

Strachan

Corporate

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Key Investment Drivers

1 PharmAust has established a unique and relatively low risk, vertically integrated pharmaceutical business, extending from contract drug discovery and development to product manufacturing as well as sales and marketing of healthcare and pharmaceutical products.

2 PharmAust's senior management has substantial technical and commercial skills to drive sales growth and value adding for shareholders.

3 PharmAust provides a relatively low cost entrance into a rapidly growing market segment for healthcare and generic pharmaceutical products while providing low risk, fully funded exposure to longer term benefits from the development of its own intellectual property.

4 PharmAust holds appeal for its leverage since it:

- Has a capitalisation of around \$14 million
- Is backed by \$2m in cash
- Has solid foundations as a service provider and direct participant in the global drug discovery business
- Has a pharmaceutical manufacturing and a sales and marketing agreement with a major TGA approved Asian generic drug and pharmaceuticals manufacturer.

Commissioned*

PharmAust is a new face in Australia's rapidly growing pharmaceutical industry. The company benefits from a level of synergy between its activities, which range from drug discovery and contract synthesis, to the manufacture of healthcare and over the counter products, as well as marketing and distribution of these products and other, low cost generic drugs available on the PBS. PharmAust imports via an exclusive marketing and distribution agreement with its Malaysian pharma partner.

The competency of its senior management team is vital to PharmAust's growth and success. Winning market support will depend on its ability to demonstrate market penetration for its products. Meeting its modest target of 4% of the Australian market for drugs and products it sells seems an achievable goal.

Peter Strachan

** No recommendation is offered for commissioned research.*

PharmAust Limited (Code: PAA)

Shares	m.	68.2
Options	m.	1.84
Price	\$	0.23
Market Cap	\$m.	15.7

Calculated at time of Share Consolidation.

Company Background

Building Blocks Assembled During 2004 for New Pharmaceutical Company

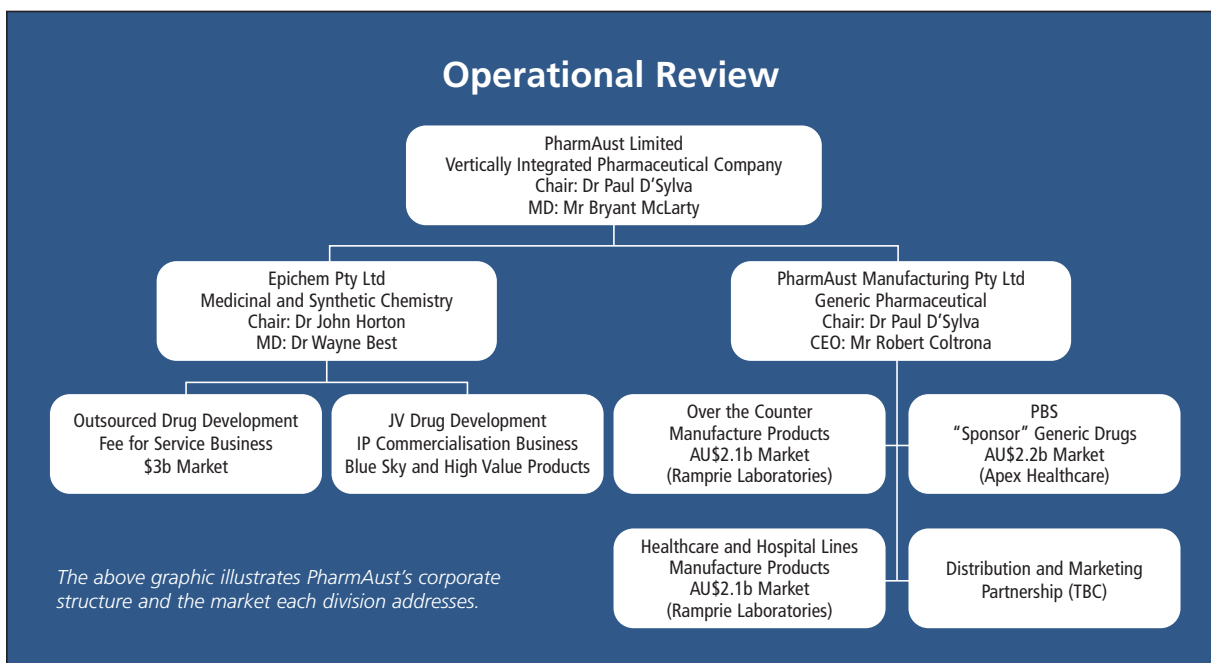
PharmAust began life as a travel software company, Echo Technologies. New management and enthusiasm arrived in mid 2003, redirecting the company towards pharmaceuticals.

PharmAust's contacts with Murdoch University's Division of Research and Development led it to fund the establishment of Epichem laboratories, staffed by former employees of the State Government's Chemistry Centre, who have established strong contacts within the global pharmaceutical industry and saw a way to build their

business as a private company with 'best of breed' equipment.

PharmAust then expanded its activities downstream, buying an established manufacturing base so as to leverage off any formulation opportunities which might arise from the Epichem work.

Finally, PharmAust made contact with Malaysian pharmaceutical manufacturer, Xepa-Soul Pattinson, which was seeking to expand into the much larger Australian market for generic drugs. PharmAust has negotiated an agreement to market and distribute generic drugs into Australia's \$6 billion pa PBS system.



PharmAust Manufacturing Pty Ltd

Marketing and Distribution

Strong Relationship with Malaysia's Largest Healthcare Company

PharmAust has entered into an exclusive marketing and distribution agreement with Malacca based

pharmaceuticals manufacturer, Xepa-Soul Pattinson (XSP), part of Malaysia's largest healthcare company Apex Healthcare. Under this arrangement, PharmAust has been set sales targets for an initial two drugs, one of which's patent protection has expired and another which is due to expire in 2005.

Under Malaysian law, patents expire a year earlier than in Australia, giving XSP a head start with developing generic forms of patent protected products. XSP is keen to gain access to the Australian market, which is five times the size of the Malaysian market in this area and it has chosen PharmAust as its Australian partner.

Low Cost OTC and Generic Drugs for the Australian Market

The first two XSP products are Melicron Gliclazade tables and a range of Covastin Simvastatin tablets. Melicron, which is presently free of Australian patent protection, is used to treat non-insulin dependent diabetes and has a current market of about \$22m pa. It stimulates insulin secretion and improves the metabolic utilisation of glucose. Covastin, whose patent protection in Australia is due to expire in June 2005, is a common drug used for the treatment of coronary heart disease, hypercholesterolemia and diabetes. Its local sales presently run at about \$350m pa.

Register H1 2005

XSP is an ARTG compliant manufacturer, so registration of its generic drugs and OTC products should be relatively straightforward. XSP will meet all costs associated with bio-equivalence testing and the like so that it should cost PharmAust no more than \$100,000 to register each generic PBS drug. Registering OTC products should cost PharmAust about \$5-8,000 per product.

Sales H2 2005

PharmAust's agreement with XSP provides an opportunity to compete vigorously in the Australian market with low cost OTC and generic drugs, in a market which is very price sensitive.

Low Cost Entry into Local Healthcare and Pharmaceutical Manufacturing Market

PharmAust Manufacturing has grown out of the ashes of TGA licensed manufacturer, Ramprie Industries. Ramprie was established in 1974 by two former Fauldings employees, who built a business with revenue of \$3.5m pa, supplying healthcare products such as sunscreens, lip balm and vapour rubs along with over the counter (OTC) medicines such as cough syrups as well as hospital products, including saline solutions, disinfectants and hand wash. The factory experienced an accidental fire in September 2003, which destroyed much of its manufacturing facility. PharmAust was thus able to purchase Ramprie's land, buildings and stock at cost with an agreement that all costs associated with reestablishing and re-licensing the facility for best operating practice, would be met by the insurance settlement and made good by the vendor.

Established Products and Market Network

This division of PharmAust is a developer and manufacturer of generic pharmaceutical products and a distributor of pharmaceuticals for Australian and international suppliers into the Australian market. The company owns a portfolio of 95 products licensed with the Australian Register of Therapeutic Goods (ARTG) and has entered into an exclusive distribution agreement with Xepa-Soul Pattinson (XSP) for a portfolio of generic PBS drugs and its ethical pharmaceutical products.

The division will focus on manufacture and sale of high value products such as OTC generic products and specialised hospital lines, where margins are expected to be most favourable. The initial focus will be on a range of sunscreens including those formulations based on a broad spectrum UV blocking zinc oxide nano-technology. The relationship with XSP will enable PharmAust to import other pharmaceutical lines at a lower cost than they can be manufactured locally.

New Manufacturing Facility Set to Commission in March 2005

Presently the manufacturing facility at Welshpool in Perth is being re-established with a modern, pressurised clean room, which is expected to be ready for production in March 2005. In addition, the company is constructing a large warehouse on the site to store goods, including imported and third party products. Prior to July 2005, the company will establish and document operating systems, quality control and prepare batches of product for inspection to enable registration of the facility and validation of each of the products it chooses to manufacture. This process is expected to take six months from the time the facility is physically ready for production in March 2005.

Over the past year, this business has maintained a large part of its network by selling goods manufactured by third parties. During FY 2006, PharmAust will build its own manufacturing output and work to license and market several OTC products from XSP.



Epichem Pty Ltd

Contract Research and Drug Discovery

The division was founded with financial assistance from PharmAust to focus on the lucrative drug discovery and pharmaceutical industries. Since its founding in October 2003, Epichem has grown rapidly and presently turns over about \$80,000 per month. The five founding staff members have been joined by an additional six professional staff and revenue is growing by the month.

The company provides fee for service, contract chemistry alongside its own research activities, generating intellectual property (IP), usually funded by research grants. In the longer term, this growing store of IP holds potential for significant wealth creation. Drug discovery research is usually undertaken in collaboration or in joint venture with others who bring skills outside of Epichem's chemistry focus.

Develops and Owns IP

In this way, Epichem can develop IP more rapidly without a negative impact on its profitability. To this end, Epichem is presently working on new drugs for a number of parasitic diseases in collaboration with Murdoch University's Centre for Biomolecular Control of Disease. A number of highly potent compounds, effective against the diseases have been identified and are undergoing toxicity tests.

Major Pharmas Outsourcing More Work

There is a growing trend within the pharmaceutical industry for large companies to outsource significant amounts of their drug discovery research. Large companies are now using outsourcing to secure access to scarce, synthetic chemistry skills.

Epichem has one of the best equipped medicinal chemistry laboratories in the southern hemisphere. It has no competitors in WA and there are only a couple of similar labs in Oceania. Epichem's highly skilled staff are well regarded and well established within the industry, so that business has flowed towards the

company by word of mouth. The company relies on the experience, expertise, innovation and dedication of its personnel, coupled with the quality of its facilities to attract project work.

Skills Shortage Favours Epichem

Major competitors are located in North America and Europe, where skills are just as short and wages are much higher. Some laboratories have emerged in China and India, offering low cost basic testing and drug identification, however clients remain concerned about the quality of that work and most importantly, the security of intellectual property dealt with in that social and legal environment.

Market Overview

Large Diverse Market

Although the dollar value of the market is large, there are a relatively small number of clients, based largely in North America, Japan and Northern Europe. This activity has been estimated to be worth US\$3.6 billion globally in 2004 and is expected to grow at 16% pa to US\$6 billion by 2007. Australia accounts for about 1% or about \$30m of this activity, representing a substantial target market for Epichem. Australian activity is predominated by drug discovery companies such as those listed on the ASX, rather than large pharma research. Chemistry has become a major bottleneck for the drug discovery process with a growing shortage of skills seen in this area.

Drug discovery companies are usually small, venture capital or listed organisations. This market is fragmented and difficult to identify, however it makes up the majority of Epichem's clients. Epichem presently carries out work for several clients with the bulk located in Victoria and the ACT.

Well Positioned and Cash Flow Positive

Pharmaceutical companies carry out most of their drug discovery activities overseas. Epichem has obtained a number of small contracts to prepare analytical standards of drug impurities and degradation products and also consults to assist in improving or trouble shooting their processes.

Universities provide a rich source of collaborative IP generating projects, often supported by government funded grants.

Competitors

Universities are active in the area as a means to fund their research activities. Contracts are usually small and opportunistic for these poorly equipped and structured institutions however, they compete with lower prices.

The **CSIRO** has excellent resources for synthetic chemistry on milligram to commercial scale production. However, the CSIRO is a large and bureaucratic organisation which lacks the flexibility to work with smaller clients.

Institute of Drug Technology Ltd (IDT) is Australia's leading developer and manufacturer of pharmaceutical active ingredients. IDT has a staff of 150 and an approved manufacturing site for large scale production. IDT does not appear to be active in preclinical drug discovery but could compete with Epichem if it chose to.

Industrial Research Ltd (IRL) is a New Zealand Government owned R&D facility which undertakes similar work to Epichem. While IRL is a potential competitor to Epichem, it is likely that its focus on carbohydrate chemistry may complement the work of Epichem, opening up opportunities for collaboration.

B Dent Global is a small New Zealand based synthesis lab spun off from IRL. The operation is small and competes in a non-core area of Epichem's activities.

Overseas Competitors are numerous and generally quite small with the largest supplier holding about 6% of the market. Competition from operators in China and India is seen as increasing rapidly. In response, Epichem is seeking to automate its activities where possible to hold costs down.

Growth Strategy

Epichem's management is constantly examining and maintaining a database of clients and potential clients and keeps its name out in the market place by attending trade shows and conferences. The company arranges to meet with scientists and management of target clients to understand their requirements so as to design packages to suit their needs.

Steady Revenue Growth

Global pharmas are very experienced in outsourcing their chemistry needs and are capable of evaluating Epichem's facilities and technical expertise to meet their requirements. Epichem aims to present itself as a reliable, high quality alternative supplier to overseas

competitors where client's IP will be secure and will focus on its capabilities for parallel synthesis and heterocyclic chemistry, especially the diazines. The company will continue to develop and promote a catalogue of specialty research chemicals which should generate new clients and projects for contract synthesis.

After just nine months of operation, Epichem's facilities are presently running at close to capacity. The company will examine duplicating its facilities or expanding into alliances where appropriate.

Management

Sound Technical and Financial Control

This is a critical area for such a company, whose business is based on the skill and integrity of its management. Epichem has instituted management and accounting systems which enable close monitoring of its projects, customers and suppliers. The company maintains an extensive industry database for marketing purposes and has systems for close control of laboratory proceedings along with quality control and accreditation.

Financial Projections

Financial year 2005 will be a period of business establishment and consolidation for PharmAust. Epichem is building and consolidating, the manufacturing operation will commission and re-license its premises, while registration of the XSP products will be undertaken, with some OTC and hospital products expected to be available for local sale during H2, FY 2005.

PharmAust will record a loss during FY 2005 despite encouraging cash flow performances from Epichem and some maintenance and start-up revenue from manufacturing during Q4. The market will have to wait until FY 2006 to measure the results of PharmAust's current strategy.

Market Cash Flow in FY 2006

After just nine months of operation, Epichem is growing steadily and now operates with a cash flow surplus. Strachan Corporate estimates sales this FY should approach \$960,000 generating a modest EBITDA surplus. The business commenced with an initial 4 chemists and has recently added its eighth chemist, so revenue is building as new contracts are won and new staff becomes fully occupied. Epichem's sales growth in FY 2006 towards \$1.5m should generate an EBITDA of close to \$0.25m with strong growth targeted thereafter.

Cash may be required during 2006 to expand Epichem's physical facilities; however the company will work towards alliances and collaborations which would ameliorate the need for additional capital.

PharmAust Manufacturing has maintained its marketing network and continues to sell small lines of contract manufactured product, despite a hiatus in manufacturing while a new clean room facility is constructed and commissioned. Sales at a rate of \$3.5m pa should be rapidly restored during FY 2006, following recommencement of production at the refurbished Welshpool site. A renewed and more rigorous marketing focus, introduction of new and repackaged products along with expansion of sales effort for OTC and licensed PBS products is set to boost total product sales towards \$6.5 m during FY2006, which should generate an EBITDA of over \$1m, assuming a net operating margin of around 16%. Sales growth of 30% pa is targeted and seems achievable given PharmAust's access to price competitive OTC and PBS products.

Generics: Strong Growth into FY 2007 and Beyond

PharmAust's distribution and marketing operations will begin to make an impact after July 2005; however management is confident of capturing 4% of the Australian market over a three year period for each of the products it introduces. The first two PBS generics imported from XSP have target sales of about \$12.5m pa by FY 2009. Additional products are set to be added to this list, provided PharmAust can demonstrate its capabilities.

Adequate Funding for Initial Phase

Additional funding of about \$2.5m could be raised by selling the Welshpool property and entering into a lease agreement.

PharmAust Statement of Financial Position

Y/E 30 June	2004 [a]	2004 Proforma
Current Assets		
Cash	0.18	2.31
receivables	0.17	0.48
Inventories		0.48
Total Current Assets	<u>0.35</u>	<u>3.27</u>
Non Current Assets		
Other Financial Assets	0.01	0.01
Property Plant and Equipment	0.43	3.18
Intangibles	0.12	0.56
Total Non Current Assets	<u>0.56</u>	<u>3.75</u>
Total Assets	<u>0.90</u>	<u>7.02</u>
Current Liabilities		
Payables	0.13	0.13
Debt	0.02	0.02
Total Current Liabilities	<u>0.14</u>	<u>0.14</u>
Non Current Liabilities		
Debt	0.02	0.02
Total Non Current Liabilities	<u>0.02</u>	<u>0.02</u>
Total Liabilities	<u>0.16</u>	<u>0.16</u>
Net Assets	<u>0.74</u>	<u>6.86</u>
Equity		
Contributed Equity	11.08	17.28
Accumulated losses	(10.42)	(10.42)
Outside Equity Interest	0.08	0.00
Total Equity	<u>0.74</u>	<u>6.86</u>

Valuation

Value Comparative to Market

It is difficult to value PharmAust at its present stage of business development since it currently has no operating track record. Strachan Corporate has made a brief summary of peer companies to illustrate typical operating margins along with EV/EBITDA and EV/sales trading ratios. In general, the larger the market capitalisation and the higher the operating margin of a company, the larger these market multiples will be. PharmAust is a minnow in this market, but it has the ability to be highly profitable once it passes critical sales levels for each business.

The market success of Genepharm Australasia (GAA), which floated on a similar marketing deal to

the PharmAust/XSP arrangement, is illustrative. GAA presently has a market capitalisation of \$100m and is not due to record its first positive result until FY 2007. By comparison, PharmAust appears to have a stronger business model with a lower cost and closer partner in Malaysia as well as local manufacturing and synergistic, upstream drug discovery operations.

At present the company has an asset backing of 10 cps but this hardly seems relevant given the unaccounted value for its intellectual property, marketing and distribution agreements in hand and the value of products, who's license is presently in abeyance pending re-establishment and re-licensing of the Welshpool facility.

Peer companies presently trade with a prospective, FY 2007 EV/EBITDA multiple ranging from 38.4 to 8 times.

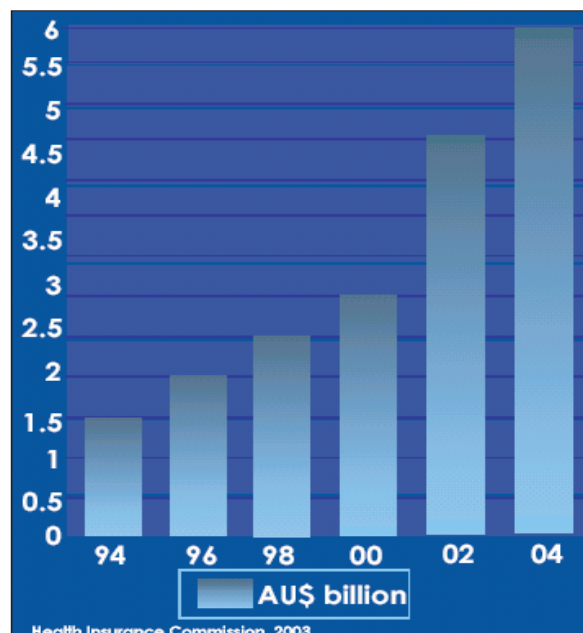
Peer Group Comparisons

Company	ASX Code	Price \$	Revenue \$m.		EBITDA \$m.		EBITDA Margin %	EV		EV	
			2004	2007	2004	2007		EBITDA	Sales		
			2004	2007	2004	2007	2004	2007	2004	2007	
Lipa Pharmaceuticals	LIP	\$ 2.45	78	145	15.1	28.3	19.5%	15.0	8.0	2.91	1.56
Arrow Pharmaceuticals	AWP	\$13.14	305	527	24.6	44.1	8.0%	34.2	19.1	2.76	1.60
Genepharm Australasia	GAA	\$ 1.05	0	32	-1.0	1.7	5.3%	-64.5	38.4	322.40	2.02
Australian Pharmaceutical Industries	API	\$ 3.34	2946	4139	59.5	109.8	2.0%	15.7	8.5	0.32	0.23
Institute of Drug Technologies	IDT	\$ 2.40	26	33	8.6	10.9	33.5%	11.9	9.3	3.98	3.11
PharmAust	PAA	\$ 0.22									

The Australian Pharmaceutical Industry

The Australian market for PBS drugs is some \$6 billion pa and growing rapidly. The Federal Government is under pressure to hold down health costs and thus is keen to introduce cheaper generic drugs into the PBS as they become available. Government funding for PBS drugs is thus set at a value which reflects the cost of the cheapest bio-equivalent alternative. In 1994 legislation was brought in to allow brand substitution, opening the way for generics. At that time generics made up less than 5% of the market. Further encouragement was added in 1999 when the effective life of patents in Australia was reduced from 20 to 15 years from market approval.

Generics represented a global market of US\$30 billion in 2004 and the market is growing at 20% pa. Generic drugs make up over 40% of all prescription drugs in many parts of the world. In the USA and the UK about 45% of prescription market is made up of generics while in Australia only 18.9% of PBS usage is derived from generics.



Rapid Growth in Generic PBS Drugs

This market is set to triple in size over the next five years. PharmAust's target market is impressive. Patents covering 12 of Australia's top 20 PBS drugs will expire by 2008, representing 27% of total spending or \$1.28 billion in 2003. Patents on over 100 drugs will expire between January 2006 and December 2010. PharmAust will work with its Malaysian partners to bring suitable generics to the market in a timely and cost effective fashion.

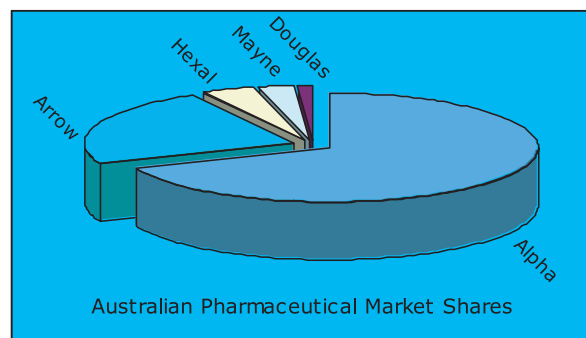
PharmAust Aims to Take 4% of the Market

The Australian market is dominated by Alphapharm, owned by Merck KgaA of Germany. Arrow is an aggressive competitor, set up by the founder of Alphapharm.

The company sells Sigma generics and has developed some products itself.

Genepharm is the local marketing arm of a large Greek generics manufacturer, hoping to sell 80 PBS listed products via existing wholesalers such as API.

PBS Market Share



Source: Arrow Pharmaceuticals ASX presentation

SWOT Analysis

Strengths

- **XEPA-SOUL PATTINSON RELATIONSHIP**
PharmAust's relationship with XSP enables it to introduce low cost, generic drugs into the Australian market in a timely fashion.
- **INTEGRATED**
Synergies arising from the integration of drug discovery and formulation with manufacturing and distribution offers long term growth potential.
- **SKILLED TEAM OF SCIENTISTS**
Management of Epichem is highly credentialed and well known in the pharmaceutical and organic chemistry world, while management at PharmAust's manufacturing facilities understands and has experience in product manufacture and marketing.

Opportunities

- **LOW COST**
PharmAust's relationship with XSP provides access to competitive products which are not expensive to license.
- **NICHE MARKET PLAYER**
PharmAust will aim to capture niche markets with low cost, imported or locally manufactured products.

Weaknesses

- **SMALL PLAYER**
PharmAust is a small company in a field dominated by much larger participants.
- **VIRTUAL STARTUP**
PharmAust manufacturing and product distribution must re-establish its licensed products in the market once new manufacturing facilities are built and licensed for production.
- **LEADERSHIP**
While divisional management is strong, the company recognises that it will need to recruit a recognised leader in the industry to drive growth.

Threats

- **DELAY IN OBTAINING THERAPEUTIC GOODS LICENSE**
Any delays in refitting or re-licensing PharmAust's manufacturing plant will delay cash flow and disappoint the market.
- **FAILURE TO ESTABLISH SALES NETWORK**
PharmAust's business plan relies on reestablishing strong networks for substantial sales growth.

PharmAust Management & Board

Managing Director, PharmAust Limited

Mr Bryant McLarty has extensive experience in capital markets as a securities adviser on ASX listed companies. He along with the Board has brought energy and vision to create the PharmAust business from a standing start over the past 14 months.

Managing Director, Epichem Pty Ltd

Director, PharmAust Limited

Dr Wayne Best has over 20 years experience in synthetic and medicinal chemistry both in academia, government and in industry. He is an organic chemist who studied at Imperial College in the UK where he obtained a DIC, followed by a year as a post doctoral fellow at the ANU in Canberra. Dr Best worked for over 4 years with ICI Australia's research group synthesising a range of biologically active compounds. Following this experience, Dr Best worked with the WA Government's Chemistry Centre for 10 years where he was responsible for forming and running the Medicinal & Biological Chemistry Section, undertaking collaborative R&D into drug discovery and contract synthesis.

Chairman, Epichem Pty Ltd

Dr John Horton is a medical practitioner based in London, who has worked for the past 17 years in Developing World Medicine – malaria, diarrhoea etc. and has been the main force behind initiatives by GlaxoSmithKline (GSK) where he worked during that period. Dr Horton consults to WHO and holds academic appointments in Liverpool and Perth, where he is the Chairman of Epichem.

Non Executive Chairman, Epichem Pty Ltd

Dr Paul D'Sylva is Director of the Division of Research and Development at Murdoch University. He has worked in commercialising early stage scientific discoveries and has led the development of a number of successful research JVs. He represents Murdoch on a number of Boards including the Australian Centre for Sustainable Energy.

Director, PharmAust Limited

Dr Stuart Gunzburg has a PhD in science and an MBA from UWA. He is a Director of PharmAust and has experience in equity markets, specialising in analysis of emerging technology companies.

Director, PharmAust Limited

Mr Thomas Picton-Warlow has postgraduate qualifications and extensive experience in fields of information management systems, business systems and computing.

Disclaimer

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