ABN·AMRO Morgans

Monday 11 February 2008 **Company visit**

Genepharm Australasia (GAA)

Entre into Asia

GAA has acquired Strides Arcolab for A$65m (8.8x FY08F EBITDA). This purchase appears strategically sound and should be 6%+ EPS accretive. While a step in the right direction, given the absence of clear catalysts, we remain cautious on GAA. Hold.

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	2.22	4.44
Normalised PE (x)	n/m	21.7	10.5	9.08	7.97
EV/EBITDA (x)	n/m	13.7	7.82	4.89	3.67
Price/net oper. CF (x)	-11.0	13.0	-5.32	12.9	11.6
ROIC (%)	-26.9	11.6	12.1	11.9	12.8

1. Pre-goodwill amortisation and exceptional items *year to Jun, fully diluted*
Accounting Standard: IFRS
Source: Company data, ABN AMRO Morgans forecasts

Strides Arcolab acquisition is strategically sound

GAA and Indian generic pharmaceutical company Strides Arcolab Limited have signed a Heads of Agreement under which GAA proposes to acquire the business of Strides in Australia and Asia. Consideration is ~A$65m in scrip (8.8x FY08F EBITDA). Given the recent market de-rating of risk, this appears to be a full price, but compares well with historic acquisition multiples. Strides is involved in the manufacture and distribution of generic prescription and over-the-counter 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 positive given: 1) the complementary product range between the two businesses; 2) the creation of a new distribution channel for GAA's product range; 3) the preservation of existing customer and supplier relationships, while providing cross-selling opportunities; 4) the provision to GAA of an Asian base, through DHA in Singapore; and 5) access by GAA to Strides' future products and its manufacturing capability.

Strides becomes majority GAA shareholder, with 55% of capital base

Strides has acquired a relevant interest over 17.7% of the issued shares held by Genepharm Asia Pacific Enterprises (GAPE). Added to Strides' existing shareholding of 2.1%, this brings its interest in GAA to 19.8%. Assuming the proposed acquisition of the Strides' Australian and Asian business is successful, Strides may have about 55% of the expanded capital base. The acquisition is subject to an EGM expected to be held in early May. There is an A$0.5m break-fee in place.

Only mildly EPS accretive due to 108m shares to be issued

We forecast Strides to generate FY08 revenue of A$32.5m and EBITDA of A$7.4m (22.7% margin). Assuming no synergies or integration costs, we estimate a pro-forma FY08 EPS impact of +6.2% (see details overleaf).

Investment view - Hold recommendation, A$0.45 price target

At this stage we make no changes to our forecasts. GAA is expected to report its interim result on 28 February. We forecast an interim profit of A$2.4m (40:60 split).

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 8 February 2008.

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$0.45

Target price

A$0.45

Market capitalisation

A$62.55m (US$55.84m)

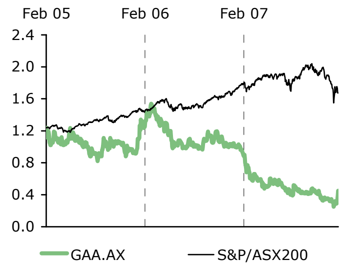
Avg (12mth) daily turnover

A$0.16m (US$0.13m)

Reuters

GAA.AX GAA80211

Price performance	(1M)	(3M)	(12M)
Price (A$)	0.3	0.5	1.0
Absolute %	36.4	-3.2	-55.0
Rel market %	47.7	11.5	-53.1
Rel sector %	40.7	5.9	-49.9



Stock borrowing: Hard onshore, Impossible offshore
Volatility (30-day): 118.45%
Volatility (6-month trend): ↑
52-week range: 1.01-0.25
S&P/ASX200: 5658.00
BBG AP Pharm & Biotech: 148.68

Source: ABN AMRO, Bloomberg

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Genepharm to acquire Strides Arcolab Limited

GAA and Indian generic pharmaceutical company Strides Arcolab Limited have signed a Heads of Agreement under which GAA proposes to acquire 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 also 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 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 is 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$0.60, a 33% premium to Friday's closing price. Given the recent market de-rating of risk and dilution to existing shareholders, this appears to be a full price, but compares well with historic acquisition multiples (Sigma acquiring Orphan Australia at 10x EBITDA, Sigma acquiring Arrow Pharmaceuticals for 16x EBITDA, Genepharm Australasia acquiring Douglas Pharmaceuticals for 11x EBITDA and Sigma acquiring Herron for 10x EBITDA).

We forecast Strides to generate FY08 revenue of A$32.5m and an EBITDA of A$7.4m (22.7% margin). Assuming no synergies or integration costs and an effective tax rate of 20%, to take into account the GAA tax losses, we estimate a pro-forma FY08 EPS impact of +6.2%. See Table 1.

Table 1 : Pro-forma acquisition analysis

A$m	FY08F	FY09F
Revenue – GAA	69.4	85.8
Revenue - Strides - assume 5% growth in FY09	32.5	34.1
Revenue – Total	**101.9**	**119.9**
EBITDA – GAA	8.2	11.0
EBITDA - Strides (22.7% margin)	7.4	7.7
EBITDA – Total	**15.6**	**18.8**
EBITDA margin	*15%*	*16%*
D&A	1.1	1.5
Net interest – GAA	0.5	0.2
NPBT	14.1	17.1
Tax @ 20%	2.8	3.4
NPAT	**11.3**	**13.7**
NPAT growth		*21.5%*
Number of shares on issue - GAA	140.7	148.8
New shares issued @ 60cps	108.3	108.3
Total shares on issue	**249.1**	**257.1**
Old EPS (cps)	4.27	4.95
New EPS (cps)	4.53	5.33
Accretion	**6.2%**	**7.7%**

Source: Company data, ABN AMRO Morgans estimates

Investment view – Hold maintained

At this stage we make no changes to our forecasts, preferring to incorporate this acquisition into our numbers following the release of the Explanatory Memorandum prior to the extraordinary general meeting to be held in May 2008. Our DCF valuation is unchanged at 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. Hold maintained

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.

GAA – financial summary

Year to 30 Jun (A$m)	AIFRS	AIFRS	AIFRS	AIFRS	AIFRS
Income statement	**2006A**	**2007A**	**2008F**	**2009F**	**2010F**
Divisional sales	1.8	54.5	69.4	85.8	107.3
Total revenue	1.8	54.5	69.4	85.8	107.3
EBITDA	-3.6	3.8	8.2	11.0	12.7
Associate income	0.0	0.0	0.0	0.0	0.0
Depreciation	-2.4	-1.2	-1.1	-1.5	-1.8
EBITA	-6.0	2.6	7.2	9.5	10.9
Amortisation/impairment	0.0	0.0	0.0	0.0	0.0
EBIT	-6.0	2.6	7.2	9.5	10.9
EBIT(incl associate profit)	-6.0	2.6	7.2	9.5	10.9
Net interest expense	0.4	-0.2	-0.5	-0.2	0.5
Pre-tax profit	-5.6	2.4	6.7	9.4	11.4
Income tax expense	0.0	0.5	-0.7	-2.0	-2.6
After-tax profit	-5.6	2.9	6.0	7.4	8.8
Minority interests	0.0	0.0	0.0	0.0	0.0
NPAT	-5.6	2.9	6.0	7.4	8.8
Significant items	0.0	-20.9	0.0	0.0	0.0
NPAT post abnormals	-5.6	-18.0	6.0	7.4	8.8

Cash flow statement	2006A	2007A	2008F	2009F	2010F
EBITDA	-3.6	3.8	8.2	11.0	12.7
Change in working capital	-0.4	19.2	-19.1	-3.7	-4.5
Net interest (pd)/rec	0.4	-0.2	-0.5	-0.2	0.5
Taxes paid	0.0	0.5	-0.7	-2.0	-2.6
Other oper cash items	0.0	-18.5	0.0	0.0	0.0
Cash flow from ops (1)	-3.6	4.8	-12.0	5.2	6.0
Capex (2)	-0.2	-0.8	-2.7	-2.5	-2.5
Disposals/(acquisitions)	-1.1	-57.1	0.0	0.0	0.0
Other investing cash flow	-0.1	2.9	0.0	0.0	0.0
Cash flow from invest (3)	-1.4	-55.0	-2.7	-2.5	-2.5
Incr/(decr) in equity	11.4	48.7	2.0	7.9	6.9
Incr/(decr) in debt	0.0	0.0	2.0	0.0	0.0
Ordinary dividend paid	0.0	0.0	0.0	0.0	-3.0
Preferred dividends (4)	0.0	0.0	0.0	0.0	0.0
Other financing cash flow	0.0	0.0	0.0	0.0	0.0
Cash flow from fin (5)	11.4	48.7	4.0	7.9	3.9
Forex and disc ops (6)	0.0	0.0	0.0	0.0	0.0
Inc/(decr) cash (1+3+5+6)	6.4	-1.5	-10.7	10.6	7.4
Equity FCF (1+2+4)	-3.8	4.0	-14.7	2.7	3.6

Balance sheet	2006A	2007A	2008F	2009F	2010F
Cash & deposits	15.0	13.5	0.1	10.7	18.2
Trade debtors	1.4	12.3	9.5	11.8	14.7
Inventory	1.9	11.6	13.9	17.2	21.5
Investments	0.0	0.0	0.0	0.0	0.0
Goodwill	0.0	51.5	51.5	51.5	51.5
Other intangible assets	21.2	10.2	9.6	9.1	8.6
Fixed assets	0.3	1.4	3.6	5.1	6.3
Other assets	1.0	2.9	2.9	2.9	2.9
Total assets	40.8	103.4	91.2	108.4	123.8
Short-term borrowings	0.0	2.7	0.2	0.2	0.2
Trade payables	3.1	27.9	8.4	10.2	13.0
Long-term borrowings	0.0	0.0	1.8	1.8	1.8
Provisions	0.0	0.0	0.0	0.0	0.0
Other liabilities	0.2	2.6	2.6	2.6	2.6
Total liabilities	3.3	33.2	13.0	14.9	17.6
Preference shares	0.0	0.0	0.0	0.0	0.0
Hybrid equity					
Share capital	46.9	97.1	105.1	120.4	133.1
Other reserves	1.7	2.2	2.2	2.2	2.2
FCTR					
Unrealised gains/losses					
Retained earnings	-11.1	-29.1	-29.1	-29.1	-29.1
Other equity	0.0	0.0	0.0	0.0	0.0
Total equity	37.5	70.1	78.2	93.5	106.2
Minority interest	0.0	0.0	0.0	0.0	0.0
Total shareholders' equity	37.5	70.1	78.2	93.5	106.2
Total liabilities & SE	40.8	103.4	91.2	108.4	123.8

Closing price (A$)	0.45	Price target (A$)	0.45
Valuation metrics			
Preferred methodology	DCF	Val'n (A$)	$ 0.56
DCF valuation inputs			
Rf	5.75%	10-year rate	5.75%
Rm-Rf	4.50%	Margin	2.0%
Beta	2.03	Kd	7.75%
CAPM (Rf+Beta(Rm-Rf))	14.9%	Ke	14.9%
E/EV*Ke+D/EV*Kd(1-t)		NPV cash flow (A$m)	81.9
Equity (E/EV)	90.0%	Minority interest (A$m)	0.0
Debt (D/EV)	10.0%	Net debt (A$m)	1.9
Interest rate	7.75%	Investments (A$m)	0.0
Tax rate (t)	30.0%	Equity market value (A$m)	80.0
WACC	13.9%	Diluted no. of shares (m)	141.7
		DCF valuation (A$)	**0.56**

Multiples	2007A	2008F	2009F	2010F
Enterprise value (A$m)	51.8	64.4	53.8	46.4
EV/Sales (x)	0.9	0.9	0.6	0.4
EV/EBITDA (x)	13.7	7.8	4.9	3.7
EV/EBIT (x)	19.8	9.0	5.6	4.3
PE (pre-goodwill) (x)	21.7	10.5	9.1	8.0
PEG (pre-goodwill) (x)	14.5	7.0	6.1	5.3

At target price	2007A	2008F	2009F	2010F
EV/EBITDA (x)	13.8	7.8	4.9	3.7
PE (pre-goodwill) (x)	21.8	10.6	9.1	8.0

Comparable company data (x)		2008F	2009F	2010F
Australian Pharmaceutical Ind	EV/EBITDA	6.5	5.5	4.8
Year to 31 Aug	EV/EBIT	8.4	7.1	6.1
	PE	15.9	10.6	9.6
Sigma Pharmaceuticals	EV/EBITDA	8.5	8.1	7.6
Year to 31 Jan	EV/EBIT	10.5	9.8	9.0
	PE	14.1	13.1	12.0

Per share data	2007A	2008F	2009F	2010F
No. shares	138.5	141.7	149.9	155.9
EPS (cps)	-13.0	4.3	5.0	5.6
EPS (normalised) (c)	2.1	4.3	5.0	5.6
Dividend per share (c)	0.0	0.0	1.0	2.0
Dividend payout ratio (%)	0.0	0.0	0.0	17.0
Dividend yield (%)	0.0	0.0	2.2	4.4

Growth ratios	2007A	2008F	2009F	2010F
Sales growth	2927.0%	27.4%	23.7%	25.1%
Operating cost growth	838.2%	20.5%	22.3%	26.6%
EBITDA growth	nm	118.1%	33.6%	14.9%
EBITA growth	nm	174.6%	32.8%	14.0%

Operating performance	2007A	2008F	2009F	2010F
Asset turnover (%)	18.9	17.8	21.5	23.1
EBITDA margin (%)	6.9	11.9	12.8	11.8
EBIT margin (%)	4.8	10.4	11.1	10.1
Net profit margin (%)	nm	8.7	8.7	8.2
Return on net assets (%)	3.7	9.2	10.2	10.2
Net debt (A$m)	-10.8	1.9	-8.7	-16.2
Net debt/equity (%)	-15.4	2.4	-9.3	-15.2
Net interest/EBIT cover (x)	11.2	15.1	62.8	-22.5
ROIC (%)	11.6	12.1	11.9	12.8

Internal liquidity	2007A	2008F	2009F	2010F
Current ratio (x)	1.2	2.4	3.3	3.6
Receivables turnover (x)	7.9	6.4	8.1	8.1
Payables turnover (x)	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.

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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