

# Genepharma Australasia (GAA)

## Transaction gets a tick

**GAA shareholders have approved the acquisition of the business of Strides in Asia and Australia. We will now watch for a smooth integration before moving to a more positive view. Industry dynamics remain tough. Hold maintained.**

### Key forecasts

	FY06A	FY07A	FY08F	FY09F	FY10F
EBITDA (A\$m)	-3.61	3.78	7.44 ▼	14.5 ▲	14.9 ▲
Reported net profit (A\$m)	-5.64	-18.0	5.09 ▼	10.6 ▲	10.9 ▲
Normalised net profit (A\$m) <sup>1</sup>	-5.64	2.88	5.39 ▼	10.6 ▲	10.9 ▲
Normalised EPS (c) <sup>1</sup>	-6.42	2.08	3.81 ▼	4.12 ▼	4.25 ▼
Normalised EPS growth (%)	2.77	n/a	83.3	8.23	3.29
Dividend per share (c)	0.00	0.00	0.00	1.00	1.00 ▼
Dividend yield (%)	0.00	0.00	0.00	5.00	5.00
Normalised PE (x)	n/m	9.64	5.26	4.86	4.70
EV/EBITDA (x)	n/m	10.7	7.14	3.30	2.64
Price/net oper. CF (x)	-4.87	5.76	-2.39	7.49 ▲	3.47 ▼
ROIC (%)	-26.9	11.6	10.8	16.5	9.03

1. Pre non-recurring items and post preference dividends

Accounting Standard: IFRS

Source: Company data, ABN AMRO Morgans forecasts

year to Jun, fully diluted

### Strides Arcolab acquisition approved

GAA shareholders have approved the acquisition of the business of Strides in Australia and Asia. Consideration was ~A\$65m in scrip (8.8x FY08F EBITDA). GAA shares will now be issued to Strides at a price of A\$0.55. Strides' is involved in the manufacture and distribution of generic prescription and over-the-counter (OTC) products across Asia. Its main sales arm is Drug Houses of Australia (Asia) (DHA), which is the leading generic group in Singapore. We view the acquisition as the minimum necessary for GAA to maintain a foothold in the sector. We highlight: 1) the complementary product range between the two businesses; 2) it creates a new distribution channel for GAA's existing product range; 3) it preserves existing customer and supplier relationships, while providing cross-selling opportunities; 4) it provides GAA with an Asian base, through DHA in Singapore; and 5) GAA now has access to future Strides' products and its manufacturing capability.

### Strides will become majority GAA shareholder, with 55% of capital base

Strides' will now have about 55% of the expanded capital base. Strides will appoint two representatives to the GAA Board, Mr Arun Kumar - Vice-Chairman and Group CEO of Strides and Mr Ravi Seth, CE International Operations of Strides.

### Combining the businesses and changing the name

We have combined the two businesses and the changes are detailed overleaf. The EPS accretion is about 10%. GAA will change its name to Ascent Pharmahealth Ltd.

### Investment view - Hold recommendation, A\$0.30 price target

Our valuation for the combined group is A\$0.37 (was A\$0.55). The key assumptions include a risk-free rate of 6.5% (was 6.25%), WACC of 14.65% (was 14.4%) and a long-term growth rate of 1.5%. We have set our price target at A\$0.30, a 20% discount to our valuation reflecting the highly competitive current environment. The upside risk to our price target is the successful integration of the Strides business and the downside risk relates to continuing margin pressure.

### 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 19 June 2008. Use of ▲ ▼ indicates that the line item has changed by at least 5%.

ABN AMRO Morgans Limited (A.B.N. 49 010 669 726) AFSL235410 A Participant of ASX Group

## 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.**

## Mod-High Volatility

### Absolute performance

n/a

### Short term (0-60 days)

### Health Care

### Australia

### Price

A\$0.20

### Target price

A\$0.30 (from A\$0.44)

### Market capitalisation

A\$51.40m (US\$48.69m)

### Avg (12mth) daily turnover

A\$0.10m (US\$0.09m)

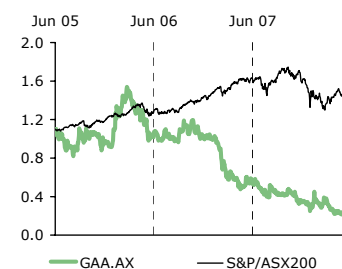
### Reuters

GAA.AX

GAA80620

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

	(1M)	(3M)	(12M)
Price (A\$)	0.25	0.34	0.58
Absolute %	-20.0	-40.3	-65.5
Rel market %	-11.3	-41.2	-59.1
Rel sector %	-16.1	-42.2	-61.6



Stock borrowing: **Hard onshore,**

**Impossible offshore**

Volatility (30-day): 82.58%

Volatility (6-month trend): ↑

52-week range: 0.58-0.19

S&P/ASX200: 5366.60

BBG AP Pharm & Biotech: 144.41

Source: ABN AMRO, Bloomberg

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## Genepharma shareholders tick the transaction

GAA shareholders have approved the acquisition of the business of Strides in Australia and Asia. Its main sales arm is Drug Houses of Australia (Asia) (DHA), which is the leading generic group in Singapore.

Strides is one of India's largest exporters of branded generic pharmaceutical products, with 14 manufacturing plants located in India, Brazil, Mexico, Italy, Poland and Singapore. As part of the heads of the agreement, GAA will enter into a five-year Preferred Supply Agreement, where it will have the first right refusal to distribute all of Strides' products (ex AIDS, TB and malaria treatments) into AU/NZ and Asia (ex China and Japan). In return, GAA will give Strides the first right to supply products manufactured by Strides in the region, subject to existing supply agreements.

The consideration was A\$65m in scrip. This equates to an EBITDA multiple of 8.8x FY08F. GAA shares will be issued to Strides at a price of A\$0.55.

## Changes to forecasts of the combined business

We have downgraded FY08 profit in line with the recent company guidance. We have reduced FY08 profit by 12.2% to A\$5.1m to reflect increased competition in the sector, leading up to the well flagged reforms in the PBS which take effect from 1 August 2008.

The Explanatory Memorandum has indicated a proforma EPS of 4.1cps for FY08 on the enlarged group. We have assumed a similar level of profitability for FY09. We prefer to wait for evidence of a successful integration before moving to a more positive view. We have not assumed any synergies at this stage. As a result, we have reduced our EPS forecast by 16.9% to 4.1cps for FY09.

In FY10, our EPS forecasts has been reduced by 24.7% to 4.3cps, which reflects less aggressive growth assumptions for the combined Group.

**Table 1 : Changes to forecasts**

A\$m	FY08			FY09F			FY10F		
	Previous	New	% Change	Previous	New	% Change	Previous	New	% Change
Revenue	67.4	64.5	-4.2%	85.8	96.7	12.7%	107.3	99.8	-7.1%
EBITDA	8.0	7.4	-6.9%	11.0	14.5	31.5%	12.7	14.9	17.7%
EBIT	7.0	6.4	-8.7%	9.5	13.0	36.2%	10.9	13.1	20.6%
NPAT	5.8	5.1	-12.2%	7.4	10.6	43.2%	8.8	10.9	24.3%
EPS (cps)	4.1	3.6	-12.4%	5.0	4.1	-16.9%	5.6	4.3	-24.7%
DPS (cps)	0.0	0.0	-	1.0	1.0	-	2.0	1.0	-

Source: ABN AMRO Morgans forecasts

## GAA – financial summary

Year to 30 Jun (A\$m)	AIFRS 2006A	AIFRS 2007A	AIFRS 2008F	AIFRS 2009F	AIFRS 2010F	Closing price (A\$)	0.20	Price target (A\$)	0.30
<b>Income statement</b>						<b>Valuation metrics</b>			
Divisional sales	1.8	54.5	64.5	96.7	99.8	Preferred methodology	DCF	Val'n (A\$)	\$ 0.37
Total revenue	1.8	54.5	64.5	96.7	99.8	<b>DCF valuation inputs</b>			
EBITDA	-3.6	3.8	7.4	14.5	14.9	Rf	6.50%	10-year rate	6.50%
Associate income	0.0	0.0	0.0	0.0	0.0	Rm-Rf	4.50%	Margin	2.0%
Depreciation	-2.4	-1.2	-1.1	-1.5	-1.8	Beta	2.03	Kd	8.50%
EBITA	-6.0	2.6	6.4	13.0	13.1	CAPM (Rf+Beta(Rm-Rf))	15.6%	Ke	15.6%
Amortisation/impairment	0.0	0.0	0.0	0.0	0.0	Equity (E/EV)	90.0%	NPV cash flow (A\$m)	54.5
EBIT	-6.0	2.6	6.4	13.0	13.1	Debt (D/EV)	10.0%	Minority interest (A\$m)	0.0
EBIT(incl associate profit)	-6.0	2.6	6.4	13.0	13.1	Interest rate	8.50%	Net debt (A\$m)	1.7
Net interest expense	0.4	-0.2	-0.6	-0.2	0.2	Tax rate (t)	30.0%	Investments (A\$m)	0.0
Pre-tax profit	-5.6	2.4	5.8	12.8	13.3	Equity market value (A\$m)			
Income tax expense	0.0	0.5	-0.4	-2.2	-2.3	<b>WACC</b>			
After-tax profit	-5.6	2.9	5.4	10.6	10.9	14.6% Diluted no. of shares (m)			
Minority interests	0.0	0.0	0.0	0.0	0.0	<b>DCF valuation (A\$)</b>			
NPAT	-5.6	2.9	5.4	10.6	10.9	<b>0.37</b>			
Significant items	0.0	-20.9	-0.3	0.0	0.0	<b>Multiples</b>			
NPAT post abnormal	-5.6	-18.0	5.1	10.6	10.9	<b>2007A 2008F 2009F 2010F</b>			
<b>Cash flow statement</b>						<b>Enterprise value (A\$m)</b>			
EBITDA	-3.6	3.8	7.4	14.5	14.9	40.6 53.1 47.8 39.3			
Change in working capital	-0.4	19.2	-18.0	-5.2	2.1	EV/Sales (x)			
Net interest (pd)/rec	0.4	-0.2	-0.6	-0.2	0.2	0.7 0.8 0.5 0.4			
Taxes paid	0.0	0.5	-0.4	-2.2	-2.3	EV/EBITDA (x)			
Other oper cash items	0.0	-18.5	-0.3	0.0	0.0	10.7 7.1 3.3 2.6			
Cash flow from ops (1)	-3.6	4.8	-11.9	6.9	14.9	EV/EBIT (x)			
Capex (2)	-0.2	-0.8	-2.7	-2.5	-2.5	15.5 8.3 3.7 3.0			
Disposals/(acquisitions)	-1.1	-57.1	0.0	0.0	0.0	PE (pre-goodwill) (x)			
Other investing cash flow	-0.1	2.9	0.0	0.0	0.0	9.6 5.3 4.9 4.7			
Cash flow from invest (3)	-1.4	-55.0	-2.7	-2.5	-2.5	PEG (pre-goodwill) (x)			
Incr/(decr) in equity	11.4	48.7	2.0	1.0	0.0	6.4 3.5 3.2 3.1			
Incr/(decr) in debt	0.0	0.0	3.0	0.0	0.0	<b>At target price</b>			
Ordinary dividend paid	0.0	0.0	0.0	0.0	-3.9	<b>2007A 2008F 2009F 2010F</b>			
Preferred dividends (4)	0.0	0.0	0.0	0.0	0.0	EV/EBITDA (x)			
Other financing cash flow	0.0	0.0	0.0	0.0	0.0	17.4 10.5 5.0 4.3			
Cash flow from fin (5)	11.4	48.7	5.0	1.0	-3.9	PE (pre-goodwill) (x)			
Forex and disc ops (6)	0.0	0.0	0.0	0.0	0.0	14.4 7.8 7.2 7.0			
Incr/(decr) cash (1+3+5+6)	6.4	-1.5	-9.6	5.4	8.5	<b>Comparable company data (x)</b>			
Equity FCF (1+2+4)	-3.8	4.0	-14.6	4.4	12.4	<b>2008F 2009F 2010F</b>			
<b>Balance sheet</b>						<b>Australian Pharmaceutical Ind</b>			
Cash & deposits	15.0	13.5	1.3	6.6	15.1	EV/EBITDA			
Trade debtors	1.4	12.3	8.8	15.9	13.7	4.1 3.8 3.6			
Inventory	1.9	11.6	12.9	14.5	15.0	Year to 31 Aug			
Investments	0.0	0.0	0.0	0.0	0.0	EV/EBIT			
Goodwill	0.0	51.5	51.5	111.5	111.5	PE			
Other intangible assets	21.2	10.2	9.6	9.1	8.6	14.1 11.7 9.7			
Fixed assets	0.3	1.4	3.6	5.1	6.3	Sigma Pharmaceuticals			
Other assets	1.0	2.9	2.9	2.9	2.9	EV/EBITDA			
Total assets	40.8	103.4	90.7	165.8	173.2	6.4 5.8 5.6			
Short-term borrowings	0.0	2.7	0.3	0.3	0.3	Year to 31 Jan			
Trade payables	3.1	27.9	7.8	11.3	11.6	EV/EBIT			
Long-term borrowings	0.0	0.0	2.7	2.7	2.7	7.7 7.1 6.7			
Provisions	0.0	0.0	0.0	0.0	0.0	PE			
Other liabilities	0.2	2.6	2.6	2.6	2.6	10.5 10.8 10.1			
Total liabilities	3.3	33.2	13.5	16.9	17.3	<b>Per share data</b>			
Preference shares	0.0	0.0	0.0	0.0	0.0	<b>2007A 2008F 2009F 2010F</b>			
Hybrid equity	0.0	0.0	0.0	0.0	0.0	No. shares			
Share capital	46.9	97.1	104.1	175.8	182.9	138.5 141.7 258.2 257.3			
Other reserves	1.7	2.2	2.2	2.2	2.2	EPS (cps)			
FCTR	0.0	0.0	0.0	0.0	0.0	-13.0 3.6 4.1 4.3			
Unrealised gains/losses	0.0	0.0	0.0	0.0	0.0	EPS (normalised) (c)			
Retained earnings	-11.1	-29.1	-29.1	-29.1	-29.1	2.1 3.8 4.1 4.3			
Other equity	0.0	0.0	0.0	0.0	0.0	Dividend per share (c)			
Total equity	37.5	70.1	77.2	148.9	156.0	0.0 0.0 1.0 1.0			
Minority interest	0.0	0.0	0.0	0.0	0.0	Dividend payout ratio (%)			
Total shareholders' equity	37.5	70.1	77.2	148.9	156.0	0.0 0.0 0.0 23.6			
Total liabilities & SE	40.8	103.4	90.7	165.8	173.2	Dividend yield (%)			
						0.0 0.0 5.0 5.0			
						<b>Growth ratios</b>			
						<b>2007A 2008F 2009F 2010F</b>			
						Sales growth			
						838.2% 12.5% 44.0% 3.2%			
						Operating cost growth			
						97.0% 94.3% 3.0%			
						EBITDA growth			
						144.2% 103.3% 0.9%			
						EBITA growth			
						<b>Operating performance</b>			
						<b>2007A 2008F 2009F 2010F</b>			
						Asset turnover (%)			
						18.9 16.6 18.9 14.7			
						EBITDA margin (%)			
						11.5 15.0 14.9			
						EBIT margin (%)			
						9.9 13.4 13.2			
						Net profit margin (%)			
						8.4 11.0 11.0			
						Return on net assets (%)			
						3.7 8.3 8.7 8.4			
						Net debt (A\$m)			
						-10.8 1.7 -3.6 -12.1			
						Net debt/equity (%)			
						-15.4 2.3 -2.4 -7.8			
						Net interest/EBIT cover (x)			
						11.2 10.4 79.0 -83.6			
						ROIC (%)			
						11.6 10.8 16.5 9.0			
						<b>Internal liquidity</b>			
						<b>2007A 2008F 2009F 2010F</b>			
						Current ratio (x)			
						1.2 2.4 2.8 3.2			
						Receivables turnover (x)			
						7.9 6.1 7.8 6.7			
						Payables turnover (x)			
						3.3 3.2 8.6 7.4			

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.

Each stock has been assigned a Volatility Rating to assist in assessing the risk of the security. The rating measures the volatility of the security's daily closing price data over the previous year relative to other stocks included in either the S&P/ASX200 Index (large caps) or the Small Ordinaries Index (small caps) of which it is a member. This rating is a quantitative (objective) measure provided as an additional resource and is independent of the qualitative research process undertaken by our research analysts.

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: GAA.AX.

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