RBS Morgans

Equity | Australia | Pharma & Biotech

30 June 2010

Produced by: RBS Morgans Limited

Biota Holdings

Marking time for now

Change of recommendation

Hold (from 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$1.11 (from A$2.49)

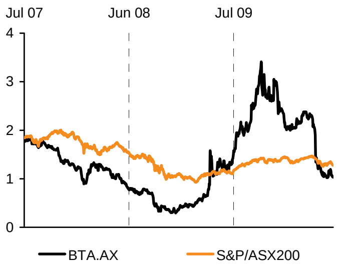
Price
A$1.02

Short term (0-60 days)
n/a

BTA100630

Price performance

	(1M)	(3M)	(12M)
Price (A$)	1.11	2.29	1.20
Absolute (%)	-8.1	-55.5	-14.6
Rel market (%)	-5.7	-49.8	-23.7
Rel sector (%)	-10.5	-53.5	-21.2



Market capitalisation
A$182.48m (US$155.41m)

Average (12M) daily turnover
A$2.30m (US$2.06m)

Sector: BBG AP Pharm & Biotech
Part of: ASX/S&P 300
RIC: BTA.AX, BTA AU
Priced A$1.02 at close 30 Jun 2010.
Source: Bloomberg

Analysts

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Although we see a number of catalysts pending over the next quarter, sentiment on the sector remains poor. We have reduced our forecasts and set a target price reflecting a more of a neutral near-term view. Recommendation back to Hold.

Key forecasts

	FY08A	FY09A	FY10F	FY11F	FY12F
EBITDA (A$m)	-9.78	44.3	31.8 ▼	3.45 ▼	35.8
Reported net profit (A$m)	-6.49	38.2	17.1 ▼	1.01 ▼	25.9
Normalised net profit (A$m)[1]	-6.49	38.2	17.1 ▼	1.01 ▼	25.9
Normalised EPS (c)[1]	-3.79	22.4	9.57 ▼	0.57 ▼	14.5
Normalised EPS growth (%)	n/a	n/a	-57.2	-94.1	2,452
Dividend per share (c)	0	0	0	0	0
Dividend yield (%)	0	0	0	0	0
Normalised PE (x)	n/m	4.56	10.7	n/m	7.05
EV/EBITDA (x)	n/m	2.16	2.9	24.8	1.79
Price/net oper. CF (x)	36.2	5.18	6.61 ▲	18.9 ▲	7.92 ▲
ROIC (%)	-93.4	869.1	142.4	-28.7	-1,329

Use of ▲ ▼ indicates that the line item has changed by at least 5%. year to Jun, fully diluted
1. Pre non-recurring items and post preference dividends
Accounting standard: IFRS
Source: Company data, RBS Morgans forecasts

Lower Relenza numbers likely

We have continued to review the literature and search various government web sites for clues on additional stockpiling orders for Relenza. We have found little evidence of stockpiling and, given governments around the world are reining in healthcare costs, it is possible that stockpiles will be allowed to run down over the next 12 months. As flagged by management in their latest release, the next quarterly Relenza royalties (due on 22 July) are likely to be low and we surmise this may continue into FY11.

Changes to forecasts

We have downgraded our FY10 and FY11 forecasts. The main driver is our revised expectation of lower Relenza royalties, additional RSV spend and a more conservative take on the LANI licensing deal (see Table 1 for more details).

Catalysts highlighted

As always, a focus on milestones is key in this sector. The most obvious short-term catalyst is the pending approval of LANI in Japan, which we expect in the next few months. Harder to predict is the timing and quantum the global licensing deal for LANI (ex Japan) and HRV.

Investment view – taking a short-term view

Following changes to our forecasts, our DCF valuation has reduced to A$2.21 (from A$2.49). The key assumptions in deriving the 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$1.11, a 50% discount to the valuation reflecting our view of where we believe the stock will trade on achieving near-term milestones. We maintain a positive longer-term stance on BTA, although the market's aversion to risk is driving our view. The main downside risk includes a delay in securing a global (ex-Japan) licensing deal for LANI. The upside risk is approval in Japan for LANI. We have moved our rating to Hold (from Buy) and will move quickly to review this when we sense a change in risk appetite.

Changes to forecasts

We have downgraded our FY10 and FY11 forecasts and made only minor changes to FY12.

Table 1 : Changes to forecasts

	FY10F			FY11F			FY12F		
	old	new	% chg	old	new	% chg	old	new	% chg
Revenue	88.9	73.8	-17.0%	50.1	46.3	-7.6%	57.7	57.7	-0.1%
EBITDA	38.3	31.8	-17.0%	12.2	3.5	-71.7%	35.8	35.8	-0.1%
NPAT	25.4	17.1	-32.6%	7.0	1.0	-85.5%	26.1	25.9	-0.9%
EPS	14.2	9.6	-32.6%	3.9	0.6	-85.5%	14.6	14.5	-0.9%

Source: RBS Morgans estimated

We have reduced our Relenza royalty in FY10 from A$73.1m to A$68.4m or 54% of total theoretical production capacity of 90m courses. Similarly, in FY11 we have reduced the Relenza royalty revenue from A$37.8m to A$34.0m or 27% of theoretical capacity. We have continued to review the literature and search various government web sites for clues on additional stockpiling orders for Relenza. We have found little evidence of stockpiling and, given governments around the world are reining in healthcare costs, it is possible that stockpiles will be allowed to run down over the next 12 months. As flagged by management in their latest release, the next quarterly Relenza royalties (due on 22 July) are likely to be low and we surmise that this may continue into FY11. From FY12 to FY14 we are forecasting normal seasonal patterns returning and royalty revenue of A$37.8m.

Also in FY10, we have reclassified some amortisation charges (from operating costs) for the recent acquisitions and sub royalty to A$9m (was A$6m) in line with company guidance (there was no effect on profit).

We have increased the forecast spend in FY11 on the respiratory syncytial virus (RSV) programme to A$5m. The programme was returned by AstraZeneca (NYSE: AZN) earlier this year citing issues over the safety margin. BTA has reworked a backup compound and is confident the programme can be relicensed in the future at considerable value. The value of the programme is difficult to quantify at this stage. However, we note recent news from AZN suggests it could quickly become valuable following difficulties with a competitive product. Earlier this week AZN's MedImmune unit received word from the FDA that it has delayed a decision date for its review of motavizumab (an investigational monoclonal antibody being considered to help prevent serious respiratory syncytial virus) from 24 June to 27 August. AZN said it is hoping the experimental drug, which had been in MedImmune's pipeline as a successor to Synagis, wins approval. However, these hopes may be dashed, especially after a 14-to-3 vote by an FDA expert panel that raised a red flag on data linking motavizumab to a higher number of allergic reactions. The panel members also criticised the lack of proof of improved efficacy over Synagis – which loses patent protection in 2015 – and suggested that more clinical trials may be needed to be conducted in children (source: Pharma Times).

With the state of the global equity markets, we have taken a more conservative stance on a potential licensing LANI (ex-Japan) deal. We now assume a royalty of 16% (was 20% and BTA gets 50%), a 60% probability of success and market share of 10% (unchanged).

Valuation

Table 2 below sets out the divisional split of each of the programmes and our estimate of the probability of success.

Table 2 : Valuation summary

	Valuation (A$)	Probability of success
Relenza	0.37	100%
LANI (ex Japan)	1.03	60%
LANI (Japan)	0.39	80%
Human Rhinovirus Virus	0.28	25%
Prolysis	(0.15)	0%
RSV	(0.03)	0
Total	1.89	
cash	0.53	
Corporate	(0.21)	
Total	**2.21**	

Source: RBS Morgans estimates

Milestones to focus on

Table 3 : Milestone to watch

Milestone	Timing	Impact
GSK quarterly results	22 Jul 10	Neutral
Approval of LANI in Japan	2HCY10	Positive
LANI licensing deal	2HCY10 (was mid CY10)	Positive (was very positive)
HRV licence	2HCY10 (was 3QCY10)	Positive

Source: Company data, RBS Morgans

Key risks

The main downside risk includes a delay in securing a global (ex-Japan) licensing deal for LANI. The upside risk is approval in Japan for LANI.

Investment view

Following changes to our forecasts, our DCF valuation has reduced to A$2.21 (was A$2.49). The key assumptions in deriving the 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 price target at A$1.11, a 50% discount to the valuation reflecting where we believe the stock will trade on achieving near-term milestones. We maintain a positive longer-term stance on BTA, although the market's aversion to risk is driving our view. We have moved our recommendation to Hold (from Buy) and will move quickly when we sense a change in risk appetite.

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) influenza. BTA receives a 7% royalty on the sale of each course of Relenza.

BTA – financial summary

Year to 30 Jun (A$m)	AIFRS	AIFRS	AIFRS	AIFRS	AIFRS
Income statement	**2008A**	**2009A**	**2010F**	**2011F**	**2012F**
Divisional sales	41.7	80.4	73.8	46.3	57.7
Total revenue	41.7	80.4	73.8	46.3	57.7
EBITDA	**-9.8**	**44.3**	**31.8**	**3.5**	**35.8**
Associate income	0.0	0.0	0.0	0.0	0.0
Depreciation	-2.7	-5.4	-10.8	-5.1	-1.7
EBITA	-12.5	38.9	21.0	-1.7	34.1
Amortisation/impairment	0.0	0.0	0.0	0.0	0.0
EBIT	-12.5	38.9	21.0	-1.7	34.1
EBIT(incl associate profit)	-12.5	38.9	21.0	-1.7	34.1
Net interest expense	3.2	2.9	2.6	2.7	2.9
Pre-tax profit	-9.3	41.9	23.6	1.0	37.0
Income tax expense	2.8	-3.6	-6.5	0.0	-11.1
After-tax profit	-6.5	38.2	17.1	1.0	25.9
Minority interests					
NPAT	**-6.5**	**38.2**	**17.1**	**1.0**	**25.9**
Significant items	0.0	0.0	0.0	0.0	0.0
NPAT post abnormals	-6.5	38.2	17.1	1.0	25.9

Cash flow statement	**2008A**	**2009A**	**2010F**	**2011F**	**2012F**
EBITDA	-9.8	44.3	31.8	3.5	35.8
Change in working capital	8.6	-9.9	-0.3	3.5	-4.6
Net interest (pd)/rec	3.2	2.9	2.6	2.7	2.9
Taxes paid	2.8	-3.6	-6.5	0.0	-11.1
Other oper cash items	0.0	0.0	0.0	0.0	0.0
Cash flow from ops (1)	4.8	33.7	27.6	9.6	23.0
Capex (2)	-3.8	-0.8	-1.2	-1.8	-1.7
Disposals/(acquisitions)	0.0	0.0	0.0	0.0	0.0
Other investing cash flow	0.0	0.0	0.0	0.0	0.0
Cash flow from invest (3)	-3.8	-0.8	-1.2	-1.8	-1.7
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
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
Other financing cash flow	0.0	0.0	0.0	0.0	0.0
Cash flow from fin (5)	-3.0	-5.1	-20.0	0.0	0.0
Forex and disc ops (6)	0.0	0.0	0.0	0.0	0.0
Inc/(decr) cash (1+3+5+6)	-2.0	27.8	6.4	7.9	21.3
Equity FCF (1+2+4)	**1.0**	**32.9**	**26.4**	**7.9**	**21.3**

Balance sheet	**2008A**	**2009A**	**2010F**	**2011F**	**2012F**
Cash & deposits	60.2	86.7	90.1	97.0	118.3
Trade debtors	4.3	8.1	9.1	5.7	7.1
Inventory	0.0	0.0	0.0	0.0	0.0
Investments	0.0	0.0	0.0	0.0	0.0
Goodwill					
Other intangible assets	12.1	8.4	2.4	0.0	0.0
Fixed assets	7.5	6.9	6.3	6.4	6.4
Other assets	5.2	1.5	1.5	1.5	1.5
Total assets	**89.3**	**111.6**	**109.5**	**110.6**	**133.3**
Short-term borrowings	0.0	0.0	0.0	0.0	0.0
Trade payables	12.0	5.6	6.3	6.5	3.3
Long-term borrowings	0.0	0.0	0.0	0.0	0.0
Provisions	0.0	0.0	0.0	0.0	0.0
Other liabilities	13.9	9.0	9.0	9.0	9.0
Total liabilities	**26.0**	**14.6**	**15.3**	**15.4**	**12.3**
Share capital	159.1	154.6	151.7	152.7	178.6
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	94.2	95.2	121.0
Minority interest					
Total shareholders' equity	63.3	97.0	94.2	95.2	121.0
Total liabilities & SE	**89.3**	**111.6**	**109.5**	**110.6**	**133.3**

Closing price (A$)	**1.04**	**Price target (A$)**	**1.11**
Valuation metrics			
Preferred methodology	DCF	Val'n (A$)	$ 2.21
DCF valuation inputs			
Rf	5.25%	10-year rate	5.25%
Rm-Rf	6.00%	Margin	2.0%
Beta	1.40	Kd	7.25%
CAPM (Rf+Beta(Rm-Rf))	13.6%	Ke	13.7%
Equity (E/EV)	100.0%	NPV cash flow (A$m)	305.5
Debt (D/EV)	0.0%	Minority interest (A$m)	0.0
Interest rate	7.25%	Net debt (A$m)	-90.1
Tax rate (t)	30.0%	Investments (A$m)	0.0
Franking credit	100.0	Equity market value (A$m)	395.6
WACC	13.7%	Diluted no. of shares (m)	178.9
		DCF valuation (A$)	**2.21**

Multiples	**2009A**	**2010F**	**2011F**	**2012F**
Enterprise value (A$m)	98.5	95.0	88.2	66.9
EV/Sales (x)	1.2	1.3	1.9	1.2
EV/EBITDA (x)	2.2	3.0	25.5	1.9
EV/EBIT (x)	2.5	4.5	-53.2	2.0
PE (pre-goodwill) (x)	4.6	10.8	182.6	7.2

At target price	**2009A**	**2010F**	**2011F**	**2012F**
EV/EBITDA (x)	2.5	3.4	29.2	2.2
PE (pre-goodwill) (x)	4.9	11.5	195.1	7.6

Comparable company data (x)		**2010F**	**2011F**	**2012F**
Acrux	EV/EBITDA	4.8	1.8	2.4
Year to 30 Jun	EV/EBIT	4.9	1.8	2.4
	PE	5.9	3.6	7.1
Pharmaxis	EV/EBITDA	-9.1	-10.6	-105.4
Year to 30 Jun	EV/EBIT	-8.5	-9.9	-61.7
	PE	-10.7	-11.1	-66.9

Per share data	**2009A**	**2010F**	**2011F**	**2012F**
No. shares	171.0	178.9	178.9	178.9
EPS (cps)	22.4	9.6	0.6	14.5
EPS (normalised) (c)	22.4	9.6	0.6	14.5
Dividend per share (c)	0.0	0.0	0.0	0.0
Dividend payout ratio (%)	0.0	0.0	0.0	0.0
Dividend yield (%)	0.0	0.0	0.0	0.0

Growth ratios	**2009A**	**2010F**	**2011F**	**2012F**
Sales growth	92.6%	-8.2%	-37.3%	24.5%
Operating cost growth	-30.0%	16.6%	2.0%	-48.9%
EBITDA growth				935.9%
EBITA growth				319.3%

Operating performance	**2009A**	**2010F**	**2011F**	**2012F**
Asset turnover (%)	20.0	16.7	10.5	11.8
EBITDA margin (%)	55.2	43.1	7.5	62.1
EBIT margin (%)	48.4	28.5	-3.6	59.1
Net profit margin (%)	47.6	23.2	2.2	44.9
Return on net assets (%)	40.1	22.3	-1.7	28.1
Net debt (A$m)	-86.7	-90.1	-97.0	-118.3
Net debt/equity (%)	-89.4	-95.7	-101.9	-97.7
Net interest/EBIT cover (x)	-13.3	-8.1	0.6	-11.7
ROIC (%)	869.1	142.4	-28.7	-1329.3

Internal liquidity	**2009A**	**2010F**	**2011F**	**2012F**
Current ratio (x)	6.5	6.5	6.7	10.2
Receivables turnover (x)	13.0	8.6	6.3	9.0
Payables turnover (x)	4.1	7.0	6.7	4.5

Priced at close of business 29 June 2010.
Source: Company data, RBS Morgans

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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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