is on the verge of where we thought it was nearly a year ago. Everything is in position for a great year and yet the share price just doesn't get it.

InVivo is a biotech company primarily focused on spinal cord injury (SCI) that has developed *a number of technologies* that it has tested in over 40 paralyzed African Green monkeys (AGMs) and every one of them was able to run again within 3 weeks. These monkeys are excellent models for humans with a genomic similarity in excess of 98%, and the neuro-physiological characteristics of how the spinal cord works in humans as compared to these AGMs is nearly identical. As of today at long last InVivo has filed everything needed to gain approval from the FDA to commence human clinical trials which the Company hopes to have (well) under way by this summer. The preclinical data from its primate testing has been published in the *Journal of Neuroscience Methods* and won the prestigious Apple Award in 2011 from the American Spinal Injury Association.

As I noted, InVivo has a number of patented technologies to treat spinal cord injury. For the most part these were co-invented by recent Nobel Prize finalist Dr. Bob Langer of MIT in collaboration with Jospeh Vacanti, MD of Mass General Hospital. After Frank Reynolds, who had been almost completely paralyzed himself for three years (and now walks) learned about Dr. Langer's work and they traded notes … long story short, they decided to form InVivo to bring these technologies to market. (The patent rights that are the basis for InVivo's products are under an exclusive, world-wide license from Children's Medical Center and M.I.T.) Dr. Langer's involvement is no small part of this story. So at this point I need to explain why his involvement is very exciting- "Dr. Langer has written over 1,100 articles. He also has approximately 760 issued and pending patents worldwide. Dr. Langer's patents have been licensed or sublicensed to over 220 pharmaceutical, chemical, biotechnology and medical device companies. He served as a member of the United States Food and Drug Administration's SCIENCE Board, the FDA's highest advisory board, from 1995 - 2002 and as its Chairman from 1999- 2002. Dr. Langer has received over 180 major awards including the 2006 United States National Medal of Science, the

Charles Stark Draper Prize, considered the equivalent of the Nobel Prize for engineers, and the 2008 Millennium Prize, the world's most prestigious technology prize…" Any questions? So Dr. Langer's involvement here lends a *huge* dose of credibility to this story. He is the second largest shareholder with over 7 million shares.

Okay, so let me get on to the technologies. First up to bat and hopefully finally on the brink of entering clinical trials is its biocompatible polymer scaffolding device to treat acute SCI. This is an already FDA approved material that in time dissolves into water and CO2 and has been used for years in sutures and microspheres for drug delivery. So it's very safe. Inserting a small piece of this into a human spine to reduce the bleeding, inflammation and ultimately scarring which in combination is what actually causes the paralysis after SCI … well, that's the innovation here. By surgically inserting this scaffolding device/material into the spine, if even 10% of the nerve tissue can be preserved, it can make a world of difference to the SCI patient's outcome and quality of life. Even something so small as a patient who is totally paralyzed vs. one who can move a finger to press buttons on a wheel chair is a *huge* difference … let alone walk across the room as the monkeys all could afterwards. So there is a whole range of degrees of success that could come out of this pending clinical trial. For years the state of the art has been to go in, remove/ repair any damaged bone and stabilize the spine with rods and screws, period. Paralysis from the point of injury on down is the usual result. Heretofore there have been no treatment options for SCI patients to successfully restore function following a spinal cord injury. This is a $10 billion market and is one of the holy grails of medicine.

During an April 2012 meeting with the FDA (which itself took forever to happen, it seemed) defining what needed to be done for InVivo to gain approval, the FDA indicated that the device would qualify for the Humanitarian Use Device/Humanitarian Device Exemption (HUD/HDE) pathway that in short makes approval *much* quicker. Great news. Investors thought they were on their way to clinical trials shortly and the stock soared. But as time dragged on, InVivo's move from scattered facilities into a new 21,000 sf facility at the end of the summer threw a monkey wrench into the timeline as the FDA decided that InVivo needed to move in, make batches in its new facilities, validate everything, have it inspected and submit it all for approval. While that was done by December they then had to do a whole bunch of testing of these batches and documentation of them, which took into February. And also we learned that as far as HUD/HDE designation for the scaffolding device, the FDA doesn't just say it (back in April) and it's done, you actually have to apply for it. And this was not done until December after a new hire with an expertise in this area came on board. This started what investors thought was a 45-day hard clock for approval by the FDA. As that deadline came and went in late January, investors started fearing no news was bad news and the stock which had run up nicely in January to that point began a sell off that bottomed this past week around $1.65. However, everything *is* now finally in to the FDA as I understand it to the point the Company has even had a celebration of completing this process. So we really *are* now just awaiting FDA approval, of the HUD and HDE. Moreover under this pathway, because there is currently nothing out there for these SCI patients, the FDA has told InVivo that a clinical trial of just five patients that shows some benefit and no harm will be sufficient for the Company to be able to market its product for sale. If this open label trial gets underway by the end of Q2, the Company has promised some word on results after the first patient, or two, is tested. Ultimately if successful InVivo can market this product itself as there are only 75 trauma centers in the country that can handle such patients.

As far as other technologies (they have seven)- InVivo has a hydrogel (essentially a liquid form of this scaffolding material) that it can *inject* into the spine at the point of injury to reduce inflammation and scarring, and this works as well in monkeys as, or better than, inserting it surgically. And when this scaffolding material is combined with anti-inflammatory drugs, or human stem cells, those work even better. But these have *much* longer approval timelines. Actually <u>next at bat</u>, InVivo discovered that if it used its hydrogel to deliver corticosteroids to the site where patients are getting periodic injections for chronic pain (often along the spine), then rather than dissipating in a week, the hydrogel holds on to the medicine and continues to work for up to a year. This is a $24 billion market and will require a partner. And there are more applications, like its injectable dura sealant, many of which will be partnered out, and this too could start happening in 2013. Of course, at some point I now think it is quite likely that one of these partners is going to want to acquire InVivo (Stryker?) … the likely end game here. I could go on and on, but I think you have the idea. If this works I can see a great movie being made out of this story. InVivo has a low burn rate and about $15 million in the till to pursue all this through 2013. It's finally all coming together now. Accordingly these shares are a Buy. www.invivotherapeutics.com For more, *visit their site and click on the many videos there*.

Time for a Correction?

With the S&P 500 up 502 days without a 10% correction and up for 7 weeks in a row without a down week for the first time in 42 years, until this past week when it had a midweek correction (though ending only 4 points lower for the week), one could argue that we are due for a correction. Judging from the stock market, you might think our economy was growing at 5% and housing was booming like the old days. But in fact, GDP was down a little in Q4 and at best it's likely to grow by about 1.5-2% this year. Thompson Reuters recently said that corporate profits climbed just 0.1% in Q3, the lowest since Q3 of 2009. Also housing, which had been reviving, has slumped lately. And this past week the Fed put a chill on the market as the ranks began to split on how long to maintain QE3. Plus nobody yet knows what that extra 2% of social security tax coming back out of pay checks and the pending automatic budget cuts effective 3/1 will do to the economy. The obvious answer is- it can't help. It all takes money out of the economy, not even to pay down the federal deficit, but just to keep it from going up as steeply as it had been. So why has the market been so ebullient? Well, I come back to the stock market being the best horse at the glue factory. With interest rates still near zero, and bonds at high rates maturing, where are you going to reinvest the money? This time of year a lot of pension and IRA money is looking for a place to invest as well. Investing in bonds now when interest rates are so low and have nowhere to go but up (and thus bond prices have nowhere to go but down) is risky business unless you plan on holding until maturity. CD yields are even more pitiful. So many are concluding the best place to park funds until rates improve is in the steadily rising stock market, especially in dividend paying stocks, and up we go. The thing is, this picture is not changing anytime soon so maybe we won't get much of a correction. And more than one legendary investor has cautioned not to invest against the trend, never underestimate how much higher a stock can go, and don't fight the Fed. So while a correction seems likely, it's not a sure thing by any means. Balancing all this with the fact that we are still in a seasonally strong 6 months of the year, I'll ease off the throttle just a touch to 80% invested. Currently most attractive for purchase are In Vivo, Sanchez, PetroBakken, Taseko, Kodiak, Spirit, VASC and MAPTX. Next issue mail date is 4/8.

QUANTA SERVICES* (PWR $28.70 NYSE, +18%); BI Rank = 7.6 – Hold

www.quantaservices.com TX (713) 629-7600 (Rec. 10/12)

Quanta Services is primarily engaged in the construction and maintenance of electrical transmission and distribution lines as well as pipelines primarily for the oil and gas industry. Quanta finds itself in the sweet spot of energy infrastructure build-out over the next few years which has driven backlog to record levels and promises to expand even more when the many pipeline contracts the Company is currently negotiating/bidding come to fruition later this year and in 2014. Approval of the Keystone XL pipeline would only add on top of this. Indeed pipeline companies planning a multitude of projects (besides Keystone) are nervous that there will be enough resources available to get the job done. Quanta is the biggest operator in the pipeline construction business and notes nobody is better prepared to handle this surge than it is. 2012 was the best year in the Company's history capped by a quarter that will take a while to top, in part due to 40,000 hours of round-the-clock, higher margined work for Hurricane Sandy. Storm work generated $250 million in revenues in 2012 vs. a norm of $100 million. Quanta earned an adjusted $.51 a share in Q4 from continuing operations (recall they sold their telecom unit in Q4) up 34% over last year's $.38, clobbering expectations of $.35 by a whopping $.16 and also sequentially improving over Q3's $.45. Q4 continuing revenues increased to $1.67 billion vs. last year's $1.39 billion, so clearly as things get busier margins are improving. During the full year revenues grew 41% to $5.9 billion from continuing operations. Internally the Company grew 36% in 2012. Full year GAAP earnings were $1.36 from continuing ops. and $1.52 adjusted (primarily for stock based compensation and amortization of intangibles on prior acquisitions). One problem with such a strong Q4 and the extra earnings from Sandy (which are not in next year's more normalized budget) is that by comparison guidance for 2013 of $1.23 - $1.53 doesn't look as good, and the consensus has since dropped from $1.49 to $1.40. *However,* Quanta doesn't budget much for work it doesn't know will start this year. For example, little or nothing for those big pipeline projects coming down the … pipe, and the low end of guidance assumes excess regulatory delays on electrical transmission line starts. Also analysts shouldn't abandon their earlier estimates so quickly because in 2012 Quanta reported $1.52. And guess what its guidance was at the start of the year … $1.08 - $1.28. Yeah… I'll stick with $1.50 for 2013. And with these pipeline projects coming in 2014, that should be an even better year. With a nod to all this, investors gave Quanta a pass on its somewhat weak looking guidance. It's actually up 2% since the release- Hold.

PERRIGO* (PRGO $113.31 NMS, +9%); BI Rank = 8.0 – Buy at $110
www.perrigo.com (12/12)

Perrigo is primarily in the business of making store brand, over-the-counter healthcare products. The products contain the same active ingredients, work just as well and yet generally cost consumers about 25-30% less than the brand name products right next to them on the shelf. Meanwhile they also cost the retailer (like CVS or Wal-Mart) about 50% less, thereby enabling a fatter profit margin and great return on a smaller investment in inventory. Everybody wins. Within this store brand segment, besides the obvious Perrigo also sells infant formula, pet care products (like flea collars), nutraceuticals and vitamins. In all, this accounts for about 75% of revenues. Another 20% of its revenue comes from prescription topical and specialty generics, with the balance coming from its active pharmaceutical ingredients business.

Perrigo's *fiscal* Q2 results and forward looking comments were well received on Wall Street with the shares since rising nearly $11, including $3 on 2/10 on the heels of an acquisition (see below). The Company reported a 14% increase in adjusted net income to $128 million or $1.36 a share and record Q2 operating cash flow of $185 million, and reaffirmed its FY6/13 guidance of $5.45 - $5.65. Then on 2/10 Perrigo announced that it is acquiring UK-based Rosemont Pharmaceuticals Ltd., a specialty and generic prescription company, for about $283 million. Rosemont specializes in liquids formulations, which for many are easier to take, and Perrigo has been interested in expanding its presence in this segment. The acquisition will add 90 products, $60 million of revenues (based on 2012), approximately $.24 of adjusted EPS in the first year after closing and is expected to add $.08 to adjusted FY6/13 EPS. Accordingly the Company took up its adjusted EPS guidance for FY6/13 to $5.50 - $5.73 vs. 2012's adjusted EPS of $4.99. After the $10 rise, PRGO is a Buy at $110.

SANCHEZ ENERGY* (SN $19.18 NYSE, -7%); BI Rank = 10.1 - Buy
www.sanchezenergycorp.com TX (1/13)

Sanchez is a rapidly growing independent oil and gas producer that plies the Eagle Ford Shale trend in South Texas. This has been called "the best shale play in the world or definitely in the United States." The Company has 95,000 net acres here and 1,200 net identified lower risk, high return drilling opportunities based on 80-acre well spacing, with more locations at tighter spacing being studied. Sanchez is a pure play Eagle Ford company, and well situated near Gulf Coast refineries with plenty of pipeline infrastructure (as compared to the Bakken). EPS estimates for 2013 actually continued to rise to as high as a $1.62 consensus, before backing off to about the same as it was when I recommend the stock 4 weeks ago. Actually estimates were $1.36 ninety days ago and now $1.51, so that's pretty good. Of the 11 analysts covering the stock, there are 7 Strong Buys, 4 Buys and 1 recent Hold on the stock. I am amazed that the one analyst now at Hold did so because he was not satisfied that Sanchez recently projected to *only* double its exit rate to about 9,000 boepd in 2013 and roughly triple its *average* production level for 2013 to about 6,000 boepd. (See the recent guidance press release and slide 17 on the new February presentation on their web site). Geez, what was *he* looking for!? I'm certainly more than happy with the forecast. As I noted, I am using $1.35 for 2013, for now, not the $1.51 consensus (vs. the $.34 consensus for 2012). Looking further ahead, it's worth noting that per Zacks the consensus for **2014** is a mind boggling $3.83!! I'll believe that when I see it, but $.32 in 2012 to $1.35-$1.50 this year and $3.00+ next year certainly gets *my* attention, even if I am more conservative. One might think growth prospects like this would command better than a 13 PE on 2013 EPS. Oil prices remain strong and I think the shares remain an even better buy today. Q4 results are due out on March 7th, with the current consensus at $.16- Buy.

VASCULAR SOLUTIONS* (VASC $15.72 NGM, +21%); BI Rank = 8.2 – Buy to $16
www.vasc.com MN (763) 656-4300 (Rec. 9/12)

Vascular Solutions is a medical device company with 60 products focused on coronary and peripheral vascular procedures. Its three product categories are comprised of catheter products used to clear/open arteries, hemostat products used to control bleeding and vein products used primarily in treating varicose veins. The Company was one of the first out of the gate with Q4 results, reporting an excellent Q and guidance that bracketed the current consensus for upcoming revenue and earnings. EPS soared 39% to $.18 a share beating the consensus of $.17. Revenues rose 14.5% to $25.3 million a virtual bull's-eye vs. the consensus of $25.6 million (within 1%). This marked the 9th consecutive *year* of double-digit product revenue growth. The Company also surpassed its long standing goal of $100 million in annualized sales and set its new sight on attaining $200 million, which it feels like it can reach without changing its business strategy or underlying cost structure. The Company does not anticipate the need to make substantial additions to its sales force or its international distribution strategy to reach this goal. Accordingly it expects operating margins which were 16.1% in 2012 and are forecasted at 17% for 2013 will continue to rise to the 23-25% range by the time it reaches the $200 million level. Based on Q4 levels, the Company also attained its goal of $1 million in annualized US revenue <u>per field employee</u>. Furthermore gross margin increased 150 basis points to 67.2% and the Company generated $5.2 million in cash flow from operations in Q4 and $19.2 million for the full year. Overall, EPS advanced 33% to $.60 from a normalized $.45 in 2011, beating the estimate in my original recommendation by $.02. They ended the year with $11.5 million cash, a $10 million untapped credit line and no debt. So the Company is well positioned to grow organically (it has 30 new products in development and plans to launch about 10 new products annually) and via tuck-in acquisitions as well as new licensing agreements.

At this point with only organic growth assured, the Company forecasts sales growing 10% to $106 - $110 million from last year's $98.4 million leading to $.66 - $.70 of EPS vs. last year's $.60, about 13% growth at the mid-point. Once again it is worth noting that most companies exclude stock based compensation from their adjusted EPS and many exclude amortization of intangibles as well. But Vascular Solutions has burdened its EPS forecast with $3.1 million of stock based compensation and $1.7 million of amortization of intangibles. Adjusting EPS for just stock based compensation, as most companies do, would increase EPS by $.12 - $.18 cents depending on (complicated) taxation. Therefore, even setting aside a further increase to adjusted EPS if we also exclude amortization of intangibles, I think it is more appropriate for investors to use $.80 - $.85 of EPS for 2013 in *valuing* this company. Let me also note that last year's initial guidance was $.51 to $.55 and they ultimately posted $.60. So there may well be some upside to the $.66 - $.70 guidance and rising estimates are good for stocks. Indeed analysts are huddled near the top of the range at $.70. Accordingly the shares remain a Buy to $16.

KODIAK OIL & GAS* (KOG $8.87 NYSE, +25%); BI Rank = 8.5 - Buy
www.kodiakog.com CO (Rec. 11/11)

Kodiak drills for and produces oil (85%) and gas (15%) primarily in the Bakken of North Dakota. The Company has been growing rapidly via acquisition and especially the drill bit and had a phenomenal 2012 with more to follow in 2013. In 2012 they drilled 51 net wells, double 2011, with a 50% increase to 75 slated for 2013. Kodiak now has about 157,000 net acres with 1,100 gross and 800 net drilling locations. In combination, this enabled oil reserves to increase 138% from 40 million boe at 12/31/11 to 95 million as of 12/2012 (and 70 million at 6/30/12). Twenty analysts follow KOG, adding credibility to its significance. <u>KOG entered 2011 producing about 2,000 boepd … the Company anticipates exiting 2013 at a run rate of 38-40,000 boepd</u>. Commenting on 2012 results in its 2/20 release, the CEO commented: "Last year was transformational for Kodiak and its shareholders. After successfully integrating the acquisitions, completed during October 2011 and January 2012, we essentially doubled the size of our operations while increasing the *average* daily equivalent sales from approximately 3,900 BOE/d in 2011 to 14,400 BOE/d in 2012, representing 267% growth. We are on track to deliver approximately 100% sales growth in 2013, with projected sales expected to range from 29,000 to 31,000 BOE/d. This sales growth expected in 2013 will be the result of our estimated $775 million capital expenditures budget for 2013.

"We are in the best financial position in our history. Our current liquidity of over $400 million comprised of current available borrowings under our credit facility and cash on hand, taken together with our expected 2013 cash flow stream, should allow us to execute our 2013 drilling program. With the increase in our announced reserve base as of 12/31/12, we anticipate that the borrowing base of our revolver will also increase at the time of our next borrowing base re-determination date in April 2013, thereby providing the Company additional liquidity. We have driven our well costs down to a range of approximately $9.5 million to $10.2 million per well, and expect further well cost improvements through the efficiencies gained by drilling more wells per pad on our contiguous acreage blocks. Ongoing Williston Basin infrastructure build-out is resulting in more gas being sold and processed and greater volumes of crude being hauled by rail to strong pricing points throughout the US and Canada. Due in part to the proliferation of rail terminals and their access to premium markets, we are currently experiencing historically low Williston Basin differentials. We expect the contracted Williston Basin differential to continue to the benefit of most operators." I couldn't have said it better myself, so I didn't. Q4 is due out 2/28 with analysts looking for $.13 and eyeing $.71 for 2013. The shares remain a Buy.

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So without giving away too many of our current stock holdings, an issue continues along like this updating every stock we've recommended (and haven't previously advised selling) in detail. In all, stock updates take up about 9-10 pages of our 12-page issue, with a featured recommendation and market update accounting for the rest.