

EQUITY RESEARCH REPORT



Auriga Laboratories, Inc.
OTCBB : ARGA

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September 27, 2006

Close as of: September 27, 2006
DJIA: 11,689.24
S&P 500: 1,336.59
NASDAQ Composite: 2,263.39
Russell 2000: 732.54

Recommendation: **Buy**

Price Target: \$ 4.17

Stock Price:	\$1.45	Market Cap.:	\$51.45 M	3-mo. Avg. Vol. (est.)	7,200
52 Week Price Range:	\$0.60 – 13.00	Shares Outstanding:	35.48 M	Current Ratio	0.44
Industry/Sector:	Pharmaceutical	Float (est.):	13.65 M	Fiscal Year	Sept.

BASIS FOR RECOMMENDATION

- We are initiating a **Buy** rating for Auriga Laboratories, Inc. (OTCBB: ARGA). Auriga is specialty pharmaceutical company whose focus is multidisciplinary, with two divisions supporting the Auriga Laboratories mission. Auriga Pharmaceuticals, ARGAs sales and marketing division, is led by executives who are leaders in commercializing new products. Auriga Development has expertise in the use of new drug delivery technologies to produce improved formulations of already-approved drugs and to use these drugs for new clinical indications.



- Strong competitive advantages:** The Company is pursuing a wide variety of indications, and works on reformulation of already approved drugs, thus eliminating the need for lengthy and costly FDA approval.
- Large collective market opportunity:** Collectively, the illnesses targeted are some of the most common and affect literally millions of Americans each year.
- Strong Management and Scientific Advisory Teams.** The Company's world-class management and advisory team have expertise in drug delivery, innovative sales and marketing and drug development, coming from such firms and institutions as SmithKline Beecham, First Horizon Pharmaceutical Corp., Cardinal Health, and the Squibb Institute for Medical Research.
- Increased Market Visibility.** By initially focusing on common brand names such as Levall™, Auriga is gaining rapid market visibility and legitimacy. The Company also recently provided revenue guidance for FY 06 and 07, the latter of which we have used as a basis for our valuation target.

BUSINESS / PRODUCT OVERVIEW



Auriga Laboratories Inc., a Delaware corporation, is a specialty pharmaceutical company with sales, marketing, and development capabilities divided into two divisions. Auriga Pharmaceuticals, the company's sales and marketing division, is led by experienced industry executives who oversee Auriga's dedicated and growing direct sales team. The second division, Auriga Development, consists of a team of professionals with deep expertise in the use of new, patented drug delivery technologies to produce improved formulations of already-approved drugs. These drugs can then be used for new clinical indications, which is a key element of Auriga's unique strategy and will be touched upon throughout this report.

In short however, these reformulations produce unique products with distinct market and clinical advantages, and are designed to create more effective drug treatments -- improved clinical profiles, lower dosage frequencies; reduced side effects; and easier patient compliance. In addition, new delivery technologies can support the development and marketing of drugs that are difficult to formulate, as well as new drug combinations for a single therapeutic target.

Extendryl® and Levall™ – Established Names Already on the Shelf

Auriga exclusively licenses the Extendryl® and Levall™ families of products and promotes the medicines through its dedicated sales force. Both lines are indicated for treatment and relief of cough, cold and allergy symptoms. These products offer different combinations of antihistamines, expectorants, decongestants, anticholinergics, and anti-tussive that are designed to provide symptomatic relief for several patient types in the acute respiratory disease area. Auriga plans to become a fully integrated pharmaceutical company by acquiring its own manufacturing and development capabilities.



Levall[®] G

Pseudoephedrine HCl 30mg
Guaifenesin 400mg

Levall[®] 12
suspension

Carbetapentane Tartrate 30mg
Phenylephrine Tartrate 30mg

Levall[®] LIQUID

Levall[®] 50

Company Strategy Brief

Product Focus. Auriga focuses on already-approved drugs with market presence and established reputations in the medical community, but now without patent protection. Using these drugs in combination with patented reformulations and drug delivery technologies, Auriga can create unique products with distinct market and clinical advantages.

Product Development. The Company has a highly focused development team that has produced a pipeline of medically needed new drug formulations utilizing novel drug delivery technologies. The team utilizes an intricate process for selecting drugs based on market size, drug characteristics, and possible medical improvements the Company's reformulation can add.

Sales and Marketing. Marketing and direct sales of one's own drugs and therapies traditionally was something usually left to the Big Pharmas – Johnson & Johnson, Merck, Pfizer, etc. Several reasons account for this. First, it was a long-held view that only the behemoths had the clout to go directly to the healthcare community.

Second, after eating up huge amounts of capital in R&D, most small pharmaceutical companies had little money leftover for marketing. In fact, many believed that if a small drug company did not team with a Big Pharma, they would be squeezed out somewhere down the road anyway.

Not the case today. The landscape is completely different and many small drug companies are keeping their marketing (and profits) in-house. The Company recently implemented an innovative plan to significantly expand its sales force through a commission-only structure designed to maximize revenues while minimizing costs.

Growth Through License Acquisitions. In keeping with its product focus, Auriga plans an aggressive series of acquisitions of established but underexposed drug brands that have been overlooked by other pharmaceutical companies. The Company will then reformulate these brands and improve them with its proprietary delivery technologies, thereby creating new medicinal therapies while building its intellectual property portfolio.

MARKET SNAPSHOT

Industry Background – Drug Delivery

Projected to be a \$67 billion industry by the end of this year, drug delivery comprises enabling technologies that are helping to expand other pharmaceutical industry sectors such as generic drugs and specialty pharmaceuticals. Drug delivery companies develop technologies to improve the administration of therapeutic compounds. These technologies are designed to enhance safety, efficacy, ease-of-use and patient compliance with prescribed therapy. Drug delivery technologies provide opportunities for pharmaceutical and biotechnology companies to extend their drug franchises as well as develop new and innovative products.

The vast majority of the drugs currently on the market are taken orally or are administered through injection. A decline in patient compliance can increase the risk of medical complications and lead to higher healthcare costs. Also, the costs of injectable drugs typically are higher as a result of the additional costs associated with medical personnel to administer the injections, the need to prepare the product under sterile conditions and the costs associated with the purchase and disposal of syringes.

Pharmaceutical and biotechnology companies look to drug delivery enhancements as a way of gaining a competitive advantage. Alternative drug delivery technologies, which avoid first-pass metabolism and are less invasive, may also be sought by pharmaceutical and biotechnology companies for product line extensions for a branded drug and, in some cases, may possibly postpone competition from generic equivalents. In order to maintain the competitiveness of their proprietary drug candidates, large pharmaceutical companies seek delivery enhancements that will increase safety and efficacy, reduce side effects and make administration more convenient. Further, drug delivery companies can apply their technologies to off-patent products to formulate their own proprietary products, which they often commercialize by seeking marketing partnerships with larger pharmaceutical companies that have greater capabilities and resources.

Developing safer and more efficient ways of delivering existing drugs is generally far less risky than attempting to discover new drugs, because of lower development costs and the time it takes to gain FDA approval. On average, it takes 10 to 15 years for an experimental new drug to progress from the laboratory to commercialization in the U.S., with an average cost in excess of \$800 million. A drug can prove ineffective at any time in the process, thus, a traditional pharmaceutical development company might spend years and hundreds of millions of dollars developing and testing a drug that never produces a dime in revenue. It is estimated that only one in 5,000 compounds entering preclinical testing advances into human testing and only 20% of human-tested compounds are approved for commercialization. By contrast, drug delivery companies typically target drugs that have already been approved, have a track record of safety and efficacy and have established markets for which there is a proven medical need. Consequently, clinical trials related to drug delivery technologies applied to previously-approved pharmaceuticals need only show that the new technologies deliver the drug without adverse side effects and with the same clinical efficacy.

PRODUCTS

Like any fledgling company in a rapidly-changing industry, the Company's product strategy is dynamic and evolving. Initially, Auriga was focused on three primary areas: cough and cold medications (respiratory); gastrointestinal disorders; and central nervous system disorders, including pain control. As of the date of this report, Auriga's product line consists of the following products:

- **Extendryl®**. As mentioned earlier, the Extendryl® line is indicated for treatment and relief of cough, cold and allergy symptoms. These products offer different combinations of antihistamines, expectorants, decongestants, anticholinergics, and anti-tussive that are designed to provide symptomatic relief for several patient types in the acute respiratory disease area.
- **Levall™**. Also in the respiratory arena, Auriga recently acquired the exclusive license to market the Levall family of common cold remedy prescription drug products from Athlon Pharmaceuticals. The Levall product line includes four trademarked lines that address medical needs in the multibillion-dollar market for respiratory and common cold ailments.
- **Aquoral™**. The Company also recently acquired an exclusive license to market FDA-cleared Aquoral™, a prescription-only product designed to treat Xerostomia, a condition characterized by a lack of saliva in the mouth. Xerostomia is a common side-effect of many prescription drugs – particularly psychiatric medication such as anti-depressants - as well as many medical treatments and represents a potential marketplace estimated at more than \$1 billion – according to?

In addition, Auriga entered into a strategic agreement with Degussa to develop a proprietary formulation targeting serious chronic gastrointestinal diseases utilizing Degussa's proprietary EUDRACOL™ technology. Auriga is developing an oral, controlled-release corticosteroid formulation that targets inflammatory bowel disease lesions at different sites within the GI tract. This is a primary example of the development pipeline.

The Company's proprietary process enables it to systematically review detailed profiles of thousands of drugs currently marketed in the United States, examining each for technical and marketing qualities. This process is the basis for Auriga's assessment and prioritization in building a drug development pipeline that addresses both the medical benefits of reformulation and market need. This is a key growth aspect of the Company. While traditional pharmaceutical companies, with their shrinking pipelines, labor for years developing new drugs, Auriga's process allows it to quickly narrow down the huge field of potential revenue-generating candidates. A crucial aspect is the market exclusivity of a particular medication. Obviously, if Auriga can corner the market for a \$10-50 million a year medication for example, it doesn't take that many products to quickly ramp up revenues.

Management states that one example is the dermatology field. Many dermatology drugs that have been on the market for a long time have been "designated" by the FDA as having no more patent protection. Recently, the FDA concluded that once these drugs have been re-packaged and protected, all other providers must cease sales. This brings up what we feel is a niche, systematic process:

- Scrutinize the market for highest return designated drugs,
- Reformulate through new delivery technologies,
- Patent new formula, and
- Obtain market exclusivity.

So, while certainly not abandoning the aforementioned markets, as of the date of this report, the areas we see of primary focus for the Company seem to be: 1) respiratory; 2) psychiatric; and 3) dermatological.

Sales Strategy

Among Auriga's newest initiatives is the Company's recent implementation of an innovative plan to significantly expand its sales force through a commission-only structure – versus the industry-standard salary + commission - designed to maximize revenues while minimizing costs. Auriga is among the first pharmaceutical companies to apply such an aggressive sales strategy. The Company currently has 31 sales representatives and plans on adding another 20 in October, rounding out to 100+ within the next 18 months.

Management estimates that this strategy will attract the best performers in the business and that fielding the same number of representatives under the old compensation structure would have cost the Company close to \$20 million annually. While to some this might seem counter-intuitive, the logic does make sense. First of all, at most pharmaceutical companies, sales commissions are pooled. Therefore, a top salesman must split his or her commission with other salespeople whose performance could be vastly below the top people. Top salespeople in any industry with this structure would prefer 100% of their compensation based solely on their performance. So again, while it will take some time to see whether the Company's strategy is successful, the logic does make sense.

MANAGEMENT

Auriga's founders, management team and directors draw on decades of experience in the pharmaceutical industry and biosciences, as well as business and financial management. The management team has served in senior management and research positions in global pharmaceutical companies, as well as the biotechnology industry. The team has long experience with drug launch strategies, product valuation, and structuring of strategic partnerships.

Auriga management also includes executives with extensive experience in taking new medications to market, developing highly successful marketing and sales teams with strong relationships with healthcare professionals. Management's collective strength unites experience in medical research, development of new delivery technologies, and the commercialization of pharmaceutical products.

Scientific Advisory Board

The Auriga Scientific Advisory Board provides counsel for drug development initiatives in support of the Company's commitment to bring to market high-quality pharmaceutical products for consumers. The board is comprised of world renowned scientists with deep medical and pharmaceutical industry expertise in the areas of drug delivery, clinical trial design, patient selection, and FDA interaction. Glynn Wilson, Ph.D., Auriga's chief scientific officer, serves as the board's chairman. Since its founding, Auriga has created a structure for these scientists to meet regularly with Auriga's senior management team to help initiate new development projects, evaluate current projects, and suggest other avenues of discovery.

OUTLOOK / VALUATION

Valuing a start-up with solid potential, but with a limited operating history and little visibility is a daunting task at best. Particularly in the biotech and pharmaceutical sectors, especially with development stage companies, estimating revenue and earnings is nearly impossible with any reasonable certainty. That makes traditional valuation methods such as discounted cash flow (DCF), a near impossibility, or at least having limited value in our opinion. Multiple comparisons, such as discounted forward price-to-earnings ratio (P/E), and discounted forward price-to-sales ratio (P/S), do have value in our opinion in that they show the current market values of similar companies. In addition, we only need to forecast next year's revenue and earnings rather than the more-uncertain future years.

Since we are not valuing a development stage company, to form the basis for our valuation we are using the underlying assumption that the value of Auriga should mirror that of its closest peers (based on product, sales and corporate strategies), which are on the next page:

Peer Data

	Adams Respiratory Therapeutics Inc. (ARXT)	Sciele Pharma Inc. (SCRX)	Penwest Pharmaceuticals Co. (PPCO)	Biovail Corp. (BVF)	MacroChem Corp. (MACM.OB)	Matrix Initiatives, Inc. (MTXX)	Novadel Pharma Inc. (NVD)
TTM Revenues (\$000)	\$239,100	\$264,440	\$5,970	\$1,020,000	\$0	\$95,110	\$12,880
TTM Earnings (\$000)	\$46,350	\$42,920	(\$21,980)	\$378,740	(\$6,140)	\$927	(\$9,540)
Net Margin	19.39%	16.23%	-368.17%	37.13%	N/A	0.97%	-74.07%
Shares Outstanding (000)	34,830	35,220	22,990	160,230	1,090	9,860	48,970
Earnings Per Share	\$1.33	\$1.22	(\$0.96)	\$2.36	(\$5.63)	\$0.09	(\$0.19)
Price as of 9/26/06 close	\$38.08	\$19.16	\$16.86	\$15.00	\$0.30	\$17.84	\$1.21
Market Cap (000)	\$1,326,326	\$674,815	\$387,611	\$2,403,450	\$327	\$175,902	\$59,254
Market Cap / TTM Revenue	5.55	2.55	64.93	2.36	N/A	1.85	4.60
Price/Earnings	28.62	15.72	N/A	6.35	N/A	189.75	N/A
Price/Book	6.30	1.84	6.79	1.91	0.64	3.00	5.12

Valuation Matrix

ARGA Actual & Projected

TTM Revenues	7,080,000		
TTM Earnings	(6,620,000)		
P/E	N/A		
P/S	7.42		
Shares Outstanding	35,480,000		
Earnings Per Share \$	(0.187)	Averages:	
Price as of 9/26/06 close \$	1.48	Weighted:	
Market Cap (000)	52,510,400	P/E	19.33
'07E Revenues \$	26,400,000	P/S	7.99
Discounted \$	22,956,522	Simple:	
'07E Earnings \$	4,865,636	Net Margin	18.43%
Discounted \$	4,230,988		
Proj Market Cap based on Wtd. P/S \$		183,469,802	
Proj Share Price based on Wtd. P/S \$		5.171	
Proj Market Cap based on Wtd. P/E \$		81,792,123	
Proj Share Price based on Wtd. P/E \$		2.31	

For our final valuation, we have taken the average of the four companies that had positive net margins and applied it Auriga to get an estimate of the Company's FY07 earnings. Since the Company did \$7.6 million in revenue last year, we do not feel the need to use the high discount rates afforded most start-ups. Therefore, we have discounted the FY07 revenue and earnings figures by 15% to get \$22,956,522 and \$4,230,988, respectively. Applying these figures to the peer multiples, we obtain fair prices of \$5.17 and \$2.31. Since we are more secure with the sales figures and management estimates a higher net margin, we weighted the sales multiple by 65% and the earnings multiple by 35% to obtain our current fair value of **\$4.17 per share**.

Capital Resources

The Company has financed its operations since inception primarily through the sale of shares of its common stock, credit facilities and other loans. With upfront and ongoing licensing payments, maturing debt and working capital needs, the Company will obviously have to raise additional capital fairly soon. To date, however, Auriga has shown the ability to raise the funds necessary to fund operations and development. Management estimates that it is planning to raise \$2-4MM in the next few months to fund these payments and further product development, as well as all other operating expenses. Just this month the Company closed a private placement of almost \$1MM for working capital needs.

Risk Factors

Start-up Company. Auriga is a relatively new company with a very limited history of operations.

Competitive Threat. ARGA faces intense competition from a number of companies that offer or are developing products in its targeted application areas. We also expect that Auriga will encounter intense competition from a number of established and development-stage companies that continually enter the Company's target markets.

Loss of Proprietary Rights. While patent protection should minimize this threat, the protection of ARGA's proprietary drugs is critical to its business prospects. The loss of any of the proprietary rights that the Company believes are protected under intellectual property safeguards may result in the loss of its competitive advantage over present and potential competitors.

Dilution. All else being equal, the raising of future equity capital and relatively heavy use of stock-based compensation will depress share price and could significantly affect our price target.

Strategic Risks. While we believe the business model is fresh and sound, going against industry standard practices, such as sales force compensation, always poses risks.

Competitive Advantages

Despite the risk of current and potential competition, which will always be present in the ever-changing healthcare sector, we believe that the Company holds several key, competitive advantages:

- The Company has a diverse pharmaceutical portfolio, thus reducing dependence on any one drug for its success.
- The Company's Initial focus has been on drugs that are already approved and overlooked by the big Pharmas, potentially minimizing competition and eliminating the need to go head-to-head with larger industry players.
- Auriga's dynamic business model allows it to quickly pursue potential high-margin products and adapt to industry changes.
- The management team and Scientific Advisory Board are made up of knowledgeable, deeply experienced people, some spending years at at least one comparable company we chose for our valuation.

Recommendation and Conclusion

This report has laid out our investment thesis for Auriga Labs. Rather than a typical fledgling pharmaceutical company, we see ARGA as a bona-fide specialty drug concern, one that has a very unique market niche, great leadership and alignment with top-notch pharmaceutical community members. Operating results and stock performance could be subject to greater volatility as the Company grows, but with the stock at these levels,

long-term investors might be interested in using this period as an opportunity to build positions with risk capital in anticipation of stronger performance in FY2007 and beyond.

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About the Analyst

Randy Lewis, CFA, founder and Senior Equity Analyst of EquityNet, has more than 10 years experience in equity and portfolio analysis, as well as financial consulting and strategic planning. Prior to forming EquityNet, Mr. Lewis served as an equity analyst at SSI Investment Management, Inc., a \$500-million, money management firm, specializing in sophisticated, hedged investment strategies, and serving institutional and high net worth clients. Previous to SSI, Mr. Lewis was a financial analyst for Griffin Financial Services, the securities brokerage arm of Home Savings of America (now Washington Mutual), the then-largest savings and loan in the U.S. Mr. Lewis has had several articles published, most recently in HFR Journal of Hedge Fund Research on the subject of merger arbitrage. Mr. Lewis received his Bachelors Degree with honors in Finance from California State University, Fullerton, his MBA at the Anderson School of Business at UCLA, and has earned the Chartered Financial Analyst (CFA) designation. He is also an Instructor of Finance and Accounting at the University of Phoenix.

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