

Biota Holdings

Game changer

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\$2.02 (from A\$1.67)

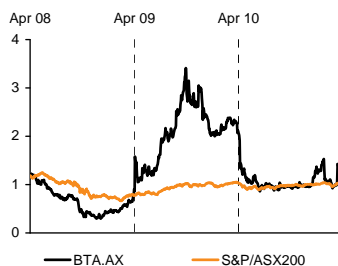
Price
A\$1.37

Short term (0-60 days)
n/a

BTA110406

Price performance

	(1M)	(3M)	(12M)
Price (A\$)	1.08	1.02	2.23
Absolute (%)	27.4	34.3	-38.6
Rel market (%)	26.5	29.2	-38.5
Rel sector (%)	33.1	43.2	-42.1



Market capitalisation
A\$245.09m (US\$253.47m)

Average (12M) daily turnover
A\$0.97m (US\$0.93m)

Sector: BBG AP Pharm & Biotech
Part of: ASX/S&P 300
RIC: BTA.AX, BTA AU
Priced A\$1.37 at close 5 Apr 2011.
Source: Bloomberg

Analysts

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BTA has secured a US\$231m grant to advance LANI. This is clear validation of the product which is already selling in Japan. It will enable BTA to sell directly into the US stockpile market which potentially can generate substantial revenue post FY17.

Key forecasts

	FY09A	FY10A	FY11F	FY12F	FY13F
EBITDA (A\$m)	44.30	28.00	-24.3 ▼	-0.97 ▼	34.50 ▼
Reported net profit (A\$m)	38.20	16.20	-23.7 ▼	-0.20 ▼	25.20 ▼
Normalised net profit (A\$m) ¹	38.20	16.20	-23.7 ▼	-0.20 ▼	25.20 ▼
Normalised EPS (c) ¹	22.40	9.08	-13.2 ▼	-0.11 ▼	14.10 ▼
Normalised EPS growth (%)	n/a	-59.4	n/a	-99.2	122.4
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)	6.13	15.10	n/m	n/m	9.73
EV/EBITDA (x)	3.57	5.01	n/m	n/m	4.23
Price/net oper. CF (x)	6.95	5.75	-11.2 ▲	-318 ▼	10.80 ▲
ROIC (%)	869.1	120.5	-71,110	-349	791.6

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

Major grant funding awarded

BTA has announced that the Office of Biomedical Advanced Research and Development Authority (BARDA) within the Office of the Assistant Secretary for Preparedness and Response (ASPR) at the US Department of Health and Human Services (HHS) has awarded up to an estimated US\$231m contract to its wholly owned subsidiary, Biota Scientific Management Pty Ltd, for the advanced development of laninamivir (LANI). The contract is fully funded over an estimated five-year period and is contingent upon the delivery of key milestones throughout the period. The contract is designed to provide US-based manufacturing and clinical data to support a New Drug Application for laninamivir, to the US Food and Drug Administration. In our view, this is a game changer for BTA, providing clear validation on the technology and providing the opportunity to take secure a significant proportion of the US stockpile market in six years' time.

Changes to forecasts lead to a higher valuation

We have made a number of changes to our forecasts, which are detailed overleaf. With the funding risk for LANI-ROW removed, BTA now has greater flexibility with a number of its programmes, which potentially can be taken further down the clinical path to achieve a higher valuation point. As a result we have increased R&D expenditure over the next two years and also remodelled the LANI-ROW programme to account for the BARDA grant over our forecast period to 2020.

Investment view – Buy maintained

Following changes to forecasts, our DCF valuation has increased to A\$2.53 (was A\$2.38). We have set the price target at A\$2.02 (from A\$1.67), a 20% (was 30%) discount to reflect an improving risk appetite towards the sector. The main short-term downside risk we see is lower quarterly Relenza royalties.

Changes to forecasts

Table 1 : Changes to forecasts

	FY11F			FY12F			FY13F		
	Old	New	% Change	Old	New	% Change	Old	New	% Change
Revenue	16.4	12.6	-23.2%	54.1	56.5	4.5%	54.6	99.5	82.3%
EBITDA	-17.9	-24.3	-35.7%	17.6	-1.0	nm	37.1	34.5	-7.1%
NPAT	-15.0	-23.7	-57.7%	13.0	-0.2	nm	28.8	25.2	-12.5%
EPS	-8.4	-13.2	-57.4%	7.2	-0.1	nm	16.1	14.1	-12.5%

Source: RBS Morgans forecasts

In FY11 we have reduced our Relenza forecast from A\$16.1m (or 13% of GSK's capacity) to A\$12.6m (or 10% of capacity). The first two quarters of Relenza royalties were A\$3.3m and GSK is due to report 3QFY11 results on 26 April 2011. We are expecting a stronger 3Q result with increasing influenza rates but have moderated our full-year forecast taking a more conservative stance. We have increased our spend on the RSV programme by A\$1m to A\$6m, the LANI-ROW programme by A\$1m to A\$7m and reduced the tax benefit by A\$2m.

The key changes to FY12 and onwards relate to remodelling our LANI ROW assumptions in light of the US\$231m BARDA grant. We have also increased the spend on the RSV programme to A\$3m now assuming that BTA will be able to take this programme to a Phase1 before licensing. Additionally we have taken a more conservative stance on the growth of Inavir in the Japanese market and we now assume royalty revenue of A\$11m (was A\$19m) and A\$15m (was A\$20m) for FY12 and FY13, respectively.

We now have made the following assumptions on LANI-ROW:

- We have modelled only the US stockpile market and assume BTA go direct to market without a partner. We believe this is a reasonable view, given the buyer on the product for the stockpile is the commercial arm of BARDA. We had previously assumed that LANI ROW would be licensed to a large pharmaceutical company and an upfront fee of A\$10m would be received, given the BARDA grant, this clearly will not occur.
- We estimate the US antiviral stockpile market is aiming to get to 91m courses (as per the HHS Pandemic Planning update March 2008).
- The selling price is assumed at A\$25 per course.
- The stockpile is replenished every seven years in line with the shelf life (ie, each year an order of A\$325m is made).
- A stockpile ratio of 40% LANI, 40% Tamiflu and 20% Relenza is assumed.
- The COGS is estimated at 30% and royalties back to Daiichi Sankyo and the device maker is 10%.
- The BARDA funding will be received over the next five years in the proportion of A\$30m in FY12, A\$50m in FY13, A\$80m in FY14, A\$50m in FY15 and A\$20m in FY16.
- A small margin is assumed to be earned on the funding.
- A prophylaxis clinical trial will need to be completed before the US stockpile can be accessed. We have assumed that BARDA will fund the trial in FY13 and FY14 costing A\$45m per year. It is possible that BTA will fund this trial which is downside to our valuation.
- BTA will access the global seasonal flu market with the help of a partner in FY18. The key assumptions include that the probability of success is 50%, the global market is A\$1.1bn, and BTA secures a 40% market share and receives a 20% royalty on sales.
- The product is filed with the FDA for approval in FY17 and takes 12 months for approval. It is assumed that LANI will be ready for US stockpile sales in FY18 (previously we had assumed FY14).
- A 65% (was 60%) probability of success in the stockpile market.

Upside risks to our revised assumptions

The upside risk in our modelling includes: 1) BTA supplying other stockpile markets outside the US, which potentially could be twice as large; 2) accessing the global seasonal market; in this case we would expect BTA to utilise a large pharmaceutical partner and Daiichi Sankyo would share in 50% of the royalties generated. Our review of Medtrack's royalty analyser for marketed products could see BTA achieving royalties between 10% and 20%.

Downside risks to our revised assumptions

The BARDA funding is subject to the achievement of specific milestones. In brief, it relates to building a GMP manufacturing facility for LANI in the US, successfully completing a Phase II and Phase III clinical trial and the submission of a registration application to the US FDA for approval. A series of checks and balances will be in place to monitor and verify progress. It is BTA's responsibility to ensure that the programme is achieved. As with all clinical programmes, budget and time overruns are common and this remains a risk for BTA to manage.

Sensitivity analysis

We have run a number of sensitivities. The valuation is most sensitive to the following:

- A 5% change in the probability of success increases our valuation by 6 cents per share.
- A 5% change in the LANI/Tamiflu stockpile mix increases the valuation by 10 cents per share.
- A A\$1 increase in selling price increases the valuation by 5 cents per share.
- If BTA is not successful in additional grant funding from BARDA for the prophylaxis trial, the valuation would decrease by A\$0.23 to A\$2.20.

Investment view and recommendation

Following changes to forecasts, our DCF valuation has increased to A\$2.53 (was A\$2.38). The individual programmes are valued as follows: Relenza A\$0.17 (was A\$0.23); Inavir in Japan at A\$0.67 (was A\$0.73); the HRV programme at A\$0.21; LANI ROW at A\$1.30 (was A\$1.03) and other programmes including RSV, Prolysis, Max Thera, cash and corporate overheads at A\$0.18. 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 price target at A\$2.02 (from A\$1.67), a 20% (was 30%) discount to the valuation to reflect improving risk appetite in the sector. The main short-term downside risk is lower quarterly Relenza royalties.

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 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 has clinical trials underway with its lead compound for human rhinovirus (HRV) infection in patients with compromised respiration or immune systems. BTA other research includes a series of candidate drugs aimed at the treatment of respiratory syncytial virus (RSV) disease.

BTA – financial summary

Year to 30 Jun (A\$m)	AIFRS 2009A	AIFRS 2010A	AIFRS 2011F	AIFRS 2012F	AIFRS 2013F	Closing price (A\$)	1.37	Price target (A\$)	2.02		
Income statement	2009A	2010A	2011F	2012F	2013F	Valuation metrics					
Divisional sales	80.4	68.9	12.6	56.5	99.5	Preferred methodology	DCF	Val'n (A\$)	\$ 2.53		
Total revenue	80.4	68.9	12.6	56.5	99.5	DCF valuation inputs					
EBITDA	44.3	28.0	-24.3	-1.0	34.5	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	-5.4	-10.2	-5.2	-1.7	-1.7	Beta	1.40	Kd	7.25%		
EBITA	38.9	17.8	-29.5	-2.7	32.7	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)	371.9		
EBIT	38.9	17.8	-29.5	-2.7	32.7	Debt (D/EV)	0.0%	Minority interest (A\$m)	0.0		
EBIT(incl associate profit)	38.9	17.8	-29.5	-2.7	32.7	Interest rate	7.25%	Net debt (A\$m)	-80.7		
Net interest expense	2.9	2.5	2.8	2.4	4.7	Tax rate (t)	30.0%	Investments (A\$m)	0.0		
Pre-tax profit	41.9	20.3	-26.6	-0.3	37.4	Franking credit	100.0%	Equity market value (A\$m)	452.6		
Income tax expense	-3.6	-4.0	3.0	0.1	-12.2	WACC	13.7%	Diluted no. of shares (m)	178.9		
After-tax profit	38.2	16.2	-23.7	-0.2	25.2			DCF valuation (A\$)	2.53		
Minority interests						Multiples		2010A	2011F	2012F	2013F
NPAT	38.2	16.2	-23.7	-0.2	25.2	Enterprise value (A\$m)	140.2	164.4	166.9	145.9	
Significant items	0.0	0.0	0.0	0.0	0.0	EV/Sales (x)	2.0	13.0	3.0	1.5	
NPAT post abnormals	38.2	16.2	-23.7	-0.2	25.2	EV/EBITDA (x)	5.0	-6.8	-172.8	4.2	
						EV/EBIT (x)	7.9	-5.6	-61.7	4.5	
Cash flow statement	2009A	2010A	2011F	2012F	2013F	PE (pre-goodwill) (x)	15.1	-10.4	-1224.1	9.7	
EBITDA	44.3	28.0	-24.3	-1.0	34.5	At target price		2010A	2011F	2012F	2013F
Change in working capital	-9.9	16.2	-3.4	-2.3	-4.2	EV/EBITDA (x)	9.2	-11.6	-294.0	7.6	
Net interest (pd)/rec	2.9	2.5	2.8	2.4	4.7	PE (pre-goodwill) (x)	22.3	-15.3	-1808.4	14.4	
Taxes paid	-3.6	-4.0	3.0	0.1	-12.2	Comparable company data (x)		2011F	2012F	2013F	
Other oper cash items	0.0	0.0	0.0	0.0	0.0	AcruX	EV/EBITDA	5.9	8.3	5.0	
Cash flow from ops (1)	33.7	42.6	-21.8	-0.8	22.8	Year to 30 Jun	EV/EBIT	5.9	8.5	5.1	
Capex (2)	-0.8	-4.8	-1.4	-1.8	-1.7		PE	9.1	14.1	9.4	
Disposals/(acquisitions)	0.0	0.0	0.0	0.0	0.0	Pharmaxis	EV/EBITDA	-14.0	-28.5	9.4	
Other investing cash flow	0.0	0.0	0.0	0.0	0.0	Year to 30 Jun	EV/EBIT	-13.1	-24.8	10.0	
Cash flow from invest (3)	-0.8	-4.8	-1.4	-1.8	-1.7		PE	-14.4	-25.3	10.6	
Incr/(decr) in equity	-5.1	-19.5	0.0	0.0	0.0	Per share data		2010A	2011F	2012F	2013F
Incr/(decr) in debt	0.0	0.0	0.0	0.0	0.0	No. shares	178.9	178.9	178.9	178.9	
Ordinary dividend paid	0.0	0.0	0.0	0.0	0.0	EPS (cps)	9.1	-13.2	-0.1	14.1	
Preferred dividends (4)	0.0	0.0	0.0	0.0	0.0	EPS (normalised) (c)	9.1	-13.2	-0.1	14.1	
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)	-5.1	-19.5	0.0	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)	27.8	18.3	-23.3	-2.6	21.0	Growth ratios		2010A	2011F	2012F	2013F
Equity FCF (1+2+4)	32.9	37.8	-23.3	-2.6	21.0	Sales growth	-14.3%	-81.7%	348.7%	76.0%	
						Operating cost growth	13.6%	-9.9%	55.9%	13.1%	
Balance sheet	2009A	2010A	2011F	2012F	2013F	EBITDA growth				110.7%	
Cash & deposits	86.7	104.9	80.7	78.1	99.2	EBITA growth				122.9%	
Trade debtors	8.1	2.1	1.6	7.0	12.3	Operating performance		2010A	2011F	2012F	2013F
Inventory	0.0	0.0	0.0	0.0	0.0	Asset turnover (%)	14.7	2.9	14.7	22.5	
Investments	0.0	0.0	0.0	0.0	0.0	EBITDA margin (%)	40.6	-192.7	-1.7	34.6	
Goodwill						EBIT margin (%)	25.8	-233.8	-4.8	32.9	
Other intangible assets	8.4	7.3	4.8	4.8	4.8	Net profit margin (%)	23.6	-187.7	-0.4	25.3	
Fixed assets	6.9	6.8	6.4	6.5	6.4	Return on net assets (%)	17.0	-36.3	-3.3	30.8	
Other assets	1.5	1.2	1.2	1.2	1.2	Net debt (A\$m)	-104.9	-80.7	-78.1	-99.2	
Total assets	111.6	122.2	94.6	97.5	123.9	Net debt/equity (%)	-100.0	-99.3	-96.4	-93.4	
Short-term borrowings	0.0	0.0	0.0	0.0	0.0	Net interest/EBIT cover (x)	-7.1	10.4	1.1	-7.0	
Trade payables	5.6	9.4	5.6	8.7	9.8	ROIC (%)	120.5	-71110.4	-349.3	791.6	
Long-term borrowings	0.0	0.0	0.0	0.0	0.0	Internal liquidity		2010A	2011F	2012F	2013F
Provisions	0.0	0.0	0.0	0.0	0.0	Current ratio (x)	6.2	6.1	5.2	6.3	
Other liabilities	9.0	7.8	7.8	7.8	7.8	Receivables turnover (x)	13.6	7.0	13.3	10.3	
Total liabilities	14.6	17.3	13.4	16.5	17.6	Payables turnover (x)	5.4	4.9	8.1	7.0	
Share capital	154.6	146.4	122.7	122.5	147.7						
Other reserves	1.5	1.4	1.4	1.4	1.4						
Retained earnings	-59.1	-42.8	-42.8	-42.8	-42.8						
Other equity	0.0	0.0	0.0	0.0	0.0						
Total equity	97.0	104.9	81.2	81.0	106.2						
Minority interest											
Total shareholders' equity	97.0	104.9	81.2	81.0	106.2						
Total liabilities & SE	111.6	122.2	94.6	97.5	123.9						

Source: Company data, RBS Morgans forecasts

QUEENSLAND

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BURLEIGH HEADS	(07) 5520 8788
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CHERMSIDE	(07) 3350 9000
EDWARD ST	(07) 3121 5677
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MACKAY	(07) 4957 3033
MILTON	(07) 3114 8600
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SPRINGWOOD	(07) 3808 7588
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YEPPON	(07) 4939 3021

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SYDNEY – LEVEL 33	(02) 8215 5111
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BALLINA	(02) 6686 4144
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CHATSWOOD	(02) 8116 1700
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MERIMBULA	(02) 6495 2869
NEUTRAL BAY	(02) 8969 7500

NEWCASTLE	(02) 4926 4044
NEWPORT	(02) 9998 4200
ORANGE	(02) 6361 9166
PARRAMATTA	(02) 9615 4500
PORT MACQUARIE	(02) 6583 1735
REYNOLDS EQUITIES	(02) 9373 4452
SCONE	(02) 6544 3144
WOLLONGONG	(02) 4227 3022

VICTORIA

MELBOURNE	(03) 9947 4111
BERWICK	(03) 9796 2676
BRIGHTON	(03) 9519 3555
CAMBERWELL	(03) 9813 2945
CARLTON	(03) 9066 3200
GEELONG	(03) 5222 5128
FARRER HOUSE	(03) 8644 5488
RICHMOND	(03) 9916 4000
SOUTH YARRA	(03) 9098 8511
TRARALGON	(03) 5176 6055
WARRNAMBOOL	(03) 5559 1500

ACT

CANBERRA	(02) 6232 4999
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SOUTH AUSTRALIA

ADELAIDE	(08) 8464 5000
NORWOOD	(08) 8461 2800

WESTERN AUSTRALIA

PERTH	(08) 6462 1999
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NORTHERN TERRITORY

DARWIN	(08) 8981 9555
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TASMANIA

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