ABN·AMRO Morgans

Thursday 21 February 2008

Change of target price

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%.

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)

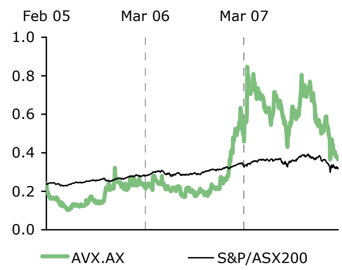
Avg (12mth) daily turnover

A$0.97m (US$0.82m)

Reuters

AVX.AX AVX80221

Price performance	(1M)	(3M)	(12M)
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	AIFRS	AIFRS	AIFRS	AIFRS
Income statement	**2006A**	**2007A**	**2008F**	**2009F**	**2010F**
Divisional sales	0.2	0.2	0.2	20.2	20.2
Total revenue	0.2	0.2	0.2	20.2	20.2
EBITDA	-12.3	-16.7	-38.0	-28.1	-3.3
Associate income	0.0	0.0	0.0	0.0	0.0
Depreciation	-6.1	-0.1	0.0	0.0	-0.1
EBITA	-18.4	-16.8	-38.0	-28.2	-3.4
Amortisation/impairment	0.0	0.0	0.0	0.0	0.0
EBIT	-18.4	-16.8	-38.0	-28.2	-3.4
EBIT(incl associate profit)	-18.4	-16.8	-38.0	-28.2	-3.4
Net interest expense	0.5	1.6	4.6	3.1	1.6
Pre-tax profit	-17.8	-15.2	-33.4	-25.1	-1.9
Income tax expense	0.0	0.0	0.0	0.0	0.0
After-tax profit	-17.8	-15.2	-33.4	-25.1	-1.9
Minority interests	0.0	0.0	0.0	0.0	0.0
NPAT	-17.8	-15.2	-33.4	-25.1	-1.9
Significant items	0.0	0.0	0.0	0.0	0.0
NPAT post abnormals	-17.8	-15.2	-33.4	-25.1	-1.9

Cash flow statement	2006A	2007A	2008F	2009F	2010F
EBITDA	-12.3	-16.7	-38.0	-28.1	-3.3
Change in working capital	2.8	-0.4	8.1	-0.5	-7.6
Net interest (pd)/rec	0.5	1.6	4.6	3.1	1.6
Taxes paid	0.0	0.0	0.0	0.0	0.0
Other oper cash items	0.0	0.0	0.0	0.0	0.0
Cash flow from ops (1)	-9.0	-15.5	-25.2	-25.5	-9.3
Capex (2)	-0.1	-0.2	-0.1	0.0	-1.0
Disposals/(acquisitions)	0.0	-12.9	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)	-0.1	-13.1	-0.1	0.0	-1.0
Incr/(decr) in equity	14.4	85.3	0.0	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	-0.8	0.0	0.0	0.0	0.0
Cash flow from fin (5)	13.5	85.3	0.0	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)	4.4	56.7	-25.3	-25.5	-10.4
Equity FCF (1+2+4)	-9.2	-15.7	-25.3	-25.5	-10.4

Balance sheet	2006A	2007A	2008F	2009F	2010F
Cash & deposits	20.2	76.9	51.6	26.1	15.7
Trade debtors	0.0	0.1	0.0	3.2	4.2
Inventory	0.0	0.0	0.0	0.0	0.0
Investments	0.0	16.5	16.5	16.5	16.5
Goodwill	0.0	0.0	0.0	0.0	0.0
Other intangible assets					
Fixed assets	0.2	0.3	0.4	0.4	1.3
Other assets	0.1	0.1	0.1	0.1	0.1
Total assets	20.6	94.0	68.6	46.3	37.8
Short-term borrowings	0.0	0.0	0.0	0.0	0.0
Trade payables	3.4	2.2	10.2	12.9	6.3
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	0.3	0.5	0.5	0.5	0.5
Total liabilities	3.7	2.7	10.7	13.4	6.8
Preference shares					
Hybrid equity					
Share capital	48.2	137.2	103.8	78.7	76.9
Other reserves	0.0	0.0	0.0	0.0	0.0
FCTR					
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

Closing price (A$)		0.37	Price target (A$)		0.92
Valuation metrics					
Preferred methodology	DCF		Val'n (A$)	$	1.32
DCF valuation inputs					
Rf		6.25%	10-year rate		6.25%
Rm-Rf		4.50%	Margin		2.0%
Beta		2.09	Kd		8.25%
CAPM (Rf+Beta(Rm-Rf))		15.7%	Ke		15.7%
E/EV*Ke+D/EV*Kd(1-t)			NPV cash flow (A$m)		482.7
Equity (E/EV)		100.0%	Minority interest (A$m)		0.0
Debt (D/EV)		0.0%	Net debt (A$m)		-51.6
Interest rate		8.25%	Investments (A$m)		0.0
Tax rate (t)		30.0%	Equity market value (A$m)		534.3
Franking credit		0.0	0.0		0.0
WACC		15.7%	Diluted no. of shares (m)		405.8
			DCF valuation (A$)		**1.32**

Multiples	2007A	2008F	2009F	2010F
Enterprise value (A$m)	71.3	96.5	122.0	132.4
EV/Sales (x)	331.2	444.1	6.0	6.5
EV/EBITDA (x)	-4.3	-2.5	-4.3	-39.8
EV/EBIT (x)	-4.3	-2.5	-4.3	-38.7
PE (pre-goodwill) (x)	-9.8	-4.4	-5.9	-80.0
PEG (pre-goodwill) (x)				

At target price	2007A	2008F	2009F	2010F
EV/EBITDA (x)	-17.8	-8.5	-12.4	-107.7
PE (pre-goodwill) (x)	-24.7	-11.2	-14.9	-202.0

Comparable company data (x)		2008F	2009F	2010F
Alchemia	EV/EBITDA	-5.9	-45.3	1.7
Year to 30 Jun	EV/EBIT	-5.1	-19.3	1.9
	PE	-5.9	-26.9	1.6
	PEG	-1.7	-7.7	0.5
Peplin	EV/EBITDA	-1.5	-2.1	16.3
Year to 30 Jun	EV/EBIT	-1.5	-2.0	18.1
	PE	-4.3	-3.8	24.3
	PEG			

Per share data	2007A	2008F	2009F	2010F
No. shares	405.8	405.8	405.8	405.8
EPS (cps)	-3.7	-8.2	-6.2	-0.5
EPS (normalised) (c)	-3.7	-8.2	-6.2	-0.5
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	2007A	2008F	2009F	2010F
Sales growth	1.0%	1.0%	9205.7%	0.0%
Operating cost growth	34.7%	126.0%	26.7%	-51.3%
EBITDA growth	35.3%	127.6%	-25.9%	-88.2%
EBITA growth	-8.8%	126.7%	-25.8%	-87.9%

Operating performance	2007A	2008F	2009F	2010F
Asset turnover (%)	0.1	0.1	8.8	12.0
EBITDA margin (%)	-7752.2	-17468.2	-139.2	-16.5
EBIT margin (%)	-7789.0	-17485.9	-139.4	-16.9
Net profit margin (%)	-7045.2	-15361.3	-124.0	-9.2
Return on net assets (%)	-18.4	-65.6	-85.8	-11.0
Net debt (A$m)	-76.9	-51.6	-26.1	-15.7
Net debt/equity (%)	-84.2	-89.2	-79.5	-50.8
Net interest/EBIT cover (x)	10.5	8.2	9.1	2.2
ROIC (%)	354.6	-184.5	-314.5	-35.5

Internal liquidity	2007A	2008F	2009F	2010F
Current ratio (x)	28.7	4.8	2.2	2.9
Receivables turnover (x)	2.4	2.4	12.4	5.5
Payables turnover (x)	6.1	6.1	4.2	2.4

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
CAIRNS	(07) 4052 9222	HURSTVILLE	(02) 9570 5755
CALOUNDRA	(07) 5491 5422	MERIMBULA	(02) 6495 2869
CAPALABA	(07) 3245 5466	NEUTRAL BAY	(02) 8969 7500
CHERMSIDE	(07) 3350 9000	NEWCASTLE	(02) 4926 4044
EMERALD	(07) 4988 2777	NEWPORT	(02) 9998 4200
GLADSTONE	(07) 4972 8000	ORANGE	(02) 6361 9166
GOLD COAST	(07) 5592 5777	PARRAMATTA	(02) 9615 4500
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
MISSION BEACH	(07) 4088 6188	**MELBOURNE**	(03) 9947 4111
NOOSA	(07) 5449 9511	BERWICK	(03) 9796 2676
REDCLIFFE	(07) 3897 3999	BRIGHTON	(03) 9592 4555
ROCKHAMPTON	(07) 4922 5855	CAMBERWELL	(03) 9813 2945
SPRINGWOOD	(07) 3808 7588	GEELONG	(03) 5222 5128
SUNSHINE COAST	(07) 5479 2757	TRARALGON	(03) 5176 6055
TOOWOOMBA	(07) 4639 1277	WARRNAMBOOL	(03) 5559 1500
TOWNSVILLE	(07) 4771 4577	**CANBERRA**	(02) 6232 4999
YEPPOON	(07) 4939 3021	**ADELAIDE**	(08) 8464 5000
SYDNEY	(02) 8215 5000	**PERTH**	(08) 9261 0888
ARMIDALE	(02) 6772 1288	BUNBURY	(08) 9791 9188
BALLINA	(02) 6686 4144	**DARWIN**	(08) 8981 9555
BALMAIN	(02) 8755 3333	**HOBART**	(03) 6236 9000

RECOMMENDATION STRUCTURE

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

Subject companies: AVX.AX.