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Biota Holdings Limited (BTA)

Speculative Buy

Excellent 1H Profit of \$4.1 million; Outlook Remains Strong

\$1.61

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1H07 Overview

Biota has reported a 1H07 NPAT of \$4.1 million, and 47% ahead of our estimates.

1H EPS of 2.3 cps versus EPS loss of 5.8 cps pcp.

1H Relenza™ royalty revenues of \$12.7 million were in line with our estimates.

R&D expenditure was \$3.9 million, up 13.2% pcp and slightly below our estimates.

Litigation expense relating to the legal dispute with GSK increased 56.8% pcp to \$3.4 million.

Net operating cash burn of \$3.9 million, with closing cash of \$41.9 million.

Summary

Market Capitalisation (M)	\$289.8
Share Price	\$1.61
Shares on Issue (M)	180.0
52 Week High	\$2.00
52 Week Low	\$1.13
Valuation Per Share (fully diluted)	\$1.61
12 Month Price Target	\$1.81
Cash (M) as at 31/12/06	\$41.9
Price Volatility	High

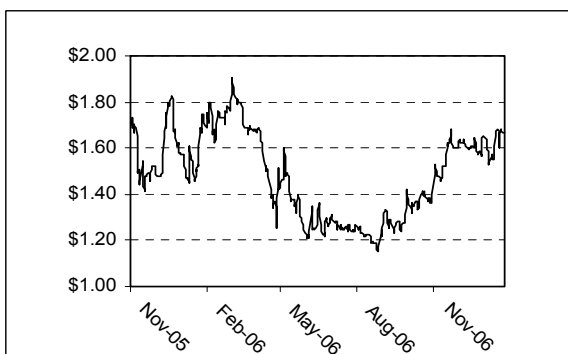
Key Financials (A\$'000)

Year End	FY06 Actual	1H07 Actual	FY07 Est.
Revenue	14,967	20,408	46,523
Litigation Expense	(4,397)	(3,402)	(7,750)
Total Op. Expenses	(17,314)	(11,655)	(28,514)
R&D Expenses	(7,685)	(3,926)	(8,737)
EBITD	(12,288)	3,534	7,056
EBIT	(13,274)	2,983	5,953
NPAT pre Net R&D	(4,716)	7,881	14,368
Reported Profit	(11,306)	4,091	8,170
EPS (c)	(6.7)	2.3	4.5
PE Ratio (x)	n/a	n/a	35.5

Our View

- Biota has delivered an excellent 1H result, which benefited from increased royalty revenues from pandemic stockpiling of Relenza™ by western governments and research/partnering income associated with Biota's two pharmaceutical partners MedImmune and Boehringer Ingelheim (BI). Biota is expecting to be cash flow positive in FY07 and expects to record back to back profitable halves. Operating cash burn for the 1H07 is a consequence of Relenza™ revenue recognition but cash only collected annually from GSK in the 2H. We note the 1H07 did not include any significant contribution from the two NIH grants awarded to Biota. We expect that as LANI and FLUNET compounds continue progress that both grant revenue and offsetting expenditure will increase in the 2H.
- We have upgraded our FY estimates for Relenza™ royalties by 9.1% to \$25.1 million, well above Biota management guidance of at least \$18 million. GSK's 1H07 Relenza™ revenues appear to indicate volumes to FY07 are likely to go close to the 15 million treatment courses previously guided. We are upgrading our FY07 NPAT estimates by 15.7% to \$8.2 million. However, we note the sensitivity of our FY07 estimates to a single milestone payment (TC estimates of \$3.7 million) from MedImmune for the ongoing RSV collaboration/license deal during 2H07. Biota is currently trading on 35.5x our FY07 EPS estimates. We continue to believe that FY08 will be a much stronger year for Biota (TC est. NPAT \$21.9 million) with Relenza™ royalties at least that of our FY07 estimates at current capacity and further more significant milestones available under the two license deals, providing the compounds move through. We maintain our Speculative Buy recommendation with a base valuation of \$1.61 and a 12 month target of \$1.81.

Share Price Graph (A\$)



1H07 Overview

Reported 1H07 NPAT of \$4.1 million well ahead of expectations.

Biota has reported an FY06 NPAT of \$4.1 million, which was well ahead of our expectations. Biota's headline revenues continue to benefit from progressive fulfilment of Relenza™ pandemic influenza stockpiling orders from western governments. GSK reported 1H Relenza™ sales of £67 million (A\$161.4 million). Biota receives a 7% royalty on sales of Relenza™. Our estimates for present stockpiling orders and the quantum of orders fulfilled are shown (across). We believe that Biota is set to receive \$42-\$44 million in future royalties from fulfilment of known stockpiling orders.

Known Government Stockpiling* as at February 2007

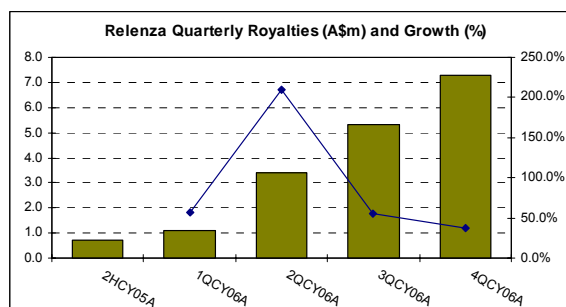
Country	Order Date	Quantity (m)
Germany	Aug-05	1.70
France	Nov-05	9.00
Australia	Feb-06	1.82
USA	Sep-05, Mar-06, Jul -06	16.20
Hong Kong	n/a	2.0 - 3.0
Netherlands	Sep-05	1.25
Czech Republic	Nov-05	0.20
Singapore	Jan-06	0.05
Malaysia	Jul-06	0.13
Canada	Nov-06	0.70
Ireland	Dec-06	0.70
TOTAL		33.73 - 34.75
<i>less est. orders filled</i>	<i>(9.6 m)</i>	24.1 - 25.2
Potential Royalties (A\$m) @ A\$25		42.2 - 44.1

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

Based on existing known annual capacity provided by GSK of 15 million treatment courses, we expect fulfilment to be completed (in the absence of any additional orders, or capacity upgrades) during 1H09.

\$12.7 million in recognised Relenza™ royalties.

Biota recognised \$12.7 million in Relenza™ royalties in the 1H, significantly higher than pcp (see across). Given the capacity guidance issued by GSK, we see only a modest uplift in 2H08 royalties, continuing into FY08. As mentioned previously, with two new manufacturing lines in places at GSK's North Carolina facility, we believe current capacity may actually exceed the 15 million in annual output, though GSK has declined to comment on this.



The contribution of particular revenue streams to total revenue is shown in the Table below.

\$ million	1H06A	1H07A	Change
Partnering Income (MedImm, Boeh)	0.11	2.45	2065.5%
Research Income (MedImm, Boeh)	0.00	3.43	n/a
Govt Grants	0.40	0.14	-66.1%
Diagnostic Profit Share	0.80	0.41	-49.0%
Relenza royalties	0.68	12.69	1780.0%
Interest Income	0.92	1.29	41.3%
TOTAL REVENUE (inc. other)	2.91	20.41	600.8%

Partnering and research income significantly higher than pcp.

The two income streams from Biota's pharmaceutical partners showed very strong growth pcp. As we understand it, under the terms of the Agreements with MedImmune and Boehringer Ingelheim there a joint research program undertaken with Biota's share of research expenditure offset against research income provided for by the licensor. Essentially, the ongoing two year hepatitis C virus (HCV) and respiratory syncytial virus (RSV) R&D programs are cost neutral to Biota.

Expectation of much higher government grant income in 2H and FY08.

Diagnostic profit share revenues were below our expectations though we expect some sales acceleration in the 2H in line with the Northern Hemisphere winter. Interestingly, very little of Biota's two existing National Institutes of Health (NIH) grants were utilised in 1H07. We note that no grant monies have been recognised from the US\$8.5 million, 4 year grant awarded in Aug 06 for Biota's FLUNET compounds and our estimates of up to A\$2.4 million available under an earlier NIH grant awarded in Oct 04 for the LANI program. As both programs develop further, we expect an increased contribution of government grant revenue in the 2H.

We have provided a breakdown of the major expenditure in the 1H06 result, as shown below.

\$ million	1H06A	1H07A	Change
Admin Expense	(2.04)	(1.80)	-11.5%
Product Development	(3.20)	(4.67)	46.2%
Business Development*	(0.36)	(0.55)	50.6%
R&D Expenses	(3.47)	(3.93)	13.2%
Litigation Expenses	(2.17)	(3.40)	56.8%

*Ex Relenza royalty payments to CSIRO and Vic College of Pharmacy

We note a continued obligation by Biota to the original developers of Relenza™, in the order of 14% of royalties received, or \$1.8 million for 1H07. We note litigation expenditure rose considerably in 1H07, as the Company prepares to lodge an amended statement of claim (see below). Product development expenditure rose in line with completion of the Phase 1b dosing study for Biota's lead human rhinovirus (HRV) therapeutic, which is expected to report during the current quarter. We expect product development expenditure to grow in both the 2H and FY08 due to Biota commencing a Phase 2 challenge study for HRV and continued development of the HCV and RSV programs.

GSK Litigation

Biota has indicated that litigation expense for the full year will be in the range \$7.5 million to \$8.0 million. This is well above our previous estimates of approximately \$5.0 million. The Company has commented that as part of the discovery process, they are drawing up their revised statement of claim. This is due before the end of March. Based on management comments on the 1H release, we expect the statement of claim to be revised up, not down with the possibility of a narrowing in the litigation amount (currently \$308-\$430 million).

Litigation expenditure of \$7.5-\$8.0 million in FY07.

We have not expressly incorporated any settlement into our valuation model, but believe in PV terms, a cash settlement of 10% of the maximum claim amount (\$43 million) will deliver \$0.21 upside to the scrip. This ignores any backdated royalties awarded to Biota as part of any settlement. A useful proxy for such a claim is the 4Q CY05 settlement between Roche (marketers of Tamiflu®) and Gilead (developers of Tamiflu®).

Utilisation of Future Income Tax Benefits (FITB)

We have removed from our model the expectation of progressive use of future income tax benefits (FITB) by Biota (est. \$2.9 million in FY07 and \$3.9 million in FY08). We believe such benefits will instead be utilised in the event of a cash settlement with GSK as part of the ongoing litigation. In our view, the two collaborative R&D programs with Boehringer Ingelheim and MedImmune, coupled with Biota's own internal R&D program should offer an income tax benefit that offsets the *prima facie* income tax payable on profit. Therefore we are not recognising an income tax expense/benefit for FY07 or FY08, unless an early settlement with GSK transpires.

FITB not to be brought to account until GSK settlement.

Outlook

In our view, Biota remains a high quality drug development company, with a strong source of continued funding from both Relenza™ royalties and partnering income from MedImmune (RSV) and Boehringer Ingelheim (HCV). During CY07, we also expect Biota to execute a license deal for its long acting neuraminidase inhibitor (LANI) program, which is currently being co-developed with Sankyo in Japan. We have conservatively valued such a license deal with worldwide rights (ex-Japan) at US\$100 million.

We have upgraded our FY07 estimates for Relenza™ royalties by 9.1% to \$25.1 million, well above management guidance (+\$18 million), given GSK's 1H07 Relenza™ revenues appear to indicate volumes to FY07 are likely to go close to the 15 million treatment courses previously guided. We are upgrading our FY07 NPAT estimates by 15.7% to \$8.2 million. However, we note the sensitivity of our FY07 estimates to a single milestone payment (TC estimates of \$3.7 million) from MedImmune for the ongoing RSV collaboration/license deal during 2H07.

Maintain price target of \$1.81.

Biota is currently trading on 35.5x our FY07 EPS estimates. We continue to believe that FY08 will be a much stronger year for Biota with Relenza™ royalties at least that of our FY07 estimates at current capacity and further more significant milestones available under the two license deals, providing the compounds move through. We note the negative impact the non-recognition of FITB in FY08 to our forecasts of approximately 9.1% to \$21.9 million. We maintain our Speculative Buy recommendation with a base valuation of \$1.61 and a 12 month target of \$1.81.

Biota Holdings Limited - Summary of Forecasts

BTA \$1.61

PROFIT & LOSS SUMMARY (A\$'000)

Period	1H06A	FY06A	1H07A	FY07E	FY08E
Total Revenue	2,912	14,967	20,408	46,523	59,558
<i>Growth (pcp)</i>	<i>64.3%</i>	<i>196.4%</i>	<i>600.8%</i>	<i>210.8%</i>	<i>28.0%</i>
Net Operating Revenue	(4,524)	(2,347)	8,753	18,010	29,530
R&D Expenses	(3,467)	(7,685)	(3,926)	(8,737)	(6,634)
EBITD	(8,906)	(12,288)	3,534	7,056	19,480
Depreciation	(434)	(986)	(551)	(1,102)	(1,014)
EBIT	(9,340)	(13,274)	2,983	5,953	18,466
Net Interest	915	2,256	1,108	2,217	3,416
Pre-Tax Profit	(8,425)	(11,018)	4,091	8,170	21,882
Tax Expense	0	0	0	0	0
Minorities	0	0	0	0	0
NPAT	(8,425)	(11,018)	4,091	8,170	21,882
<i>Growth (pcp)</i>	<i>n/a</i>	<i>n/a</i>	<i>n/a</i>	<i>n/a</i>	<i>167.8%</i>
Net Abnormals	(288)	(288)	0	0	0
Reported Profit	(8,713)	(11,306)	4,091	8,170	21,882
NPAT pre Net R&D	(5,647)	(4,716)	7,881	14,368	28,016

PER SHARE DATA

Period	1H06A	FY06A	1H07A	FY07E	FY08E
EPS (c)	(5.6)	(6.7)	2.3	4.5	12.2
<i>Growth (pcp)</i>	<i>n/a</i>	<i>n/a</i>	<i>n/a</i>	<i>n/a</i>	<i>167.9%</i>
Dividend (c)	0.0	0.0	0.0	0.0	0.0
Franking	0%	0%	0%	0%	0%
Gross CF per Share (c)	(2.0)	(4.8)	(2.7)	6.0	9.8
NTA per share (c)	32.6	28.5	28.5	30.6	41.7

VALUATION MULTIPLES

Period	1H06A	FY06A	1H07A	FY07E	FY08E
PE Ratio (x)	n/a	n/a	n/a	35.5	13.2
Dividend Yield (%)	100.0%	0.0%	100.0%	0.0%	0.0%
EV/EBITD (x)	(28.8)	(22.0)	61.9	29.2	10.9
EV/EBIT (x)	(26.1)	(18.7)	84.8	40.0	12.1

CAPITAL RAISING ASSUMPTIONS

Period	1H06A	FY06A	1H07A	FY07E	FY08E
Shares Issued (m)	41.0	41.0	0.0	0.0	0.0
Issue Price (A\$)	0.76	0.76	0.00	0.0	0.0
Cash Raised (A\$m)	31.0	31.0	0.0	0.0	0.0

KEY RATIOS

Period	1H06A	FY06A	1H07A	FY07E	FY08E
EBITD/Sales Margin %	0.0%	-82.1%	17.3%	15.2%	32.7%
EBIT/Sales Margin %	-320.7%	-88.7%	14.6%	12.8%	31.0%
Current ratio (x)	13.6	4.9	4.6	5.0	6.3
Net Debt : Equity (%)	-104.6%	-98.5%	-81.7%	-103.3%	-95.5%
ROE (%)	-17.2%	-23.5%	8.0%	16.0%	33.6%
Dividend Payout Ratio (%)	0.0%	0.0%	0.0%	0.0%	0.0%

BALANCE SHEET SUMMARY (A\$'000)

Period	1H06A	FY06A	1H07A	FY07E	FY08E
Cash	51,142	46,183	41,941	56,926	71,687
Receivables	2,043	5,573	19,824	10,235	13,103
Inventories	0	0	0	0	0
Other	0	291	0	0	0
Total Current Assets	53,185	52,047	61,765	67,162	84,790
Investments	0	0	0	0	0
Inventories	0	0	0	0	0
Property Plant & Equip	5,010	5,512	5,270	5,068	4,954
Intangibles	0	0	0	0	0
Deferred Tax Assets	0	0	0	0	0
Other	0	0	0	0	0
Total Non-Current Assets	5,010	5,512	5,270	5,068	4,954
TOTAL ASSETS	58,195	57,559	67,035	72,229	89,744
Accounts Payable	2,549	4,034	5,242	6,978	8,934
Borrowings	0	0	0	0	0
Provisions	0	516	574	574	574
Other (Inc Def Rev)	1,359	6,011	7,630	5,790	4,001
Total Current Liab	3,908	10,561	13,446	13,342	13,508
Borrowings	0	0	0	0	0
Provisions	0	100	0	58	58
Other (Inc Def Rev)	5,324	0	2,279	3,728	1,096
Total Non-Current Liab	5,382	100	2,279	3,786	1,154
TOTAL LIABILITIES	9,290	10,661	15,725	17,129	14,663
TOTAL EQUITY	48,905	46,898	51,310	55,101	75,081

CASH FLOW SUMMARY (A\$'000)

Period	1H06A	FY06A	1H07A	FY07E	FY08E
EBIT (excl Abs/Extr)	(9,340)	(13,274)	2,983	5,953	18,466
Add: Depreciation	434	986	551	1,102	1,014
Amortisation	0	0	0	0	0
Change in Pay.	(396)	863	1,208	2,944	1,955
Less: Tax paid	0	0	0	0	0
Net Interest	915	2,256	1,108	2,217	3,416
Change in Rec.	(1,196)	(4,778)	(14,556)	(4,967)	(2,868)
Change in Prov.	(28)	(20)	42	(16)	0
Change in FITB	0	0	0	0	0
Change in Inv.	0	0	0	0	0
Change in Def. Rev.	6,683	6,011	3,898	3,507	(4,421)
Gross Cashflows	(2,928)	(7,956)	(4,765)	10,741	17,562
Capex	(756)	(1,985)	(379)	(900)	(900)
Free Cashflows	(3,684)	(9,941)	(5,144)	9,841	16,662
Dividends Paid	0	0	0	0	0
Net Cash Flow	(3,684)	(9,941)	(5,144)	9,841	16,662

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