

Biota Holdings Ltd (BTA.ASX)

Flu symptoms

Thursday 25 October 2007
Healthcare

GlaxoSmithKline announced quarterly Relenza revenues of £28m, 7% below the pcp. Biota's royalty share of this was £\$1.96m, equivalent to AUD \$4.5m. We were expecting Q1 royalties to be below that of Q4 FY2007, given Q1 is traditionally seasonally weak. However, we had expected them to be higher than the pcp. Overall, we were disappointed with the result.

GSK said that the result reflected "lower demand from governments to stockpile it for use in the event of a flu pandemic". We were surprised by this. GSK has only recently lifted its production capacity for Relenza, and we believe that there are still a significant number of backorders for Relenza that are yet to be filled.

We believe this weak result may shake investor confidence in BTA. While the current investor road show and imminent commencement of Phase II trials for LANI will limit any downward move, **we believe the company's share price is unlikely to re-rate until the market sees some evidence of improving Relenza royalties.** Hopefully this will occur in Q2.

We are hosting a lunch for BTA on October 31 at 12.30pm, and we will be looking for more information from management on their expectations for Relenza going forwards. We will revisit our earnings assumptions for BTA following this, but for now we are leaving our forecasts unchanged.

We note that even factoring in a worst case scenario, where sales from Relenza decline and the law suit against GSK fails, our valuation for BTA only falls to \$1.94/share, still 23% above the current share price.

We are downgrading our recommendation for Biota Holdings from Buy to Hold, and have reduced our price target from \$2.92/share to \$1.60/share. This represents a 45% discount to our NPV. While we remain convinced that BTA's underlying value is well above the current share price, we do not believe that the stock will re-rate until the market gains confidence that the Relenza royalties will rebound.

Rating: **Hold**
(previous): Buy

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Share price: **\$1.48**

Price target: \$1.60
NPV per share \$2.92
Risk: High

Shares on issue (m): 181.7
Shares on issue (diluted) (m): 182.7
Free float: 100%
Average daily volume: 286,539

Market cap (\$m): \$270.4
Enterprise value FY07 (\$m): \$208.2
Net Debt FY07 (\$m): -62.2
Gearing (ND/ND+E) FY07: NA
S'holders equity FY07 (\$m): 71.5
NTA per share FY07: \$0.32

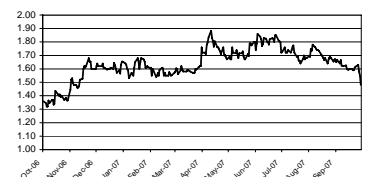
Forecast: **2008**

Free cash flow (\$m): 21.3
Return on average equity: 26.3%
Net interest cover: NA

Forecast: **2009**

Free cash flow (\$m): 136.5
Return on average equity: 28.9%
Net interest cover: NA

Shareprice (\$):



Year to Jun (\$m)	2006a	2007a	2008e	2009e*	2010e
Sales revenue	12.7	54.8	72.6	196.6	116.6
% change	246%	331%	32%	171%	-41%
EBITDA	-12.6	17.5	18.2	176.7	96.1
EBITDA margin	-99%	32%	25%	90%	82%
NPAT rep. (incl. sig items)	-11.3	20.2	24.7	136.8	71.1
NPAT normalised	-11.3	20.5	25.4	67.5	71.7
EPS diluted norm. (c)	-0.06	0.11	0.14	0.37	0.39
% change	-43%	NA	24%	166%	6%
Dividend (c)	0	0	0	0	0
PER (x)	-23.5	13.2	10.7	4.0	3.8
EV/EBITDA (x)	-17.4	11.9	10.3	0.3	-0.2
Yield (%)	0.00%	0.00%	0.00%	0.00%	0.00%

*2009 estimate includes settlement from GSK in reported numbers.

Source: Company, Foster Stockbroking

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DISAPPOINTING RELENZA SALES

Overnight GlaxoSmithKline announced quarterly Relenza revenues of £28m, 7% below the pcp. Biota's royalty share of this was £\$1.96m, equivalent to AUD \$4.5m. The strong Australian dollar exacerbated this fall. In AUD terms BTA's royalties were 16% weaker yoy, down from \$5.4m in Q1 FY2006, and 60% below Q4 FY2007 royalties of \$11.1m.

We were expecting Q1 royalties to be below that of Q4 FY2007, given Q1 is traditionally seasonally weak. However, we had expected them to be higher than the pcp. Overall, we were disappointed with the result.

In explaining the result, GSK said that it reflected "lower demand from governments to stockpile it for use in the event of a flu pandemic." We were surprised by this. GSK has only recently lifted its production capacity for Relenza, and we believe that there are still a significant number of backorders for Relenza that are yet to be filled.

Biota management have said that they are unfazed by this result, and that in their opinion the backlog, as well as some new orders, should continue to keep sales of Relenza strong.

There is some speculation that GSK is purposely suppressing sales of Relenza in order to place pressure on BTA to settle its lawsuit cheaply. However, we believe the probability of this is low. At its current annual production capacity of ca. 30M courses, GSK's yearly revenue would be close to AUD\$750m, more than covering the likely cost of a settlement acceptable to BTA's management and shareholders. We note that our expected payout in the case is \$100m.

Whatever the reason, **Q1 royalties were a disappointment, which we believe may shake investor confidence in BTA.** While the current investor road show and imminent commencement of Phase II trials for LANI will limit any downward move, **we believe the company's share price is unlikely to re-rate until the market sees some evidence of improving Relenza royalties.** Hopefully this will occur in Q2.

We are hosting a lunch for BTA on October 31 at 12.30pm, and we will be looking for more information from management on their expectations for Relenza going forwards. **We will revisit our earnings assumptions for BTA following this presentation. For now we are leaving our forecasts unchanged.**

VALUATION

Our final valuation for Biota remains \$2.92/share, assuming a \$100m settlement from GSK and that 2 of the company's development products achieve registration and sales.

Biota Valuation				
	Now		In 1 year	
	\$m	per share	\$m	per share
DCF valuation	465.8	2.56	440.5	2.42
Net debt	-65.5	-0.36	-149.7	-0.82
Total valuation	531.2	2.92	590.1	3.25

Source: FSB estimates

Our valuation includes no terminal value, as we have only forecast sales for each product up until their patents expire.

We note that even factoring in a worst case scenario, where sales from Relenza decline and the law suit against GSK fails, our valuation for BTA only falls to \$1.94/share, still 23% above the current share price.

RECOMMENDATION

For now, we are downgrading our recommendation for Biota Holdings from Buy to Hold, and have reduced our price target from \$2.92/share to \$1.60/share. This is a 45% discount to our NPV. While we remain convinced that BTA's underlying value is well above the current share price, we do not believe that the stock will re-rate until the market gains confidence that the Relenza royalties will rebound. We will revisit our recommendation following our meeting with management next week.

FINANCIALS

Biota Profit & Loss \$m

Y/e Jun	2007a	2008e	2009e	2010e	1H 08e	2H 08e
Sales revenue	54.8	72.6	196.6	116.6	33.7	38.9
EBITDA	17.5	18.2	176.7	96.1	1.7	16.5
EBITDA margin	32%	25%	90%	82%	5%	42%
Depreciation	1.2	1.3	1.3	1.3	0.6	0.6
EBITA	16.3	16.9	175.4	94.7	1.1	15.9
EBITA margin	30%	23%	89%	81%	3%	41%
Amortisation	0.3	0.6	0.6	0.6	0.3	0.3
EBIT	15.9	16.3	174.7	94.1	0.8	15.5
EBIT margin	29%	22%	89%	81%	2%	40%
Net interest expense	-1.9	-4.4	-7.3	-7.5	-1.9	-2.5
PBT	17.8	20.7	182.0	101.6	2.7	18.0
Tax	-2.3	-4.0	45.2	30.5	0.0	-4.0
NPAT	20.2	24.7	136.8	71.1	2.7	22.0
NPAT normalised	20.5	25.4	67.5	71.7	3.0	22.4

Source: Company; Foster Stockbroking estimates.

Biota Cashflow \$m

Y/e Jun	2007a	2008e	2009e	2010e
Receipts	47.3	71.7	193.3	112.1
Payments	-34.0	-53.8	-17.8	-18.8
Interest	2.7	4.4	7.3	7.5
Tax	0.0	0.0	-45.2	-30.5
Other	5.1	0.0	0.0	0.0
Operating cash flow	21.0	22.3	137.6	70.4
Loans to related parties	0.0	0.0	0.0	0.0
Sale of PPE	0.0	0.0	0.0	0.0
Acquisitions	-5.5	0.0	-4.0	0.0
Capex	-0.9	-1.1	-1.1	-1.1
Investing Cashflow	-6.4	-1.1	-5.1	-1.1
Debt repayments	0.0	0.0	0.0	0.0
Debt borrowed	0.0	0.0	0.0	0.0
Equity proceeds	1.4	0.0	0.0	0.0
Dividends	0.0	0.0	0.0	0.0
Other	0.0	0.0	0.0	0.0
Finance Cashflow	1.4	0.0	0.0	0.0

Source: Company; Foster Stockbroking estimates.

Biota Balance Sheet \$m

Y/e Jun	2007a	2008e	2009e	2010e
Cash and cash equivalents	62.2	83.4	215.9	285.2
Receivables	9.4	10.2	13.6	18.1
Inventories	0.0	0.0	0.0	0.0
PPE	5.2	4.9	4.7	4.5
Intangibles	13.4	13.1	12.5	11.9
Total Assets	92.5	115.4	274.8	329.8
Payables	6.0	6.5	8.7	10.5
Deferred revenue	7.5	0.0	0.0	0.0
Tax liabilities	0.0	0.0	13.5	12.2
Debt	0.0	0.0	0.0	0.0
Provisions	7.4	3.6	1.3	1.4
Other	0.0	8.9	18.1	1.5
Total Liabilities	20.9	19.1	41.7	25.6
Net assets	71.5	96.3	233.1	304.2
Contributed Equity	161.7	161.7	161.7	161.7
Reserves	0.6	0.6	0.6	0.6
Retained profits	-90.8	-66.0	70.8	141.9
Total Equity	71.5	96.3	233.1	304.2

Source: Company; Foster stockbroking estimates.

Biota Financial Ratios

Y/e Jun	2007a	2008e	2009e	2010e
DPS c	0.0	0.0	0.0	0.0
Yield %	0.0	0.0	0.0	0.0
Ave wtd shares dil m	182.7	182.7	182.7	182.7
EPS rep c	0.11	0.14	0.75	0.39
EPS normalised c	0.11	0.14	0.37	0.39
PER x	13.2	10.7	4.0	3.8
EPS growth %	NA	24%	166%	6%
Interest cover x	-8.4	-3.7	-24.1	-12.6
Ave RoE (%)	29%	26%	29%	24%
Ave RoA (%)	53%	51%	297%	211%
EV/EBITDA x	11.9	10.3	0.3	-0.2

Source: Company; Foster Stockbroking estimates.

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