

11 May 2009

**Change of recommendation**

# Buy

 (from Hold)

**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\$0.19 (from A\$0.15)

**Price**

A\$0.096

**Short term (0-60 days)**

n/a

AVX90511

**Price performance**

	(1M)	(3M)	(12M)
Price (A\$)	0.08	0.07	0.29
Absolute (%)	23.1	33.3	-66.4
Rel market (%)	13.0	17.4	-51.3
Rel sector (%)	19.8	53.9	-56.9


**Market capitalisation**

A\$38.96m (US\$29.44m)

**Average (12M) daily turnover**

A\$0.22m (US\$0.17m)

RIC: AVX.AX, AVX AU  
 Priced at close of business 8 May 2009.  
 Source: Bloomberg

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# Avexa

## Advance to go, collect A\$17m

**AVX has addressed its need for capital by raising A\$17m, enough for 12 months. Our focus has now shifted to the next catalyst, the release of initial data from the Phase III ATC trial. For investors with a high-risk appetite, we upgrade to Buy.**

**Key forecasts**

	FY07A	FY08A	FY09F	FY10F	FY11F
EBITDA (A\$m)	-16.7	-40.3	-39.5 ▼	22.70 ▲	20.30
Reported net profit (A\$m)	-15.2	-36.1	-37.0 ▼	23.90 ▲	22.00 ▲
Normalised net profit (A\$m) <sup>1</sup>	-15.2	-36.1	-37.0 ▼	23.90 ▲	22.00 ▲
Normalised EPS (c) <sup>1</sup>	-3.73	-8.89	-5.55 ▼	3.59 ▲	3.30 ▼
Normalised EPS growth (%)	-58.7	138.0	-37.5	-95.7	-7.98
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	n/m	n/m	2.67	2.91
EV/EBITDA (x)	2.27	0.11	n/m	0.24	n/m
Price/net oper. CF (x)	-2.51	-1.33	-1.73 ▲	5.61 ▲	2.80 ▲
ROIC (%)	354.6	-196	-224	125.1	53.40

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, ABN AMRO Morgans forecasts

**Now that concerns surrounding the cash position have been removed**

At the close of the recently completed 1:2 renounceable rights issue, AVX had received applications for entitlements and for additional shares totalling A\$17m (including A\$2.1m as a placement). AVX concluded March 2009 with A\$12.8m in cash, taking pro-forma cash to A\$29.8m. We believe this is sufficient to fund the business for at least 12 months.

**It's time to focus on upcoming milestones**

The next milestone to watch is the release of 16-week data from the first of two Phase III trials of apricitabine (ATC) in 2QCY09. We believe this newsflow is critical in the short term, and the data to date lends confidence to our view that the trials will report positive results.

**Signs option agreement for pre-clinical HIV program, a small positive step forward**

AVX has entered into a six-month, worldwide exclusive option agreement with Tibotec Pharmaceuticals (a Johnson & Johnson company) relating to its HIV integrase program (pre-clinical). The option provides an exclusivity period for the two companies to formalise a licensing agreement while Tibotec continues to review the program portfolio.

**Investment view – upgrade to Buy, for investors with a higher risk profile**

We have adjusted our underlying assumptions, leading to a reduction in our DCF valuation to A\$0.31 (from A\$0.44). In our view, investors will be wary of AVX until a partner for ATC is secured. Accordingly, we have set our target price at A\$0.19 (from A\$0.15), a 40% discount to our DCF valuation, to reflect AVX's track record on this front. Despite this, we believe the release of interim Phase III data will be an important catalyst. Also, the possibility that AVX will secure a partner for ATC provides further potential upside. We upgrade to a Buy in anticipation of these events. This is largely a shorter-term view for investors with a higher risk profile. Downside risks include delays in the development or partnering of ATC.

## Changes to forecasts

We have made the following adjustments to our forecasts:

- We have delayed the receipt of an anticipated A\$30m milestone payment expected when AVX signs a partnering deal for lead product, ATC. In our view, timing of a partnering deal for ATC is difficult to predict, but as yet there is no indication that this will occur before end FY09. Accordingly, to be conservative we have delayed this milestone payment to FY10F.
- We have diluted the number of shares to reflect the 241.4m shares issued to raise A\$17.0m under the rights issue and placement. The total number of shares on issue is now 666.1m.

**Table 1 : Changes to forecasts**

	FY09F			FY10F			FY11F		
	Previous	New	% chg	Previous	New	% chg	Previous	New	% chg
Revenue	25.4	1.4	-95%	25.4	49.4	94%	37.4	37.4	0%
NPAT	-13.5	-37.0	174%	-0.6	23.9	-4085%	20.7	22.0	6%
EPS	-3.2	-5.6	74%	-0.1	3.6	-3690%	4.9	3.3	-33%

Source: ABN AMRO Morgans forecasts

- In Table 2 we list the expected milestones, which may prove to be **catalysts** for the share price:

**Table 2 : Upcoming milestones**

Estimated date	Milestone	Impact
2QCY09	Release of 16-week data from first Phase III ATC clinical trial	Positive
4QCY09	Phase IIb 144 week final data analysis	Positive
2QCY10	Complete enrolment of first Phase III study	Positive
4QCY10	Phase III (first trial) week 24 data available	Positive
1QCY11	Potential filing from 24 week data in some jurisdictions	Major Positive

Source: Company data, ABN AMRO Morgans estimates

- The **risks** to our target price include clinical trial risk, any delay in the commercialisation of ATC, regulatory risk, and partnering risk.

## Company pipeline

### AVX pipeline

Disease State	Research	Lead Compound	Preclinical	Phase I	Phase II	Phase III
HIV	ATC – NRTI					
MRSA	Topical Antibiotic					
MRSA	Systemic Antibiotic					
HIV	HIV Integrase					
HCV	NS5B			Partner Shanghai TargetDrug		

Source: Company data, April 2009

## AVX – financial summary

Year to 30 Jun (A\$m)	AIFRS 2007A	AIFRS 2008A	AIFRS 2009F	AIFRS 2010F	AIFRS 2011F	Closing price (A\$)	0.096	Price target (A\$)	0.19	
<b>Income statement</b>						<b>Valuation metrics</b>				
Divisional sales	0.2	1.4	1.4	49.4	37.4	Preferred methodology	DCF	Val'n (A\$)	\$ 0.31	
Total revenue	0.2	1.4	1.4	49.4	37.4	<b>DCF valuation inputs</b>				
EBITDA	-16.7	-40.3	-39.5	22.7	20.3	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	-0.1	-0.2	-0.1	-0.2	-0.3	Beta	2.09	Kd	7.25%	
EBITA	-16.8	-40.4	-39.6	22.5	20.0	CAPM (Rf+Beta(Rm-Rf))	17.8%	Ke	17.8%	
Amortisation/impairment	0.0	0.0	0.0	0.0	0.0	E/EV*Ke+D/EV*Kd(1-t)		NPV cash flow (A\$m)	183.4	
EBIT	-16.8	-40.4	-39.6	22.5	20.0	Equity (E/EV)	100.0%	Minority interest (A\$m)	0.0	
EBIT(incl associate profit)	-16.8	-40.4	-39.6	22.5	20.0	Debt (D/EV)	0.0%	Net debt (A\$m)	-23.2	
Net interest expense	1.6	4.3	2.6	1.4	2.0	Interest rate	7.25%	Investments (A\$m)	0.0	
Pre-tax profit	-15.2	-36.1	-37.0	23.9	22.0	Tax rate (t)	30.0%	Equity market value (A\$m)	206.6	
Income tax expense	0.0	0.0	0.0	0.0	0.0	Franking credit	0.0			
After-tax profit	-15.2	-36.1	-37.0	23.9	22.0	<b>WACC</b>	17.8%	Diluted no. of shares (m)	666.1	
Minority interests	0.0	0.0	0.0	0.0	0.0			<b>DCF valuation (A\$)</b>	<b>0.31</b>	
NPAT	-15.2	-36.1	-37.0	23.9	22.0					
Significant items	0.0	0.0	0.0	0.0	0.0	<b>Multiples</b>				
NPAT post abnormal	-15.2	-36.1	-37.0	23.9	22.0	Enterprise value (A\$m)	2008A	2009F	2010F	2011F
						EV/Sales (x)	-4.5	15.8	5.5	-15.2
						EV/EBITDA (x)	-3.3	11.5	0.1	-0.4
						EV/EBITDA (x)	0.1	-0.4	0.2	-0.7
						EV/EBIT (x)	0.1	-0.4	0.2	-0.8
						PE (pre-goodwill) (x)	-1.1	-1.7	2.7	2.9
						<b>At target price</b>	2008A	2009F	2010F	2011F
						EV/EBITDA (x)	-0.8	-1.3	1.9	1.1
						PE (pre-goodwill) (x)	-2.1	-3.4	5.2	5.6
						<b>Comparable company data (x)</b>		2009F	2010F	2011F
						Alchemia	EV/EBITDA	-6.8	-16.9	10.0
						Year to 30 Jun	EV/EBIT	-5.6	-11.6	14.8
							PE	-7.3	-6.8	4.9
						Peplin	EV/EBITDA	-0.1	0.4	-0.4
						Year to 30 Jun	EV/EBIT	-0.1	0.4	-0.4
							PE	-0.2	-0.3	-0.6
						<b>Per share data</b>	2008A	2009F	2010F	2011F
						No. shares	406.0	666.1	666.1	666.1
						EPS (cps)	-8.9	-5.6	3.6	3.3
						EPS (normalised) (c)	-8.9	-5.6	3.6	3.3
						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
						<b>Growth ratios</b>	2008A	2009F	2010F	2011F
						Sales growth	531.7%	1.0%	3498.0%	-24.4%
						Operating cost growth	146.3%	-1.8%	-34.6%	-36.1%
						EBITDA growth	141.4%	-1.9%	-88.5%	-10.5%
						EBITA growth	141.3%	-2.1%	-87.6%	-11.2%
						<b>Operating performance</b>	2008A	2009F	2010F	2011F
						Asset turnover (%)	0.4	0.6	22.4	12.3
						EBITDA margin (%)	-2962.0	-2877.6	45.9	54.3
						EBIT margin (%)	-2975.8	-2885.0	45.6	53.5
						Net profit margin (%)	-2655.8	-2695.3	48.4	58.9
						Return on net assets (%)	-72.5	-110.7	37.7	24.5
						Net debt (A\$m)	-43.4	-23.2	-33.5	-54.1
						Net debt/equity (%)	-77.8	-64.8	-56.1	-66.3
						Net interest/EBIT cover (x)	9.3	15.2	-16.2	-10.0
						ROIC (%)	-196.4	-224.2	125.1	53.4
						<b>Internal liquidity</b>	2008A	2009F	2010F	2011F
						Current ratio (x)	4.9	2.7	7.4	15.6
						Receivables turnover (x)	5.4	3.9	9.4	4.2
						Payables turnover (x)	7.8	4.9	3.9	3.8

Source: Company data, ABN AMRO 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.

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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).

## REGULATORY DISCLOSURES

Subject companies: AVX.AX

ABN AMRO Morgans corporate acted as a lead manager to the share placement and rights issue for AVX and received fees in this regard.: AVX.AX

ABN AMRO Morgans Limited was the Underwriter to the renounceable rights issue of shares by Avexa Limited in March 2007 and received fees in this regard: AVX.AX.

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