

PharmAust (PAA \$0.26) Buy

- ▶ **Valuation:** A\$0.35
- ▶ **12m Price Target:** A\$0.48

Generic Drugs, Outsourced Medicinal Chemistry, Pharmaceutical Manufacturing.

PharmAust relists on the 1st December 2004 as Genepharma experiences an excellent share price movement over the past 3 months.

- ▶ Pharmaust recently completed a restructuring of capital (1 new share for 5 echo shares) and successfully raised \$5.5million.
- ▶ After a 2 week trading halt Pharmaust closed the day at 30.5cents, representing a 36% premium to the closing price on Nov 13 and a 50% to the new issue price of 20cents. 25% of the company was turned over.
- ▶ PharmAust is focused on the importation of Generic medications from their 3 year exclusive agreement with Xepa Soul Pattison (parent company is Apex Health care) in Malaysia.
- ▶ They also have purchased, with the funds raised, the Ramprie Pharmaceutical manufacturing facility in Welshpool (3.1m of the funds raised). The rationale for this is explained below.
- ▶ To complete the Vertical integration they now have 100% ownership of Epichem which essentially is a contract medicinal Chemistry business.
- ▶ Epichem is based at Murdoch university and through the use of grants and partnerships - currently with GSK, researches drug discovery, currently targeting parasitic diseases.
- ▶ Any significant breakthrough, Epichem retains an interest going forward.

Generic Medications

- ▶ Generic Medications are those medications which anyone can manufacture or import, subject to TGA approval, once the brand drug has come off patent.
- ▶ Biavailability (absorption and metabolism) studies need to demonstrate to the Pharmaceutical Benefits Advisory Committee (PBAC) that the generic behaves in the same manner. The PBAC also have the final word on price.
- ▶ Generic drugs are therefore as safe as the brand-name, have identical side effect profiles, work just as well and are manufactured in world class and approved facilities.
- ▶ The country of origin has to be approved by Australian Authorities. Malaysia is approved. Significantly China and India are not at this stage.
- ▶ Generic drugs rapidly take away market share (Eli Lilly lost 80% market share of its depression drug - Prozac when it came off patent in 2001).
- ▶ Average generics capture 70% of the market, usually in the first year.
- ▶ Prices inevitably fall. Can assume 50%.
- ▶ Golden age of generic drugs. Expected to grow to 2 Bil in 3 years in Aust alone.
- ▶ 30 - 70 medications coming off patent - including 'blockbuster' zocor (simvastatin - a cholesterol lower medication currently worth currently -A\$360m pa) & zoloft (AntiDepressent) 100m

- ▶ In 2001 in Australia Generics captured 19% of the market as compared with the UK at 47% and the US at 45%. It is inevitable to increase in Australia
- ▶ Subsidised medication ensures an excellent sustainable large market.
- ▶ Pharmacists tend to review their supplier's often.
- ▶ Pharmacists prefer to purchase a range of products to simplify ordering and inventory control.
- ▶ Price the pharmacist pays for their generic is the key consideration for PBS drugs (i.e subsidised). There is a set fee from the government. The margin is therefore determined by how cheaply they can purchase the generic medication. Currently the patient pays A\$28.60 per script for the medication (real cost for example of Lipitor-cholesterol is A\$83.40. The chemist about \$6.00.
- ▶ Over the counter products have a higher margin and hence the benefit of the Ramprie Manufacturing plant enabling a range of products it can offer to Pharmacists who will not buy single items.
- ▶ Some major Distributors support pharmacists with share schemes such as Arrow.
- ▶ Cost is the key determinant of Pharmacists PBS drugs as margins lower than OTC Products.
- ▶ Doctors tend to prescribe the generic as they are also concerned about cost and encouraged to do so.
- ▶ If the prescription has not got the box "no substitution" ticked, the pharmacist can recommend a generic product.
- ▶ There is increasing pressure by the HIC and PBS to contain costs.
- ▶ Pharmacists prefer to order a range of products from one supplier and not just a single generic drug (pharmausts adv). Hence the benefit of the Ramprie production in welspool-will act as storage shed for imported generics from Malaysia. It may well end up just be a shed if production and capital employed is competing for healthier margins from their imported range.
- ▶ Malaysia patent laws are effectively 1 year ahead of Aust (i.e blockbuster drug Zocor already distributed in Malaysia). Simply ship it in, when approval granted. All the benefits of Malaysian manufacturing-cost.
- ▶ Appointment of Mr. Kee Kirk Chin (son of Apex health care in Malaysia) will join the board. Kirk is a medical Doctor by training with an MBA from the University of Hull in the UK. He is currently the Managing director of Apex Healthcare.
- ▶ Representation from ApexHealth care will give legitimacy to the commercial arrangement with Xepa Malaysia (Parent company is Apex health care).
- ▶ Reception to Pharmaust by existing pharmaceutical distributors in the industry is very positive
- ▶ Natural benefits of Apex health care (exc agreement with Pharm aust) / Soul Pats / API (Australian Pharmaceutical Industries 25% aust) / price line (retail pharm).

Quick Comparison with Genepharm**Genepharm A\$1.18**

Market cap	31m
Shares on issue	25m
Escrow shares	50million (06/06)
Trading premium	(ipo 50c Oct 04): 100%
Business essence	Generic distribution from parent company in Greece through seeking TGA approval (cost ~200K per generic drug - as bioavailability studies may cost 100K process takes 7-8 months).
Revenues	Nil expected July 2005
Management	known and 'respected'

Pharmaust A\$0.255 Raised 5.5 m, 3* oversubscribed?

Market cap	20m
Shares on issue	67m
Escrow/options	Nil sig
Trading premium on open	36%
Business essence	Generic distribution targeting retail and hospital markets in Australia. Exclusive agreement with Apex health care in Malaysia (part owned by soul pats) manufacturer of high quality medications. TGA approval costs (est cost 100Kper generic drug.
Revenues	Epichem contracted chemistry (A\$ 900,000 predicted revenue for the year 05) and Ramprie production (March05) facility of OTC drugs / creams. Nano Zinc Oxide sunscreens.

Nanopartical Zinc Oxide sunscreens will eventually become they standard as they block out both uv A and uv B light. Current sunscreens only block out uvB. Eventually the market will realise the implications.

Pharmaust's strategy is similar to Genepharm, but with the additional assets of Epichem and the Ramprie Manufacturing capabilities.

- ▶ Management appear competent. They do lack industry experience at this stage.
- ▶ Paul D'Sylva is Chairman and head of research at Murdoch university.
- ▶ Paul was instrumental in the 3 year exclusive agreement with Apex health care.
- ▶ Robert Coltrona, a Clinical Phamacist, will manage the FDA approval process, importation and Ramprie Manufacturing facility in Welshpool.
- ▶ Stewart Gunzburg will manage Epichem along with respected reasearch scientist Wayne Best who was recently appointed to the board.
- ▶ Pharmaceutical Industry experience at a senior level in the company is required. At the appropriate timing Marketing and distribution skills will be required.

Pharmaust- PAA

Share Price	\$0.27
Issued Capital (m)	67
Market Capitalisation (\$m)	19m
Debt (\$m)	0.02m
Cash (\$m)	2.3m
NPV Valuation (A\$/sh)	0.41

Year (Yr End 30 Jun)	2005f	2006f	2007f	2008f
Earnings (A\$m)	0.1	1.5	2.5	3.7
EPS (Ac/sh)	0	0.022	0.037	0.544
PER-post tax (x)	180	13	9	7
CF/Sh (Ac/sh)	NA			
CF Ratio	NA			
EV:EBITDA (x)	57	10	6.5	4.5
EV:EBIT (x)	190	13	8	5.4
Div. (Ac/sh)	0.0	0.0	0.0	0.0
Div. Yield	0.0	0.0%	0.0%	0.0%
Net Debt:Net Debt+Equity				
Interest Cover	Na	na	Na	Na

The valuation is based on capturing 5% of the Zocor (simvastatin) market in its current form. I have assume this will effectively halve in value to ~ 200m due to competition. I have assumed it will acheive this in 3 years and sustain this for af further 7. The model uses a risk adjust NPV. I have not factored in any other PBS drug. I have attributed no value to the manufacturing or epichem buiness. This is illustrates the potential upside of a profitable manufacturing business, reasearch success and further PBS drugs approved. If the companies business plan is executed EBIT of 1.5m F2006 is achievable.