

Biota Holdings

Big royalties during FY10

Buy

Important: The above recommendation has been made on a 12 month view and may not suit your investment needs or timeframe. The basis it is prepared on is summarised on the last page of this report. **PLEASE CONTACT YOUR ADVISER TO DISCUSS THIS GENERAL RECOMMENDATION BEFORE ACTING ON IT.**

High Volatility

Target price

A\$2.46 (from A\$2.24)

Price

A\$2.22

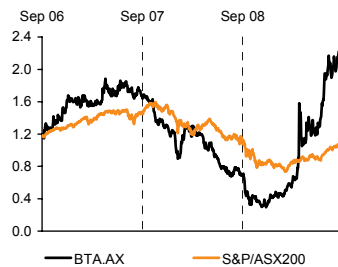
Short term (0-60 days)

n/a

BTA90915

Price performance

	(1M)	(3M)	(12M)
Price (A\$)	2.08	1.37	0.76
Absolute (%)	6.7	62.0	192.1
Rel market (%)	5.1	45.3	216.1
Rel sector (%)	1.1	42.1	210.1



Market capitalisation

A\$379.62m (US\$325.54m)

Average (12M) daily turnover

A\$1.13m (US\$0.87m)

RIC: BTA.AX, BTA AU
 Priced at close of business 14 Sep 2009.
 Source: Bloomberg

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GSK reports its quarterly sales data on 28 October (UK time). The potential of a worsening northern hemisphere flu season driven by the H1N1 pandemic may lead to higher-than-anticipated royalties flowing to BTA over the next 12 months.

Key forecasts

	FY08A	FY09A	FY10F	FY11F	FY12F
EBITDA (A\$m)	-9.78	44.30	114.7	163.8	35.20
Reported net profit (A\$m)	-6.49	38.20	88.60	112.9	28.80
Normalised net profit (A\$m) ¹	-6.49	38.20	88.60	112.9	28.80
Normalised EPS (c) ¹	-3.79	22.40	51.80	66.10	16.90
Normalised EPS growth (%)	n/a	n/a	131.8	27.50	-74.5
Dividend per share (c)	0.00	0.00	0.00	0.00	0.00
Dividend yield (%)	0.00	0.00	0.00	0.00	0.00
Normalised PE (x)	n/m	9.93	4.28	3.36	13.20
EV/EBITDA (x)	n/m	6.61	2.01	0.73	2.15
Price/net oper. CF (x)	78.90	11.30	4.53	3.39	8.26
ROIC (%)	-93.4	869.1	736.4	682.3	123.3

1. Pre non-recurring items and post preference dividends
 Accounting standard: IFRS
 Source: Company data, RBS Morgans forecasts

year to Jun, fully diluted

Strategy outlined

In BTA's recent roadshow a clear strategy was outlined to grow the revenue and profit stream in the long term. BTA's expertise as a small molecule development company will be maintained together with a philosophy of out-licensing programs at an early stage to minimise risk to shareholders. Over the next three to five years BTA aims to have two to three royalty-generating programs in its portfolio. To achieve this a combination of acquisition, organic growth and in-licensing is expected. The current obvious gaps are the lead to pre-clinical stage, at the Phase I-II stage and pre-market launch stage.

The next milestone to watch for GSK quarterly results

The next milestone to watch for will be GSK's quarterly result, due 28 October (UK time). We expect continued strong growth in Relenza royalties. We forecast royalties of A\$133m for FY10, driven by major government orders, particularly from the UK and US. Although we do not forecast quarterly royalties in detail, we estimate these could be A\$20m-30m.

Brian Larkin's perspective

At this stage we make no assumptions on M&A or additional in-licensing programs. Although we have made no changes to forecasts, we now set our target price at a 10% premium to our DCF-based valuation after reference to our technical analyst, Brian Larkin.

Investment view – Buy maintained

Our valuation remains unchanged at A\$2.24 (comprised of Relenza royalties of A\$1.21, laninamivir at A\$0.90 and the HRV program at A\$0.13). Our key assumptions in deriving this valuation include a risk-free rate of 5.25%, a WACC of 16.0% and a terminal growth rate of 3.5%. Our target price is now A\$2.46 (was A\$2.24). The main downside risk to our target price is a delay in GSK receiving regulatory approval for the alternative disk inhaler (known as Rotahaler), thus limiting its ability to achieve full production.

GSK quarterly result the next driver

We think the next milestone to watch for BTA will be GSK's quarterly result, due 28 October 2009 (UK time). We expect continued strong growth in Relenza royalties and forecast royalties of A\$133m for FY10, driven by major government orders, particularly from the UK and US. Although we do not forecast quarterly royalties in any detail, we estimate third-quarter royalties of A\$20m-30m could be achieved. As can be seen from the table and graph below, the quarterly data is volatile and difficult to predict.

Underpinning our forecasts is GSK's intention to increase production from 60m to 190m courses. To achieve this increase, GSK is seeking regulatory approval for an alternative device known as a Rotahaler. In previous notes we highlighted the growing body of evidence suggesting resistance is emerging to Relenza's competing product, Tamiflu, in certain H1N1 strains. As a result, we see potential for governments to look to rebalance their stockpiles with a more equal weighting towards Relenza. Typically, global stockpiles are 20% Relenza and 80% Tamiflu.

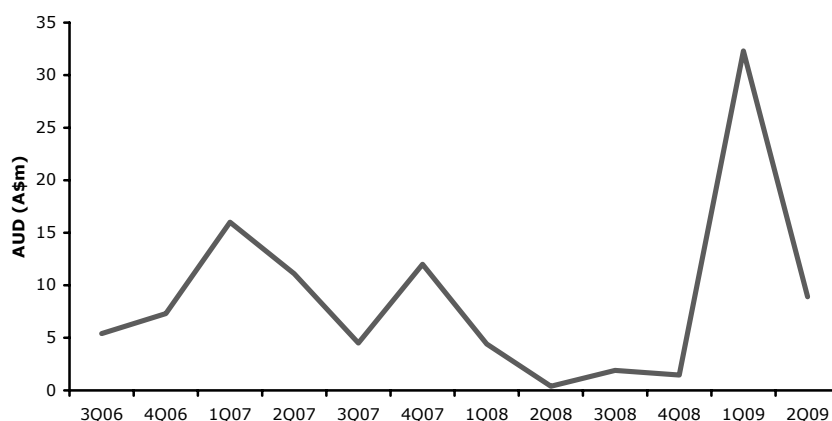
Companies like CSL and GSK are manufacturing a swine flu vaccine that is seen as complementary to the current therapies of Relenza and Tamiflu. The intention of governments and health authorities around the world is to vaccinate a large percentage of the population in an attempt to slow or reduce the severity of the current pandemic. It is too early to gauge the success of this program.

Table 1 : GSK's quarterly Relenza sales

(£m)	4Q06	CY06	1Q07	2Q07	3Q07	4Q07	2007	1Q08	2Q08	3Q08	4Q08	2008	1Q09	2Q09	Change on pcp	Change on pcp
US	0	0	44	34	12	41	131	8	2	5	5	20	11	19	73%	850%
EU	22	62	32	26	14	4	76	0	1	0	5	6	110	25	-77%	2,400%
ROW	15	29	16	7	2	30	55	21	0	7	3	31	101	16	-84%	na
Total	37	91	92	67	28	75	262	29	3	12	13	57	222	60	-73%	1,900%

Source: Company data, RBS Morgans

Chart 1 : Graphical representation of GSK quarterly sales



Source: Company data, RBS Morgans

Milestones to watch

The milestone table below highlights a number of other near-term milestones. One that is difficult to predict is the out-licensing of the Human Rhinovirus (HRV) program. In June 2009, BTA announced that its Phase IIa challenge study of (BTA798), its orally active inhibitor of HRV, was successful in demonstrating proof-of-concept in humans and was shown to reduce the incidence and severity of an HRV infection. Further studies will be developed to confirm the drug's efficacy and safety in target patient groups, and will be discussed with regulatory agencies. BTA intends to license the global rights to the HRV programme. It is hard to predict the timing, but this could surprise on the upside as we have only modest forecasts for this program and value it at 13cps.

Table 2 : Milestones to watch

	Timing	Impact
LANI results	Aug-09	Achieved
GSK quarterly results	Oct-09	Positive
Government orders	Various	Positive
Regulatory approval of Rotacaps	3QCY09	Positive
HRV licence	1QCY10	Positive

Source: Company data, RBS Morgans

Other recent news flow

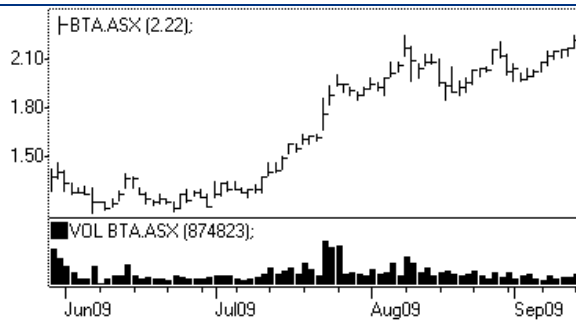
In August 2009, BTA announced positive Phase III results in adults for a single inhaled dose of its long-acting version of Relenza (now named laninamivir). The Phase III trial showed that a single inhaled dose of laninamivir was as effective as oseltamivir (Tamiflu) administered orally twice daily for five days. Laninamivir is co-owned by Daiichi Sankyo (Japan's largest pharmaceutical company), which will seek approval from the Japanese regulatory authorities, with a submission in March 2010. A licensing partner will be sought outside Japan. Given the significant interest in influenza, we believe there is a strong chance that a licensing agreement could be achieved within the next six months.

Investment view and Brian Larkin's comments

BTA is well funded with A\$86.7m in cash reserves. At this stage we make no assumptions on M&A or additional in-licensing programs. Although we have made no changes to our forecasts, we now set our target price at a 10% premium to our valuation, reflecting where we believe the stock will trade on receipt of positive quarterly GSK royalty data and after input from our technical analyst, Brian Larkin (see below).

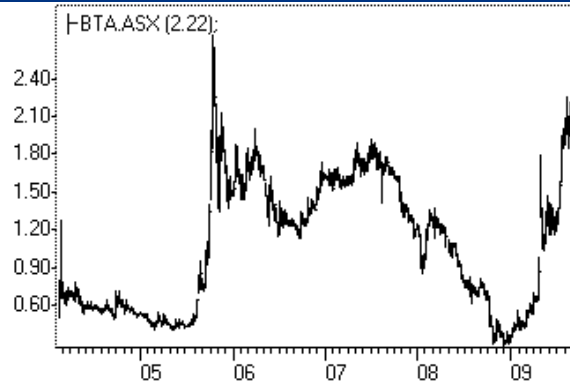
"BTA... major trend up, trading trend up. Momentum has been slowing to neutral/positive. Volumes slightly bearish but may be picking up a tad on today's action. Today's price action targets A\$2.48. If the run continues, major target A\$2.90. Bullish as long as prices are above A\$1.95."

Chart 2 : BTA share price and volume



Source: IRESS

Chart 3 : BTA share price – longer term



Source: IRESS

Our valuation of A\$2.24 is made up of by the Relenza royalties of A\$1.21, laninamivir (LANI) at A\$0.90 and the HRV program at A\$0.13. Our key assumptions in deriving the valuation include a risk-free rate of 5.25%, a WACC of 16.0% and a terminal growth rate of 3.5%. We have set our target price at A\$2.46 (was \$2.24), at a 10% premium to the valuation. The main downside risk to our target price is a delay in GSK receiving regulatory approval for the alterative disk inhaler (known as Rotahaler), thus limiting its ability to achieve full production. We maintain our Buy recommendation on BTA.

BTA overview

BTA is a leading anti-infective drug development company with expertise in respiratory diseases, particularly influenza. Biota developed the flu drug known as Relenza™ and marketed by GlaxoSmithKline (GSK). Relenza is used to treat seasonal influenza and is being stockpiled by various governments for defence against possible pandemic outbreaks of avian (bird) and swine (pig) influenza. BTA receives a 7% royalty on the sale of each course of Relenza.

BTA – financial summary

Year to 30 Jun (A\$m)	AIFRS 2008A	AIFRS 2009A	AIFRS 2010F	AIFRS 2011F	AIFRS 2012F	Closing price (A\$)	2.220	Price target (A\$)	2.46		
Income statement	2008A	2009A	2010F	2011F	2012F	Valuation metrics					
Divisional sales	41.7	80.4	148.8	188.5	43.0	Preferred methodology	DCF	Val'n (A\$)	\$ 2.24		
Total revenue	41.7	80.4	148.8	188.5	43.0	DCF valuation inputs					
EBITDA	-9.8	44.3	114.7	163.8	35.2	Rf	5.25%	10-year rate	5.25%		
Associate income	0.0	0.0	0.0	0.0	0.0	Rm-Rf	6.00%	Margin	2.0%		
Depreciation	-2.7	-5.4	-6.0	-5.4	-1.7	Beta	1.60	Kd	7.25%		
EBITA	-12.5	38.9	108.6	158.4	33.4	CAPM (Rf+Beta(Rm-Rf))	14.8%	Ke	14.8%		
Amortisation/impairment	0.0	0.0	0.0	0.0	0.0	Equity (E/EV)	100.0%	NPV cash flow (A\$m)	233.2		
EBIT	-12.5	38.9	108.6	158.4	33.4	Debt (D/EV)	0.0%	Minority interest (A\$m)	0.0		
EBIT(incl associate profit)	-12.5	38.9	108.6	158.4	33.4	Interest rate	7.25%	Net debt (A\$m)	-149.4		
Net interest expense	3.2	2.9	2.6	4.5	7.8	Tax rate (t)	30.0%	Investments (A\$m)	0.0		
Pre-tax profit	-9.3	41.9	111.2	162.9	41.2	Franking credit	100.0%	Equity market value (A\$m)	382.6		
Income tax expense	2.8	-3.6	-22.6	-50.0	-12.4	WACC	14.8%	Diluted no. of shares (m)	171.0		
After-tax profit	-6.5	38.2	88.6	112.9	28.8			DCF valuation (A\$)	2.24		
Minority interests						Multiples		2009A	2010F	2011F	2012F
NPAT	-6.5	38.2	88.6	112.9	28.8	Enterprise value (A\$m)	292.9	230.2	120.0	75.8	
Significant items	0.0	0.0	0.0	0.0	0.0	EV/Sales (x)	3.6	1.5	0.6	1.8	
NPAT post abnormal	-6.5	38.2	88.6	112.9	28.8	EV/EBITDA (x)	6.6	2.0	0.7	2.2	
						EV/EBIT (x)	7.5	2.1	0.8	2.3	
Cash flow statement	2008A	2009A	2010F	2011F	2012F	PE (pre-goodwill) (x)	9.9	4.3	3.4	13.2	
EBITDA	-9.8	44.3	114.7	163.8	35.2						
Change in working capital	8.6	-9.9	-10.8	-6.3	15.4	At target price		2009A	2010F	2011F	2012F
Net interest (pd)/rec	3.2	2.9	2.6	4.5	7.8	EV/EBITDA (x)	7.5	2.4	1.0	3.3	
Taxes paid	2.8	-3.6	-22.6	-50.0	-12.4	PE (pre-goodwill) (x)	11.0	4.7	3.7	14.6	
Other oper cash items	0.0	0.0	0.0	0.0	0.0						
Cash flow from ops (1)	4.8	33.7	83.9	112.0	46.0	Comparable company data (x)		2010F	2011F	2012F	
Capex (2)	-3.8	-0.8	-1.2	-1.8	-1.7	Avexa	EV/EBITDA	0.4	-0.5	-0.7	
Disposals/(acquisitions)	0.0	0.0	0.0	0.0	0.0	Year to 30 Jun	EV/EBIT	0.4	-0.5	-0.7	
Other investing cash flow	0.0	0.0	0.0	0.0	0.0		PE	3.1	3.4	1.6	
Cash flow from invest (3)	-3.8	-0.8	-1.2	-1.8	-1.7	Pharmaxis	EV/EBITDA	-10.9	-12.5	79.5	
Incr/(decr) in equity	-3.0	-5.1	-20.0	0.0	0.0	Year to 30 Jun	EV/EBIT	-10.1	-11.6	158.2	
Incr/(decr) in debt	0.0	0.0	0.0	0.0	0.0		PE	-12.7	-12.9	136.2	
Ordinary dividend paid	0.0	0.0	0.0	0.0	0.0						
Preferred dividends (4)	0.0	0.0	0.0	0.0	0.0	Per share data		2009A	2010F	2011F	2012F
Other financing cash flow	0.0	0.0	0.0	0.0	0.0	No. shares	171.0	171.0	171.0	171.0	
Cash flow from fin (5)	-3.0	-5.1	-20.0	0.0	0.0	EPS (cps)	22.4	51.8	66.1	16.9	
Forex and disc ops (6)	0.0	0.0	0.0	0.0	0.0	EPS (normalised) (c)	22.4	51.8	66.1	16.9	
Incr/(decr) cash (1+3+5+6)	-2.0	27.8	62.7	110.2	44.3	Dividend per share (c)	0.0	0.0	0.0	0.0	
Equity FCF (1+2+4)	1.0	32.9	82.7	110.2	44.3	Dividend payout ratio (%)	0.0	0.0	0.0	0.0	
						Dividend yield (%)	0.0	0.0	0.0	0.0	
Balance sheet	2008A	2009A	2010F	2011F	2012F	Growth ratios		2009A	2010F	2011F	2012F
Cash & deposits	60.2	86.7	149.4	259.6	303.9	Sales growth	92.6%	85.1%	26.7%	-77.2%	
Trade debtors	4.3	8.1	18.3	23.2	5.3	Operating cost growth	-30.0%	-5.3%	-27.8%	-68.2%	
Inventory	0.0	0.0	0.0	0.0	0.0	EBITDA growth				-78.5%	
Investments	0.0	0.0	0.0	0.0	0.0	EBITA growth				-78.9%	
Goodwill						Operating performance		2009A	2010F	2011F	2012F
Other intangible assets	12.1	8.4	4.2	0.5	0.5	Asset turnover (%)	20.0	25.5	20.0	3.5	
Fixed assets	7.5	6.9	6.3	6.4	6.4	EBITDA margin (%)	55.2	77.1	86.9	81.8	
Other assets	5.2	1.5	1.5	1.5	1.5	EBIT margin (%)	48.4	73.0	84.1	77.7	
Total assets	89.3	111.6	179.7	291.3	317.6	Net profit margin (%)	47.6	59.6	59.9	67.1	
Short-term borrowings	0.0	0.0	0.0	0.0	0.0	Return on net assets (%)	40.1	65.6	56.9	10.9	
Trade payables	12.0	5.6	5.1	3.7	1.2	Net debt (A\$m)	-86.7	-149.4	-259.6	-303.9	
Long-term borrowings	0.0	0.0	0.0	0.0	0.0	Net debt/equity (%)	-89.4	-90.2	-93.2	-98.8	
Provisions	0.0	0.0	0.0	0.0	0.0	Net interest/EBIT cover (x)	-13.3	-41.8	-35.4	-4.3	
Other liabilities	13.9	9.0	9.0	9.0	9.0	ROIC (%)	869.1	736.4	682.3	123.3	
Total liabilities	26.0	14.6	14.1	12.7	10.1	Internal liquidity		2009A	2010F	2011F	2012F
Share capital	159.1	154.6	223.2	336.1	365.0	Current ratio (x)	6.5	11.9	22.3	30.5	
Other reserves	1.4	1.5	1.5	1.5	1.5	Receivables turnover (x)	13.0	11.3	9.1	3.0	
Retained earnings	-97.3	-59.1	-59.1	-59.1	-59.1	Payables turnover (x)	4.1	6.3	5.6	3.2	
Other equity	0.0	0.0	0.0	0.0	0.0						
Total equity	63.3	97.0	165.6	278.6	307.4						
Minority interest											
Total shareholders' equity	63.3	97.0	165.6	278.6	307.4						
Total liabilities & SE	89.3	111.6	179.7	291.3	317.6						

Source: Company data, RBS Morgans forecasts

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Absolute performance, long-term (fundamental) recommendation: The recommendation is based on implied upside/downside for the stock from the target price. A Buy/Sell implies upside/downside of 10% or more and a Hold less than 10%. The target price is the level the stock should currently trade at if the market accepted the analyst's view of the stock, provided the necessary catalysts are in place to effect the change in perception. If it is felt that the catalysts are not fully in place to effect a re-rating of the stock to its warranted value the target price will differ from 'fair' value. Given the volatility of share prices and our pre-disposition not to change recommendations frequently, these performance parameters should be interpreted flexibly. Performance in this context only reflects capital appreciation and the horizon is 12 months.

For listed property trusts (LPTs) the recommendation is based upon the target price plus the dividend yield, ie total return. A Buy implies a total return of 10% or more; a Hold 5-10%, and a Sell less than 5%.

Absolute performance, short-term (trading) recommendation: The Trading Buy/Sell recommendation implies upside/downside of 3% or more. The trading recommendation time horizon is 0-60 days.

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A rating of Low indicates very little movement in price over the previous year (Coefficient of Variation < 4 for small caps or < 5 for large caps). A Moderate rating implies average price movement over the previous year (Coefficient of Variation of 9 - 21 for small caps or 7.25 - 15 for large caps). A High rating implies significant price movement over the past year (Coefficient of Variation greater than 25 for small caps or 35 for large caps).

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