

Genepharma Australasia (GAA)

Competition aplenty

GAA held its AGM earlier this week. Operations are tracking OK, despite new players entering the generic drug market in 2007. Price competition is expected continue. We maintain our Hold recommendation.

Key forecasts

	FY06A	FY07A	FY08F	FY09F	FY10F
EBITDA (A\$m)	-3.61	3.78	8.24	11.0	12.7
Reported net profit (A\$m)	-5.64	-18.0	6.05	7.43	8.80
Normalised net profit (A\$m) ¹	-5.64	2.88	6.05	7.43	8.80
Normalised EPS (c) ¹	-6.42	2.08	4.27	4.95	5.65
Normalised EPS growth (%)	2.77	n/a	105.6	16.1	14.0
Dividend per share (c)	0.00	0.00	0.00	1.00	2.00
Dividend yield (%)	0.00	0.00	0.00	2.50	5.00
Normalised PE (x)	n/m	19.3	9.37	8.07	7.08
EV/EBITDA (x)	n/m	11.9	6.97	4.26	3.12
Price/net oper. CF (x)	-9.74	11.5	-4.73	11.5	10.3
ROIC (%)	-26.9	11.6	12.1	11.9	12.8

1. Pre-goodwill amortisation and exceptional items
Accounting Standard: IFRS
Source: Company data, ABN AMRO Morgans forecasts

year to Jun, fully diluted

AGM commentary - no surprises

Key points from GAA's AGM include: 1) its market share across its product categories increased from 6% in FY06 to 11% in FY07; 2) three new players entered the generic drug market in 2007; 3) pricing competition is expected to continue; 4) GAA continues to review potential acquisitions across medical, pharmacy and consumer lines; and 5) GAA is expecting to launch five other major drugs this year with combined PBS sales greater than A\$150m.

Outlook statement reiterates FY08 profit

Management has reconfirmed guidance for FY08 of 25% profit growth on the FY07 underlying profit of A\$4.6m. As a result, we have made no changes to our forecasts. There is currently a 10% share buyback in place, which should help to underpin the current share price. Also management has foreshadowed a dividend for FY08, which we have not factored into our forecasts.

Changes to PBS create competitive pressures

The changes to the PBS by the government are creating increased competition. A key element is a 25% cut in the subsidised cost of all major generic pharmaceuticals taking effect from August 2008. We believe the macro environment will remain challenging as a result. Because of this, we prefer to wait until GAA has demonstrated its ability to successfully navigate this potentially difficult operating environment. Evidence of this should be seen with the 1HFY08 result due in February. At that point we will reassess our investment view.

Investment view: Hold maintained, target price down to A\$0.45

Our DCF valuation is A\$0.56, based on a risk-free rate of 5.75%, a WACC of 13.9% and a terminal growth rate of 1.5%. The share price has weakened over recent months and we see few catalysts to move the price higher. Therefore, we have now applied a 20% discount in setting our A\$0.45 target price. The key risks to our target price are increased competition and delays in receiving product registrations from the TGA. Upside risks include better-than-expected take-up of the product.

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 29 November 2007.

Hold

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.**

High Volatility

Absolute performance

n/a

Short term (0-60 days)

Health Care

Australia

Price

A\$0.40

Target price

A\$0.45 (from A\$0.56)

Market capitalisation

A\$55.60m (US\$48.88m)

Avg (12mth) daily turnover

A\$0.17m (US\$0.14m)

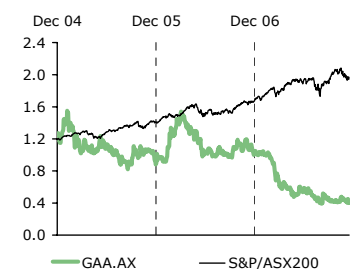
Reuters

GAA.AX

GAA71130

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

	1M	3M	12M
Price (A\$)	0.4	0.5	1.1
Absolute %	-3.6	-20.0	-63.1
Rel market %	1.6	-24.3	-68.8
Rel sector %	-1.8	-21.1	-64.3



Stock borrowing: **Hard onshore,**

Impossible offshore

Volatility (30-day): 61%

Volatility (6-month trend): ↓

52-week range: 1.14-0.38

S&P/ASX200: 6444.50

BBG AP Pharm & Biotech: 166.57

Source: ABN AMRO, Bloomberg

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GAA – financial summary

Year to 30 Jun (A\$m)	AIFRS 2006A	AIFRS 2007A	AIFRS 2008F	AIFRS 2009F	AIFRS 2010F	Closing price (A\$) as at 26 0.40	Price target (A\$) 0.45
Income statement						Valuation metrics	
Divisional sales	1.8	54.5	69.4	85.8	107.3	Preferred methodology	DCF
Total revenue	1.8	54.5	69.4	85.8	107.3	DCF valuation inputs	
EBITDA	-3.6	3.8	8.2	11.0	12.7	Rf	5.75%
Associate income	0.0	0.0	0.0	0.0	0.0	Rm-Rf	4.50%
Depreciation	-2.4	-1.2	-1.1	-1.5	-1.8	Beta	2.03
EBITA	-6.0	2.6	7.2	9.5	10.9	CAPM (Rf+Beta(Rm-Rf))	14.9%
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)
EBIT	-6.0	2.6	7.2	9.5	10.9	Equity (E/EV)	90.0%
EBIT(incl associate profit)	-6.0	2.6	7.2	9.5	10.9	Debt (D/EV)	10.0%
Net interest expense	0.4	-0.2	-0.5	-0.2	0.5	Interest rate	7.75%
Pre-tax profit	-5.6	2.4	6.7	9.4	11.4	Tax rate (t)	30.0%
Income tax expense	0.0	0.5	-0.7	-2.0	-2.6	WACC	
After-tax profit	-5.6	2.9	6.0	7.4	8.8	13.9% Diluted no. of shares (m)	
Minority interests	0.0	0.0	0.0	0.0	0.0	DCF valuation (A\$)	
NPAT	-5.6	2.9	6.0	7.4	8.8	0.56	
Significant items	0.0	-20.9	0.0	0.0	0.0	Multiples	
NPAT post abnormals	-5.6	-18.0	6.0	7.4	8.8	Enterprise value (A\$m)	2007A 2008F 2009F 2010F
Cash flow statement						2007A 2008F 2009F 2010F	
EBITDA	-3.6	3.8	8.2	11.0	12.7	EV/Sales (x)	0.8 0.8 0.5 0.4
Change in working capital	-0.4	19.2	-19.1	-3.7	-4.5	EV/EBITDA (x)	11.9 7.0 4.3 3.1
Net interest (pd)/rec	0.4	-0.2	-0.5	-0.2	0.5	EV/EBIT (x)	17.1 8.0 4.9 3.6
Taxes paid	0.0	0.5	-0.7	-2.0	-2.6	PE (pre-goodwill) (x)	19.3 9.4 8.1 7.1
Other oper cash items	0.0	-18.5	0.0	0.0	0.0	PEG (pre-goodwill) (x)	12.8 6.2 5.4 4.7
Cash flow from ops (1)	-3.6	4.8	-12.0	5.2	6.0	At target price	
Capex (2)	-0.2	-0.8	-2.7	-2.5	-2.5	EV/EBITDA (x)	2007A 2008F 2009F 2010F
Disposals/(acquisitions)	-1.1	-57.1	0.0	0.0	0.0	PE (pre-goodwill) (x)	13.8 7.8 4.9 3.7
Other investing cash flow	-0.1	2.9	0.0	0.0	0.0	EV/EBITDA (x)	21.8 10.6 9.1 8.0
Cash flow from invest (3)	-1.4	-55.0	-2.7	-2.5	-2.5	Comparable company data (x)	
Incr/(decr) in equity	11.4	48.7	2.0	7.9	6.9	Australian Pharmaceutical Ind EV/EBITDA	2008F 2009F 2010F
Incr/(decr) in debt	0.0	0.0	2.0	0.0	0.0	Year to 31 Aug EV/EBIT	7.5 6.4 5.6
Ordinary dividend paid	0.0	0.0	0.0	0.0	-3.0	PE	9.7 8.2 7.2
Preferred dividends (4)	0.0	0.0	0.0	0.0	0.0	PEG	18.6 12.4 11.2
Other financing cash flow	0.0	0.0	0.0	0.0	0.0	Sigma Pharmaceuticals EV/EBITDA	9.6 8.8 8.0
Cash flow from fin (5)	11.4	48.7	4.0	7.9	3.9	Year to 31 Jan EV/EBIT	11.8 10.7 9.6
Forex and disc ops (6)	0.0	0.0	0.0	0.0	0.0	PE	16.5 16.1 14.3
Incr/(decr) cash (1+3+5+6)	6.4	-1.5	-10.7	10.6	7.4	PEG	-1.6 -1.6 -1.4
Equity FCF (1+2+4)	-3.8	4.0	-14.7	2.7	3.6	Per share data	
Balance sheet						2007A 2008F 2009F 2010F	
Cash & deposits	15.0	13.5	0.1	10.7	18.2	No. shares	138.5 141.7 149.9 155.9
Trade debtors	1.4	12.3	9.5	11.8	14.7	EPS (cps)	-13.0 4.3 5.0 5.6
Inventory	1.9	11.6	13.9	17.2	21.5	EPS (normalised) (c)	2.1 4.3 5.0 5.6
Investments	0.0	0.0	0.0	0.0	0.0	Dividend per share (c)	0.0 0.0 1.0 2.0
Goodwill	0.0	51.5	51.5	51.5	51.5	Dividend payout ratio (%)	0.0 0.0 0.0 17.0
Other intangible assets	21.2	10.2	9.6	9.1	8.6	Dividend yield (%)	0.0 0.0 2.5 5.0
Fixed assets	0.3	1.4	3.6	5.1	6.3	Growth ratios	
Other assets	1.0	2.9	2.9	2.9	2.9	Sales growth	2007A 2008F 2009F 2010F
Total assets	40.8	103.4	91.2	108.4	123.8	Operating cost growth	838.2% 20.5% 22.3% 26.6%
Short-term borrowings	0.0	2.7	0.2	0.2	0.2	EBITDA growth	^MISSING 118.1% 33.6% 14.9%
Trade payables	3.1	27.9	8.4	10.2	13.0	EBITA growth	^MISSING 174.6% 32.8% 14.0%
Long-term borrowings	0.0	0.0	1.8	1.8	1.8	Operating performance	
Provisions	0.0	0.0	0.0	0.0	0.0	Asset turnover (%)	2007A 2008F 2009F 2010F
Other liabilities	0.2	2.6	2.6	2.6	2.6	EBITDA margin (%)	18.9 17.8 21.5 23.1
Total liabilities	3.3	33.2	13.0	14.9	17.6	EBIT margin (%)	11.9 12.8 11.8 11.8
Preference shares	0.0	0.0	0.0	0.0	0.0	Net profit margin (%)	10.4 11.1 10.1 10.1
Hybrid equity	0.0	0.0	0.0	0.0	0.0	Return on net assets (%)	3.7 9.2 10.2 10.2
Share capital	46.9	97.1	105.1	120.4	133.1	Net debt (A\$m)	-10.8 1.9 -8.7 -16.2
Other reserves	1.7	2.2	2.2	2.2	2.2	Net debt/equity (%)	-15.4 2.4 -9.3 -15.2
FCTR	0.0	0.0	0.0	0.0	0.0	Net interest/EBIT cover (x)	11.2 15.1 62.8 -22.5
Unrealised gains/losses	0.0	0.0	0.0	0.0	0.0	ROIC (%)	11.6 12.1 11.9 12.8
Retained earnings	-11.1	-29.1	-29.1	-29.1	-29.1	Internal liquidity	
Other equity	0.0	0.0	0.0	0.0	0.0	Current ratio (x)	2007A 2008F 2009F 2010F
Total equity	37.5	70.1	78.2	93.5	106.2	Receivables turnover (x)	1.2 2.4 3.3 3.6
Minority interest	0.0	0.0	0.0	0.0	0.0	Payables turnover (x)	7.9 6.4 8.1 8.1
Total shareholders' equity	37.5	70.1	78.2	93.5	106.2	2007A 2008F 2009F 2010F	
Total liabilities & SE	40.8	103.4	91.2	108.4	123.8	3.3 3.4 8.0 8.2	

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.

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