

17 February 2010

Produced by: RBS Morgans Limited

# Biota Holdings

## Building blocks in place

### 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\$3.20 (from A\$3.48)

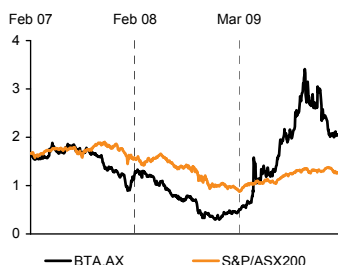
**Price**  
A\$2.05

**Short term (0-60 days)**  
n/a

BTA100217

### Price performance

	(1M)	(3M)	(12M)
Price (A\$)	2.01	2.61	0.47
Absolute (%)	2.0	-21.5	340.9
Rel market (%)	9.4	-18.2	239.4
Rel sector (%)	5.3	-24.3	322.1



**Market capitalisation**  
A\$366.74m (US\$330.46m)

**Average (12M) daily turnover**  
A\$2.38m (US\$2.02m)

Sector: BBG AP Pharm & Biotech  
Part of: ASX/S&P 300  
RIC: BTA.AX, BTA AU  
Priced A\$2.05 at close 17 Feb 2010.  
Source: Bloomberg

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**The hype surrounding swine flu is reducing. So we can now look through the noise and focus on the underlying business and pipeline. It looks impressive. Buy maintained.**

### Key forecasts

	FY08A	FY09A	FY10F	FY11F	FY12F
EBITDA (A\$m)	-9.78	44.3	85 ▼	98.4 ▼	48.4 ▼
Reported net profit (A\$m)	-6.49	38.2	66.8 ▼	66.8 ▼	36.9 ▼
Normalised net profit (A\$m) <sup>1</sup>	-6.49	38.2	66.8 ▼	66.8 ▼	36.9 ▼
Normalised EPS (c) <sup>1</sup>	-3.79	22.4	37.3 ▼	37.3 ▼	20.6 ▼
Normalised EPS growth (%)	n/a	n/a	67	0.03	-44.8
Dividend per share (c)	0	0	0	0	0
Dividend yield (%)	0	0	0	0	0
Normalised PE (x)	n/m	9.17	5.49	5.49	9.95
EV/EBITDA (x)	n/m	6.32	2.77	1.69	2.56
Price/net oper. CF (x)	72.8	10.4	5.54 ▲	5.23 ▲	8.27 ▲
ROIC (%)	-93.4	869.1	535.1	536.3	309.4

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

### Relenza royalties underpin a solid 1H10 result

BTA posted a solid 1H10 result of A\$33.5m, compared with our forecast of A\$23m. The main difference relates to expensing recent acquisitions in this period of A\$10.8m, when in fact the expense will be written off over subsequent periods. The cash position was solid at A\$52m. The result was underpinned by Relenza royalties of A\$56.7m. Tax losses are expected to be extinguished this year and dividends are possible.

### CDC cites disease continues to spread, but infection rates are lower

The latest Centre for Disease Control (CDC) briefing has noted that the H1N1 virus continues to spread across the US, however the rate of infection best measured by doctor visitation and hospitalisation rates have returned to more normal levels from the peak in November 2009. As of 5 February 2010, 23% of the US population had been vaccinated. The CDC commented it is very difficult to predict the continuing spread and severity of the disease. The northern hemisphere flu typically ends in May with the southern hemisphere season starting in April. Our view is that concern around the spread of the virus will continue until the end of CY10. We see quarterly royalties of about A\$35m for the next four quarters.

### Investment view – valuation revised

Following changes to forecasts, our DCF valuation has reduced to A\$3.20 (was A\$3.48). We have set the target price at the valuation of A\$3.20 (was A\$3.48). The downside risk is a delay in GSK receiving regulatory approval for the alternative disk inhaler therefore limiting their ability to achieve theoretical full production of 190m courses.

## Solid 1H10 result

BTA posted a 1H10 result of A\$33.5m, compared with our forecast of A\$23m. The main difference relates to expensing recent acquisitions in this period of A\$10.8m, when in fact the expense will be written off over subsequent periods. The cash position was solid at A\$52m as of 31 December 2009. The operating cash outflow was A\$14.5m for the period compared with an inflow of A\$0.6m in the pcp, reflecting the A\$20m GSK settlement receipt. Typically this period has cash outflow, with the Relenza payment from GSK paid yearly in arrears on 30 June.

Other points from the result include:

- Six-month Relenza sales were A\$56.7m compared with A\$3.8m in pcp,
- A\$1.4m in collaboration income from AstraZenca and Boehringer Ingelheim, compared with A\$6.6m in the pcp,
- Expenses were A\$20.3m, which included an increase in research costs from the recent Prolysis acquisition, and
- All tax losses will be recovered this year and a provision of A\$7.3m was made (or a tax rate of 19%).

## Changes to forecasts

**Table 1 : Changes to forecasts**

(A\$m)	FY10F			FY11F			FY12F		
	Old	New	% Change	Old	New	% Change	Old	New	% Change
Revenue	148.8	135.5	-8.9%	165.9	136.3	-17.8%	70.3	70.3	-0.1%
EBITDA	98.3	85.0	-13.6%	128.0	98.4	-23.1%	52.4	48.4	-7.7%
NPAT	76.1	66.8	-12.2%	87.7	66.8	-23.8%	40.2	36.9	-8.3%
EPS	43.4	37.3	-13.9%	50.0	37.3	-25.3%	22.9	20.6	-10.0%

Source: RBS Morgans

For FY10 we have reduced our Relenza royalty from A\$133.0m to A\$119.7m, or 50-45% of total theoretical production capacity of 190m courses. Similarly, for FY11 we have reduced Relenza royalty revenue from A\$159.6m to A\$133.0m, or 50% (from 60%) of theoretical capacity. Essentially we have moderated our forecast, recognising the lower rates of infection may reduce the peak in FY11. We can see royalty revenue of between A\$30m to A\$35m per quarter for the next four quarters. From FY12 to FY14 we are forecasting normal seasonal patterns returning and royalty revenue of A\$50m per annum.

In FY12, we have included A\$4m in amortisation charges for the antibacterial programme from Prolysis.

**Table 2 : Milestones to watch**

Milestone	Timing	Impact
GSK Qly results	2QCY10	Positive
LANI licensing deal	Mid-CY10	Very positive
Approval of LANI in Japan	2HCY10	Positive
HRV license	3QCY10	Positive

Source: RBS Morgans

The catalysts we have identified that will drive the share price include:

- Continuing solid Relenza royalties in the range of A\$30m-35m per quarter for the next four quarters, benefitting from the swine flu pandemic and resistance issues and side effects from competitor product (Tamiflu). We expect governments to continue to re-balance their anti-viral stockpiles more towards Relenza. Currently, global stockpiles are approximately 15% Relenza and 85% Tamiflu, over time we see this becoming more balanced.
- BTA has a long-acting version of Relenza known as LANI (and is co-owned by Daiichi-Sankyo), the intention is to license this product globally (ex-Japan). We expect this licensing deal to be completed by mid-CY10.

**Key risks**

There is a view that the current flu pandemic is moderating. The World Health Organisation (WHO) currently has a Phase 6 alert on the H1N1 virus, which is the pandemic status. If WHO were to downgrade the pandemic status, we would see it as poor for sentiment. Our view is that concern around the spread of the virus will continue until the end of CY10. This view is based on recent briefings from the Centre of Disease Control in the US.

**Investment view**

Following changes to forecasts, our DCF valuation has reduced to A\$3.20 (was A\$3.48). The key assumptions in deriving the valuation include a risk free rate of 5.25%, wacc of 13.6% and a terminal growth rate of 3.5%. We have set the target price at the same level as the valuation of A\$3.20 (was A\$3.48). The main downside risk is a delay in GSK receiving regulatory approval for the alternative disk inhaler (known as Rotahaler) therefore limiting its ability to achieve theoretical full production of 190m courses. We maintain our Buy recommendation.

**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 currently being stockpiled by various governments for defence against possible pandemic outbreaks of avian (bird) and swine (pig) influenzas. BTA receives a 7% royalty on the sale of each course of Relenza.

## BTA – financial summaries

Year to 30 Jun (A\$m)	AIFRS 2008A	AIFRS 2009A	AIFRS 2010F	AIFRS 2011F	AIFRS 2012F	Closing price (A\$)	2.05	Price target (A\$)	3.20	
<b>Income statement</b>						<b>Valuation metrics</b>				
Divisional sales	41.7	80.4	135.5	136.3	70.3	Preferred methodology	DCF	Val'n (A\$)	\$ 3.20	
Total revenue	41.7	80.4	135.5	136.3	70.3	<b>DCF valuation inputs</b>				
<b>EBITDA</b>	<b>-9.8</b>	<b>44.3</b>	<b>85.0</b>	<b>98.4</b>	<b>48.4</b>	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	78.9	93.0	46.7	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)	440.5	
EBIT	-12.5	38.9	78.9	93.0	46.7	Debt (D/EV)	0.0%	Minority interest (A\$m)	0.0	
EBIT(incl associate profit)	-12.5	38.9	78.9	93.0	46.7	Interest rate	7.25%	Net debt (A\$m)	-131.7	
Net interest expense	3.2	2.9	2.6	4.0	6.0	Tax rate (t)	30.0%	Investments (A\$m)	0.0	
Pre-tax profit	-9.3	41.9	81.5	97.0	52.7	Franking credit	100.0%	Equity market value (A\$m)	572.2	
Income tax expense	2.8	-3.6	-14.7	-30.2	-15.8	<b>WACC</b>	13.7%	Diluted no. of shares (m)	178.9	
After-tax profit	-6.5	38.2	66.8	66.8	36.9			<b>DCF valuation (A\$)</b>	<b>3.20</b>	
Minority interests										
<b>NPAT</b>	<b>-6.5</b>	<b>38.2</b>	<b>66.8</b>	<b>66.8</b>	<b>36.9</b>	<b>Multiples</b>	<b>2009A</b>	<b>2010F</b>	<b>2011F</b>	<b>2012F</b>
Significant items	0.0	0.0	0.0	0.0	0.0	Enterprise value (A\$m)	278.3	233.2	164.9	122.3
NPAT post abnormal	-6.5	38.2	66.8	66.8	36.9	EV/Sales (x)	3.5	1.7	1.2	1.7
						EV/EBITDA (x)	6.3	2.7	1.7	2.5
						EV/EBIT (x)	7.1	3.0	1.8	2.6
						PE (pre-goodwill) (x)	9.1	5.5	5.5	9.9
<b>Cash flow statement</b>	<b>2008A</b>	<b>2009A</b>	<b>2010F</b>	<b>2011F</b>	<b>2012F</b>	<b>At target price</b>	<b>2009A</b>	<b>2010F</b>	<b>2011F</b>	<b>2012F</b>
EBITDA	-9.8	44.3	85.0	98.4	48.4	EV/EBITDA (x)	10.9	5.2	3.8	6.8
Change in working capital	8.6	-9.9	-6.7	-2.0	5.7	PE (pre-goodwill) (x)	14.3	8.6	8.6	15.5
Net interest (pd)/rec	3.2	2.9	2.6	4.0	6.0					
Taxes paid	2.8	-3.6	-14.7	-30.2	-15.8	<b>Comparable company data (x)</b>	<b>2010F</b>	<b>2011F</b>	<b>2012F</b>	
Other oper cash items	0.0	0.0	0.0	0.0	0.0	Avexa	EV/EBITDA	-8.3	-24.3	0.8
Cash flow from ops (1)	4.8	33.7	66.2	70.2	44.3	Year to 30 Jun	EV/EBIT	-8.2	-22.5	0.8
Capex (2)	-3.8	-0.8	-1.2	-1.8	-1.7		PE	-12.8	-56.7	2.4
Disposals/(acquisitions)	0.0	0.0	0.0	0.0	0.0	Pharmaxis	EV/EBITDA	-10.8	-12.4	-122.5
Other investing cash flow	0.0	0.0	0.0	0.0	0.0	Year to 30 Jun	EV/EBIT	-10.1	-11.6	-71.8
Cash flow from invest (3)	-3.8	-0.8	-1.2	-1.8	-1.7		PE	-12.5	-12.9	-77.8
Incr/(decr) in equity	-3.0	-5.1	-20.0	0.0	0.0					
Incr/(decr) in debt	0.0	0.0	0.0	0.0	0.0	<b>Per share data</b>	<b>2009A</b>	<b>2010F</b>	<b>2011F</b>	<b>2012F</b>
Ordinary dividend paid	0.0	0.0	0.0	0.0	0.0	No. shares	171.0	178.9	178.9	178.9
Preferred dividends (4)	0.0	0.0	0.0	0.0	0.0	EPS (cps)	22.4	37.3	37.3	20.6
Other financing cash flow	0.0	0.0	0.0	0.0	0.0	EPS (normalised) (c)	22.4	37.3	37.3	20.6
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	45.0	68.4	42.6	Dividend yield (%)	0.0	0.0	0.0	0.0
<b>Equity FCF (1+2+4)</b>	<b>1.0</b>	<b>32.9</b>	<b>65.0</b>	<b>68.4</b>	<b>42.6</b>	<b>Growth ratios</b>	<b>2009A</b>	<b>2010F</b>	<b>2011F</b>	<b>2012F</b>
						Sales growth	92.6%	68.5%	0.6%	-48.4%
<b>Balance sheet</b>	<b>2008A</b>	<b>2009A</b>	<b>2010F</b>	<b>2011F</b>	<b>2012F</b>	Operating cost growth	-30.0%	40.2%	-25.1%	-42.2%
Cash & deposits	60.2	86.7	131.7	200.1	242.7	EBITDA growth				-50.8%
Trade debtors	4.3	8.1	16.7	16.8	8.7	EBITA growth				-49.9%
Inventory	0.0	0.0	0.0	0.0	0.0	<b>Operating performance</b>	<b>2009A</b>	<b>2010F</b>	<b>2011F</b>	<b>2012F</b>
Investments	0.0	0.0	0.0	0.0	0.0	Asset turnover (%)	20.0	24.9	17.7	7.2
Goodwill						EBITDA margin (%)	55.2	62.7	72.2	68.9
Other intangible assets	12.1	8.4	4.2	0.5	0.5	EBIT margin (%)	48.4	58.3	68.3	66.4
Fixed assets	7.5	6.9	6.3	6.4	6.4	Net profit margin (%)	47.6	49.3	49.0	52.5
Other assets	5.2	1.5	1.5	1.5	1.5	Return on net assets (%)	40.1	54.9	44.2	18.8
<b>Total assets</b>	<b>89.3</b>	<b>111.6</b>	<b>160.4</b>	<b>225.3</b>	<b>259.8</b>	Net debt (A\$m)	-86.7	-131.7	-200.1	-242.7
Short-term borrowings	0.0	0.0	0.0	0.0	0.0	Net debt/equity (%)	-89.4	-91.6	-95.0	-98.1
Trade payables	12.0	5.6	7.6	5.7	3.3	Net interest/EBIT cover (x)	-13.3	-30.3	-23.5	-7.8
Long-term borrowings	0.0	0.0	0.0	0.0	0.0	ROIC (%)	869.1	535.1	536.3	309.4
Provisions	0.0	0.0	0.0	0.0	0.0	<b>Internal liquidity</b>	<b>2009A</b>	<b>2010F</b>	<b>2011F</b>	<b>2012F</b>
Other liabilities	13.9	9.0	9.0	9.0	9.0	Current ratio (x)	6.5	9.0	14.8	20.5
<b>Total liabilities</b>	<b>26.0</b>	<b>14.6</b>	<b>16.6</b>	<b>14.7</b>	<b>12.3</b>	Receivables turnover (x)	13.0	10.9	8.1	5.5
Share capital	159.1	154.6	201.4	268.2	305.0	Payables turnover (x)	4.1	7.6	5.7	4.9
Other reserves	1.4	1.5	1.5	1.5	1.5					
Retained earnings	-97.3	-59.1	-59.1	-59.1	-59.1					
Other equity	0.0	0.0	0.0	0.0	0.0					
Total equity	63.3	97.0	143.9	210.6	247.5					
Minority interest										
Total shareholders' equity	63.3	97.0	143.9	210.6	247.5					
<b>Total liabilities &amp; SE</b>	<b>89.3</b>	<b>111.6</b>	<b>160.4</b>	<b>225.3</b>	<b>259.8</b>					

Source: Company data, RBS Morgans forecasts

## RESEARCH TEAM

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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.

Each stock has been assigned a Volatility Rating to assist in assessing the risk of the security. The rating measures the volatility of the security's daily closing price data over the previous year relative to other stocks included in either the S&P/ASX200 Index (large caps) or the Small Ordinaries Index (small caps) of which it is a member. This rating is a quantitative (objective) measure provided as an additional resource and is independent of the qualitative research process undertaken by our research analysts.

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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