

Biota Holdings

Disappointing quarterly numbers

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\$2.49 (from A\$3.20)

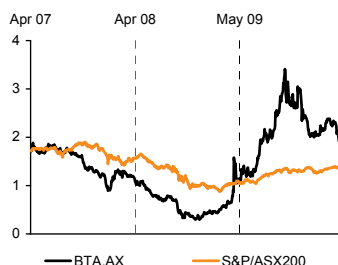
Price
A\$1.475

Short term (0-60 days)
n/a

BTA100429

Price performance

	(1M)	(3M)	(12M)
Price (A\$)	2.26	2.00	1.32
Absolute (%)	-34.7	-26.2	11.7
Rel market (%)	-33.7	-28.5	-14.1
Rel sector (%)	-31.9	-24.1	-6.9



Market capitalisation
A\$264.77m (US\$242.64m)

Average (12M) daily turnover
A\$2.41m (US\$2.09m)

Sector: BBG AP Pharm & Biotech
Part of: ASX/S&P 300
RIC: BTA.AX, BTA AU
Priced A\$1.48 at close 29 Apr 2010.
Source: Bloomberg

Analysts

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GSK reported its quarterly Relenza numbers last night and they came in below our forecasts. The effect of swine flu on Relenza sales has reduced significantly, and much faster than we expected. As a result, we have downgraded our FY10 and FY11 forecasts significantly.

Key forecasts

	FY08A	FY09A	FY10F	FY11F	FY12F
EBITDA (A\$m)	-9.78	44.3	38.3 ▼	12.2 ▼	35.8 ▼
Reported net profit (A\$m)	-6.49	38.2	25.4 ▼	7.02 ▼	26.1 ▼
Normalised net profit (A\$m) ¹	-6.49	38.2	25.4 ▼	7.02 ▼	26.1 ▼
Normalised EPS (c) ¹	-3.79	22.4	14.2 ▼	3.93 ▼	14.6 ▼
Normalised EPS growth (%)	n/a	n/a	-36.5	-72.4	272.4
Dividend per share (c)	0	0	0	0	0
Dividend yield (%)	0	0	0	0	0
Normalised PE (x)	n/m	6.62	10.4	37.7	10.1
EV/EBITDA (x)	n/m	4.02	4.35	12.6	3.69
Price/net oper. CF (x)	52.6	7.51	8.2 ▲	18.9 ▲	10.8 ▲
ROIC (%)	-93.4	869.1	207.1	123.1	-4,154

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

Lower quarterly numbers surprise

BTA has received notification from GlaxoSmithKline (GSK) that Relenza sales were A\$138m for the March quarter, from which BTA will receive a 7% royalty of A\$9.7m. We find this royalty disappointing as it is well below our estimate of A\$30m. It is now clear that the concerns around the spread of swine flu (H1N1) have abated much faster than we initially expected. We have moved to reflect this in our underlying assumptions and, accordingly, have made significant downward revisions to our forecasts for FY10 and FY11. Details are set out overleaf.

Focus on catalysts

We expect downgrades to flow through as the market digests these numbers. GSK made little comment on the outlook for Relenza in its results and we therefore expect investor confidence to be dented in the short term. Our focus remains the upcoming catalysts, including: 1) Japanese approval for the long-acting version of Relenza, known as LANI; 2) a global licensing deal for LANI (ex Japan); and 3) a licensing deal for human rhinovirus compound – all expected within six months.

Investment view – valuation and target price reduced

Following the changes to our forecasts our DCF valuation has reduced to A\$2.49 (from A\$3.20). The key assumptions we use in deriving our valuation include a risk-free rate of 5.25%, a WACC of 13.6% and a terminal growth rate of 3.5%. We have set our target price at A\$2.00 (was A\$3.20), at a 20% discount to our valuation, reflecting a short-term view on where we believe the stock will trade on achieving near-term milestones. We recognise that the stock's risk profile has increased, with material profitability now deferred by 12 months. The main downside risks to our target price include a delay in securing a global (ex-Japan) licensing deal for LANI and Japanese approval for LANI. We maintain our Buy rating, although we acknowledge that short-term sentiment will likely be against the stock.

Quarterly royalty disappoints and results in significant downgrade

BTA has received notification from GlaxoSmithKline (GSK) that Relenza sales were A\$138m for the March quarter and BTA will receive a royalty of A\$9.7m. This is disappointing and well below our estimate of A\$30m. It is now clear that the concerns around the spread of swine flu (H1N1) have abated quickly. We have moved to reflect this and made significant downward revisions to our forecasts for FY10 and FY11.

Changes to key assumptions

We have made a number of changes to our key assumptions; including the following:

- In FY10 we have reduced our Relenza royalty from A\$119.7m to A\$73.1m, or 58% of total theoretical production capacity of 90m courses. Similarly, in FY11 we have reduced Relenza royalty revenue from A\$133.0m to A\$37.8m, or 30% of theoretical capacity. This reflects our estimate of normal seasonal flu patterns and the likely demand for the product. From FY12 to FY14 we forecast normal seasonal patterns returning and royalty revenue of A\$37.8m (was A\$50m).
- In FY10 we have increased the amortisation charges for the recent acquisition of Prolysis and MaxThera to A\$6m (was A\$4m), in line with company guidance.
- In FY11 we have included an upfront milestone payment of A\$10m for a LANI licensing deal, reflecting a typical milestone payment for a Phase II program (see Table 2) and we now start royalties in FY14F (was FY13F).
- Our other assumptions in relation to a possible LANI deal remain unchanged and include a 20% royalty (BTA gets 50%), a 60% probability of success and 10% market share.

The changes to our forecasts are set out in Table 1.

Table 1 : Changes to forecasts

(A\$m)	FY10F			FY11F			FY12F		
	Old	New	Change	Old	New	Change	Old	New	Change
Revenue	135.5	88.9	-34.4%	136.3	50.1	-63.3%	70.3	57.7	-18.0%
EBITDA	85.0	38.3	-54.9%	98.4	12.2	-87.6%	48.4	35.8	-26.1%
NPAT	66.8	25.4	-62.0%	66.8	7.0	-89.5%	36.9	26.1	-29.1%
EPS	37.3	14.2	-61.9%	37.3	3.9	-89.5%	20.6	14.6	-29.0%

Source: Company data, RBS Morgans forecasts

We have reviewed a number of licensing deals in the infectious diseases space and have found that often, upfronts and milestones payments are not fully disclosed. We believe the co-owned Diiachi Snakyo Biota LANI compound will be an attractive licensing proposition to a larger pharmaceutical company. Table 2 sets out a number of recent licensing deals.

Table 2 : Examples of infectious diseases licensing deals (US\$m)

Date	Source	Partner(s)	Area of interest	Product/	Deal type(s)	Royalty	Milestone	Upfront
3/17/2010	Sinovac Biotech Co., Ltd. (Private) Sinovac Biotech Ltd (US Public)	Parenteral Drugs India Ltd (Public) Parenteral Biotech, Ltd (Private)	H1N1 influenza vaccine	Anflu, Panflu, Panflu.1, Split Pandemic Influenza Vaccine SINOVAC	Acquisition, distribution, license, supply	--	--	--
3/11/2010	Medivir AB (Global)	Daewoong Pharmaceutical Co Ltd (Global)	Hepatitis B virus infection	MIV210	Development, license, marketing	--	--	--
2/24/2010	Basilea Pharmaceutica International, Ltd (Private) Basilea Pharmaceutica, Ltd (Public)	Astellas Pharma Inc (Global)	Invasive fungal infections, Aspergillus or other filamentous fungi, Candida fungi.	BAL8557	Acquisition, co-development, co-promotion, commercialisation, license, sales	--	--	69.49
2/09/2010	Debiopharm Group (Global)	Novartis AG (US Public)	Hepatitis C	Debio025 with PegIFN Alpha-2a and Ribavirin	Acquisition, commercialisation, development, license, manufacturing, sales	--	--	--
2/01/2010	Achillion Pharmaceuticals Inc (US Public)	GCA Therapeutics Ltd (GCAT) (Global)	Hepatitis B virus infection and human immunodeficiency virus infection	ACH126433	Acquisition, license	--	--	--
1/27/2010	Pacgen Biopharmaceuticals Corporation (Global)	New Summit Biopharma Co (Private)	Oral candidiasis	PAC113	Commercialisation, development, research	--	--	--
1/25/2010		IHI Corporation (Public) UMN Pharma Inc (Global)	Cell culture, Influenza vaccine	PanBlok, UMN0502	Joint venture, manufacturing	--	--	--
1/11/2010	KaloBios Pharmaceuticals, Inc. (Global)	Sanofi Pasteur (Global) Sanofi-aventis (Global)	Pseudomonas aeruginosa Infection	KB001	Commercialisation, development	--	--	35
1/11/2010	BioCryst Pharmaceuticals Inc (US Public)	Merck KGaA (Global) Merck Serono SA (Global)	Influenza	BCX1812	Acquisition, marketing	--	--	--
1/11/2010	BioCryst Pharmaceuticals Inc (US Public)	Hikma Pharmaceuticals plc (Global)	Influenza	BCX1812	Acquisition, marketing	--	--	--

Source: Medtrack 2010

Valuation

Table 3 sets out the divisional split of each of the programs and our estimate of the probability of success.

Table 3 : Divisional split

A\$	Valuation	Probability of success
Relenza	\$0.55	100%
LANI (ex Japan)	\$1.38	60%
LANI (Japan)	\$0.39	80%
Human Rhinovirus Virus	\$0.28	25%
Prolysis	(\$0.15)	0%
RSV	(\$0.01)	0%
Total	\$2.44	
Add net cash	\$0.33	
Less Corporate Costs	(\$0.28)	
Total	\$2.49	

Source: Company data, RBS forecasts

Milestones to focus on

Table 4 : Key milestones

Milestone	Timing	Impact
GSK quarterly result	2QCY10 – lower than expected	Negative
LANI licensing deal	Mid CY10	Very positive
Approval of LANI in Japan	2HCY10	Positive
HRV license	3QCY10	Positive

Source: Company data, RBS forecasts

Investment view: maintain Buy; target price reduced to A\$2.00

Following changes to our forecasts our DCF valuation has reduced to A\$2.49 (from A\$3.20). The key assumptions we use in deriving our valuation include a risk-free rate of 5.25%, a WACC of 13.6% and a terminal growth rate of 3.5%. We have set our target price at A\$2.00 (was A\$3.20), at a 20% discount to our valuation, reflecting a short-term view on where we believe the stock will trade on achieving near-term milestones. We maintain our Buy recommendation although we acknowledge that short-term sentiment will likely be against the stock.

Key risks

The main downside risks to our target price include a delay in securing a global (ex-Japan) licensing deal for LANI and Japanese approval for LANI.

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	Valuation price (A\$)	1.475	Price target (A\$)	2.49	
Income statement						Valuation metrics				
Divisional sales	41.7	80.4	88.9	50.1	57.7	Preferred methodology	DCF	Val'n (A\$)	\$ 2.00	
Total revenue	41.7	80.4	88.9	50.1	57.7	DCF valuation inputs				
EBITDA	-9.8	44.3	38.3	12.2	35.8	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	-7.8	-4.1	-1.7	Beta	1.40	Kd	7.25%	
EBITA	-12.5	38.9	30.6	8.1	34.1	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)	348.4	
EBIT	-12.5	38.9	30.6	8.1	34.1	Debt (D/EV)	0.0%	Minority interest (A\$m)	0.0	
EBIT(incl associate profit)	-12.5	38.9	30.6	8.1	34.1	Interest rate	7.25%	Net debt (A\$m)	-97.8	
Net interest expense	3.2	2.9	2.6	2.9	3.3	Tax rate (t)	30.0%	Investments (A\$m)	0.0	
Pre-tax profit	-9.3	41.9	33.2	11.1	37.4	Franking credit	100.0%	Equity market value (A\$m)	446.2	
Income tax expense	2.8	-3.6	-7.7	-4.0	-11.2	WACC	13.7%	Diluted no. of shares (m)	178.9	
After-tax profit	-6.5	38.2	25.4	7.0	26.1			DCF valuation (A\$)	2.49	
Minority interests						Multiples				
NPAT	-6.5	38.2	25.4	7.0	26.1	2009A	2010F	2011F	2012F	
Significant items	0.0	0.0	0.0	0.0	0.0	Enterprise value (A\$m)	255.9	244.8	232.6	209.7
NPAT post abnormal	-6.5	38.2	25.4	7.0	26.1	EV/Sales (x)	3.2	2.8	4.6	3.6
						EV/EBITDA (x)	5.8	6.4	19.0	5.9
						EV/EBIT (x)	6.6	8.0	28.6	6.2
						PE (pre-goodwill) (x)	8.6	13.5	48.8	13.1
Cash flow statement	2008A	2009A	2010F	2011F	2012F	At target price	2009A	2010F	2011F	2012F
EBITDA	-9.8	44.3	38.3	12.2	35.8	EV/EBITDA (x)	8.1	9.1	27.5	8.8
Change in working capital	8.6	-9.9	-0.9	2.9	-3.3	PE (pre-goodwill) (x)	11.2	17.6	63.5	17.1
Net interest (pd)/rec	3.2	2.9	2.6	2.9	3.3	Comparable company data (x)				
Taxes paid	2.8	-3.6	-7.7	-4.0	-11.2	2010F	2011F	2012F		
Other oper cash items	0.0	0.0	0.0	0.0	0.0	Avexa	EV/EBITDA	-4.8	-31.5	1.1
Cash flow from ops (1)	4.8	33.7	32.3	14.0	24.5	Year to 30 Jun	EV/EBIT	-4.7	-28.6	1.1
Capex (2)	-3.8	-0.8	-1.2	-1.8	-1.7		PE	-6.6	-66.2	2.3
Disposals/(acquisitions)	0.0	0.0	0.0	0.0	0.0	Pharmaxis	EV/EBITDA	-13.8	-15.5	-152.4
Other investing cash flow	0.0	0.0	0.0	0.0	0.0	Year to 30 Jun	EV/EBIT	-12.9	-14.5	-89.2
Cash flow from invest (3)	-3.8	-0.8	-1.2	-1.8	-1.7		PE	-15.5	-16.0	-96.8
Incr/(decr) in equity	-3.0	-5.1	-20.0	0.0	0.0	Per share data	2009A	2010F	2011F	2012F
Incr/(decr) in debt	0.0	0.0	0.0	0.0	0.0	No. shares	171.0	178.9	178.9	178.9
Ordinary dividend paid	0.0	0.0	0.0	0.0	0.0	EPS (cps)	22.4	14.2	3.9	14.6
Preferred dividends (4)	0.0	0.0	0.0	0.0	0.0	EPS (normalised) (c)	22.4	14.2	3.9	14.6
Other financing cash flow	0.0	0.0	0.0	0.0	0.0	Dividend per share (c)	0.0	0.0	0.0	0.0
Cash flow from fin (5)	-3.0	-5.1	-20.0	0.0	0.0	Dividend payout ratio (%)	0.0	0.0	0.0	0.0
Forex and disc ops (6)	0.0	0.0	0.0	0.0	0.0	Dividend yield (%)	0.0	0.0	0.0	0.0
Incr/(decr) cash (1+3+5+6)	-2.0	27.8	11.1	12.2	22.8	Growth ratios	2009A	2010F	2011F	2012F
Equity FCF (1+2+4)	1.0	32.9	31.1	12.2	22.8	Sales growth	92.6%	10.5%	-43.6%	15.1%
						Operating cost growth	-30.0%	40.2%	-25.1%	-42.2%
						EBITDA growth				192.5%
						EBITA growth				319.3%
Balance sheet	2008A	2009A	2010F	2011F	2012F	Operating performance	2009A	2010F	2011F	2012F
Cash & deposits	60.2	86.7	97.8	110.0	132.8	Asset turnover (%)	20.0	19.3	10.3	10.6
Trade debtors	4.3	8.1	11.0	6.2	7.1	EBITDA margin (%)	55.2	43.1	24.4	62.1
Inventory	0.0	0.0	0.0	0.0	0.0	EBIT margin (%)	48.4	34.4	16.2	59.1
Investments	0.0	0.0	0.0	0.0	0.0	Net profit margin (%)	47.6	28.6	14.0	45.3
Goodwill						Return on net assets (%)	40.1	29.8	7.4	25.1
Other intangible assets	12.1	8.4	2.4	0.0	0.0	Net debt (A\$m)	-86.7	-97.8	-110.0	-132.8
Fixed assets	7.5	6.9	6.3	6.4	6.4	Net debt/equity (%)	-89.4	-95.5	-100.5	-98.0
Other assets	5.2	1.5	1.5	1.5	1.5	Net interest/EBIT cover (x)	-13.3	-11.7	-2.8	-10.3
Total assets	89.3	111.6	119.0	124.1	147.9	ROIC (%)	869.1	207.1	123.1	-4154.3
Short-term borrowings	0.0	0.0	0.0	0.0	0.0	Internal liquidity	2009A	2010F	2011F	2012F
Trade payables	12.0	5.6	7.6	5.7	3.3	Current ratio (x)	6.5	6.6	7.9	11.4
Long-term borrowings	0.0	0.0	0.0	0.0	0.0	Receivables turnover (x)	13.0	9.3	5.8	8.7
Provisions	0.0	0.0	0.0	0.0	0.0	Payables turnover (x)	4.1	7.6	5.7	4.9
Other liabilities	13.9	9.0	9.0	9.0	9.0					
Total liabilities	26.0	14.6	16.6	14.7	12.3					
Share capital	159.1	154.6	160.0	167.0	193.2					
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	102.4	109.5	135.6					
Minority interest										
Total shareholders' equity	63.3	97.0	102.4	109.5	135.6					
Total liabilities & SE	89.3	111.6	119.0	124.1	147.9					

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.

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).

REGULATORY DISCLOSURES

RBS Morgans Corporate Limited was the lead manager to the Avexa Limited renounceable rights issue in March 2009 and received fees in this regard.: AVX.AX.

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