



Biota Holdings Limited (BTA)

Speculative Buy

US Government Intends to Order a Further 12.3 million Relenza™ Courses

\$1.35

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Key Points

The US Department of Health and Human Services (HHS) intends to order a further 12.3 million Relenza™ treatment courses.

US govt orders/intent to order now stands at 16.2 million courses.

Summary

Market Capitalisation (M)	\$241.7
Share Price	\$1.35
Shares on Issue (M)	179.3
52 Week High	\$2.75
52 Week Low	\$0.43
Valuation Per Share (fully diluted)	\$1.50
12 Month Price Target	\$1.70
Cash (M) as at 31/12/05	\$51.1
Price Volatility	High

Our View

- The ultimate goal of the HHS is to accumulate 81 million courses of Tamiflu® and Relenza™ into the strategic stockpile by December 2008. We note the ratio of Tamiflu®:Relenza™ has reduced from 85:15 to 80:20, largely based on the observation that less resistance to Relenza™ is likely. The upside of 12.3m doses represents 20% of the envisaged stockpile, slightly below our previous expectations of 13.2m additional doses (representing 21.2% of stockpile). We view this as an excellent result for Biota, and could flow on to dual stockpiling efforts in countries that have traditionally relied on Tamiflu® (e.g. Japan, UK).

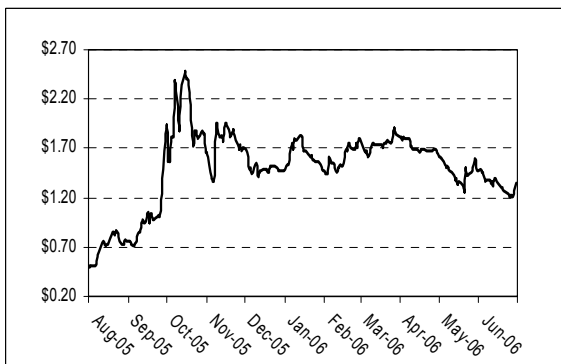
Key Financials (A\$'000)

Year End	FY05 Actual	FY06 Est.	FY07 Est.
Revenue	5,049	11,227	38,175
Litigation Expense	(3,700)	(4,825)	(5,000)
Total Op. Expenses	(11,908)	(18,509)	(21,590)
R&D Expenses	(7,337)	(5,315)	(5,395)
EBITD	(15,485)	(14,439)	9,982
EBIT	(16,352)	(15,379)	9,040
NPAT pre Net R&D	(9,020)	(11,049)	13,101
Reported Profit	(15,062)	(13,825)	10,247
EPS (c)	(12.2)	(8.2)	5.7
PE Ratio (x)	n/a	n/a	23.5
EPS pre R&D (c)	(7.3)	(6.7)	7.4

- We believe total worldwide orders for Relenza™ stands at approximately 32.5 to 33.5 million treatment courses. At our base value of A\$25 per course, this represents \$56.9 to \$58.6 million in royalties to Biota. We believe the majority of which will be forthcoming in FY07 and FY08. The Company also provided an update on the Glaxo (GSK) litigation (for which Biota is seeking \$308m to \$430m in damages). Biota indicated that a trial date may not occur until Feb 08. As a result, we have pushed back our expectations for a settlement of the dispute, which has impacted our 12 month target price.

- We have downgraded our base valuation by 3.2% to \$1.50 per share (fully diluted) to reflect the slight adjustment in US stockpiling and further litigation expenses. We have also downgraded our 12 month target price by 13.7% to \$1.70, as a result of our belief that a settlement with GSK is now unlikely until at least FY08. The \$0.20 upside represented in our target price is via potential production increases to our 2 year estimates. We believe GSK may be in a position to update the market during CY06 on manufacturing capacity for CY07, particularly in light of the HHS order. GSK has previously indicated CY06 production capacity will be 15m courses, and could be doubled or tripled in CY07, demand dependent.

Share Price Graph (A\$)



- We are forecasting an FY06 NPAT loss of \$13.8m. We maintain our FY07 NPAT of \$10.2m, and have made a 4.9% adjustment on the downside in our FY08 NPAT estimate from \$38.5 million to \$35.0 million as a result of yesterday's announcement, coupled with litigation expense associated with the GSK case flowing into FY08. At current levels, Biota is trading at a 10.0% discount to our base value (20.6% to target) and as such we believe the Company continues to represent value for investors at these levels. We note that Biota is very much dependent on H5N1 (avian influenza) news flow, and until recently traded above our implied base valuation (but not target). We note some evidence of further orders emanating from California and Ireland. We therefore maintain our Speculative Buy recommendation.

The Significant US Order We Expected Has Arrived

Up to A\$28.4 million in Relenza™ royalties from US order possible.

The intention of the US government to see Relenza™ represent 20% of its target 81 million treatment courses of stockpiled anti-viral drugs (or 16.2 million courses) is a significant milestone for Biota in a number of ways. Firstly, the HHS has acknowledged Relenza™ appears to have a more desirable resistance profile than Tamiflu®. Further, the positive statements and a Relenza™ stockpiling ratio at the high end of most expectations (though largely within our estimates) is likely to drive similar ratios from other countries. On our modelling estimates, the 16.2 million treatment courses could equate to A\$405 million in Relenza™ revenues to GSK between CY06-CY08, and approximately A\$28.4 million in royalties to Biota. We therefore view the US announcement as highly significant.

Worldwide stockpiles estimated at 32.2 to 33.2 million courses.

We summarise our estimates for total government stockpiling recorded to date (see across). As a result of the US intention to order, we have upgraded our estimates by 54-57% to 32.2 to 33.2 million courses. As evidenced across, there is still significant upside for Biota through other countries seeking to co-stockpile Relenza™ and Tamiflu®. We believe the bottleneck to stockpiling orders is a direct result of limited Relenza™ supply to date, in contrast to annual capacity of 400 million doses for Tamiflu® by CY07. As a result of likely capacity expansion in CY07 of Relenza™, we believe additional orders from alternative governments are still likely through the remainder of CY06 and into CY07.

Government Stockpiling* as at July 1st 2006

Country	Order Date	Quantity (m)
Germany	Aug-05	1.70
France	Nov-05	9.00
Australia	Feb-06	1.82
USA	Sep-05, Mar-06, Jul -06	16.20
Hong Kong	n/a	2.0 - 3.0
Netherlands	Sep-05	1.25
Czech Republic	Nov-05	0.20
Singapore	Jan-06	0.05
TOTAL		32.2 - 33.2

* Actual and intention to order. Source: Taylor Collison estimates

North Carolina facility likely to produce US Relenza™.

We believe additional manufacturing capacity for Relenza™ will come from GSK's existing plant in North Carolina. Worldwide, we understand GSK has committed over A\$100 million in Capex to increase manufacturing capacity for Relenza™. GSK has guided CY06 capacity of 15 million treatment courses. Based on the US intention to order a further 12.3 million courses, we expect an upgrade to capacity in CY07 and beyond. Indeed, we note comments by GSK management that it would seek to double or triple capacity in CY07, subject to product demand. We understand GSK has spent approximately A\$30 million in Capex to bring the Boronia facility in Melbourne on line.

Unlikely to see further single additional orders over 10 million courses.

The current US order probably represents the last single order we would expect over 10 million doses. Given the impetus for increasing the percentage of Relenza™ in stockpiles as a result of no discernable resistance emerging, we believe this will act as a catalyst for other countries to increase their holdings of Relenza™. We see two attractive jurisdictions as Japan (~25 million doses of Tamiflu®) and the UK (14.6 million doses of Tamiflu®) in this regard.

Possible Irish order of 600-800,000 courses.

We understand an Irish order of 600-800,000 treatment courses is close, which may result in a further A\$1.0 to \$1.5 million in royalty revenues. There is also reports that Germany (who were one of the first governments to stockpile significant courses of Relenza™, viz 1.7m doses) is looking to increase its stockpile of Tamiflu® and Relenza™ from 10% of the population to 20% (one German state is already at 30%).

Follow on German order also slated.

We understand negotiations with Roche and GSK have commenced. If Relenza™ was able to capture 20% of any potential new order (as it already has for the previous German order) this would equate to a further A\$2.8 million at A\$25 per dose in royalty revenues. We see this as further away than the Irish order, but could still eventuate during CY06.

Litigation Update – Trial Date Slated for February 2008

Discovery still ongoing, expect completion in August.

In an update to shareholders in late June, Biota indicated that GSK were ordered to provide an additional 35,000 documents related to the case during July and August. We view this as a net positive and should mark the end of the discovery process. Importantly, the judge appeared to acknowledge GSK has been towing the line with discovery by setting such timelines. Both parties are due to appear in court on August 18th through to 24th August.

Trial date Feb 08.

The earliest and most likely trial date has been set down for February 2008. Given this timeline, we view it less likely (though still possible) that a settlement will be reached during FY07. This has directly impacted our 12 month target price (see below). We note that mediation hearings between now and Feb 08 are possible, which may direct towards settlement.

Settlement likely, but not in FY07 in our view.

We continue to believe the dispute will be settled prior to both parties going to trial, though in our modelling we expect Biota to receive only a percentage (10%) of its damages claim (\$308-\$430 million), with an increased royalty rate on Relenza™ sales, up from the current rate of 7% gross, 6% net.

Hepatitis C – Recent Deal Flow Suggests Space is Hotting Up

HCV space continues to remain buoyant.

Hepatitis C Virus (HCV) continues to remain a hot therapeutic space at present, as evidenced by both deal flow and the size of deals negotiated. Biota has developed novel compounds to the viral polymerase enzyme, which represents a well defined therapeutic target. We understand the program is currently generating a series of compounds for lead selection, a prelude to formal pre-clinical development. Biota has indicated that its portfolio of HCV compounds is available for licensing.

We believe a license deal for Biota's HCV program may eventuate over the next 12 months. Judging on recent deal flow (see below), we would expect any license deal could exceed market expectations with respect to its size. We note Biota has previously struck a US\$112.5 million license deal for its respiratory syncytial virus (RSV) program.

Key market drivers warrant increased interest in HCV.

In our view, both major biotech/pharma companies are showing an increased interest in the area, primarily due to the lack of efficacy of existing therapies, with increased infection rates in Western countries. For example, in the US 1.8% of population are infected amounting to 3.9 million people. In more than 60% of cases, infection with HCV leads to long-term disease and disability. It is the most common cause of chronic liver disease, hepatocellular carcinoma, and the most frequent reason for liver transplantation. The HCV market is today dominated by interferon-based treatment regimes which have both limitations in efficacy and tolerability. The HCV market is expected to be worth US\$9 billion by 2010.

Three HCV deals in June alone.

Vertex Pharmaceuticals and Janssen Pharmaceuticals (a J&J subsidiary) recently announced a US\$545 million global license deal for a protease inhibitor (VX-950) currently in Phase 2 clinical trials. The royalty rate negotiated is understood to be in the high 20% range, with a 50/50 development cost sharing arrangement. Significantly, a substantial upfront payment of US\$165 million was negotiated and Vertex retains full North American rights. Also very recently, Novartis and GeneLabs struck a US\$195 million deal for a suite of pre-clinical non-nucleoside inhibitors targeting the viral polymerase. A summary of recent deals in the HCV space is illustrated below.

HCV - Recent Technology Deals

Date	Licensor	Licensee	Drug	Stage at Execution	Upfront (US\$m)	Milestones (US\$m)	Total Value (US\$m)
Jun-06	Vertex Pharma	Janssen Pharma (J&J)	VX-950	Phase 2	165.0	380.0	545.0
Jun-06	GeneLabs	Novartis	various	Pre-clinical	12.5	182.5	195.0
Jun-06	Human Genome Sciences	Novartis	Albuferon	Phase 2	45.0	507.5	552.5
Mar-06	PTC Therapeutics	Schering-Plough	various	Pre-clinical	12.0	188.0	200.0
Nov-04	Achillion	Gilead	various	Pre-clinical	5.0	105.0	110.0
Nov-04	Medivir	Tibotec (J&J)	various	Pre-clinical	8.0	73.0	81.0

Source: Recombinant Capital

Outlook

Forecasting profitability in FY07 and FY08.

The outlook for Biota continues to remain very favourable, with considerable Relenza™ royalties expected in FY07 and FY08, based on total known stockpiling orders. Such royalties will more than offset costs associated with Biota's development pipeline, and we maintain our belief the company will turn a profit in FY07 and FY08. Given the shelf life of current stockpiling, in the absence of a pandemic, all stockpiles must be replaced within three years. Investors should note further upside through license deals in the human rhinovirus (HRV, "common cold"), hepatitis C and long acting neuraminidase inhibitor (LANI) programs over the next 12-18 months. We expect the results of the Phase 1 HRV trial in 2H CY06. We also expect manufacturing upgrades from GSK management during CY06 for CY07 and beyond, particularly in light of the US intention to order.

License deals possible over next 12-18 months.

Revised base valuation of \$1.50 per share, 12 month target \$1.70.

We are forecasting an FY06 NPAT loss of \$13.8m. We maintain our FY07 NPAT of \$10.2m, and have made a 4.9% adjustment on the downside in our FY08 NPAT estimate from \$38.5 million to \$35.0 million as a result of yesterday's announcement, coupled with litigation expense associated with the GSK case flowing into FY08. At current levels, Biota is trading at a 10.0% discount to our base value (20.6% to target) and as such we believe the Company continues to represent value for investors at these levels. We note that Biota is very much dependent on H5N1 (avian influenza) news flow, and until recently traded above our implied base valuation (but not target). We note some evidence of outstanding orders from California and Ireland. We therefore maintain our Speculative Buy recommendation.

Maintain Speculative Buy.

Biota Holdings Limited - Summary of Forecasts

BTA \$1.35

PROFIT & LOSS SUMMARY (A\$'000)				
Period	FY05A	FY06E	FY07E	FY08E
Total Revenue	5,049	11,227	38,175	63,409
<i>Growth (pcp)</i>	-37.3%	122.4%	240.0%	66.1%
Net Operating Revenue	(6,859)	(7,282)	16,585	41,489
R&D Expenses	(7,337)	(5,315)	(5,395)	(5,583)
EBITD	(15,485)	(14,439)	9,982	32,962
Depreciation	(867)	(940)	(942)	(864)
EBIT	(16,352)	(15,379)	9,040	32,098
Net Interest	1,289	1,842	1,207	2,945
Pre-Tax Profit	(15,063)	(13,537)	10,247	35,043
Tax Expense	0	0	0	0
Minorities	0	0	0	0
NPAT	(15,063)	(13,537)	10,247	35,043
<i>Growth (pcp)</i>	n/a	n/a	n/a	242.0%
Net Abnormals	0	(288)	0	0
Reported Profit	(15,062)	(13,825)	10,247	35,043
NPAT pre Net R&D	(9,020)	(11,049)	13,103	40,126

PER SHARE DATA				
Period	FY05A	FY06E	FY07E	FY08E
EPS (c)	(12.2)	(8.2)	5.7	19.7
<i>Growth (pcp)</i>	n/a	n/a	n/a	242.0%
Dividend (c)	0.0	0.0	0.0	0.0
Franking	0%	0%	0%	0%
Gross CF per Share (c)	(10.8)	(2.6)	6.0	22.2
NTA per share (c)	21.1	24.4	31.3	53.7

VALUATION MULTIPLES				
Period	FY05A	FY06E	FY07E	FY08E
PE Ratio (x)	n/a	n/a	23.5	6.9
Dividend Yield (%)	0.0%	0.0%	0.0%	0.0%
EV/EBITA (x)	(17.0)	(16.8)	19.9	5.3
EV/EBIT (x)	(15.2)	(14.8)	24.0	5.5

CAPITAL RAISING ASSUMPTIONS				
Period	FY05A	FY06E	FY07E	FY08E
Shares Issued (m)	n/a	41.0	0.0	0.0
Issue Price (A\$)	n/a	0.76	0.0	0.0
Cash Raised (A\$m)	n/a	31.0	0.0	0.0

KEY RATIOS				
Period	FY05A	FY06E	FY07E	FY08E
EBITD/Sales Margin %	-306.7%	-128.6%	26.1%	52.0%
EBIT/Sales Margin %	-323.9%	-137.0%	23.7%	50.6%
Current ratio (x)	6.3	7.6	13.6	14.7
Net Debt : Equity (%)	-92.7%	-114.3%	-100.7%	-99.4%
ROE (%)	-57.9%	-33.7%	18.4%	36.6%
Dividend Payout Ratio (%)	0.0%	0.0%	0.0%	0.0%

BALANCE SHEET SUMMARY (A\$'000)				
Period	FY05A	FY06E	FY07E	FY08E
Cash	24,753	45,991	56,094	95,067
Receivables	972	1,090	3,705	6,154
Inventories	0	0	0	0
Other	0	0	0	0
Total Current Assets	25,725	47,081	59,799	101,221
Investments	0	0	0	0
Inventories	0	0	0	0
Property Plant & Equip	4,702	4,712	4,319	4,005
Intangibles	0	0	0	0
Other	0	0	0	1
Total Non-Current Assets	4,702	4,712	4,319	4,006
TOTAL ASSETS	30,427	51,793	64,118	105,227
Accounts Payable	3,727	5,614	3,817	6,341
Borrowings	366	0	0	0
Provisions	0	0	0	0
Other	0	568	568	568
Total Current Liab	4,093	6,182	4,385	6,909
Borrowings	366	0	0	0
Provisions	0	0	0	0
Other	0	5,324	3,968	2,612
Total Non-Current Liab	298	5,382	4,026	2,670
TOTAL LIABILITIES	4,391	11,564	8,411	9,579
TOTAL EQUITY	26,036	40,229	55,707	95,648

CASH FLOW SUMMARY (A\$'000)				
Period	FY05A	FY06E	FY07E	FY08E
EBIT (excl Abs/Extr)	(16,352)	(15,379)	9,040	32,098
Add: Depreciation	867	940	942	864
Amortisation	0	0	0	0
Change in Pay.	478	1,887	(1,796)	2,523
Less: Tax paid	0	0	0	0
Net Interest	1,289	1,842	1,207	2,945
Change in Rec.	361	600	2,615	2,449
Change in Prov.	12	18	0	0
Change in Inv.	0	0	0	0
Change in Def. Rev.	0	5,892	(1,356)	(1,356)
Gross Cashflows	(13,345)	(4,201)	10,653	39,523
Capex	(4,323)	(950)	(550)	(550)
Free Cashflows	(17,668)	(5,151)	10,103	38,973
Dividends Paid	0	0	0	0
Net Cash Flow	(17,668)	(5,151)	10,103	38,973

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