

Avexa (AVX)

The results are real

AVX announced outstanding 48-week Phase IIb data last week. The key finding was that more than 90% of patients treated had undetectable HIV levels in their blood. The focus is now to move the Phase III trial forward and lock in a marketing partner.

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)	-7.67	-9.15	-5.63	-5.57	-15.2
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 forecasts

year to Jun, fully diluted

Outstanding results

The key conclusions from the 48-week Phase IIb data were: 1) more than 90% of patients treated had HIV levels that were undetectable; 2) even patients who started with the standard treatment and changed to AVX's product (called ATC) at week 24 improved their response after the switch; 3) the CD4 cell count (immune response) of ATC continued to increase out to 48 weeks; 4) there was no resistance to ATC after 48 weeks of treatment (this demonstrates ATC's ability to withstand selection of HIV resistance even in patients who have already failed other drugs); and 5) the safety profile is excellent.

Phase III trial has started and technology to help patient selection

AVX has initiated the first of two Phase III trials. To assist with patient selection, AVX has signed an agreement with Monogram Biosciences to provide HIV resistance and testing technology.

Securing a partner a key catalyst to watch for

AVX has A\$66.6m in cash and has stated its intention to look for a marketing partner. 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 a marketing partner may speed the time to file a New Drug Application (NDA). We believe securing a partnership deal will be an important share price catalyst.

Investment view - Maintain Buy

We have made no changes to our forecasts, so our valuation remains unchanged at A\$1.32. To derive our DCF valuation the key assumptions are a risk-free rate of 6.25%, WACC of 15.7% and a terminal growth rate of 1.5%. We have used 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. Downside risk to our target price 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 17 March 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.**

Mod-High Volatility

Absolute performance

n/a

Short term (0-60 days)

Pharmaceuticals & Biotechnology

Australia

Price

A\$0.35

Target price

A\$0.92

Market capitalisation

A\$142.04m (US\$130.64m)

Avg (12mth) daily turnover

A\$0.92m (US\$0.79m)

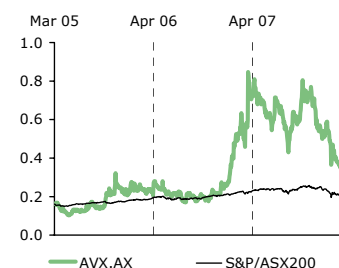
Reuters

AVX.AX

AVX80318

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

Price (A\$)	0.4	0.5	0.6
Absolute %	-6.7	-30.0	-41.2
Rel market %	2.9	-13.8	-32.5
Rel sector %	-0.2	-21.8	-30.8



Stock borrowing: Easy onshore, Impossible offshore

Volatility (30-day): 90.76%

Volatility (6-month trend): ↑

52-week range: 0.99-0.32

S&P/ASX200: 5087.00

BBG AP Pharm & Biotech: 139.81

Source: ABN AMRO, Bloomberg

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Phase III clinical trial design

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

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

- First trial – Two possible doses (800mg 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 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 IIb clinical trial. The trials will be conducted in North and South America, Europe, Africa and Asia (as well as Australia).

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 had commenced a Phase III trial has ultimately been approved for sale. Given the 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.

Near term catalysts to watch

Table 1 : Upcoming milestones to watch

Estimated date	Milestone	Impact
1QCY07	Release of the first results from Phase IIb clinical trial of apricitabine	Achieved
2QCY07	Publication of 21-day results at IAS conference (July)	Achieved
3QCY07	Release 24-week data Phase IIb	Achieved
4QCY07	Start first of two Phase III clinical trials for ATC	Achieved
1QCY08	Release of 48-week data of Phase IIb study	Achieved
1QCY09	Release of 16-week data from first Phase III ATC clinical trial	Positive
1HCY09	Commence second Phase III 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.

Therefore, 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 with the other HIV drugs on the market, as part of a combined treatment regime, is high.

AVX – financial Summaries

Year to 30 Jun (A\$m)	AIFRS 2006A	AIFRS 2007A	AIFRS 2008F	AIFRS 2009F	AIFRS 2010F	Closing price (A\$)	0.35	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\$)	\$ 1.33	
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)	487.4	
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)	539.1	
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				
Minority interests	0.0	0.0	0.0	0.0	0.0	WACC	15.7%	Diluted no. of shares (m)	405.8	
NPAT	-17.8	-15.2	-33.4	-25.1	-1.9	DCF valuation (A\$)				
Significant items	0.0	0.0	0.0	0.0	0.0	Multiples				
NPAT post abnormals	-17.8	-15.2	-33.4	-25.1	-1.9	2007A 2008F 2009F 2010F				
Cash flow statement						Enterprise value (A\$m)				
EBITDA	-12.3	-16.7	-38.0	-28.1	-3.3	Enterprise value (A\$m)	65.2	90.4	115.9	126.3
Change in working capital	2.8	-0.4	8.1	-0.5	-7.6	EV/Sales (x)	302.9	416.1	5.7	6.2
Net interest (pd)/rec	0.5	1.6	4.6	3.1	1.6	EV/EBITDA (x)	-3.9	-2.4	-4.1	-38.0
Taxes paid	0.0	0.0	0.0	0.0	0.0	EV/EBIT (x)	-3.9	-2.4	-4.1	-37.0
Other oper cash items	0.0	0.0	0.0	0.0	0.0	PE (pre-goodwill) (x)	-9.4	-4.3	-5.7	-76.7
Cash flow from ops (1)	-9.0	-15.5	-25.2	-25.5	-9.3	PEG (pre-goodwill) (x)				
Capex (2)	-0.1	-0.2	-0.1	0.0	-1.0	At target price				
Disposals/(acquisitions)	0.0	-12.9	0.0	0.0	0.0	EV/EBITDA (x)	-18.0	-8.6	-12.5	-108.7
Other investing cash flow	0.0	0.0	0.0	0.0	0.0	PE (pre-goodwill) (x)	-24.9	-11.3	-15.0	-203.8
Cash flow from invest (3)	-0.1	-13.1	-0.1	0.0	-1.0	Comparable company data (x)				
Incr/(decr) in equity	14.4	85.3	0.0	0.0	0.0	2008F 2009F 2010F				
Incr/(decr) in debt	0.0	0.0	0.0	0.0	0.0	Alchemia	EV/EBITDA	-3.5	-28.6	1.0
Ordinary dividend paid	0.0	0.0	0.0	0.0	0.0	Year to 30 Jun	EV/EBIT	-3.0	-12.2	1.1
Preferred dividends (4)	0.0	0.0	0.0	0.0	0.0		PE	-3.9	-17.8	1.1
Other financing cash flow	-0.8	0.0	0.0	0.0	0.0		PEG	-1.1	-5.1	0.3
Cash flow from fin (5)	13.5	85.3	0.0	0.0	0.0	Peplin	EV/EBITDA	-0.4	-1.2	9.7
Forex and disc ops (6)	0.0	0.0	0.0	0.0	0.0	Year to 30 Jun	EV/EBIT	-0.4	-1.2	10.7
Incr/(decr) cash (1+3+5+6)	4.4	56.7	-25.3	-25.5	-10.4		PE	-3.1	-2.7	17.4
Equity FCF (1+2+4)	-9.2	-15.7	-25.3	-25.5	-10.4		PEG			
Balance sheet						Per share data				
Cash & deposits	20.2	76.9	51.6	26.1	15.7	No. shares	405.8	405.8	405.8	405.8
Trade debtors	0.0	0.1	0.0	3.2	4.2	EPS (cps)	-3.7	-8.2	-6.2	-0.5
Inventory	0.0	0.0	0.0	0.0	0.0	EPS (normalised) (c)	-3.7	-8.2	-6.2	-0.5
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	1.3	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%	-87.9%
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	-16.9
Share capital	48.2	137.2	103.8	78.7	76.9	Net profit margin (%)	-7045.2	-15361.3	-124.0	-9.2
Other reserves	0.0	0.0	0.0	0.0	0.0	Return on net assets (%)	-18.4	-65.6	-85.8	-11.0
FCTR						Net debt (A\$m)	-76.9	-51.6	-26.1	-15.7
Unrealised gains/losses						Net debt/equity (%)	-84.2	-89.2	-79.5	-50.8
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	-35.5
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	2.9
Total liabilities & SE	20.6	94.0	68.6	46.3	37.8	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

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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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