

Biota Holdings

Postcard from Notting Hill

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\$3.22 (from A\$2.46)

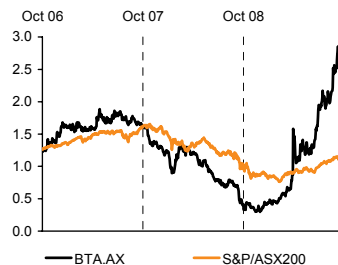
Price
A\$2.83

Short term (0-60 days)
n/a

BTA91007

Price performance

	(1M)	(3M)	(12M)
Price (A\$)	2.02	1.30	0.62
Absolute (%)	40.1	117.7	356.5
Rel market (%)	35.3	79.4	351.4
Rel sector (%)	36.6	97.1	384.1



Market capitalisation
A\$483.93m

Average (12M) daily turnover
A\$1.27m (US\$0.99m)

RIC: BTA.AX, BTA AU
Priced at close of business 6 Oct 2009.
Source: Bloomberg

Analysts

Scott Power
+61 7 3334 4884
scott.power@rbsmorgans.com

Tanya Solomon
+61 7 3334 4521
tanya.solomon@rbsmorgans.com

RBS Morgans Limited
(A.B.N. 49 010 669 726) AFSL235410
A Participant of ASX Group

<http://www.rbsmorgans.com>

Following a site visit to BTA's premises at Notting Hill we have increased some of our key assumptions. Our valuation and target price are higher. We are still happy to buy at current levels, given the expectation of positive news flow over the near term.

Key forecasts

	FY08A	FY09A	FY10F	FY11F	FY12F
EBITDA (A\$m)	-9.78	44.30	114.7	163.8	38.70 ▲
Reported net profit (A\$m)	-6.49	38.20	88.60	112.9	31.30 ▲
Normalised net profit (A\$m) ¹	-6.49	38.20	88.60	112.9	31.30 ▲
Normalised EPS (c) ¹	-3.79	22.40	51.80	66.10	18.30 ▲
Normalised EPS growth (%)	n/a	n/a	131.8	27.50	-72.3
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	12.70	5.46	4.28	15.50
EV/EBITDA (x)	n/m	8.96	2.92	1.37	4.60
Price/net oper. CF (x)	100.5	14.40	5.77	4.32	10.10
ROIC (%)	-93.4	869.1	736.4	682.3	137.0

Use of ▲ ▼ indicates that the line item has changed by at least 5%.

1. Pre non-recurring items and post preference dividends

Accounting standard: IFRS

Source: Company data, RBS Morgans forecasts

year to Jun, fully diluted

Site visit provides higher level of confidence

Following a visit to Biota's Notting Hill premises in Melbourne we have revised a number of our assumptions. The main change was to increase our market share assumption for LANI from 5% to 10%. LANI is a single-dose treatment used once a week for the prevention of influenza. The small, convenient device makes it appropriate for both seasonal influenza and pandemic stockpiling. This has increased our valuation for the LANI program to A\$1.49 (from A\$0.90 per share). In respect of the HRV program we have increased our estimate of the probability of success to 25% from 15%, reflecting a more detailed analysis of the competition and the superior performance of the compound to date compared with competitors. Our valuation of HRV has increased to A\$0.26 from A\$0.13. We have also lowered our WACC estimate from 14.9% to 13.6%, believing BTA has built a sustainable platform for growth.

The next milestone to watch for GSK quarterly results

The next milestone to watch for will be GSK's quarterly result, due 28 October 2009 (UK time). We expect continued strong growth in RelenzaTM royalties. We forecast royalties of A\$133m for FY10, driven by major government orders, particularly from the UK and the US. We estimate 3Q royalties could be A\$20m-30m.

Investment view – valuation upgraded

As a result of our assumption changes our DCF valuation has increased to A\$3.22 (from A\$2.24). We have set our target price at the same level as our valuation A\$3.22 (was A\$2.46), removing the 10% premium in the belief that our new valuation now captures the upside. The main downside risk is a delay in GSK receiving regulatory approval for the alternative disk inhaler (Rotahaler), thus limiting its ability to achieve full production.

Postcard from Notting Hill

We visited BTA's Notting Hill leased premises last Friday. As BTA has recently outlined in its roadshow, its strategy is to create a globally recognised small molecule drug discovery company focussed on infectious diseases, and this is well on track. From the site visit it is clear that BTA has plenty of room to expand and is well placed, in terms of both funding and personnel, to achieve its goal of having two to three royalty-generating products in the market as soon as possible. BTA has current cash reserves of A\$86m and employs more than 60 people, including 36 chemists and 12 biologist. Subsequent to the visit we have reviewed a number of the assumptions we use to determine our valuation. The changes are discussed below.

Changes to forecasts and key assumptions

Table 1 sets out the changes to our forecasts, with the main impact being after FY12.

Table 1 : Changes to forecasts

(A\$m)	FY10F			FY11F			FY12F		
	Old	New	Change	Old	New	% Change	Old	New	Change
Revenue	148.8	148.8	0.0%	188.5	192.5	2.1%	43.0	46.5	8.1%
EBITDA	114.7	114.7	0.0%	163.8	163.8	0.0%	35.9	38.7	7.7%
NPAT	88.6	88.6	0.0%	112.9	112.9	0.0%	28.8	31.3	8.7%
EPS (Ac)	51.8	51.8	0.0%	66.1	66.1	-0.1%	16.9	18.3	8.3%

Source: RBS Morgans forecasts

The key changes to our assumptions include:

- We have increased our market share assumption for laninamivir (LANI) from 5% to 10%. The increase to 10% market share essentially replaces the revenue stream from the seasonal Relenza™ royalty once the patent expires in 2014. We assume royalty revenue of about A\$60m is generated over 2013-18. The recently completed Phase III trial in Japan showed that a single inhaled dose of LANI was as effective as oseltamivir (Tamiflu) administered orally twice daily for five days. LANI is co-owned by Daiichi Sankyo. Given LANI is a single-dose treatment used once a week to prevent influenza, the small, convenient device makes it appropriate for both seasonal influenza and pandemic stockpiling. This higher market share assumption has increased our valuation for the LANI program to A\$1.49 (from A\$0.90 per share). The other key assumptions are a A\$5m milestone payment in FY10 as the program is out-licensed and product approval in 2013 with a probability of success of 60%. In terms of the Japanese program we assume Daiichi Sankyo will submit the data from the Phase III trial in March 2010 and with product approval expected in 2011 (we assume a probability of success of 80%). We understand from discussions with management that LANI will have about five years patent protection from the date of product launch.
- In the Human Rhinovirus (HRV) programme we have increased our estimate of the probability of success to 25% from 15%, reflecting a more detailed analysis of the competition and the superior performance of the compound to date compared with competitors. The analysis shows there are few competitors (see Table 2). As a result, our valuation of the HRV programme rises to A\$0.26 (from A\$0.13). Other key assumptions include milestone payments of A\$2m in FY10 and FY11, and a 10% royalty on product sales in FY12 on a A\$300m market. To recap on the programme: in June 2009 BTA announced its Phase IIa challenge study of the HRV programme (known as BTA798) and 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 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 we believe a licensing deal is possible before mid 2010.

Table 2 : Competitive companies

Drug	Company	Delivery	Clinical Development Phase
Pleconaril (Picovir)	Virpharma/Schering Plough	Intranasal	Phase II
Pleconaril (Picovir)	Virpharma	Oral	Failed registration
AG7088 (Rupintrivir)	Pfizer (formerly Agouron)	Intranasal	Discontinued
Pirodavir	Jassen	Intranasal	Discontinued

Source: Company data

- We have also decreased our WACC estimate from 14.9% to 13.6%, believing BTA has built a sustainable platform for growth. In BTA's recent roadshow, a clear strategy was outlined to grow the revenue and profit stream in the long term. We expect BTA's expertise as a small molecule development company to be maintained, together with a philosophy of out-licensing programs at an early stage to minimise the risk to shareholders. BTA's stated aim over the next three to five years is 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 to be undertaken. The current obvious gaps are the lead to pre-clinical stage, at the Phase I-II stage and pre-market launch stage.

Milestones to watch

Table 3 : Milestones

Milestone	Timing	Impact
GSK qly result	Oct-09	Positive
Capital return decision (tax free)	4QCY09	Positive
Government orders	Various	Positive
Regulatory approval on Rotacaps	4QCY09 (was 3Q)	Positive
HRV license	1QCY10	Positive

Source: Company data, RBS Morgans

The next milestone to watch for will be GSK's quarterly result, due 28 October 2009 (UK time). We expect continued strong growth in Relenza™ royalties. We forecast royalties of A\$133m for FY10, which will be driven by major government orders particularly from the UK and US. Although we don't forecast quarterly royalties in any detail we estimate 3Q royalties between A\$20m to A\$30m could be achieved.

Underpinning our forecasts is GSK's intention to increase production from 60m to 190m courses. To achieve this, 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 the competing product Tamiflu in certain H1N1 strains. Government's may look to rebalance their stockpiles with a more equal weighting towards Relenza™. Typically global stockpiles are 20% Relenza™ and 80% Tamiflu.

Investment view

As a result of our assumption changes our DCF valuation has increased to A\$3.22 (from A\$2.24). The key assumptions used in deriving our valuation include a risk-free rate of 5.25%, a WACC of 13.6% (was 14.9%) and a terminal growth rate of 3.5%. We have set our target price at the same level as our valuation of A\$3.22 (was A\$2.46), removing the 10% premium in the belief that our new valuation now captures the upside. The main downside risk is a delay in GSK receiving regulatory approval for the alternative disk inhaler (known as Rotahaler), thus limiting its ability to achieve full production.

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\$)	2.830	Price target (A\$)	3.22	
Income statement						Valuation metrics				
Divisional sales	41.7	80.4	148.8	192.5	46.5	Preferred methodology	DCF	Val'n (A\$)	\$ 3.22	
Total revenue	41.7	80.4	148.8	192.5	46.5	DCF valuation inputs				
EBITDA	-9.8	44.3	114.7	163.8	38.7	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	1.40	Kd	7.25%	
EBITA	-12.5	38.9	108.6	158.4	36.9	CAPM (Rf+Beta(Rm-Rf))	13.6%	Ke	13.7%	
Amortisation/impairment	0.0	0.0	0.0	0.0	0.0	Equity (E/EV)	100.0%	NPV cash flow (A\$m)	402.0	
EBIT	-12.5	38.9	108.6	158.4	36.9	Debt (D/EV)	0.0%	Minority interest (A\$m)	0.0	
EBIT(incl associate profit)	-12.5	38.9	108.6	158.4	36.9	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	44.7	Franking credit	100.0%	Equity market value (A\$m)	551.4	
Income tax expense	2.8	-3.6	-22.6	-50.0	-13.4	WACC	13.7%	Diluted no. of shares (m)	171.0	
After-tax profit	-6.5	38.2	88.6	112.9	31.3			DCF valuation (A\$)	3.22	
Minority interests						Multiples				
NPAT	-6.5	38.2	88.6	112.9	31.3	Enterprise value (A\$m)	2009A	2010F	2011F	2012F
Significant items	0.0	0.0	0.0	0.0	0.0	EV/Sales (x)	383.5	320.9	210.5	164.4
NPAT post abnormal	-6.5	38.2	88.6	112.9	31.3	EV/EBITDA (x)	4.8	2.2	1.1	3.5
						EV/EBITDA (x)	8.7	2.8	1.3	4.3
						EV/EBIT (x)	9.9	3.0	1.3	4.4
						PE (pre-goodwill) (x)	12.3	5.3	4.2	15.0
Cash flow statement	2008A	2009A	2010F	2011F	2012F	At target price	2009A	2010F	2011F	2012F
EBITDA	-9.8	44.3	114.7	163.8	38.7	EV/EBITDA (x)	10.5	3.5	1.8	6.4
Change in working capital	8.6	-9.9	-10.8	-6.2	14.9	PE (pre-goodwill) (x)	14.4	6.2	4.9	17.6
Net interest (pd)/rec	3.2	2.9	2.6	4.5	7.8	Comparable company data (x)				
Taxes paid	2.8	-3.6	-22.6	-50.0	-13.4	Avexa	2010F	2011F	2012F	
Other oper cash items	0.0	0.0	0.0	0.0	0.0	EV/EBITDA	0.5	-0.4	-0.7	
Cash flow from ops (1)	4.8	33.7	83.9	112.1	47.9	EV/EBIT	0.5	-0.4	-0.7	
Capex (2)	-3.8	-0.8	-1.2	-1.8	-1.7	PE	3.3	3.5	1.7	
Disposals/(acquisitions)	0.0	0.0	0.0	0.0	0.0	Pharmaxis	2010F	2011F	2012F	
Other investing cash flow	0.0	0.0	0.0	0.0	0.0	EV/EBITDA	-10.5	-12.2	77.4	
Cash flow from invest (3)	-3.8	-0.8	-1.2	-1.8	-1.7	EV/EBIT	-9.8	-11.3	154.2	
Incr/(decr) in equity	-3.0	-5.1	-20.0	0.0	0.0	PE	-12.4	-12.5	132.8	
Incr/(decr) in debt	0.0	0.0	0.0	0.0	0.0	Per share data				
Ordinary dividend paid	0.0	0.0	0.0	0.0	0.0	No. shares	2009A	2010F	2011F	2012F
Preferred dividends (4)	0.0	0.0	0.0	0.0	0.0	EPS (cps)	171.0	171.0	171.0	171.0
Other financing cash flow	0.0	0.0	0.0	0.0	0.0	EPS (normalised) (c)	22.4	51.8	66.1	18.3
Cash flow from fin (5)	-3.0	-5.1	-20.0	0.0	0.0	Dividend per share (c)	0.0	0.0	0.0	0.0
Forex and disc ops (6)	0.0	0.0	0.0	0.0	0.0	Dividend payout ratio (%)	0.0	0.0	0.0	0.0
Incr/(decr) cash (1+3+5+6)	-2.0	27.8	62.7	110.3	46.2	Dividend yield (%)	0.0	0.0	0.0	0.0
Equity FCF (1+2+4)	1.0	32.9	82.7	110.3	46.2	Growth ratios				
						Sales growth	2009A	2010F	2011F	2012F
						Operating cost growth	92.6%	85.1%	29.4%	-75.8%
						EBITDA growth	-30.0%	-5.3%	-16.0%	-72.6%
						EBITA growth				-76.4%
										-76.7%
						Operating performance				
						Asset turnover (%)	2009A	2010F	2011F	2012F
						EBITDA margin (%)	20.0	25.5	20.4	3.8
						EBIT margin (%)	55.2	77.1	85.1	83.1
						Net profit margin (%)	48.4	73.0	82.3	79.4
						Return on net assets (%)	47.6	59.6	58.7	67.3
						Net debt (A\$m)	40.1	65.6	56.9	11.9
						Net debt/equity (%)	-86.7	-149.4	-259.7	-305.9
						Net interest/EBIT cover (x)	-89.4	-90.2	-93.2	-98.7
						ROIC (%)	-13.3	-41.8	-35.4	-4.7
							869.1	736.4	682.3	137.0
						Internal liquidity				
						Current ratio (x)	2009A	2010F	2011F	2012F
						Receivables turnover (x)	6.5	11.9	21.3	30.7
						Payables turnover (x)	13.0	11.3	9.1	3.2
							4.1	6.3	6.1	2.9

Source: Company data, RBS Morgans forecasts

RESEARCH TEAM

ROGER LEANING	-	Executive Director - Research	SCOTT MURDOCH	-	Analyst
CHRIS BROWN	-	Senior Analyst	SCOTT POWER	-	Director - Research
NIK BURNS	-	Senior Analyst	TOM SARTOR	-	Associate Director - Research
ALEX CLARKE	-	Analyst	TAMARA STRETCH	-	Associate Director - Research
FIONA BUCHANAN	-	Director - Research	TANYA SOLOMON	-	Associate Director - Research
NICK HARRIS	-	Senior Analyst	PAUL STEVENSON	-	Analyst
MICHAEL KNOX	-	Executive Director - Economic Strategy	REBECCA SULLIVAN	-	Research/Special Projects
JAMES LAWRENCE	-	Fixed Interest Analyst	SAM TURNER	-	Analyst
JOSEPHINE LITTLE	-	Associate Director - Research	MARCEL VON PFYFFER	-	Director - Strategy
BELINDA MOORE	-	Director - Research			

RBS MORGANS LIMITED OFFICES

BRISBANE	(07) 3334 4888	BALMAIN	(02) 8755 3333
BRISBANE – EDWARD STREET	(07) 3121 5677	COFFS HARBOUR	(02) 6651 5700
BUNDABERG	(07) 4153 1050	GOSFORD	(02) 4325 0884
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ARMIDALE	(02) 6770 3300	DARWIN	(08) 8981 9555
BALLINA	(02) 6686 4144	HOBART	(03) 6236 9000

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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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Subject companies: BTA.AX.

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