

Avexa (AVX)

Phase III trial underway

AVX posted 1H08 results in line with our forecast. AVX has a solid cash balance of A\$66.6m. The next milestone is the release of the 48 week Phase IIb data in March. Our target price has been reduced to reflect the volatility in the market.

Key forecasts

	FY06A	FY07A	FY08F	FY09F	FY10F
EBITDA (A\$m)	-12.3	-16.7	-38.0	-28.1	-3.33
Reported net profit (A\$m)	-17.8	-15.2	-33.4	-25.1	-1.85
Normalised net profit (A\$m) ¹	-17.8	-15.2	-33.4	-25.1	-1.85
Normalised EPS (c) ¹	-9.03	-3.73	-8.22	-6.18	-0.46
Normalised EPS growth (%)	-7.96	-58.7	120.2	-24.9	-92.6
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	n/m	n/m
EV/EBITDA (x)	n/m	n/m	n/m	n/m	n/m
Price/net oper. CF (x)	-8.00	-9.54	-5.87	-5.81	-15.9▲
ROIC (%)	-238.9	354.6	-184.5	-314.5	-35.5

1. Pre-goodwill amortisation and exceptional items
Accounting Standard: IFRS
Source: Company data, ABN AMRO Morgans forecasts

year to Jun, fully diluted

1H08 results in line - next milestone in March 2008

AVX posted a 1H08 loss of A\$17.3m, in line with our forecasts. At this stage we make no changes to our FY08 forecasts. All patients have now completed the 48-week dosing period of AVX's Phase IIb clinical trial and the results are expected in March 2008. Our table of milestones is provided overpage.

First site initiated for pivotal trial

AVX has initiated the first of two pivotal trials, referred to as AVX-301. Given the success rate of previous HIV drugs entering Phase III clinical trials (100%) and the strong clinical data released by AVX to date, we are increasingly confident that AVX is developing a marketable drug.

Securing a partner a key catalyst to watch for

AVX has A\$66.6m in cash. We estimate the Phase III program will cost about A\$85m and AVX has previously stated its intention to look for a partner to supply additional capital. While at this stage it is still too early to know what form this may take, in our model we assume the potential partner will license ATC from AVX in return for a royalty and funding assistance for the Phase III trial. We believe the successful negotiation of a partnership deal will be an important share price catalyst, although it is difficult to predict the timing of this.

Investment view - maintain Buy, target price reduced to A\$0.92

Although we have made no changes to our forecasts, our DCF valuation is now A\$1.32 (from A\$1.39) due to changes in the risk-free rate. The key assumptions are a risk free rate of 6.25% (was 5.75%), WACC of 15.7% (was 15.2%) and a terminal growth rate of 1.5%. We have assumed a probability of success of 80%. Each 1% change in the probability of success alters our valuation by 2cps. Given the current volatility in the market we have applied a 30% discount to our valuation and set our target price at A\$0.92. The key downside risk to our target price is any delay in the progress of the Phase III trial.

Important disclosures regarding companies that are the subject of this report and an explanation of recommendations and volatility can be found at the end of this document.

Priced at close of business 20 February 2008. Use of ▲▼ indicates that the line item has changed by at least 5%.
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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.**

Moderate Volatility

Absolute performance

n/a

Short term (0-60 days)

Pharmaceuticals & Biotechnology

Australia

Price

A\$0.365

Target price

A\$0.92 (from A\$1.39)

Market capitalisation

A\$148.13m (US\$135.24m)

Avg (12mth) daily turnover

A\$0.97m (US\$0.82m)

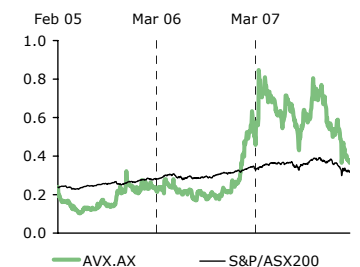
Reuters

AVX.AX

AVX80221

Price performance (1M) (3M) (12M)

	1M	3M	12M
Price (A\$)	0.5	0.7	0.6
Absolute %	-24.0	-45.9	-42.4
Rel market %	-20.5	-36.8	-37.3
Rel sector %	-14.8	-38.9	-31.4



Stock borrowing: Easy onshore,

Impossible offshore

Volatility (30-day): 91.48%

Volatility (6-month trend): ↑

52-week range: 0.99-0.32

S&P/ASX200: 5496.50

BBG AP Pharm & Biotech: 144.49

Source: ABN AMRO, Bloomberg

Analysts

Tanya Solomon

+61 7 3334 4521

tsolomon@abnamromorgans.com.au

Scott Power

+61 7 3334 4884

scottp@abnamromorgans.com.au

www.abnamromorgans.com.au

Table 1 : Key milestones

Estimated date	Milestone	Impact
1QCY07	Release of the first results from Phase 2b clinical trial of Apricitabine	Achieved
2QCY07	Publication of 21 day results at IAS conference (July)	Achieved
3QCY07	Release 24 week data Phase 2b	Achieved
4QCY07	Start first of two Phase 3 clinical trials for ATC	Achieved
1QCY08	Release of 48 week data of Phase 2b study	Positive
1QCY09	Release of 16 week data from first Phase 3 ATC clinical trial	Positive
1HCY09	Commence second Phase 3 ATC clinical trial	Positive
2HCY10	File NDA with FDA	Major positive

Source: Company data, ABN AMRO Morgans

AVX – financial summary

Year to 30 Jun (A\$m)	AIFRS 2006A	AIFRS 2007A	AIFRS 2008F	AIFRS 2009F	AIFRS 2010F	Closing price (A\$)	0.37	Price target (A\$)	0.92	
Income statement						Valuation metrics				
Divisional sales	0.2	0.2	0.2	20.2	20.2	Preferred methodology	DCF	Val'n (A\$)	\$ 1.32	
Total revenue	0.2	0.2	0.2	20.2	20.2	DCF valuation inputs				
EBITDA	-12.3	-16.7	-38.0	-28.1	-3.3	Rf	6.25%	10-year rate	6.25%	
Associate income	0.0	0.0	0.0	0.0	0.0	Rm-Rf	4.50%	Margin	2.0%	
Depreciation	-6.1	-0.1	0.0	0.0	-0.1	Beta	2.09	Kd	8.25%	
EBITA	-18.4	-16.8	-38.0	-28.2	-3.4	CAPM (Rf+Beta(Rm-Rf))	15.7%	Ke	15.7%	
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)	482.7	
EBIT	-18.4	-16.8	-38.0	-28.2	-3.4	Equity (E/EV)	100.0%	Minority interest (A\$m)	0.0	
EBIT(incl associate profit)	-18.4	-16.8	-38.0	-28.2	-3.4	Debt (D/EV)	0.0%	Net debt (A\$m)	-51.6	
Net interest expense	0.5	1.6	4.6	3.1	1.6	Interest rate	8.25%	Investments (A\$m)	0.0	
Pre-tax profit	-17.8	-15.2	-33.4	-25.1	-1.9	Tax rate (t)	30.0%	Equity market value (A\$m)	534.3	
Income tax expense	0.0	0.0	0.0	0.0	0.0	Franking credit	0.0	0.0	0.0	
After-tax profit	-17.8	-15.2	-33.4	-25.1	-1.9	WACC	15.7%	Diluted no. of shares (m)	405.8	
Minority interests	0.0	0.0	0.0	0.0	0.0			DCF valuation (A\$)	1.32	
NPAT	-17.8	-15.2	-33.4	-25.1	-1.9					
Significant items	0.0	0.0	0.0	0.0	0.0	Multiples	2007A	2008F	2009F	2010F
NPAT post abnormals	-17.8	-15.2	-33.4	-25.1	-1.9	Enterprise value (A\$m)	71.3	96.5	122.0	132.4
						EV/Sales (x)	331.2	444.1	6.0	6.5
Cash flow statement	2006A	2007A	2008F	2009F	2010F	EV/EBITDA (x)	-4.3	-2.5	-4.3	-39.8
EBITDA	-12.3	-16.7	-38.0	-28.1	-3.3	EV/EBIT (x)	-4.3	-2.5	-4.3	-38.7
Change in working capital	2.8	-0.4	8.1	-0.5	-7.6	PE (pre-goodwill) (x)	-9.8	-4.4	-5.9	-80.0
Net interest (pd)/rec	0.5	1.6	4.6	3.1	1.6	PEG (pre-goodwill) (x)				
Taxes paid	0.0	0.0	0.0	0.0	0.0	At target price	2007A	2008F	2009F	2010F
Other oper cash items	0.0	0.0	0.0	0.0	0.0	EV/EBITDA (x)	-17.8	-8.5	-12.4	-107.7
Cash flow from ops (1)	-9.0	-15.5	-25.2	-25.5	-9.3	PE (pre-goodwill) (x)	-24.7	-11.2	-14.9	-202.0
Capex (2)	-0.1	-0.2	-0.1	0.0	-1.0	Comparable company data (x)	2008F	2009F	2010F	
Disposals/(acquisitions)	0.0	-12.9	0.0	0.0	0.0	Alchemia	EV/EBITDA	-5.9	-45.3	1.7
Other investing cash flow	0.0	0.0	0.0	0.0	0.0	Year to 30 Jun	EV/EBIT	-5.1	-19.3	1.9
Cash flow from invest (3)	-0.1	-13.1	-0.1	0.0	-1.0		PE	-5.9	-26.9	1.6
Incr/(decr) in equity	14.4	85.3	0.0	0.0	0.0		PEG	-1.7	-7.7	0.5
Incr/(decr) in debt	0.0	0.0	0.0	0.0	0.0	Peplin	EV/EBITDA	-1.5	-2.1	16.3
Ordinary dividend paid	0.0	0.0	0.0	0.0	0.0	Year to 30 Jun	EV/EBIT	-1.5	-2.0	18.1
Preferred dividends (4)	0.0	0.0	0.0	0.0	0.0		PE	-4.3	-3.8	24.3
Other financing cash flow	-0.8	0.0	0.0	0.0	0.0		PEG			
Cash flow from fin (5)	13.5	85.3	0.0	0.0	0.0	Per share data	2007A	2008F	2009F	2010F
Forex and disc ops (6)	0.0	0.0	0.0	0.0	0.0	No. shares	405.8	405.8	405.8	405.8
Inc/(decr) cash (1+3+5+6)	4.4	56.7	-25.3	-25.5	-10.4	EPS (cps)	-3.7	-8.2	-6.2	-0.5
Equity FCF (1+2+4)	-9.2	-15.7	-25.3	-25.5	-10.4	EPS (normalised) (c)	-3.7	-8.2	-6.2	-0.5
						Dividend per share (c)	0.0	0.0	0.0	0.0
Balance sheet	2006A	2007A	2008F	2009F	2010F	Dividend payout ratio (%)	0.0	0.0	0.0	0.0
Cash & deposits	20.2	76.9	51.6	26.1	15.7	Dividend yield (%)	0.0	0.0	0.0	0.0
Trade debtors	0.0	0.1	0.0	3.2	4.2	Growth ratios	2007A	2008F	2009F	2010F
Inventory	0.0	0.0	0.0	0.0	0.0	Sales growth	1.0%	1.0%	9205.7%	0.0%
Investments	0.0	16.5	16.5	16.5	16.5	Operating cost growth	34.7%	126.0%	26.7%	-51.3%
Goodwill	0.0	0.0	0.0	0.0	0.0	EBITDA growth	35.3%	127.6%	-25.9%	-88.2%
Other intangible assets						EBITA growth	-8.8%	126.7%	-25.8%	-87.9%
Fixed assets	0.2	0.3	0.4	0.4	1.3	Operating performance	2007A	2008F	2009F	2010F
Other assets	0.1	0.1	0.1	0.1	0.1	Asset turnover (%)	0.1	0.1	8.8	12.0
Total assets	20.6	94.0	68.6	46.3	37.8	EBITDA margin (%)	-7752.2	-17468.2	-139.2	-16.5
Short-term borrowings	0.0	0.0	0.0	0.0	0.0	EBIT margin (%)	-7789.0	-17485.9	-139.4	-16.9
Trade payables	3.4	2.2	10.2	12.9	6.3	Net profit margin (%)	-7045.2	-15361.3	-124.0	-9.2
Long-term borrowings	0.0	0.0	0.0	0.0	0.0	Return on net assets (%)	-18.4	-65.6	-85.8	-11.0
Provisions	0.0	0.0	0.0	0.0	0.0	Net debt (A\$m)	-76.9	-51.6	-26.1	-15.7
Other liabilities	0.3	0.5	0.5	0.5	0.5	Net debt/equity (%)	-84.2	-89.2	-79.5	-50.8
Total liabilities	3.7	2.7	10.7	13.4	6.8	Net interest/EBIT cover (x)	10.5	8.2	9.1	2.2
Preference shares						ROIC (%)	354.6	-184.5	-314.5	-35.5
Hybrid equity						Internal liquidity	2007A	2008F	2009F	2010F
Share capital	48.2	137.2	103.8	78.7	76.9	Current ratio (x)	28.7	4.8	2.2	2.9
Other reserves	0.0	0.0	0.0	0.0	0.0	Receivables turnover (x)	2.4	2.4	12.4	5.5
FCTR						Payables turnover (x)	6.1	6.1	4.2	2.4
Unrealised gains/losses										
Retained earnings	-31.2	-45.9	-45.9	-45.9	-45.9					
Other equity	0.0	0.0	0.0	0.0	0.0					
Total equity	16.9	91.3	57.9	32.8	31.0					
Minority interest	0.0	0.0	0.0	0.0	0.0					
Total shareholders' equity	16.9	91.3	57.9	32.8	31.0					
Total liabilities & SE	20.6	94.0	68.6	46.3	37.8					

Source: Company data, ABN AMRO Morgans forecasts

RESEARCH TEAM

ROGER LEANING	-	Head of Research	JOSEPHINE LITTLE	-	Analyst
ROBERT BITOMSKY	-	Analyst	ROSS MACLEOD CAREY	-	Analyst
CHRIS BROWN	-	Senior Analyst	BELINDA MOORE	-	Senior Analyst
FIONA BUCHANAN	-	Senior Analyst	SCOTT POWER	-	Senior Analyst
NICK HARRIS	-	Analyst	TOM SARTOR	-	Analyst
LINDSAY HURST	-	Retail Strategy Analyst	TAMARA STRETCH	-	Analyst
MICHAEL KNOX	-	Director of Strategy & Chief Economist	TANYA SOLOMON	-	Analyst
JAMES LAWRENCE	-	Fixed Interest Analyst	REBECCA SULLIVAN	-	Retail Strategy

ABN AMRO MORGANS OFFICES

BRISBANE	(07) 3334 4888	CHATSWOOD	(02) 9411 8988
BUNDABERG	(07) 4153 1050	COFFS HARBOUR	(02) 6651 5700
BURLEIGH HEADS	(07) 5520 8788	GOSFORD	(02) 4325 0884
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IPSWICH	(07) 3202 3995	PORT MACQUARIE	(02) 6583 1735
MACKAY	(07) 4957 3033	SCONE	(02) 6545 9811
MILTON	(07) 3114 8600	WOLLONGONG	(02) 4227 3022
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BALLINA	(02) 6686 4144	DARWIN	(08) 8981 9555
BALMAIN	(02) 8755 3333	HOBART	(03) 6236 9000

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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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Subject companies: AVX.AX.

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