

In this edition...

Reporting season has begun and the big three stocks in the sector – Cochlear, CSL and Resmed – have produced mixed results, with Resmed charging ahead with a 30% increase in net profit, Cochlear posting a 19% gain and CSL limping forward with a 3% increase. The exchange rate has been cited as a key impact on CSL's profit result. News has emerged that a US biodegradable stent company, Reva Medical, is looking to list on the ASX, reportedly doing so on a pre-money valuation of \$250 million. The Andrew Forrest-backed Allied Medical from Perth is flagging a listing in 12 months time, and that it is on the look-out for additional investments. And we lead the edition with coverage of Phylogica's discovery deal with AstraZeneca.

The Editors

Companies Covered: BKL, BTA, CSL, COH, PYC, RMD, Allied Medical, Reva Medical

	Bioshares Portfolio
Year 1 (May '01 - May '02)	21.2%
Year 2 (May '02 - May '03)	-9.4%
Year 3 (May '03 - May '04)	70.0%
Year 4 (May '04 - May '05)	-16.3%
Year 5 (May '05 - May '06)	77.8%
Year 6 (May '06 - May '07)	17.3%
Year 7 (May '07 - May '08)	-36%
Year 8 (May '08 - May '09)	-7.3%
Year 9 (May '09 - May '10)	49.2%
Year 10 (May '10 - Current)	-6.2%
Cumulative Gain	171%
Av Annual Gain (9 yrs)	18.5%

Bioshares is published by Blake Industry & Market Analysis Pty Ltd.

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Individual Subscriptions (48 issues/year)
\$350 (Inc. GST)
Edition Number 373 (20 August 2010)
ISSN 1443-850X

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Bioshares

20 August 2010
Edition 373

Delivering independent investment research to investors on Australian biotech, pharma and healthcare companies.

– Extract from *Bioshares*

Phylogica Signs Second Drug Discovery Collaboration With Major Partner

Phylogica signed its second drug discovery collaboration in eight months with a major pharmaceutical company. **AstraZeneca** will pay Phylogica an upfront US\$750,000 with a further US\$750,000 in committed research funding over the next year. If the collaboration is successful with a product reaching market, Phylogica stands to gain a further US\$98 million from clinical and sales-based milestones.

Phylogica will use its unique peptide libraries to screen for potential drug candidates against the bacterium *Pseudomonas aeruginosa*. This bacteria is the cause of one of the most common hospital acquired infections and is also the cause of around 70% of lung infections experienced by patients living with cystic fibrosis. The prevalence of multi-drug resistant strains of this bug is becoming an increasingly threatening problem.

Potent Drug-like Properties

What has likely given AstraZeneca confidence in Phylogica's abilities is that Phylogica had previously found a number of peptide hits when working on an in-house program on another related bacterial target. Phylogica believes that its peptides, derived from ancient bacterial genomes, have been pre-selected through evolution to offer potent drug-like properties with strong multiple binding sites to targets. This potentially makes the peptides very good candidates for combating emerging drug resistant bacteria, where the strength of the binding to the target site becomes the determinant issue in drug efficacy over infection.

In December last year Phylogica signed a collaboration with **Roche**, where the focus was on exploring how peptides could transport biologic drugs into cells. The company is confident it will be successful in this first stage of the collaboration and expects to send its report to Roche shortly. The Roche deal involved an upfront payment (of \$411,000 according to the company's cash flow statement) with an option to move the collaboration to a second stage, which would presumably involve another upfront payment. The deal could be extended to a number of intracellular targets using Roche's biological drug candidates.

Phylogica believes it now has a sustainable business model that can deliver a profitable business in the medium-term rather than the long-term commercial timelines involved in traditional in-house drug discovery then development. At the *Bioshares* Thredbo Biotech Summit last month, CEO Paul Watt pointed to several drug library, discovery companies that are generating significant revenue streams from collaborative work with biotech and pharmaceutical companies.

These included **Morphosys** which generated revenues of 81 million Euros in 2009, **Galapagos** (100 million Euro in 2009), **Evolva** (CHF \$19 million in 2009) and **Evotec** (more than 40 million Euro in 2009).

– Cont'd over

Bioshares Model Portfolio (20 August 2010)

Company	Price (current)	Price added to portfolio	Date added
Sunshine Heart	\$0.032	\$0.036	June 2010
Biota Holdings	\$0.93	\$1.09	May 2010
Tissue Therapies	\$0.20	\$0.21	January 2010
QRxPharma	\$0.95	\$0.25	December 2008
Hexima	\$0.25	\$0.60	October 2008
Atcor Medical	\$0.14	\$0.10	October 2008
CathRx	\$0.16	\$0.70	October 2008
Impedimed	\$0.67	\$0.70	August 2008
Mesoblast	\$1.95	\$1.25	August 2008
Circadian Technologies	\$0.65	\$1.03	February 2008
Patrys	\$0.10	\$0.50	December 2007
Bionomics	\$0.30	\$0.42	December 2007
Cogstate	\$0.24	\$0.13	November 2007
Sirtex Medical	\$5.14	\$3.90	October 2007
Clinuvel Pharmaceuticals	\$0.23	\$0.66	September 2007
Starpharma Holdings	\$0.52	\$0.37	August 2007
Pharmaxis	\$2.10	\$3.15	August 2007
Universal Biosensors	\$1.50	\$1.23	June 2007
Probiotec	\$1.27	\$1.12	February 2007
AcruX	\$2.00	\$0.83	November 2004
Alchemia	\$0.49	\$0.67	May 2004

Portfolio Changes – 20 August 2010**IN:**

No changes.

OUT:

No changes.

– *Phylogica cont'd from page 1*

Each research collaboration lasts for around 12 months. Phylogica says it currently has the capacity to screen for six different partners at the one time and it is investing in robotics capabilities to increase this capacity to handle 12 parallel collaborations.

For Phylogica this model allows early revenue streams to make the company profitable, and the flow through from collaborations that progress into clinical studies (further milestones) and potentially to marketed products, from which Phylogica would stand to receive a single digit royalty.

Phylogica has a further two potential drug discovery deals with major pharmaceutical companies which it says are currently in late stage discussions and believes it may close by year's end. If the company could engage four significant drug discovery collaborations over 12 months, including the two already signed, and progress its Roche collaboration to the second stage, it will be well on the way to building a sustainable business and joining its peers listed above.

Summary

At 30 June, the company had \$1.2 million in cash. Adding the funding from the AstraZeneca collaboration, we estimate the company has around \$2.4 million in funds to support the business. We believe there is a very good chance the company will continue to build its revenue from discovery collaborations. The company also has a supportive shareholder base to access should it need to raise further funding.

Bioshares recommendation: **Speculative Buy Class B**

Bioshares

How Bioshares Rates Stocks

For the purpose of valuation, *Bioshares* divides biotech stocks into two categories. The first group are stocks with existing positive cash flows or close to producing positive cash flows. The second group are stocks without near term positive cash flows, history of losses, or at early stages of commercialisation. In this second group, which are essentially speculative propositions, *Bioshares* grades them according to relative risk within that group, to better reflect the very large spread of risk within those stocks.

Group A

Stocks with existing positive cash flows or close to producing positive cash flows.

- Buy** CMP is 20% < Fair Value
- Accumulate** CMP is 10% < Fair Value
- Hold** Value = CMP
- Lighten** CMP is 10% > Fair Value
- Sell** CMP is 20% > Fair Value
(CMP–Current Market Price)

Group B

Stocks without near term positive cash flows, history of losses, or at early stages commercialisation.

Speculative Buy – Class A

These stocks will have more than one technology, product or investment in development, with perhaps those same technologies offering multiple opportunities. These features, coupled to the presence of alliances, partnerships and scientific advisory boards, indicate the stock is relative less risky than other biotech stocks.

Speculative Buy – Class B

These stocks may have more than one product or opportunity, and may even be close to market. However, they are likely to be lacking in several key areas. For example, their cash position is weak, or management or board may need strengthening.

Speculative Buy – Class C

These stocks generally have one product in development and lack many external validation features.

Speculative Hold – Class A or B or C

Sell

Corporate Subscribers: Pharmaxis, Starpharma Holdings, Cogstate, Bionomics, ChemGenex Pharmaceuticals, Circadian Technologies, Biota Holdings, Halcygen Pharmaceuticals, Impedimed, QRxPharma, Patrys, LBT Innovations, Hexima, Tyrian Diagnostics, Mesoblast, Atcor Medical, CathRx, BioMD, Tissue Therapies, Viralytics, Phosphagenics

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