

Avexa (AVX)

Off and racing

The initiation of the Phase 3 clinical program by AVX for its anti-HIV drug is an important milestone. We expect the first 16-week data to be released early CY09. In the interim, key milestones are securing a partner and the release of further Phase 2b data. Buy.

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	-1.80
Normalised net profit (A\$m) ¹	-17.8	-15.2	-33.4	-25.1	-1.80
Normalised EPS (c) ¹	-9.03	-3.73	-8.22	-6.18	-0.44
Normalised EPS growth (%)	-7.96	-58.7	120.2	-24.9	-92.8
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)	-12.3	-14.6	-9.01 ▼	-8.91 ▼	-27.0 ▼
ROIC (%)	-238.9	354.6	-184.5	-314.5	-35.0

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

year to Jun, fully diluted

Clinical trial program kicks off

AVX has initiated the Phase 3 clinical trial program for its lead drug, apricitabine (ATC), an anti-HIV drug. We have outlined the clinical trial design over the page. Given the success rate of previous HIV drugs entering Phase 3 clinical trials (100%) and the strong clinical data released by AVX to date, we are increasingly confident that AVX is developing a marketable drug.

Final results of Phase 2b clinical trial due 1QCY08

All patients have now completed the 48-week dosing period of AVX's Phase 2b clinical trial. Furthermore, all except one eligible patient have progressed into the extension study, giving the company confidence that patients are experiencing long-term benefit from the inclusion of ATC as part of daily treatment. The final results of this are expected in 1QCY08, in line with our expectations.

Securing a partner - a key catalyst to watch for

AVX has about A\$70m in cash. We estimate that the Phase 3 program will cost around 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 tell what form this may take, in our model we assume that the potential partner will license ATC from AVX in return for a royalty and funding assistance for the Phase 3 trial. It is also expected that the appointment of a marketing partner may speed the time to file a New Drug Application (NDA) and ultimately assist with marketing of the drug. 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, A\$1.39 price target

We make no changes to our forecasts. We use a probability of success of 80% to determine our A\$1.39 DCF valuation (WACC 15.2%, beta 2.1, terminal value 1.5%). Given the commercialisation success of each HIV drug in Phase 3 trials to date, we believe our probability of success is conservative. Each 1% change in the probability of success alters our valuation by 2cps. Buy maintained.

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 3 January 2008.

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

Absolute performance

n/a

Short term (0-60 days)

Pharmaceuticals & Biotechnology

Australia

Price

A\$0.555

Target price

A\$1.39

Market capitalisation

A\$227.27m (US\$200.38m)

Avg (12mth) daily turnover

A\$1.15m (US\$0.95m)

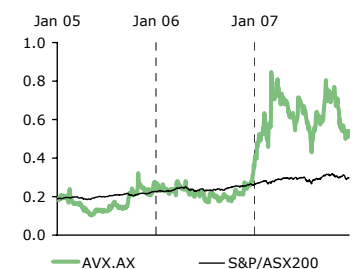
Reuters

AVX.AX

AVX80103

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

	1M	3M	12M
Price (A\$)	0.6	0.7	0.3
Absolute %	-0.9	-18.4	98.2
Rel market %	1.9	-14.4	76.9
Rel sector %	5.7	-10.0	115.8



Stock borrowing: Easy onshore,

Impossible offshore

Volatility (30-day): 60.41%

Volatility (6-month trend): ↑

52-week range: 0.99-0.26

S&P/ASX200: 6353.20

BBG AP Pharm & Biotech: 156.13

Source: ABN AMRO, Bloomberg

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Phase 3 clinical trial design

The FDA and EMEA have given the green light for AVX to commence a Phase 3 clinical trial program for its lead HIV compound apricitabine (ATC).

The Phase 3 program will again compare ATC to 3TC and FTC. It will consist of two clinical trials of 900 patients each:

- First trial - Two possible doses (800 mg or 1200mg twice daily) of ATC initially, with the higher dose dropped at week 16, in order to confirm the optimal dose.
- Second trial – Single dose of ATC (800mg twice daily). This trial will commence when 16-week data from the first trial is released.

The primary end point will be set at 24 weeks, and is the % of patients with less than 400 copies of the virus per milliliter of blood after 24 weeks, the same end point achieved by AVX at the 24-week point of the Phase 2b clinical trial. The trials will be conducted in North & South America, Europe, Africa and Asia (including Australia).

Prospects for Phase 3 trial are strong

According to a US Bureau of Economics 2003 paper, all 29 HIV drugs that entered Phase III between 1989 and 2002 made it to market. Since then, three additional drugs in separate classes to ATC have also been successful, with two more imminent, taking it to 34 from 34 successful in Phase III clinical trials.

Near-term catalysts to watch

Table 1 : Upcoming milestones to watch

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: ABN AMRO Morgans

We do not rule out corporate activity

Given the clinical trial results achieved to date and the progress the company has made, we continue to believe that AVX has become an attractive acquisition target for an international pharmaceutical company looking to build its HIV pipeline. We believe the most likely acquirers include Merck, Pfizer, Boehringer Ingelheim, Gilead or Tibotec Pharma (a J&J company). We believe the potential to combine ATC with the other HIV drugs on the market, as part of a combined treatment regime, is high.

AVX – financial summary

Year to 30 Jun (A\$m)	AIFRS 2006A	AIFRS 2007A	AIFRS 2008F	AIFRS 2009F	AIFRS 2010F	Closing price (A\$)	0.555	Price target (A\$)	1.39	
Income statement						Valuation metrics				
Divisional sales	0.2	0.2	0.2	20.2	20.2	Preferred methodology	DCF	Val'n (A\$)	\$ 1.39	
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	5.75%	10-year rate	5.75%	
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	0.0	Beta	2.09	Kd	7.75%	
EBITA	-18.4	-16.8	-38.0	-28.2	-3.4	CAPM (Rf+Beta(Rm-Rf))	15.2%	Ke	15.2%	
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)	513.6	
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	7.75%	Investments (A\$m)	0.0	
Pre-tax profit	-17.8	-15.2	-33.4	-25.1	-1.8	Tax rate (t)	30.0%	Equity market value (A\$m)	565.2	
Income tax expense	0.0	0.0	0.0	0.0	0.0	Franking credit	0.0			
After-tax profit	-17.8	-15.2	-33.4	-25.1	-1.8	WACC	15.2%	Diluted no. of shares (m)	405.8	
Minority interests	0.0	0.0	0.0	0.0	0.0	DCF valuation (A\$)				
NPAT	-17.8	-15.2	-33.4	-25.1	-1.8	1.39				
Significant items	0.0	0.0	0.0	0.0	0.0	Multiples				
NPAT post abnormals	-17.8	-15.2	-33.4	-25.1	-1.8	2007A	2008F	2009F	2010F	
Cash flow statement						Enterprise value (A\$m)				
EBITDA	-12.3	-16.7	-38.0	-28.1	-3.3	138.2	163.5	189.0	197.4	
Change in working capital	2.8	-0.4	8.1	-0.5	-6.6	EV/Sales (x)	642.5	752.3	9.3	
Net interest (pd)/rec	0.5	1.6	4.6	3.1	1.6	EV/EBITDA (x)	-8.3	-4.3	-6.7	
Taxes paid	0.0	0.0	0.0	0.0	0.0	EV/EBIT (x)	-8.2	-4.3	-6.7	
Other oper cash items	0.0	0.0	0.0	0.0	0.0	PE (pre-goodwill) (x)	-14.2	-6.4	-8.6	
Cash flow from ops (1)	-9.0	-15.5	-25.2	-25.5	-8.4	PEG (pre-goodwill) (x)			-119.4	
Capex (2)	-0.1	-0.2	-0.1	0.0	0.0	At target price				
Disposals/(acquisitions)	0.0	-12.9	0.0	0.0	0.0	2007A	2008F	2009F	2010F	
Other investing cash flow	0.0	0.0	0.0	0.0	0.0	EV/EBITDA (x)	-29.3	-13.5	-19.2	
Cash flow from invest (3)	-0.1	-13.1	-0.1	0.0	0.0	PE (pre-goodwill) (x)	-37.3	-16.9	-22.5	
Incr/(decr) in equity	14.4	85.3	0.0	0.0	0.0	Comparable company data (x)				
Incr/(decr) in debt	0.0	0.0	0.0	0.0	0.0	2008F	2009F	2010F		
Ordinary dividend paid	0.0	0.0	0.0	0.0	0.0	Alchemia	EV/EBITDA	-8.6	-153.2	1.8
Preferred dividends (4)	0.0	0.0	0.0	0.0	0.0	Year to 30 Jun	EV/EBIT	-7.4	-36.0	1.9
Other financing cash flow	-0.8	0.0	0.0	0.0	0.0		PE	-8.3	-56.0	1.8
Cash flow from fin (5)	13.5	85.3	0.0	0.0	0.0	ChemGenex Pharmaceuticals	EV/EBITDA	-20.5	3.7	2.3
Forex and disc ops (6)	0.0	0.0	0.0	0.0	0.0	Year to 30 Jun	EV/EBIT	-20.5	3.7	2.3
Incr/(decr) cash (1+3+5+6)	4.4	56.7	-25.3	-25.5	-8.4		PE	-27.6	4.9	4.4
Equity FCF (1+2+4)	-9.2	-15.7	-25.3	-25.5	-8.4	Per share data				
Balance sheet						2007A	2008F	2009F	2010F	
Cash & deposits	20.2	76.9	51.6	26.1	17.7	No. shares	405.8	405.8	405.8	405.8
Trade debtors	0.0	0.1	0.0	3.2	3.2	EPS (cps)	-3.7	-8.2	-6.2	-0.4
Inventory	0.0	0.0	0.0	0.0	0.0	EPS (normalised) (c)	-3.7	-8.2	-6.2	-0.4
Investments	0.0	16.5	16.5	16.5	16.5	Dividend per share (c)	0.0	0.0	0.0	0.0
Goodwill	0.0	0.0	0.0	0.0	0.0	Dividend payout ratio (%)	0.0	0.0	0.0	0.0
Other intangible assets						Dividend yield (%)	0.0	0.0	0.0	0.0
Fixed assets	0.2	0.3	0.4	0.4	0.4	Growth ratios				
Other assets	0.1	0.1	0.1	0.1	0.1	2007A	2008F	2009F	2010F	
Total assets	20.6	94.0	68.6	46.3	37.8	Sales growth	1.0%	1.0%	9205.7%	0.0%
Short-term borrowings	0.0	0.0	0.0	0.0	0.0	Operating cost growth	34.7%	126.0%	26.7%	-51.3%
Trade payables	3.4	2.2	10.2	12.9	6.3	EBITDA growth	35.3%	127.6%	-25.9%	-88.2%
Long-term borrowings	0.0	0.0	0.0	0.0	0.0	EBITA growth	-8.8%	126.7%	-25.8%	-88.1%
Provisions	0.0	0.0	0.0	0.0	0.0	Operating performance				
Other liabilities	0.3	0.5	0.5	0.5	0.5	2007A	2008F	2009F	2010F	
Total liabilities	3.7	2.7	10.7	13.4	6.8	Asset turnover (%)	0.1	0.1	8.8	12.0
Preference shares						EBITDA margin (%)	-7752.2	-17468.2	-139.2	-16.5
Hybrid equity						EBIT margin (%)	-7789.0	-17485.9	-139.4	-16.7
Share capital	48.2	137.2	103.8	78.7	76.9	Net profit margin (%)	-7045.2	-15361.3	-124.0	-8.9
Other reserves	0.0	0.0	0.0	0.0	0.0	Return on net assets (%)	-18.4	-65.6	-85.8	-10.9
FCTR						Net debt (A\$m)	-76.9	-51.6	-26.1	-17.7
Unrealised gains/losses						Net debt/equity (%)	-84.2	-89.2	-79.5	-56.9
Retained earnings	-31.2	-45.9	-45.9	-45.9	-45.9	Net interest/EBIT cover (x)	10.5	8.2	9.1	2.2
Other equity	0.0	0.0	0.0	0.0	0.0	ROIC (%)	354.6	-184.5	-314.5	-35.0
Total equity	16.9	91.3	57.9	32.8	31.0	Internal liquidity				
Minority interest	0.0	0.0	0.0	0.0	0.0	2007A	2008F	2009F	2010F	
Total shareholders' equity	16.9	91.3	57.9	32.8	31.0	Current ratio (x)	28.7	4.8	2.2	3.1
Total liabilities & SE	20.6	94.0	68.6	46.3	37.8	Receivables turnover (x)	2.4	2.4	12.4	6.3
						Payables turnover (x)	6.1	6.1	4.2	2.4

Source: Company data, ABN AMRO Morgans forecasts

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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%.

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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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