Alchemia ACL.AX ACL AU

HEALTH CARE & PHARMACEUTICALS

NOMURA EQUITY RESEARCH

Announces a research collaboration with AZN

ACL will receive a small royalty in FY13F

April 23, 2013

Rating Remains	**Buy**
Target price Remains	AUD 0.55
Closing price April 22, 2013	AUD 0.34
Potential upside	+61.8%

Announces a research collaboration with AZN

ACL announced that it has signed a multi-target drug discovery collaboration with AstraZeneca (AZN LN, unrated). This collaboration includes the use of ACL's Versatile Assembly on Stable Templates (VAST) platform to discover and develop novel small molecules against multiple AZN targets. Alchemia will provide VAST to develop 10-12 small molecule clinical candidates for AZN to treat diseases in the oncology, respiratory, cardiovascular, metabolism, infection and neuroscience spaces.

ACL will receive a small royalty in FY13F

As a result of this agreement, we forecast ACL will receive a AUD0.5mn upfront payment and is eligible for potential preclinical, clinical and commercial launch payments totalling up to AUD240mn, as well as a low-single-digit royalty should any candidates eventually be approved. Given the early-stage nature of the collaboration, we do not currently forecast revenues from AZN from the use of this technology. As a result of this news, FY13F EPS increases to -3.6cps (from -3.8cps).

Valuation: TP AUD0.55 unchanged, Buy rating maintained

Our target price is unchanged. Our AUD0.55 TP is based on the risk-weighted valuation of the company's product opportunities. In our view, ACL has: 1) a de-risked business model, as it has a product (generic fondaparinux) on market; and 2) potential near-to-medium earnings upside surprise from entry to new markets with this product.

Anchor themes

The percentage of the population in the older age group in developed countries is increasing. Improved longevity and the aging population demographic will likely lead to growing demand for treatments and surgeries, which leads to increased need for anti-clotting products, the target market for generic fondaparinux.

Nomura vs consensus

There is minimal consensus data available.

Research analysts

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30 Jun	FY12		FY13F		FY14F		FY15F
Currency (AUD)	Actual	Old	New	Old	New	Old	New
Revenue (mn)	0	15	15	20	20	33	33
Reported net profit (mn)	-15	-11	-11	0	0	11	11
Normalised net profit (mn)	-15	-11	-11	0	0	11	11
FD normalised EPS	-6.23c	-3.71c	-3.55c	0.02c	0.02c	3.32c	3.32c
FD norm. EPS growth (%)	na	na	na	na	na	13,391.9	13,391.9
FD normalised P/E (x)	na	N/A	na	N/A	>100	N/A	10.1
EV/EBITDA (x)	na	N/A	na	N/A	70.7	N/A	4.2
Price/book (x)	3.9	N/A	4.1	N/A	4.1	N/A	3.7
Dividend yield (%)	na	N/A	na	N/A	na	N/A	7.2
ROE (%)	-70.0	-45.7	-43.3	0.3	0.3	40.3	39.6
Net debt/equity (%)	net cash	net cash	net cash	net cash	net cash	net cash	net cash

Source: Company data, Nomura estimates

Key company data: *See page 2 for company data and detailed price/index chart.*

See Appendix A-1 for analyst certification, important disclosures and the status of non-US analysts.

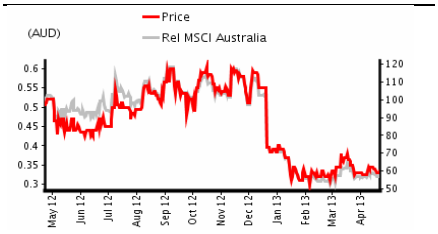
Key data on Alchemia

Income statement (AUDmn)

Year-end 30 Jun	FY11	FY12	FY13F	FY14F	FY15F
Revenue	**0**	**0**	**15**	**20**	**33**
Cost of goods sold	-4	0	0	0	0
Gross profit	**-4**	**0**	**15**	**20**	**33**
SG&A	-12	-17	-27	-21	-18
Employee share expense					
Operating profit	**-15**	**-16**	**-12**	**-1**	**15**
EBITDA	**-13**	**-15**	**-10**	**1**	**17**
Depreciation	0	0	0	0	0
Amortisation	-1	-1	-1	-1	-1
EBIT	-15	-16	-12	-1	15
Net interest expense	0	0	0	1	1
Associates & JCEs					
Other income	1	0	0	0	0
Earnings before tax	**-14**	**-15**	**-11**	**0**	**16**
Income tax	0	0	0	0	-5
Net profit after tax	**-13**	**-15**	**-11**	**0**	**11**
Minority interests	0	0	0	0	0
Other items					
Preferred dividends					
Normalised NPAT	**-13**	**-15**	**-11**	**0**	**11**
Extraordinary items	0	0	0	0	0
Reported NPAT	**-13**	**-15**	**-11**	**0**	**11**
Dividends	0	0	0	0	-8
Transfer to reserves	**-13**	**-15**	**-11**	**0**	**3**
Valuation and ratio analysis					
Reported P/E (x)	na	na	na	>100	9.8
Normalised P/E (x)	-4.8	-5.4	-9.3	1,318.7	9.8
FD normalised P/E (x)	na	na	na	>100	10.1
FD normalised P/E at price target (x)	na	na	na	>100	16.6
Dividend yield (%)	na	na	na	na	7.2
Price/cashflow (x)	na	na	na	53.7	8.5
Price/book (x)	3.4	3.9	4.1	4.1	3.7
EV/EBITDA (x)	na	na	na	70.7	4.2
EV/EBIT (x)	na	na	na	na	4.7
Gross margin (%)	na	100.0	100.0	100.0	100.0
EBITDA margin (%)	na	-4,306.5	-65.9	5.3	50.2
EBIT margin (%)	na	-4,819.9	-77.4	-3.3	45.0
Net margin (%)	na	-4,475.7	-72.8	0.4	33.5
Effective tax rate (%)	na	na	na	30.0	30.0
Dividend payout (%)	na	na	na	0.0	70.0
Capex to sales (%)	na	0.0	0.0	0.0	0.0
Capex to depreciation (x)	0.0	0.0	0.0	0.0	0.0
ROE (%)	-53.4	-70.0	-43.3	0.3	39.6
ROA (pretax %)	-57.5	-83.0	-61.4	-3.5	81.2
Growth (%)					
Revenue	na	na	4,359.0	33.8	64.9
EBITDA	na	na	na	na	1,466.6
EBIT	na	na	na	na	na
Normalised EPS	na	na	na	na	13,391.9
Normalised FDEPS	na	na	na	na	13,391.9
Per share					
Reported EPS (AUD)	-7.02c	-6.23c	-3.62c	0.03c	3.43c
Norm EPS (AUD)	-7.02c	-6.23c	-3.62c	0.03c	3.43c
Fully diluted norm EPS (AUD)	-7.02c	-6.23c	-3.55c	0.02c	3.32c
Book value per share (AUD)	0.10	0.09	0.08	0.08	0.09
DPS (AUD)	0.00	0.00	0.00	0.00	0.02

Source: Company data, Nomura estimates

Relative performance chart (one year)



Source: ThomsonReuters, Nomura research

(%)	1M	3M	12M
Absolute (AUD)	-4.3	1.5	-34.3
Absolute (USD)	-5.5	-0.9	-34.8
Relative to index	-4.5	-3.2	-49.7
Market cap (USDmn)	96.9		
Estimated free float (%)	100.0		
52-week range (AUD)	.62/.29		
3-mth avg daily turnover (USDmn)	0.13		
Major shareholders (%)			
Orbi Global	9.1		
Allan Gray Australia	7.4		

Source: Thomson Reuters, Nomura research

Notes

ACL is well positioned to generate earnings from US sales of fondaparinux

Cashflow (AUDmn)

Year-end 30 Jun	FY11	FY12	FY13F	FY14F	FY15F
EBITDA	-13	-15	-10	1	17
Change in working capital	10	4	0	0	0
Other operating cashflow	-8	-1	-1	1	-4
Cashflow from operations	**-12**	**-12**	**-11**	**2**	**13**
Capital expenditure					
Free cashflow	**-12**	**-12**	**-11**	**2**	**13**
Reduction in investments					
Net acquisitions	0	0	0	0	0
Reduction in other LT assets					
Addition in other LT liabilities					
Adjustments	9	0	0	0	0
Cashflow after investing acts	**-2**	**-11**	**-11**	**2**	**13**
Cash dividends	0	0	0	0	-8
Equity issue	0	20	13	0	0
Debt issue	0	0	0	0	0
Convertible debt issue					
Others	0	2	2	0	0
Cashflow from financial acts	**0**	**22**	**15**	**0**	**-8**
Net cashflow	**-2**	**10**	**3**	**2**	**5**
Beginning cash	5	4	14	17	19
Ending cash	4	14	17	19	24
Ending net debt	-4	-14	-17	-19	-24

Source: Company data, Nomura estimates

Notes

ACL had a AUD20mn equity raising in FY12A. We now assume ACL raises a total of AUD12.95mn in FY13F

Balance sheet (AUDmn)

As at 30 Jun	FY11	FY12	FY13F	FY14F	FY15F
Cash & equivalents	4	14	17	19	24
Marketable securities					
Accounts receivable	0	0	3	3	4
Inventories	0	0	0	0	0
Other current assets	2	2	2	2	2
Total current assets	**6**	**16**	**21**	**23**	**29**
LT investments	0	0	0	0	0
Fixed assets	1	0	0	0	0
Goodwill	6	6	6	6	6
Other intangible assets	12	10	9	8	6
Other LT assets	0	0	0	0	0
Total assets	**24**	**32**	**37**	**37**	**42**
Short-term debt	0	0	0	0	0
Accounts payable	1	3	4	5	6
Other current liabilities	1	1	3	3	3
Total current liabilities	**2**	**5**	**7**	**8**	**9**
Long-term debt	0	0	0	0	0
Convertible debt					
Other LT liabilities	4	3	3	3	3
Total liabilities	**6**	**8**	**10**	**11**	**12**
Minority interest	0	0	0	0	0
Preferred stock	0	0	0	0	0
Common stock	118	139	151	151	151
Retained earnings	-103	-118	-129	-129	-126
Proposed dividends					
Other equity and reserves	4	4	4	4	4
Total shareholders' equity	**19**	**24**	**26**	**26**	**30**
Total equity & liabilities	**24**	**32**	**37**	**37**	**42**
Liquidity (x)					
Current ratio	3.60	3.35	3.07	3.04	3.35
Interest cover	na	na	na	na	na
Leverage					
Net debt/EBITDA (x)	na	na	na	net cash	net cash
Net debt/equity (%)	net cash	net cash	net cash	net cash	net cash
Activity (days)					
Days receivable	na	209.1	32.5	51.8	37.7
Days inventory	0.0	na	na	na	na
Days payable	34.3	na	na	na	na
Cash cycle	na	na	na	na	na

Source: Company data, Nomura estimates

Notes

ACL had net cash of AUD6.2mn as at 31 December 2012

Announces a research collaboration with AZN

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As a result of this agreement, we forecast ACL will receive a AUD0.5mn upfront payment and is eligible for potential preclinical, clinical and commercial launch payments totalling up to AUD240mn, as well as a low-single-digit royalty should any candidates eventually be approved. Given the early-stage nature of the collaboration, we do not currently forecast revenues from AZN from the use of this technology. As a result, FY13F EPS is -3.6cps (from -3.8cps).

Fig. 1: ACL – changes to forecasts

	FY13F			FY14F			FY15F		
	Prev	Rev	Diff (%)	Prev	Rev	Diff (%)	Prev	Rev	Diff (%)
EBIT (AUDmn)	(12.1)	(11.6)	nm	(0.7)	(0.7)	nm	14.9	14.9	0.0
NPAT (AUDmn)	(11.4)	(10.9)	nm	0.1	0.1	nm	11.1	11.1	0.0
EPS (c)	(3.8)	(3.6)	nm	0.0	0.0	nm	3.4	3.4	0.0
DPS (c)	0.0	0.0	nm	0.0	0.0	nm	2.0	2.0	0.0
Net op cash flow (AUDmn)	(12.3)	(11.8)	nm	1.3	1.3	nm	17.0	17.0	0.0

Source: Nomura estimates

Update on HA-Irinotecan phase III clinical trial

Completes enrolment for HA-Irinotecan trial

In February 2013, ACL announced that it had recruited 415 patients to participate in its pivotal Phase III clinical trial of HA-Irinotecan. Second- and third-line colorectal cancer patients were recruited from 76 sites across Australia, Eastern, and Western Europe. ACL expects to determine the outcome of this trial in the first half of 2014.

The study's primary objective is to demonstrate that HA-Irinotecan is superior against Irinotecan alone in metastatic colorectal cancer patients, as indicated by an increase in Progression-Free Survival (PFS) of six weeks or more, without increasing treatment toxicity. The primary endpoint of this double-blind trial will be reached when 350 patients have experienced disease progression.

Patients receiving treatment for longer than expected – may be a positive signal…

However, statistical review and modelling on the available blinded data suggests that on average, patients on this trial are continuing treatment for longer than anticipated, before their disease progresses. This means that the primary endpoint is likely to be met in 1HCY14. We assume HA-irinotecan will get to market in FY16F.

Fig. 2: Clinical trials of antibody anti-CD44 conjugates

Antibody	Drug	Injection Method	Cancer Type	Effect
U36	Re-186	Single intravenous	Head and Neck Squamous Cell Carcinoma	Stable disease in 5 of 9 patients, mild myelotoxicity
BIWA 4	Tc-99m	Single intravenous	Head and Neck Squamous Cell Carcinoma	Tumor targeting
BIWA 4	Re-186	Dose escalation	Head and Neck Squamous Cell Carcinoma	Stable disease in 3 of 6 patients, limiting myelotoxicity
BIWA 4	Re-186	Single intravenous	Early Stage Breast Cancer	Moderate tumor identification, no correlation with CD44v6 expression
BIWA 4	Mertansine	Dose escalation	Head and Neck Squamous Cell Carcinoma	Moderate disease stabilization, skin toxicity
BIWA 4	Mertansine	Dose escalation	Head and Neck Squamous Cell Carcinoma	Low interpatient pharmacokinetic variability, skin toxicity
BIWA 4	Mertansine	Dose escalation	CD44v6 Positive Metastatic Breast Cancer	Stable disease in 12 of 24 patients, dose limiting toxicity

Source: PubMed, Nomura research

In summary, several intrinsic characteristics of HA highlight its potential as a drug-delivery vehicle:

- The nature of HA makes it a vehicle for the delivery of smaller molecules;
- There is up-regulation and activation of the HA receptor CD44 on malignant cancer tissue. An active CD44 within the tumoural environment mediates HA internalization; and
- HA is non-immunogenic and considered by regulatory bodies as a biologically inert compound.

Hence, there is a potential opportunity to target the HA tumour matrix to provide a sustained drug source within the tumour. There have been a number of Targeted Drugs and Drug Carriers trials using HA.

Fig. 3: Targeted drugs and drug carriers *in vitro*

Carrier	Drug	Cancer targeted	Effect
LMW-HA	Paclitaxel	mammary, colon, ovarian	Cytotoxicity, CD44 specific uptake
HMW-HA	Butyrate	mammary, liver, non-small cell lung	Inhibited proliferation, CD44 specific uptake
HMW-HA	Paclitaxel	bladder, ovarian	Cytotoxicity
HMW-HA	Paclitaxel	ovarian	Cytotoxicity
HMW-HA	Carborane	colorectal, mammary, ovarian, transitional cell	CD44 specific uptake
LMW-HA, HMW-HA	siRNA	colon	CD44 specific uptake, gene silencing
HMW-HA Fe2O3 Particle	Peptide	alveolar squamous	Peptide internalization
HPMA Polymer, LMW-HA	Doxorubicin	mammary, colon, ovarian	Cytotoxicity, CD44 specific uptake
Liposome HA Oligos	Doxorubicin	melanoma	Cytotoxicity, CD44 specific uptake
HMW-HA PLGA Particle	Doxorubicin	breast	Cytotoxicity, CD44 specific uptake

Source: PubMed, Nomura research

What is the HA–Irinotecan timeline?

ACL may deliver potential upside if successful in its oncology and drug-discovery platforms. ACL has finalised recruitment for its phase III clinical trial to evaluate HA-Irinotecan and is currently recruiting a phase II clinical trial for HA-Irinotecan in Small Cell Lung Cancer (SCLC). ACL's timeline is shown below.

Fig. 4: ACL – stage of development

Trial stage	Preclinical	Phase I	Phase II	Phase III	Filed	On market	Partner
General time until cashflow	7 years+	5-7 years	3-5 years	1-2 years			
General probability of product getting to market	c10%	13%	21%	61%			
Industry standard cost of trials	cUSD5m	cUSD10m	cUSD20m	cUSD75m			
Indications and stages of development							
Cardiovascular							
Fondaparinux (VTE)							Dr Reddy's
HyACT Oncology							
HA-Irinotecan (Colorectal)					Recruiting complete		
HA-Irinotecan (SCLC)					Recruiting		
HA-Doxorubicin							
HA-5FU							
VAST Drug Discovery Platform							
Various targets							Pharma Partners

Source: Nomura estimates, Tufts data

Valuation and risks

Our AUD0.55 TP remains unchanged. It is based on the risk-weighted valuation of the company's product opportunities. In our view, ACL has: 1) a de-risked business model, as it has a product (generic fondaparinux) on market; and 2) potential near- to medium-term earnings upside surprise from entry to new markets with this product. Finally, at the current share price, we believe investors are getting a free option on any upside ACL may deliver if successful in its anti-cancer projects.

We have valued the generic fondaparinux opportunity in line with our forecasts for growth of the fondaparinux market in the US market, as well as potential entry into other developed markets. In addition, we have valued other opportunities for ACL, namely HA-irinotecan. Our valuation can be seen in the following figure.

Fig. 5: ACL – valuation methodology

Product	Valuation (AUDps)	Probability (%)	Risk-weighted valuation
Fondaparinux	0.41	100.0	0.41
ACL Oncology	0.40	61.2	0.24
Less R&D	-0.16		-0.16
Cash	0.05		0.05
Valuation	**0.70**		0.55

Source: Nomura estimates

Risks to our investment view

For ACL's leading product, generic fondaparinux, there is still uncertainty around the potential level of growth in most of its prospective markets. ACL's rate of earnings growth is dependent on the sales and marketing support provided by its partner Dr Reddy's Laboratories. Should ACL enter further clinical trials in new methods of drug delivery, we note that early results give no real enough indication of a product's true viability, and full foresight on future market conditions is difficult to obtain.

In addition, there is still a good deal of uncertainty around the viability of ACL's HA-irinotecan in most of its prospective markets. Early clinical trials, although positive, give no real enough indication of a product's true viability and full foresight on future market conditions is difficult to obtain. To date, all preclinical and Phase II trials have shown indications for product viability. As it stands, there have been no significant adverse effects or health issues and Phase II trials indicate a product with the potential for market viability. Therefore, we believe this is an investment opportunity for investors with a higher risk appetite.

Appendix A-1

Analyst Certification

I, Zara Lyons, hereby certify (1) that the views expressed in this Research report accurately reflect my personal views about any or all of the subject securities or issuers referred to in this Research report, (2) no part of my compensation was, is or will be directly or indirectly related to the specific recommendations or views expressed in this Research report and (3) no part of my compensation is tied to any specific investment banking transactions performed by Nomura Securities International, Inc., Nomura International plc or any other Nomura Group company.

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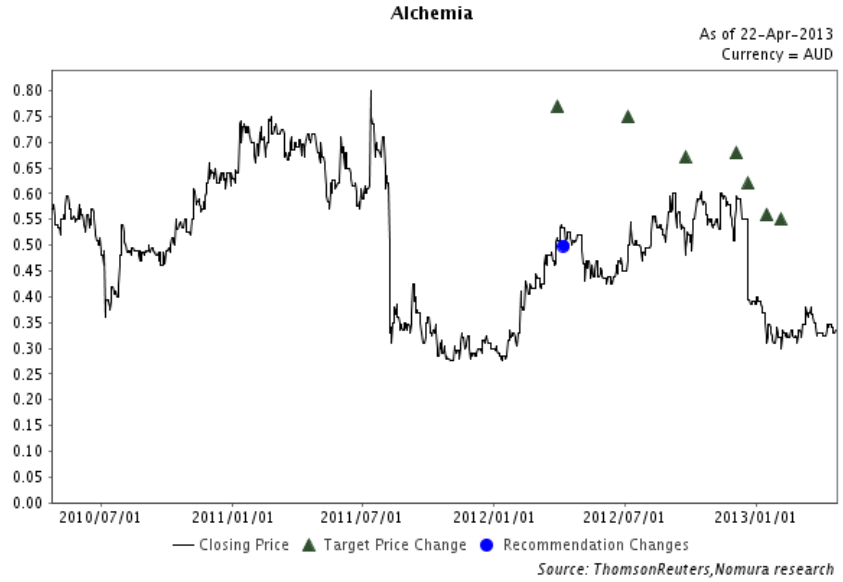
Materially mentioned issuers

Issuer	Ticker	Price	Price date	Stock rating	Sector rating	Disclosures
Alchemia	ACL AU	AUD 0.34	22-4-2013	Buy	Not rated	

Alchemia (ACL AU) **AUD 0.34 (22-4-2013)** Buy (Sector rating: Not rated)

Rating and target price chart (three year history)



Date	Rating	Target price	Closing price
04-Feb-13		0.55	0.32
16-Jan-13		0.56	0.31
21-Dec-12		0.62	0.395
04-Dec-12		0.68	0.57
24-Sep-12		0.67	0.48
06-Jul-12		0.75	0.50
30-Mar-12	Buy		0.51
30-Mar-12		0.77	0.51

For explanation of ratings refer to the stock rating keys located after chart(s)

Valuation Methodology Our AUD0.55 TP is based on the risk-weighted valuation of the company's product opportunities plus cash and less R&D expenses. We have valued the generic fondaparinux opportunity (AUD0.39/sh) in line with our forecasts for the growth of the fondaparinux market in the US market, as well as potential entry into other developed markets. In addition, we have valued other opportunities (AUD0.23/sh)for ACL, namely HA-Irinotecan, and have added cash (AUD0.07/sh) and subtracted R&D expenses (-AUD0.15/sh).

Risks that may impede the achievement of the target price For ACL's leading product, generic fondaparinux, there is still uncertainty around the potential level of growth in most of its prospective markets. ACL's rate of earnings growth is dependent on the sales and marketing support provided by its partner Dr Reddy's Laboratories. Should ACL enter further clinical trials in new methods of drug delivery, we note that early results give no real enough indication of a product's true viability, and full foresight on future market conditions is difficult to obtain. For irinotecan, there is still a good deal of uncertainty around the viability of ACL's HA-iriontecan in most of its prospective markets. Early clinical trials, although positive, give no real enough indication of a product's true viability and full foresight on future market conditions is difficult to obtain. To date, all preclinical and Phase II trials have shown indications for product viability. As it stands, there have been no significant adverse effects or health issues and Phase II trials indicate a product with the potential for market viability. Therefore, we believe this is an investment opportunity for investors with a higher risk appetite.

Important Disclosures

Online availability of research and conflict-of-interest disclosures

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The distribution of all ratings published by Nomura Global Equity Research is as follows:
43% have been assigned a Buy rating which, for purposes of mandatory disclosures, are classified as a Buy rating; 40% of companies with this rating are investment banking clients of the Nomura Group*.
46% have been assigned a Neutral rating which, for purposes of mandatory disclosures, is classified as a Hold rating; 48% of companies with this rating are investment banking clients of the Nomura Group*.
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As at 31 March 2013. **The Nomura Group as defined in the Disclaimer section at the end of this report.*

Explanation of Nomura's equity research rating system in Europe, Middle East and Africa, US and Latin America

The rating system is a relative system indicating expected performance against a specific benchmark identified for each individual stock. Analysts may also indicate absolute upside to target price defined as (fair value - current price)/current price, subject to limited management discretion. In most cases, the fair value will equal the analyst's assessment of the current intrinsic fair value of the stock using an appropriate valuation methodology such as discounted cash flow or multiple analysis, etc.

STOCKS

A rating of '**Buy**', indicates that the analyst expects the stock to outperform the Benchmark over the next 12 months. A rating of '**Neutral**', indicates that the analyst expects the stock to perform in line with the Benchmark over the next 12 months. A rating of '**Reduce**', indicates that the analyst expects the stock to underperform the Benchmark over the next 12 months. A rating of '**Suspended**', indicates that the rating, target price and estimates have been suspended temporarily to comply with applicable regulations and/or firm policies in certain circumstances including, but not limited to, when Nomura is acting in an advisory capacity in a merger or strategic transaction involving the company. Benchmarks are as follows: **United States/Europe**: please see valuation methodologies for explanations of relevant benchmarks for stocks, which can be accessed at: http://go.nomuranow.com/research/globalresearchportal/pages/disclosures/disclosures.aspx; **Global Emerging Markets (ex-Asia):** MSCI Emerging Markets ex-Asia, unless otherwise stated in the valuation methodology.

SECTORS

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Explanation of Nomura's equity research rating system in Japan and Asia ex-Japan

STOCKS

Stock recommendations are based on absolute valuation upside (downside), which is defined as (Target Price - Current Price) / Current Price, subject to limited management discretion. In most cases, the Target Price will equal the analyst's 12-month intrinsic valuation of the stock, based on an appropriate valuation methodology such as discounted cash flow, multiple analysis, etc. A '**Buy**' recommendation indicates that potential upside is 15% or more. A '**Neutral**' recommendation indicates that potential upside is less than 15% or downside is less than 5%. A '**Reduce**' recommendation indicates that potential downside is 5% or more. A rating of '**Suspended**' indicates that the rating and target price have been suspended temporarily to comply with applicable regulations and/or firm policies in certain circumstances including when Nomura is acting in an advisory capacity in a merger or strategic transaction involving the subject company. Securities and/or companies that are labelled as '**Not rated**' or shown as '**No rating**' are not in regular research coverage of the Nomura entity identified in the top banner. Investors should not expect continuing or additional information from Nomura relating to such securities and/or companies.

SECTORS

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