

Avexa (AVX)

Current price presents opportunity

The current share price implies only a 20% probability of success that AVX will successfully deliver ATC to the market. Given the clinical data reported to date, a Phase 3 programme underway, and a partnership deal on the horizon, we reiterate our Buy call.

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)	-6.14	-7.32	-4.51	-4.46	-12.2
ROIC (%)	-238.9	354.6	-184.5	-314.5	-35.5

1. Pre non-recurring items and post preference dividends
Accounting Standard: IFRS
Source: Company data, ABN AMRO Morgans forecasts

year to Jun, fully diluted

Recruitment for Phase 3 clinical trial on track

Since starting in Dec-07, the first of two Phase 3 trials has progressed well. About 40 centres have been opened across North America, Israel, Europe and Australia. Given the increased rate of expenditure by the company (operating cash outflow of A\$9.3m vs A\$3.9m in the pc), we believe the rate of recruitment is strong, with AVX on track to finish recruitment by 3QCY08 and release the initial data 1QCY09.

Securing a partner before CY end a key catalyst to watch for

At March 2008, AVX had A\$53.4m in cash and it has confirmed its intention to look for a partner to supply additional capital and marketing expertise. 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 III 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, the company has confirmed its December year-end target.

Current share price wrongly attributes little chance of success

We have used a probability of success of 80%. But the current share price implies only a 20% probability that AVX will successfully deliver ATC to the market. Given that every HIV compound to enter Phase 3 clinical trials to date has been successfully commercialised, we consider the current share price an exciting entry point. Each 1% change in the probability of success alters our valuation by 2cps.

Investment view – maintaining Buy

With no changes to our forecasts, our valuation is unchanged at A\$1.32 (risk free rate of 6.25%, WACC of 15.7% and a terminal growth rate of 1.5%). Given the current volatility in the market, we have applied a 30% discount to our valuation and have set the price target at A\$0.92. The downside risk to our price target includes delays 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 30 May 2008.

ABN AMRO Morgans Limited (A.B.N. 49 010 669 726) AFSL235410 A Participant of ASX Group

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 ADVISOR TO DISCUSS THIS GENERAL RECOMMENDATION BEFORE ACTING ON IT.**

Mod-High Volatility

Absolute performance

n/a

Short term (0-60 days)

Pharmaceuticals & Biotechnology

Australia

Price

A\$0.28

Target price

A\$0.92

Market capitalisation

A\$113.63m (US\$108.61m)

Avg (12mth) daily turnover

A\$0.62m (US\$0.55m)

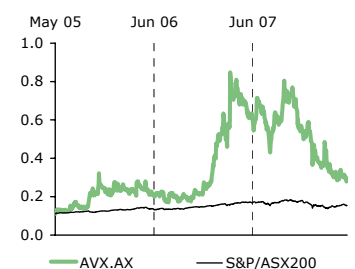
Reuters

AVX.AX

AVX80530

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

	1M	3M	12M
Price (A\$)	0.3	0.4	0.6
Absolute %	-3.4	-25.3	-55.2
Rel market %	-5.2	-27.1	-50.4
Rel sector %	-7.3	-25.6	-51.1



Stock borrowing: Easy onshore,

Impossible offshore

Volatility (30-day): 53.99%

Volatility (6-month trend): ↑

52-week range: 0.84-0.28

S&P/ASX200: 5709.40

BBG AP Pharm & Biotech: 151.59

Source: ABN AMRO, Bloomberg

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Phase III clinical trial design

AVX commenced the Phase 3 clinical trial programme for its lead HIV compound apricitabine (ATC) in December 2007. The Phase III programme will compare ATC to 3TC (lamivudine, first trial) and FTC (emtricitabine, second trial). The two clinical trials will involve 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 the 16-week data from the first trial is released.

The primary end point will be set at 24 weeks, and is the percentage of patients with less than 400 copies of the virus per millilitre 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 (which includes Australia), with about 40 sites already opened across these geographies.

Prospects for Phase III trial are strong

Our analysis shows that 34 HIV drugs have been approved for sale. We have noted in previous research that every HIV drug that commences a Phase III trial has ultimately been approved for sale. Given this success rate of previous HIV drugs and the strong clinical data released by AVX to date, we are increasingly confident that AVX is developing a marketable drug.

Appointment of new director

Since our last update, Dr Hugh Niall has resigned as Chairman of the Board citing health reasons. Existing Non-Executive Director Stephen Cooper has assumed this role.

In addition, Nathan Drona has been appointed as a new non-executive director. Drona was most recently a managing director for Challiss, an independent M&A advisory firm based in New York. Based in the US, he will bring a constant on-the-ground presence in this geography to the company.

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	Achieved
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

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 GSK, Merck, Pfizer, Boehringer Ingelheim or

Tibotec Pharma (a J&J company). We believe the potential to combine ATC (an NRTI) with the other HIV drugs on the market, as part of a combined treatment regime, is high.

Table 2 : Competitive landscape – approved medications to treat HIV

Class of drug	Brand Name	Manufacture Name	Approval Date/Time to Approval	Major 2005 Sales (US\$m)
(1) Nucleoside Reverse Transcriptase Inhibitors (NRTI) NRTIs are the backbone of HIV therapy. NRTs are faulty versions of building blocks that HIV needs to make more copies of itself. When HIV uses an NRTI instead of a normal building block, reproduction of the virus is stalled.	Combivir (zidovudine + lamivudine)	GlaxoSmithKline	27-Sep-97/3.9 months	1,061
	Emtriva (emtricitabine, FTC)	Gilead Sciences	02-Jul-03/10 months	47
	Epivir	GlaxoSmithKline	17-Nov-95/4.4 months	475
	Epzicom	GlaxoSmithKline	02-Aug-04/10 months	215
	Hivid	Hoffmann-La Roche	19-Jun-92/7.6 months	unknown
	Retrovir	GlaxoSmithKline	19-Mar-87/3.5 months	75
	Trizivir	GlaxoSmithKline	14-Nov-00/10.9 months	551
	Truvada	Gilead Sciences, Inc.	02-Aug-04/5 months	567
	Videx EC	Bristol Myers-Squibb	31-Oct-00/9 months	174 (together with Videx)
	Videx	Bristol Myers-Squibb	9-Oct-91/6 months	778
	Viread	Gilead	26-Oct-01/5.9 months	216
Zerit	Bristol Myers-Squibb	24-Jun-94/5.9 months	248	
Ziagen	GlaxoSmithKline	17-Dec-98/5.8 months		
(2) Nonnucleoside Reverse transcriptase Inhibitors (NNRTI) NNRTIs bind to and disable reverse transcriptase, a protein that HIV needs to make more copies of itself.	Rescriptor	Pfizer	4-Apr-97/8.7 months	20
	Sustiva	Bristol Myers-Squibb	17-Sep-98/3.2 months	680
	Viramune	Boehringer Ingelheim	21-Jun-96/3.9 month	370
(3) Protease Inhibitors (PI) PIs disable protease, a protein that HIV needs to make more copies of itself.	Agenerase	GlaxoSmithKline	15-Apr-99/6 months	204 (together with Lexiva)
	Lexiva	GlaxoSmithKline	20-Oct-03/10 months	unknown
	Aptivus	Boehringer Ingelheim	22-Jun-05/6 months	unknown
	Crixivan	Merck	13-Mar-96/1.4 months	unknown
	Fortovase	Hoffmann-La Roche	7-Nov-97/5.9 months	unknown
	Invirase	Hoffmann-La Roche	6-Dec-95/3.2 months	1005
	Kaletra	Abbott Laboratories	15-Sep-00/3.5 months	unknown
	Norvir	Abbott Laboratories	1-Mar-96/2.3 months	696
	Reyataz	Bristol-Myers Squibb	20-Jun-03/6 months	unknown
Viracept	Agouron Pharma	14-Mar-97/2.6 months	na	
Prezista	Tibotec Pharma	23-Jun-06/6 months		
(4) Fusion Inhibitors Fusion inhibitors work by blocking HIV entry into cells.	Enfuvirtide	Hoffmann-La Roche & Trimeris	13-Mar-03/6 months	88
(5) Multi-class Combination Products (Combination of Emtriva, Viread and Sustiva)	Atripla	Bristol-Myers Squibb and Gilead Sciences	12-Jul-06/2.5 months	na

Source: ABN AMRO Morgans, Company data, <http://www.fda.gov/oashi/aids/virals.html>

AVX - financial summary

Year to 30 Jun (A\$m)	AIFRS 2006A	AIFRS 2007A	AIFRS 2008F	AIFRS 2009F	AIFRS 2010F	Closing price (A\$)	0.280	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	Equity (E/EV)	100.0%	NPV cash flow (A\$m)	484.7				
EBIT	-18.4	-16.8	-38.0	-28.2	-3.4	Debt (D/EV)	0.0%	Minority interest (A\$m)	0.0				
EBIT(incl associate profit)	-18.4	-16.8	-38.0	-28.2	-3.4	Interest rate	8.25%	Net debt (A\$m)	-51.6				
Net interest expense	0.5	1.6	4.6	3.1	1.6	Tax rate (t)	30.0%	Investments (A\$m)	0.0				
Pre-tax profit	-17.8	-15.2	-33.4	-25.1	-1.9	Franking credit	0.0	Equity market value (A\$m)	536.3				
Income tax expense	0.0	0.0	0.0	0.0	0.0	WACC	15.7%	Diluted no. of shares (m)	405.8				
After-tax profit	-17.8	-15.2	-33.4	-25.1	-1.9	DCF valuation (A\$)							
Minority interests	0.0	0.0	0.0	0.0	0.0	1.32							
NPAT	-17.8	-15.2	-33.4	-25.1	-1.9	Multiples							
Significant items	0.0	0.0	0.0	0.0	0.0	Enterprise value (A\$m)	36.8	2007A	62.0	2008F	87.5	2009F	97.9
NPAT post abnormal	-17.8	-15.2	-33.4	-25.1	-1.9	EV/Sales (x)	170.9	285.3	4.3	4.8			
Cash flow statement						At target price							
EBITDA	-12.3	-16.7	-38.0	-28.1	-3.3	EV/EBITDA (x)	-2.2	-1.6	-3.1	-29.4			
Change in working capital	2.8	-0.4	8.1	-0.5	-7.6	EV/EBIT (x)	-2.2	-1.6	-3.1	-28.7			
Net interest (pd)/rec	0.5	1.6	4.6	3.1	1.6	PE (pre-goodwill) (x)	-7.5	-3.4	-4.5	-61.4			
Taxes paid	0.0	0.0	0.0	0.0	0.0	Comparable company data (x)							
Other oper cash items	0.0	0.0	0.0	0.0	0.0	Alchemia	EV/EBITDA	-4.2	-33.5	1.2			
Cash flow from ops (1)	-9.0	-15.5	-25.2	-25.5	-9.3	Year to 30 Jun	EV/EBIT	-3.6	-14.3	1.3			
Capex (2)	-0.1	-0.2	-0.1	0.0	-1.0		PE	-4.5	-20.5	1.2			
Disposals/(acquisitions)	0.0	-12.9	0.0	0.0	0.0	ChemGenex Pharmaceuticals	EV/EBITDA	-9.8	9.5	2.6			
Other investing cash flow	0.0	0.0	0.0	0.0	0.0	Year to 30 Jun	EV/EBIT	-9.7	9.5	2.6			
Cash flow from invest (3)	-0.1	-13.1	-0.1	0.0	-1.0		PE	-11.5	10.6	4.0			
Incr/(decr) in equity	14.4	85.3	0.0	0.0	0.0	Per share data							
Incr/(decr) in debt	0.0	0.0	0.0	0.0	0.0	No. shares	405.8	405.8	405.8	405.8			
Ordinary dividend paid	0.0	0.0	0.0	0.0	0.0	EPS (cps)	-3.7	-8.2	-6.2	-0.5			
Preferred dividends (4)	0.0	0.0	0.0	0.0	0.0	EPS (normalised) (c)	-3.7	-8.2	-6.2	-0.5			
Other financing cash flow	-0.8	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)	13.5	85.3	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)	4.4	56.7	-25.3	-25.5	-10.4	Growth ratios							
Equity FCF (1+2+4)	-9.2	-15.7	-25.3	-25.5	-10.4	2007A	2008F	2009F	2010F				
Balance sheet						Sales growth	1.0%	1.0%	9205.7%	0.0%			
Cash & deposits	20.2	76.9	51.6	26.1	15.7	Operating cost growth	34.7%	126.0%	26.7%	-51.3%			
Trade debtors	0.0	0.1	0.0	3.2	4.2	EBITDA growth	35.3%	127.6%	-25.9%	-88.2%			
Inventory	0.0	0.0	0.0	0.0	0.0	EBITA growth	-8.8%	126.7%	-25.8%	-87.9%			
Investments	0.0	16.5	16.5	16.5	16.5	Operating performance							
Goodwill	0.0	0.0	0.0	0.0	0.0	2007A	2008F	2009F	2010F				
Fixed assets	0.2	0.3	0.4	0.4	1.3	Asset turnover (%)	0.1	0.1	8.8	12.0			
Other assets	0.1	0.1	0.1	0.1	0.1	EBITDA margin (%)	-7752.2	-17468.2	-139.2	-16.5			
Total assets	20.6	94.0	68.6	46.3	37.8	EBIT margin (%)	-7789.0	-17485.9	-139.4	-16.9			
Short-term borrowings	0.0	0.0	0.0	0.0	0.0	Net profit margin (%)	-7045.2	-15361.3	-124.0	-9.2			
Trade payables	3.4	2.2	10.2	12.9	6.3	Return on net assets (%)	-18.4	-65.6	-85.8	-11.0			
Long-term borrowings	0.0	0.0	0.0	0.0	0.0	Net debt (A\$m)	-76.9	-51.6	-26.1	-15.7			
Provisions	0.0	0.0	0.0	0.0	0.0	Net debt/equity (%)	-84.2	-89.2	-79.5	-50.8			
Other liabilities	0.3	0.5	0.5	0.5	0.5	Net interest/EBIT cover (x)	10.5	8.2	9.1	2.2			
Total liabilities	3.7	2.7	10.7	13.4	6.8	ROIC (%)	354.6	-184.5	-314.5	-35.5			
Share capital	48.2	137.2	103.8	78.7	76.9	Internal liquidity							
Other reserves	0.0	0.0	0.0	0.0	0.0	2007A	2008F	2009F	2010F				
Retained earnings	-31.2	-45.9	-45.9	-45.9	-45.9	Current ratio (x)	28.7	4.8	2.2	2.9			
Other equity	0.0	0.0	0.0	0.0	0.0	Receivables turnover (x)	2.4	2.4	12.4	5.5			
Total equity	16.9	91.3	57.9	32.8	31.0	Payables turnover (x)	6.1	6.1	4.2	2.4			
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

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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

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

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