Bell Potter
SECURITIES LIMITED

Research

Date of issue

27.11.07

CompanyUpdate

INVESTMENT DATA

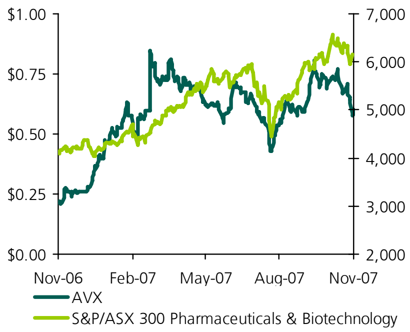
Share Price	$0.58
Issued Capital	
Ordinary Shares	406.0m
Options	14.6m
Fully Diluted	420.6m
Market Capitalisation	$241.9m
52 Week Low/High	$0.21 / $0.85
Valuation	$1.35

Top 20 shareholders as at 5 Sep 2007 held 36% of total shares on issue.

Year end Jun		07a	08f	09f	10f
Revenue	$m	0	0	0	0
EBITDA	$m	-16.7	-28.6	-28.7	-10.8
NPAT	$m	-15.2	-25.0	-26.4	-9.7
EPS (adj)	¢	-5.0	-4.2	-4.4	-1.6
EPS growth	%	n/a	n/a	n/a	n/a
PER	x	n/a	n/a	n/a	n/a

Data is normalised and fully diluted.

Share price chart: AVX



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Avexa (AVX) — Buy

Well-positioned to benefit from shifting HIV market

Late-stage development of ATC heading in the right direction

In light of Monday's 10.9% share price decline, we reiterate that AVX is on track to commence its Phase III program for commercialising its lead HIV drug, Apriticitabine (ATC).

We understand that the sell down was triggered by concerns regarding AVX's need to find a partner to commercialise ATC and news that the cost of clinical trials for ATC may increase.

For Phase III, we understand the FDA has requested that AVX include a higher dose of ATC (1,200mg) than what was previously used in Phase IIb trials. This may increase trial costs but we do not view the request as an indication of decreasing chances of trial success. Rather, the FDA is trying to gain assurance on the drug's safety and tolerability at higher dose levels. We remind investors that ATC had an excellent safety profile at the 600 mg and 800 mg dose levels.

HIV drug resistance a key issue with developers always seeking new HIV drugs

As a result of the extra dose, more patients are required for the trial. We do not expect this to have a major impact on cost given AVX has always planned to out-license or co-develop ATC with a larger pharmaceutical company with a strong presence in the HIV drug sector. Given the significance of the HIV market opportunity, we maintain our view that this will facilitate AVX's negotiations. Our analysis suggests that there are some significant changes ahead for the HIV market and ATC is well-positioned to benefit from these changes.

The number of HIV patients worldwide continues to grow and patients' resistance to current HIV therapies have fuelled the need for bespoke therapies and therefore, the need for newer drugs. In addition, the HIV market leader - GlaxoSmithKline (GSK) - is also experiencing la oss in sales due to patent expiries on its key drugs. We feel that the current market situation is ideal for an emerging HIV drug like ATC.

Earning estimates unchanged

AVX's development timelines for commercialising ATC appear to be on track and in line with our assumptions. We expect the Phase III trial to take 18 months to fully recruit patients implying availability of trial results during late 2009. ATC is currently under US FDA Fast Track designation so market approval during 2H10 is still likely.

Buy rating maintained, probability-weighted DCF $1.35 valuation

We remain confident in management's ability to deliver on its key milestones during 2008 and we reiterate our Buy recommendation based on a probability-weighted valuation of $1.35. In addition to the signing of a potential licensing deal, AVX expect to announce further Phase IIb results during March 2008. These results, which are based on patients treated with ATC for 48 weeks, will indicate further long-term safety and efficacy of the drug as well as provide a good proxy for the Phase III outcome.

Clarification of Phase III development

First patients to be treated in January 2008

AVX expect to start treating patients in its Phase III trial during January next year. AVX has already received approval from the US FDA and EU EMEA and is currently in the process of applying for hospital ethics approval. AVX has identified 165 sites worldwide to participate in the Phase III program comprising two trials with each trial involving approximately 900 patients. One of these trials will involve a higher dose (1,200mg) than what was previously used in the Phase IIb study. We do not view this as a risk as the FDA is trying to gain assurance on the drug's safety and tolerability at higher dose levels. We remind investors that ATC had an excellent safety profile at the 600 mg and 800 mg dose levels.

We do not expect patient recruitment to be an issue for the company given the abundance of HIV patients that have developed resistance to current therapies. We provide further analysis on this subset of the HIV market later in the report.

Approval timelines for 2H 2010 given US FDA Fast Track status

At the recent AGM, AVX advised shareholders that it expects to file for US FDA approval during 2H10. This is in line with our estimates given Apriticitabine (ATC) has been awarded Fast Track status and approval should, therefore, be granted within six months of filing.

Co-development deal to be signed in 2008

We have previously alluded to AVX signing a potential deal with a large pharmaceutical company active in the HIV drug sector. This assumption was based on positive Phase IIb trial data and the need for a high-profile partner in the competitive HIV drug space. We understand that AVX is in continued negotiations with a number of parties and the deal terms are likely to take on a "co-development" structure rather than a traditional licensing agreement. This implies AVX will part-fund the Phase III program and, consequently, will be able to maintain a substantial share in sales of the drug. Our valuation currently assumes AVX retains a royalty rate of 40%.

During our past conversations with management, AVX would not commit to timeframes. However, we maintain our view that a deal is likely to be signed in 2008. In addition to providing expertise in late-stage HIV drug development, the deal would also give AVX access to the additional capital in a non-dilutive manner.

ATC well-positioned to benefit from the shifting HIV market

The HIV market is currently undergoing some significant changes. The number of HIV patients worldwide continues to grow and patients' resistance to current HIV therapies have fuelled the need for bespoke therapies and therefore, the need for newer drugs. In addition, the HIV market leader - GlaxoSmithKline (GSK) - is also experiencing loss in sales due to patent expiries on its key drugs. We feel that the current market situation is ideal for an emerging HIV drug like ATC.

$US8 billion market expected to expand by nearly 50% through to 2016

Despite several developments in efforts to tackle the spread of HIV, the total number of people living with the disease has continued to increase. The outlook for patients, however, has considerably improved due to the significant advances in understanding, treating and managing HIV. In essence, HIV patients are living longer, they are able to manage their disease for life and hence, the market is growing. From a market perspective, this means that drug companies can sell their products to patients for many years. Also, long-term patients develop resistance treatment over time, so the demand for new drugs is particularly strong. Recent reports (Datamonitor) suggest the $US8b drug market for HIV will shift dramatically as it expands by nearly 50% through 2016. Growth is forecast to be driven by gains in the launch of new combination pills and new drugs.

ATC well-positioned to benefit from the shifting HIV market

In the US and EU, there are approximately 1.1m patients diagnosed with HIV and, according to a physician survey conducted by Datamonitor, 18% of patients are treatment-naïve and approximately 800,000 are currently receiving therapy. It is this latter market that ATC will initially target.

Personalised drug combinations

The complexity of HIV drug therapy increases as patients progress through the later stages of therapy, with regimens comprising up to six different drugs. As a result, treatments have also become much more individualised as changes to the regimen are required when patients become resistance to certain drugs. Research shows that the top five most popular drug combinations selected by physicians account for only 13% of patients in late-stage therapy. Consequently, physicians continue to be interested in new combinations and new approaches to HIV given the rapid mutation of the virus.

Lead HIV maker losing market share to emerging players

Recent reports (Datamonitor) also suggest that more than two-thirds of the current HIV drug patents will expire in the next decade. GSK is expected to be the worst affected given it has one of the largest aging portfolios of HIV drugs. GSK has a number of drugs that will gradually lose patent protection over the coming years. GSK's HIV drug sales totalled $US2.2b for the first nine months of 2007, down 1% from the pcp. This was largely due to sales of GSK's flagship HIV drug Combivir, which fell 10% to $US700m during the first nine months of 2007.

Gilead Sciences, whose drugs now account for more than 55% of HIV drug prescriptions, and Bristol-Myers Squibb have emerged as GSK's key challengers. Gilead sales grew by nearly half to $US2.3b for the first nine months of 2007.

The surge in Gilead's sales have largely been due to the introduction of Atripla - a combination pill comprising existing HIV drugs - Sustiva (Bristol-Myers Squibb), Emtriva (Gilead) and Viread (Gilead). Atripla sales reached nearly $US650 million in the first nine months of 2007, almost ten times its sales from the pcp. Patients are now able to take the combination pill once a day which represents a significant improvement for patient compliance rates. Another drug combo, Truvada (which comprises Emtriva and Viread), has also contributed to Gilead's success. Sales for the drug exceeded $US1.1b in the first nine months of 2007, up from $US850m during the same period last year.

Given the trend towards developing combination pills, we view this as an opportunity for AVX given companies, particularly GSK, would be looking for a new HIV combination pill. The last combination pill GSK launched was Kivexa/Epzicom in August 2004.

AIDS vaccine still a long way off; the more new therapies, the better

Merck, the most advanced researcher in search of an elusive AIDS vaccine, said in September 2007 that it was discontinuing its study because the vaccine failed to protect participants. The results showed that a greater number of HIV infections occurred in the vaccinated group than among the placebo patients. As a result, research in pursuit of the next AIDS vaccine has been placed on hold. There are two dozen groups around the world actively pursuing an AIDS vaccine but only two major clinical trials have taken place and neither has succeeded.

Consequently, there continues to be a need for new HIV drugs. Despite the abundance of availability of HIV drugs currently on the market, pharmaceutical companies continue to develop new ways to treat the disease. Isentress (Merck and Co) and Prezista (Johnson and Johnson's Tibotec) are two new drugs recently approved only for patients who have tried other types of treatment first. Given this scenario, we believe there continues to be a significant opportunity for ATC.

Valuation

Buy rating maintained - probability-weighted DCF $1.35 valuation

We remain confident in management's ability to deliver on its key milestones during 2008 and we reiterate our Buy recommendation based on a probability-weighted valuation of $1.35. In addition to the signing of a potential licensing deal, AVX expect to announce further Phase IIb results during March 2008. These results, which are based on patients treated with ATC for 48 weeks, will indicate further long-term safety and efficacy of the drug as well as provide a good proxy for the Phase III outcome.

Key drivers

Event	Impact on valuation	Expected due date
Hospital ethics approval to commence Phase III trial	Low - Med	Before year-end
First patients treated in Phase III trial	Med	Early 2008
Phase IIb (48-week data) results	Med - High	1Q 2008
Update on patient recruitment for Phase III trial	Med - High	1H 2008
Co-development deal	High	2008

Avexa (AVX)		Share price:	$0.575
As at: 26/11/2007	**Recommendation: Buy**	Market cap:	$241.9m

Income Statement					
Year end June 30	2006A	2007A	2008F	2009F	2010F
Reported revenue	$0m	$0m	$0m	$0m	$0m
EBITDA	-12.52	-16.73	-28.57	-28.68	-10.80
EBITA	-18.57	-16.81	-28.68	-28.82	-10.96
Amortisation		0.00	0.00	0.00	0.00
EBIT	-18.57	-16.81	-28.68	-28.82	-10.96
Net interest	0.74	1.59	3.69	2.43	1.27
Abnormals	0.00	0.00	0.00	0.00	0.00
Pre-tax profit	-17.83	-15.22	-24.99	-26.38	-9.69
Tax	0.00	0.00	0.00	0.00	0.00
Equity-accounted profits	0.00	0.00	0.00	0.00	0.00
Reported net profit	-17.83	-15.22	-24.99	-26.38	-9.69
Adjusted net profit	**-12.48**	**-10.65**	**-17.49**	**-18.47**	**-6.78**

(adjusted net profit = pre-tax profit before abnormals and goodwill minus tax at marginal rate)

Cashflow					
Year end June 30	2006A	2007A	2008F	2009F	2010F
Reconciliation					
Net profit	-$17.83m	-$15.22m	-$24.99m	-$26.38m	-$9.69m
Amortisation	0.00	0.00	0.00	0.00	0.00
Depreciation	6.05	0.08	0.11	0.13	0.16
Change in working capital	2.77	-1.04	5.52	0.00	-6.21
Other	0.12	0.56	0.00	0.00	0.00
Net operating cashflow	-8.89	-15.62	-19.36	-26.25	-15.74
Investing cashflow					
Sale/purchase of PPE	-0.14	-0.21	-0.11	-0.13	-0.16
Payment for intangibles	0.00	-12.90	0.00	0.00	0.00
Investments & acquisitions	0.00	0.00	0.00	0.00	0.00
Net investing cash flow	-0.14	-13.10	-0.11	-0.13	-0.16
Financing activities					
Issue of shares	14.39	89.20	0.00	0.00	0.00
Buy backs	0.00	0.00	0.00	0.00	0.00
Dividends paid	0.00	0.00	0.00	0.00	0.00
Debt	0.00	0.00	0.00	0.00	0.00
Others	-0.85	-3.83	0.00	0.00	0.00
Net financing cash flow	13.54	85.37	0.00	0.00	0.00
Net change in cash held	**4.50**	**56.65**	**-19.46**	**-26.38**	**-15.90**

Balance Sheet					
Year end June 30	2006A	2007A	2008F	2009F	2010F
Assets					
Cash assets	$20.23m	$76.87m	$57.41m	$31.03m	$15.13m
Receivables	0.03	0.15	0.00	0.00	0.00
Other	0.11	0.08	0.08	0.08	0.08
Total current assets	20.37	77.10	57.49	31.11	15.21
Property, plant & equipment	0.22	0.35	0.35	0.35	0.35
Deferred tax assets	0.00	0.00	0.00	0.00	0.00
Financial assets	0.00	0.00	0.00	0.00	0.00
Intangible assets and goodwill	0.00	16.54	16.54	16.54	16.54
Other	0.00	0.00	0.00	0.00	0.00
Total non-current assets	0.22	16.88	16.88	16.88	16.88
Total assets	**20.59**	**93.98**	**74.37**	**47.99**	**32.09**
Liabilities					
Payables	3.36	2.21	6.90	6.90	1.50
Short-term debt	0.00	0.00	0.00	0.00	0.00
Income tax payable	0.00	0.00	0.00	0.00	0.00
Employee benefits	0.28	0.35	1.04	1.04	0.23
Other	0.00	0.09	0.09	0.09	0.09
Total current liabilities	3.64	2.65	8.03	8.03	1.82
Bank debt	0.00	0.00	0.00	0.00	0.00
Deferred tax liabilities	0.00	0.00	0.00	0.00	0.00
Provisions	0.03	0.04	0.04	0.04	0.04
Total non-current liabilities	0.03	0.04	0.04	0.04	0.04
Total liabilities	**3.67**	**2.69**	**8.06**	**8.06**	**1.85**
Net assets	**16.92**	**91.29**	**66.30**	**39.92**	**30.23**
Equity					
Contributed equity	48.16	137.19	137.19	137.19	137.19
Reserves & outside equity	0.00	0.00	0.00	0.00	0.00
Retained earnings	-31.24	-45.90	-70.89	-97.27	-106.96
Total equity	**16.92**	**91.29**	**66.30**	**39.92**	**30.23**
Diluted shares on issue	197.85	420.96	420.96	420.96	420.96
Weighted ave diluted shares	150.40	212.95	420.81	420.96	420.96

Valuation Data					
Year end June 30	2006A	2007A	2008F	2009F	2010F
Adjusted net profit	-12.48	-10.65	-17.49	-18.47	-6.78
Adjusted EPS	-8.3c	-5.0c	-4.2c	-4.4c	-1.6c
EPS growth	N/A	N/A	N/A	N/A	N/A
P/E ratio	N/A	N/A	N/A	N/A	N/A
OpCFPS (exl. abnormals)	-5.9c	-7.3c	-4.6c	-6.2c	-3.7c
Price/OpCFPS	N/A	N/A	N/A	N/A	N/A
DPS	0.0c	0.0c	0.0c	0.0c	0.0c
Yield	0.00%	0.00%	0.00%	0.00%	0.00%
EV/EBITDA	N/A	N/A	N/A	N/A	N/A

Profitability Ratios					
Year end June 30	2006A	2007A	2008F	2009F	2010F
EBITDA/sales	N/A	N/A	N/A	N/A	N/A
EBITA/sales	N/A	N/A	N/A	N/A	N/A
Return on assets (avg.)	-90.20%	-29.34%	-34.07%	-47.10%	-27.37%
Return on equity (avg.)	-73.8%	-19.7%	-22.2%	-34.8%	-19.3%
Dividend cover	N/A	N/A	N/A	N/A	N/A
Effective tax rate	0.0%	0.0%	0.0%	0.0%	0.0%

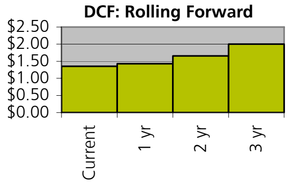
Liquidity & Leverage					
Year end June 30	2006A	2007A	2008F	2009F	2010F
Net debt	-$20.2m	-$76.9m	-$57.4m	-$31.0m	-$15.1m
Net debt/equity	-119.6%	-84.2%	-86.6%	-78%	-50%
Interest cover (EBITDA / interest)	17.0x	10.5x	7.7x	11.8x	8.5x

DCF Valuation

WACC = 15.9%
Terminal growth rate = 1.5%
Target debt ratio = 5.2%
Portion franking PV = 0.0%

	$m	$/share
Operations	491.2	1.17
- net debt	76.9	0.18
+ PV franking	0.0	0.00
Total	**568.1**	**1.35**

DCF: Rolling Forward



Valuation sensitivity			
Terminal growth	**WACC** 13.9%	15.9%	17.9%
-0.5%	$1.51	$1.26	$1.07
0.5%	$1.57	$1.30	$1.10
1.5%	$1.65	**$1.35**	$1.13
2.5%	$1.73	$1.40	$1.17
3.5%	$1.83	$1.47	$1.21

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