Research Note

Investors should consider this report as only a single factor in making their investment decision.

Nephros, Inc.

Rating: Speculative Buy

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NEPH $10.06 — (NASDAQ)

October 16, 2019

	2016 A	2017 A	2018 A	***2019 E***	***2020 E***
Total Revenue (in millions)	$2.3	$3.8	$5.7	***$9.6***	***$14.4***
Earnings (loss) per share*	($0.56)	($0.14)	($0.49)	***($0.59)***	***($0.16)***

52-Week range*	$10.74 – $3.69	Fiscal year ends:	December
Shares outstanding a/o 08/03/19	7.7 million	Revenue/shares (ttm)*	$1.03
Approximate float	3.0 million	Price/Sales (ttm)	9.8X
Market Capitalization	$77.5 million	Price/Sales (2020) E	5.2X
Tangible Book value/shr*	$0.32	Price/Earnings (ttm)	NMF
Price/Book	NMF	Price/Earnings (2020) E	NMF

All per share figures adjusted for a 1-9 reverse stock split effective on 7/9/19

Nephros Inc., headquartered in South Orange, NJ, is a water purification company that develops and sells high performance filters and ultrafilters (filters with pore size below 0.01 microns) primarily to hospitals for the prevention of infection from waterborne pathogens and in dialysis centers for the removal of biological contaminants from water and bicarbonate concentrates. The company's 62.5% owned subsidiary, Specialty Renal Products, is a development stage company focused on improving therapies for patients with renal disease.

Key Investment Considerations:

Maintaining Speculative Buy rating and increasing our 12-month price target to $15.50 per share from $10.00 per share.

The catalyst for increasing our 12-month price target and revenue forecasts for 2019 and 2020 was the company pre-announcing 3Q19 sales, as well as a continued diminished risk profile.

On October 7, 2019, NEPH announced 3Q19 product revenues to reach approximately $3.1 million with total revenue increasing at least 80% compared to 3Q18. For 2019, the company anticipates revenue of at least $9.5 million with the potential of reaching $10 million. Revenue growth is being driven by hospital customers and distribution partnerships.

For 2019, we project a net loss of $4.3 million or ($0.59) per share on sales growth of 69.7% to $9.6 million. We previously projected a loss of $4.4 million or ($0.60) per share on sales of $9 million. Our forecast reflects pre-announced 3Q19 guidance issued by the company on October 7, 2019.

For 2020, we project a net loss of $1.2 million or ($0.16) per share on revenue growth of 49.5% to $14.4 million. We previously projected a loss of $1.3 million or ($0.17) per share on sales of $13.6 million. Our forecast reflects initial sales from its waterborne pathogen diagnostics test device and 2nd generation renal device, as well as increasing recurring revenue (faster than previously anticipated) as NEPH expands its hospital, dialysis, and hospitality/foodservice customer base and distribution partnerships.

Please view our Disclosures pages 10 - 12

Appreciation Potential

Maintaining Speculative Buy rating and increasing our 12-month price target to $15.50 per share from $10.00 per share.

The catalyst for increasing our 12-month price target and revenue forecasts for 2019 and 2020 was the company pre-announcing 3Q19 sales expectations, as well as a diminished risk profile.

On October 7, 2019, NEPH announced 3Q19 product revenues to reach approximately $3.1 million with total revenue increasing at least 80% compared to 3Q18. For 2019, the company anticipates revenue of at least $9.5 million with the potential of reaching $10 million. Revenue growth is being driven by hospital customers and distribution partnerships.

The diminished risk profile reflects 2H19 and 2020 growth in the company's customer base (primarily hospitals and dialysis centers) driving recurring revenue from the water filtration filter replacement cycle, as well as the 2H19 launch of its new waterborne pathogen diagnostics test device that will require a new test kit each time a test is performed.

Our rating reflects anticipated growth from Nephros' commercial water purification product portfolio that includes high performance filters and ultrafilters (filters with pore size below 0.01 microns), as well as from its AETHER® brand of water filters to expand its market to include companies in the hospitality/foodservice industries. Our rating should be reinforced once its Specialty Renal Products subsidiary receives FDA 510(k) clearance for its 2nd generation Hemodiafiltration (a form of renal replacement therapy that removes more middle-molecular-weight solutes) system. NEPH anticipates submitting the 2nd generation Hemodiafiltration product for 510(k) clearance in the first part of 2020.

Our 12-month price target of $15.50 per share implies shares could appreciate approximately 55% over the next twelve months. According to Thomson Reuters, the average trailing twelve-month and 2020 price-to-sales multiples for companies in the Healthcare Equipment and Supplies sectors are 3.6X and 3.5X (unchanged), respectively (on estimated 2020 sales growth of 7.5%). NEPH's trailing twelve-month and 2020 price-to-sales multiples are 9.8X and 5.2X (prior was 6.5X and 3.6X), respectively (on estimated 2020 sales growth of nearly 50%). We anticipate investors are likely to accord a sales multiple approaching the current trailing sales multiple of 9.8X, due primarily to higher than anticipated forecasted revenue. We applied a sales multiple of 8X (prior was 6.5X) to our 2020 sales per share forecast of $1.95 (prior was $1.84), to obtain a year ahead price target of approximately $15.50 per share.

A higher valuation of Nephros is likely to be supported by rapid quarterly sales growth (i.e., pre-announcing approximately 80% total revenue growth), a narrowing of operating losses, and receiving FDA 510(k) clearance for its 2nd generation Hemodiafiltration system in 2020. In 2020, we forecast NEPH's operating losses narrowing to $760,000 from a loss of $3.9 million in 2019. The company should generate cash earnings of $85,000 in 2020, up from an estimated loss of $3 million in 2019.

We believe Nephros, Inc. is most suitable for risk tolerant investors that seek exposure to a micro cap company providing FDA cleared water filtration products.

Projections

Basis of Forecast

The primary growth driver is an expansion of the company's reseller network, which in turn should increase the company's customers for its portfolio of water filtration filters. The leverage that the company should experience from a growing number of customers using its filters is that once a defined replacement cycle exists (depending on the type of filter purchased), a recurring revenue stream should be sustained during our forecast period.

On October 7, 2019, NEPH announced 3Q19 product revenues to reach approximately $3.1 million with total revenue increasing at least 80% compared to 3Q18. For 2019, the company anticipates revenue of at least $9.5

million with the potential of reaching $10 million. Revenue growth is being driven by hospital customers and distribution partnerships.

We anticipate the company's core operations in 2020 should more than breakeven on a cash basis. However, the investments being made in the Specialty Renal Products subsidiary and spending to launch its waterborne pathogen diagnostics test device in 2H19 should result in operating losses of $3.9 million and cash burn of $3 million in 2019. In 2020, we forecast operating losses narrowing to $760,000, with cash earnings of $85,000.

We anticipate gross margin expansion to 58.8% in 2020, up from an estimated 58% in 2019. The gross margin improvement should be due primarily to the increase in recurring revenue from the replacement lifecycle of the company's water filters.

In 2020, we project operating expenses of $9.2 million, down from an estimated $9.5 million in 2019 primarily due to a $439,000 reduction in R&D as the Specialty Renal Products subsidiary's product should be submitted to the FDA for 510(k) clearance in the first part of 2020.

Operations – 2019

We project revenue growth of 69.7% to $9.6 million (prior was $9 million) due to the company pre-announcing 3Q19 sales, as well as an increase in the installed based of products stemming from new customers and expansion from existing customers, as well as sales to customers experiencing pathogen outbreaks, which are seasonal in nature typically occurring during the warmer months of the year.

Gross profit should increase 74.7% to $5.6 million due primarily to sales growth and gross margin of 58% compared to 56.3% in 2018.

We project operating losses increasing to $3.9 million from $3 million as operating expenses increase by 52.2% to nearly $9.5 million. We anticipate SG&A expense increasing 36.3% to $6.2 million to support sales growth from the company's existing and new Aether brand filters. We anticipate R&D expenses more than doubling to $3.1 million from $1.5 million in 2018. The more than doubling of R&D expense compared to 2018 reflects more rapid spending to complete, test, and launch its waterborne pathogen diagnostics test device and 2nd generation Hemodiafiltration device.

Non-operating expense consists of interest expense of $184,000 and other expense of $30,000. In 2018, the company had interest expense of $168,000, other expense of $35,000, and a $199,000 loss on extinguishment of debt.

We project a net loss of $4.3 million or ($0.59) per share compared to a loss of $3.4 million or ($0.49) per share. We previously projected a net loss of $4.4 million or ($0.60) per share.

We estimate the company's federal, state, and foreign net operating loss carryforwards were in excess of $82 million at June 30, 2019.

Finances – 2019

We project cash burn of $3 million and an increase in working capital of $181,000. The increase in working capital is due primarily to an increase in inventory, offset in party by increases in payables and accruals. Cash used in operations of $3.2 million, capital expenditures, and the repayment of debt should be partially offset by an approximate $2 million common stock offering. We project cash to decrease by $1.6 million to $3 million at December 31, 2019.

Operations – 2020

We project revenue increasing 49.5% to $14.4 million (prior was $13.6 million) due primarily to the company's customer base expanding to include companies within the food service, convenience store, and hospitality industries, as well as the launch of its waterborne pathogen diagnostic product into its existing hospital customers and of its 2nd generation Hemodiafiltration device, and a higher base of recurring revenue than anticipated due primarily to anticipated 3Q19 results.

Gross profit should increase 51.7% to $8.5 million reflecting revenue growth and gross margin expansion to 58.8% compared to an estimated 58% in 2019. The improvement in gross margin reflects an increase in the number of replacement filters installed and sales from filter and assays for its waterborne pathogen diagnostic product.

We project the operating loss narrowing to $760,000 from an estimated loss of $3.9 million in 2019 as operating expense margin improves to 64.1% from an estimated 98.1% in 2019. We anticipate operating expenses decreasing by $219,000 to $9.2 million. We anticipate R&D expense decreasing by $439,000 to $2.7 million as spending should slow after the launch of its waterborne pathogen diagnostics test device and 2nd generation Hemodiafiltration device. Partly offsetting the decrease in operating expenses is a projected $229,000 increase in SG&A expense to $6.4 million due primarily to higher compensation costs and the implementation of marketing initiatives to support the growth of newly launched products. We project non-operating interest expense of $160,000 compared to $184,000 due lower debt balances. We project a net loss of $1.2 million or ($0.16) per share. We previously projected a net loss of $1.3 million or ($0.17) per share.

Finances – 2020

We project cash earnings of $85,000 and an increase in working capital of $71,000. The increase in working capital is due primarily increases in inventory and receivables, nearly offset by increases in payable and accruals. Cash from operations of $14,000 should not cover capital expenses and repayment of debt. We estimate a decrease in cash by $259,000 to $2.8 million at December 31, 2020.

Risks

In our view, these are the principal risks underlying the stock.

Operating Losses

Nephros Inc. has yet to turn profitable. At June 30, 2019, the company's accumulated deficit was over $126.4 million, up from $124.2 million in 2018. Losses are likely to continue but diminish through our forecast period. The lack of profitability could result in the company's inability to execute its growth strategy and diminish its operations.

Compliance

The company's operations have a significant compliance burden under the FDC Act (set of laws giving authority to the US Food and Drug Administration (FDA) to oversee the safety of food, drugs, medical devices, and cosmetics) and other applicable statutes and regulations which govern the testing, labeling, storage, record keeping, distribution, sale, marketing, advertising and promotion of Nephro's medically approved products. A violation of the FDC Act or other regulatory requirements at any time during or after the product development and/or approval process, could subject NEPH to enforcement actions by the FDA or other agencies.

Product Liability

The production, marketing and sale of kidney dialysis and water-filtration products have liability risks in the event of product failure or claim of harm caused by the products operation. Voluntary recalls could subject the company to claims or proceedings by consumers, the FDA or other regulatory authorities, which would adversely impact future sales and revenues. Also, meritless claims of product liability may be costly to defend against. While the company does have product liability insurance, it may not be able to maintain this insurance on acceptable terms or at all.

Regulatory Approval

NEPH cannot ensure that any existing product(s) that have not yet been approved, or any new products developed in the future, will be approved for marketing. The clearance and/or approval processes are lengthy and uncertain and can require substantial financial resources, as well as management's time and effort. As a result, the company's global sales efforts may be slow to materialize and could drain financial resources to continue the development of new products for sale in the US.

Intellectual Property

The company's success depends in part on the ability to protect the intellectual property for its technology through patents. NEPH will only be able to protect its products and methods from unauthorized use by third parties to the extent that the products and methods developed are covered by valid and enforceable patents or are effectively maintained as trade secrets. The company has been granted 12 US patents that will expire at various times from 2019 to 2027, assuming they are properly maintained.

Licensing Agreement
In 2012, Nephros entered into a licensing and supply agreement with Medica S.p.A., an Italy-based medical product manufacturing company for the marketing and sale of certain filtration products based upon their proprietary Medisulfone ultrafiltration technology. The license and supply agreement with Medica expires on December 31, 2025. During the period (April 23, 2014 through December 31, 2025), the company will pay Medica a royalty rate of 3% of net sales of the filtration products sold, subject to reduction as a result of a supply interruption pursuant to the terms of the agreement.

510(k) Regulations
Before a new medical device can be introduced to the market, FDA clearance of a pre-market notification under Section 510(k) of the FDC Act or FDA clearance of a pre-market approval application under Section 515 of the FDC Act must be obtained. A 510(k) clearance will be granted if the submitted information establishes that the proposed device is substantially equivalent to a legally marketed medical device or to a medical device for which the FDA has not called for pre-market approval under Section 515. The Section 510(k) pre-market clearance process is generally faster and simpler than the Section 515 pre-market approval process. The company's filters and ultrafilters are medical devices that have gone through the 510(k) approval process.

Any devices cleared through the 510(k) process, modifications or enhancements that could significantly affect the safety or effectiveness of the device or that constitute a major change to the intended use of the device will require a new 510(k) pre-market notification submission. If the company seeks to obtain Section 510(k) pre-market clearance for any of its new or modified devices or filtration products, it would need to submit another 510(k) pre-market notification that could be costly and time consuming that may divert financial and management resources from products already approved and generating revenue in the US.

Shareholder Control
All executive officers and directors as a group, own 6.8% of the outstanding voting stock (March 2019). Two large investors own 56% of the company's outstanding voting stock. These owners could greatly influence the outcome of matters requiring stockholder approval, which decisions may or may not be in the best interests of the other shareholders.

Miscellaneous Risk
The company's financial results and equity values are subject to other risks and uncertainties, including competition, operations, financial markets, regulatory risk, and/or other events. These risks may cause actual results to differ from expected results.

Trading Volume
Based on our calculations, the average daily-volume in 2018 was 41,100 shares. During the three months to October 15, 2019, average daily-volume to 13,300. The company has a float of approximately 3 million shares and shares outstanding of 7.7 million. The company effected a reverse stock split (1-9) on July 9, 2019.

Nephros, Inc.
Consolidated Balance Sheets
FY2016 – FY2020E
(in thousands)

	FY16A	FY17A	FY18A	2Q19A	**FY19E**	**FY20E**
ASSETS						
Current assets:						
Cash	$ 275	$ 2,194	$ 4,581	$ 4,318	**$ 3,014**	**$ 2,755**
Accounts receivable, net	388	836	1,452	1,539	**1,608**	**1,803**
Investment in lease, net	27	20	-	-	**-**	**-**
Inventory, net	479	674	1,864	2,314	**2,702**	**2,970**
Prepaid expenses and other current assets	95	85	276	266	**304**	**303**
Total current assets	1,264	3,809	8,173	8,437	**7,628**	**7,831**
Property and equipment, net	70	52	91	89	**89**	**90**
Investment in lease, net and operating lease right-of-use assets	61	39	-	1,250	**750**	**750**
Intangible assets	-	-	590	569	**545**	**500**
Goodwill	-	-	748	759	**759**	**759**
License and supply agreement, net	1,262	1,072	938	871	**805**	**713**
Other assets	21	11	18	39	**39**	**39**
Total assets	$ 2,678	$ 4,983	$ 10,558	$ 12,014	**$ 10,615**	**$ 10,682**
LIABILITIES AND STOCKHOLDERS' EQUITY						
Current liabilities:						
Secured revolving credit facility	-	711	991	1,021	**1,021**	**1,021**
Secured note payable	-	-	195	203	**203**	**203**
Accounts payable	585	872	836	915	**1,036**	**1,238**
Accrued expenses	240	218	396	601	**965**	**1,154**
Contingent consideration	-	-	236	329	**329**	**329**
Operating lease liabilities	-	-	-	223	**818**	**880**
Deferred revenue	70	70	-	-	**-**	**-**
Total current liabilities	895	1,871	2,654	3,292	**4,372**	**4,825**
Secured note payable, net	-	-	843	730	**620**	**389**
Contingent consideration, net	-	-	263	163	**163**	**131**
Long-term operating lease liabilities	-	-	-	1,023	**1,023**	**1,023**
Unsecured long-term note payable, net	838	954	-	-	**-**	**-**
Long-term portion of deferred revenue	278	208	-	-	**-**	**-**
Stockholders' equity:						
Common stock,$.001 par value; authorized 90,000,000 shares;	6	6	7	8	**8**	**8**
Additional paid-in capital	120,879	122,973	127,873	130,169	**130,615**	**131,415**
Accumulated other comprehensive income	67	77	71	70	**70**	**70**
Retained earnings (accumulated deficit)	(120,285)	(121,106)	(124,153)	(126,444)	**(128,236)**	**(129,156)**
Total stockholders' equity	667	1,950	3,798	3,803	**2,457**	**2,337**
Noncontrolling interest	-	-	3,000	3,003	**3,003**	**3,000**
Total liabilities and stockholders' equity	$ 2,678	$ 4,983	$ 10,558	$ 12,014	**$ 10,615**	**$ 10,682**
SHARES OUT	49,783	55,293	7,180	7,673	**7,680**	**7,690**

Source: Company reports and Taglich Brothers estimates

Nephros, Inc.
Annual Income Statement
FY2016 – FY2020E
(in thousands)

	FY16 A	FY17 A	FY18 A	**FY19 E**	**FY20 E**
Total Revenue - Product and License, royalty, other	$ 2,320	$ 3,809	$ 5,687	**$ 9,648**	**$ 14,425**
Total Cost of sales	1,026	1,517	2,484	**4,053**	**5,940**
Gross Profit	1,294	2,292	3,203	**5,595**	**8,485**
Operating Expenses:					
Research and development	1,079	1,002	1,539	**3,139**	**2,700**
Depreciation and amortization	230	218	163	**188**	**160**
Selling, general, and administrative	2,854	3,298	4,517	**6,156**	**6,385**
Change in fair value of contingent consideration	-	-	-	**(19)**	-
Total Operating Expenses	4,163	4,518	6,219	**9,464**	**9,245**
Operating Income (loss)	(2,869)	(2,226)	(3,016)	**(3,869)**	**(760)**
Loss on extinguishment of debt	-	-	(199)	-	-
Interest (expense) income	(167)	(298)	(168)	**(184)**	**(160)**
Other income (expense)	4	(74)	(35)	**(30)**	-
Total Other Income (expense)	(163)	(372)	(402)	**(214)**	**(160)**
Pre-Tax Income (loss)	(3,032)	(2,598)	(3,418)	**(4,083)**	**(920)**
Income Tax Expense (Benefit)	-	(1,789)	(93)	-	-
Net income (loss)	(3,032)	(809)	(3,325)	**(4,083)**	**(920)**
Undeclared deemed dividend - Non-controlling interest	-	-	(77)	**(240)**	**(240)**
Net income (loss) - attributable to Nephros, Inc.	$ (3,032)	$ (809)	$ (3,402)	**$ (4,323)**	**$ (1,160)**
Earning (loss) per share	$ (0.56)	$ (0.14)	$ (0.49)	**$ (0.59)**	**$ (0.16)**
Avg Shares Outstanding	5,398	5,882	6,847	**7,326**	**7,413**
EBITDA - Adjusted - includes renal subsidiary	$ (1,989)	$ (1,216)	$ (1,734)	**$ (2,344)**	**$ 740**
Margin Analysis					
Gross margin	55.8%	60.2%	56.3%	**58.0%**	**58.8%**
Research & Development	46.5%	26.3%	27.1%	**32.5%**	**18.7%**
Selling, general, and administrative	123.0%	86.6%	79.4%	**63.8%**	**44.3%**
Operating margin	(123.7%)	(58.4%)	(53.0%)	**(40.1%)**	**(5.3%)**
Pre-tax margin	(130.7%)	(68.2%)	(60.1%)	**(42.3%)**	**(6.4%)**
Tax rate	0.0%	68.9%	2.7%	**0.0%**	**0.0%**
YEAR / YEAR GROWTH					
Total Revenues	N/A	64.2%	49.3%	**69.7%**	**49.5%**

Source: Company reports and Taglich Brothers estimates

Nephros, Inc.
Income Statement Model
Quarters FY2018A – 2020E
(in thousands)

	Q1 18 A	Q2 18 A	Q3 18 A	Q4 18 A	FY18 A	Q1 19 A	Q2 19 A	Q3 19 E	Q4 19 E	**FY19 E**	Q1 20 E	Q2 20 E	Q3 20 E	Q4 20 E	**FY20 E**
Total Revenue - Product and License, royalty, other	$ 985	$ 1,366	$ 1,724	$ 1,612	$ 5,687	$ 1,769	$ 2,309	$ 3,120	$ 2,450	**$ 9,648**	$ 2,630	$ 3,440	$ 4,680	$ 3,675	**$ 14,425**
Total Cost of sales	518	536	772	658	2,484	771	942	1,275	1,065	**4,053**	1,130	1,390	1,885	1,535	**5,940**
Gross Profit	467	830	952	954	3,203	998	1,367	1,845	1,385	**5,595**	1,500	2,050	2,795	2,140	**8,485**
Operating Expenses:															
Research and development	289	352	352	546	1,539	756	793	795	795	**3,139**	750	750	600	600	**2,700**
Depreciation and amortization	41	40	42	40	163	50	48	45	45	**188**	40	40	40	40	**160**
Selling, general, and administrative	1,260	1,091	1,069	1,097	4,517	1,503	1,403	1,750	1,500	**6,156**	1,450	1,535	1,885	1,515	**6,385**
Change in fair value of contingent consideration	-	-	-	-	-	(10)	(9)	-	-	**(19)**	-	-	-	-	-
Total Operating Expenses	1,590	1,483	1,463	1,683	6,219	2,299	2,235	2,590	2,340	**9,464**	2,240	2,325	2,525	2,155	**9,245**
Operating Income (loss)	(1,123)	(653)	(511)	(729)	(3,016)	(1,301)	(868)	(745)	(955)	**(3,869)**	(740)	(275)	270	(15)	**(760)**
Loss on extinguishment of debt	(199)	-	-	-	(199)	-	-	-	-	-	-	-	-	-	-
Interest (expense) income	(85)	(27)	(31)	(25)	(168)	(46)	(46)	(46)	(46)	**(184)**	(40)	(40)	(40)	(40)	**(160)**
Other income (expense)	(22)	(2)	(8)	(3)	(35)	(2)	(28)	-	-	**(30)**	-	-	-	-	-
Total Other Income (expense)	(306)	(29)	(39)	(28)	(402)	(48)	(74)	(46)	(46)	**(214)**	(40)	(40)	(40)	(40)	**(160)**
Pre-Tax Income (loss)	(1,429)	(682)	(550)	(757)	(3,418)	(1,349)	(942)	(791)	(1,001)	**(4,083)**	(780)	(315)	230	(55)	**(920)**
Income Tax Expense (Benefit)	-	-	-	(93)	(93)	-	-	-	-	-	-	-	-	-	-
Net income (loss)	(1,429)	(682)	(550)	(664)	(3,325)	(1,349)	(942)	(791)	(1,001)	**(4,083)**	(780)	(315)	230	(55)	**(920)**
Undeclared deemed dividend - Non-controlling interest	-	-	(16)	(61)	(77)	(59)	(61)	(60)	(60)	**(240)**	(60)	(60)	(60)	(60)	**(240)**
Net income (loss) - attributable to Nephros, Inc.	$ (1,429)	$ (682)	$ (566)	$ (725)	$ (3,402)	$ (1,408)	$ (1,003)	$ (851)	$ (1,061)	**$ (4,323)**	$ (840)	$ (375)	$ 170	$ (115)	**$ (1,160)**
Earning (loss) per share	$ (0.23)	$ (0.10)	$ (0.08)	$ (0.09)	$ (0.49)	$ (0.20)	$ (0.14)	$ (0.12)	$ (0.14)	**$ (0.59)**	$ (0.11)	$ (0.05)	$ 0.02	$ (0.02)	**$ (0.16)**
Avg Shares Outstanding	6,174	6,940	7,130	7,143	6,847	7,130	7,388	7,390	7,395	**7,326**	7,400	7,410	7,415	7,425	**7,413**
EBITDA - Adjusted - includes renal subsidiary	$ (773)	$ (394)	$ (314)	$ (253)	$ (1,734)	$ (909)	$ (485)	$ (370)	$ (580)	**$ (2,344)**	$ (365)	$ 100	$ 645	$ 360	**$ 740**
Margin Analysis															
Gross margin	47.4%	60.8%	55.2%	59.2%	56.3%	56.4%	59.2%	59.1%	56.5%	**58.0%**	57.0%	59.6%	59.7%	58.2%	**58.8%**
Research & Development	29.3%	25.8%	20.4%	33.9%	27.1%	42.7%	34.3%	25.5%	32.4%	**32.5%**	28.5%	21.8%	12.8%	16.3%	**18.7%**
Selling, general, and administrative	127.9%	79.9%	62.0%	68.1%	79.4%	85.0%	60.8%	56.1%	61.2%	**63.8%**	55.1%	44.6%	40.3%	41.2%	**44.3%**
Operating margin	(114.0%)	(47.8%)	(29.6%)	(45.2%)	(53.0%)	(73.5%)	(37.6%)	(23.9%)	(39.0%)	**(40.1%)**	(28.1%)	(8.0%)	5.8%	(0.4%)	**(5.3%)**
Pre-tax margin	(145.1%)	(49.9%)	(31.9%)	(47.0%)	(60.1%)	(76.3%)	(40.8%)	(25.4%)	(40.9%)	**(42.3%)**	(29.7%)	(9.1%)	4.9%	(1.5%)	**(6.4%)**
Tax rate	0.0%	0.0%	0.0%	12.3%	2.7%	0.0%	0.0%	0.0%	0.0%	**0.0%**	0.0%	0.0%	0.0%	0.0%	**0.0%**
YEAR / YEAR GROWTH															
Total Revenues	34.2%	59.0%	88.2%	24.0%	49.3%	79.6%	69.0%	81.0%	52.0%	**69.7%**	48.7%	49.0%	50.0%	50.0%	**49.5%**

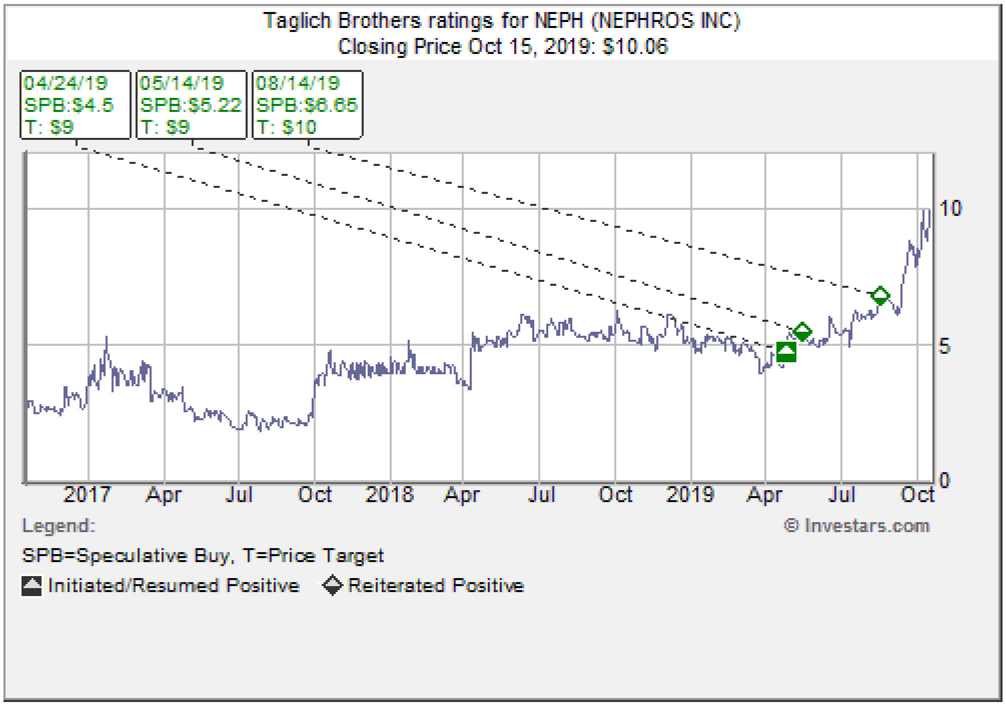
Source: Company reports and Taglich Brothers estimates

Nephros, Inc.
Cash Flow Statement
FY2016 – FY2020E
(in thousands)

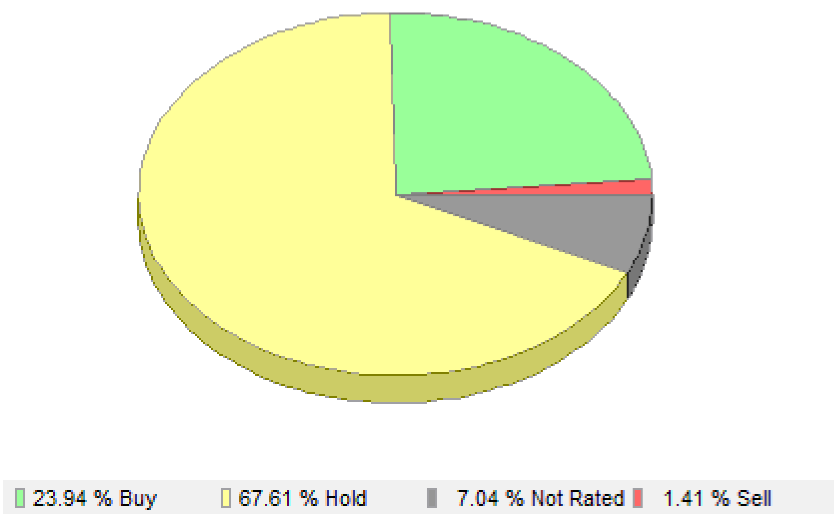
	FY2016A	FY2017A	FY2018A	6 Mos19A	**FY2019E**	**FY2020E**
Cash Flows from Operating Activities						
Net Income (loss)	$ (3,032)	$ (809)	$ (3,325)	$ (2,291)	**$ (4,083)**	**$ (920)**
Depreciation of property and equipment	19	28	29	16	**32**	**30**
Amortization of license and supply agreement	211	190	134	88	**176**	**175**
Non-cash stock-based comopensation, including stock options/restricted stock	551	772	985	308	**750**	**800**
Non-employee stock-based compensation	46	-	-	-	-	-
Loss on extinguishment of debt	-	-	199	-	-	-
Inventory reserve	27	-	70	37	**60**	-
Change in fair value of contingent consideration	-	-	-	(19)	**(37)**	-
Accretion of contingent consideration	-	-	-	28	**56**	-
Provision for bad debt expense	35	-	40	-	-	-
Amortization of debt discount	53	116	34	-	-	-
Loss on disposal of equipment	-	-	10	-	-	-
Loss on capital lease termination	-	-	11	-	-	-
Loss on foreign currency transactions	(4)	19	3	6	**6**	-
Cash earnings (burn)	(2,094)	316	(1,810)	(1,827)	**(3,040)**	**85**
Changes In:						
Accounts receivable	(17)	(416)	(484)	(87)	**(156)**	**(195)**
Inventory	(103)	(195)	(1,082)	(487)	**(838)**	**(268)**
Prepaid expenses and other current assets	(10)	30	(191)	(5)	**(28)**	**1**
Other assets	206	(10)	-	(21)	**(21)**	-
Accounts payable	(76)	268	(130)	73	**200**	**202**
Accrued expenses	51	-	35	328	**569**	**189**
Deferred revenue	(69)	(70)	-	-	**93**	-
(Increase)/decrease in Working Capital	(18)	(393)	(1,852)	(199)	**(181)**	**(71)**
Net cash provided by Operations	(2,112)	(77)	(3,662)	(2,026)	**(3,221)**	**14**
Cash Flows from Investing Activities						
Purchase of property and equipment	(45)	-	-	-	-	**(10)**
Biocon Acquisition, net	-	-	(991)	(137)	**(137)**	-
Cash Flows from Investing Activities	(45)	-	(991)	(137)	**(137)**	**(10)**
Cash Flows from Financing Activities						
Proceeds from issuance of common stock, net	-	1,179	3,778	1,992	**1,992**	-
Net proceeds (repayment) from secured revolving credit facility	-	711	280	30	**30**	-
Proceeds from sale of subsidiary preferred shares to noncontrolling interest	-	-	3,000	-	-	-
Payments on secured note payable	-	-	(149)	(105)	**(214)**	**(231)**
Payment of contingent consideration	-	-	-	(16)	**(16)**	**(32)**
Proceeds from issuance of secured note	1,187	-	1,187	-	-	-
Repayment of unsecured long-term not payable	-	-	(1,187)	-	-	-
Proceeds from exercise of warrants	1	100	138	-	-	-
Net cash provided (used) by Financing	1,188	1,990	7,047	1,901	**1,792**	**(263)**
Effect of exchange rates	(4)	6	(7)	(1)	**(1)**	-
Net change in Cash	(973)	1,919	2,387	(263)	**(1,567)**	**(259)**
Cash Beginning of Period	1,248	275	2,194	4,581	**4,581**	**3,014**
Cash End of Period	$ 275	$ 2,194	$ 4,581	$ 4,318	**$ 3,014**	**$ 2,755**

Source: Company reports and Taglich Brothers estimates

Price Chart



Taglich Brothers Current Ratings Distribution



Investment Banking Services for Companies Covered in the Past 12 Months

Rating	#	%
Buy	2	10
Hold		
Sell		
Not Rated	1	25

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I, Howard Halpern, the research analyst of this report, hereby certify that the views expressed in this report accurately reflect my personal views about the subject securities and issuers; and that no part of my compensation was, is, or will be directly or indirectly related to the specific recommendations or views contained in this report.

Public Companies mentioned in this report:

Meaning of Ratings

Buy – The growth prospects, degree of investment risk, and valuation make the stock attractive relative to the general market or comparable stocks.

Speculative Buy – Long-term prospects of the company are promising but investment risk is significantly higher than it is in our BUY-rated stocks. Risk-reward considerations justify purchase mainly by high risk-tolerant accounts. In the short run, the stock may be subject to high volatility and could continue to trade at a discount to its market.

Neutral – Based on our outlook the stock is adequately valued. If investment risks are within acceptable parameters, this equity could remain a holding if already owned.

Sell – Based on our outlook the stock is significantly overvalued. A weak company or sector outlook and a high degree of investment risk make it likely that the stock will underperform relative to the general market.

Dropping Coverage – Research coverage discontinued due to the acquisition of the company, termination of research services, non-payment for such services, diminished investor interest, or departure of the analyst.

Some notable Risks within the Microcap Market

Stocks in the Microcap segment of the market have many risks that are not as prevalent in Large-cap, Blue Chips or even Small-cap stocks. Often it is these risks that cause Microcap stocks to trade at discounts to their peers. The most common of these risks is liquidity risk, which is typically caused by small trading floats and very low trading volume which can lead to large spreads and high volatility in stock price. In addition, Microcaps tend to have significant company-specific risks that contribute to lower valuations. Investors need to be aware of the higher probability of financial default and higher degree of financial distress inherent in the microcap segment of the market.

From time to time our analysts may choose to withhold or suspend a rating on a company. We continue to publish informational reports on such companies; however, they have no ratings or price targets. In general, we will not rate any company that has too much business or financial uncertainty for our analysts to form an investment conclusion, or that is currently in the process of being acquired.