



CogState Limited (CGS)

Speculative Buy

Cognisant of Generating New Clients – Executes First Clinical Deal with Merck

\$0.23

Thomas Duthy *PhD MBA*
tduthy@taylorcollison.com.au
+61 2 9232 1688

Key Points

CogState has executed its first clinical trial agreement with global pharmaceutical company Merck (NYSE:MRK).

The contract is for a Phase 1 clinical trial, presumably testing one of Merck's CNS drugs.

Merck has an extensive CNS program potentially available for further cognition testing.

CogState current order book now exceeds \$2.4 million.

Summary

Market Capitalisation (M)	\$10.2
Share Price	\$0.23
Valuation Per Share	\$0.42
Cash (M) as at 30/6/06	\$2.7
Ave Monthly Volume (Yr Rolling)(M)	0.97
Year High	\$0.30
Year Low	\$0.10
Market Cap: Cash Ratio	3.8
Market Cap: Cash Ratio (Sector)	14.2

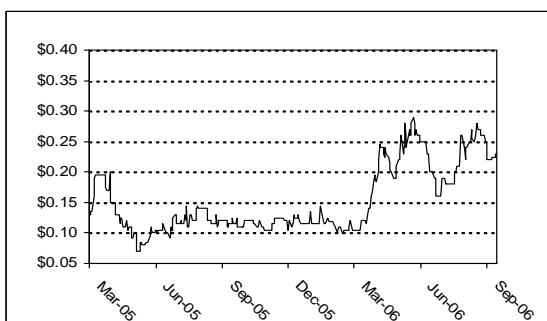
Key Financials (A\$'000)

Year End	2005	2006	2007
	Actual	Actual	Est.
Revenue	1,525	2,433	4,370
Net Op. Rev	(2,301)	(1,642)	233
R&D Expenses	(260)	(237)	(50)
EBITDA	(2,782)	(2,023)	23
EBIT	(2,896)	(2,099)	(52)
NPAT pre Net R&D	(2,307)	(1,544)	490
Reported Profit	(2,278)	(1,603)	440
Reported EPS (c)	(6.4)	(4.1)	1.0
PE Ratio (x)	n/a	n/a	23.3
EPS pre R&D (c)	(6.5)	(3.9)	1.1
PE Ratio pre R&D (x)	n/a	n/a	20.9
ROE (%)	-45.9%	-46.3%	14.0%

Our View

- CogState continues to impress with its ability to win new business from major pharmaceutical companies. We believe the contract is likely to be over \$100,000. While the contract itself is relatively small, the relationship with Merck allows CogState to further diversify its revenue base away from Pfizer. Our analysis of the Merck pipeline indicates 9 active clinical trial programs amenable for cognition testing. We believe the maximum exploitable cognition testing revenues for Merck's pipeline is approximately \$9.1 million. Our Merck estimates do not include any CNS drugs in pre-clinical development, which could progress into human clinical trials over time.
- We note that since May, the Company has added Merck, GlaxoSmithKline and Lundbeck as clients, aside from Pfizer who has historically been the major source of clinical trial revenues for CogState. We believe such contracts are valuable because of the likelihood of ongoing cognition testing requirements as the drug progresses through clinical trials, but also via contracts for other drugs in the pipeline. We believe CogState's ability to secure additional contracts to provide its cognition testing battery (ClinIT) remains strong. Taking a macro perspective, we note clinical trials in CNS diseases continue to show growth in excess of other disease indications. The regulatory environment is also proving favourable, with cognition testing now essential for a range of CNS diseases, including schizophrenia.
- ClinIT continues to form the majority of our FY07 (81.2%) and FY08 (90.1%) product revenue estimates. We have not altered our financial model as a result of the Merck agreement and maintain our FY07 NPAT forecast of \$0.4 million. CogState is currently trading on 23.3x our forecast FY07 EPS, with estimated FY07 free cash flows of \$1.0 million. CogState is currently trading at a 45.2% discount to our \$0.42 valuation per share, thus we continue with our Speculative Buy recommendation.

Share Price Graph (A\$)



CGS - Summary of Forecasts

CGS \$ 0.23

PROFIT & LOSS SUMMARY (A\$000s)				
Period	FY05A	FY06A	FY07E	FY08E
Total Revenue	1,525	2,433	4,370	5,396
<i>Growth (pcp)</i>	296.1%	59.6%	79.6%	23.5%
Net Operating Revenue	(2,301)	(1,642)	233	1,145
Direct R&D Expenses	(260)	(237)	(50)	(53)
EBITD	(2,782)	(2,023)	23	874
Dep'n/Other Amort'n	(51)	(76)	(56)	(102)
EBIT	(2,896)	(2,099)	(52)	753
Net Interest	221	144	160	218
Pre-Tax Profit	(2,675)	(1,955)	108	972
Tax Expense	397	352	332	0
Minorities	0	0	0	0
NPAT	(2,278)	(1,603)	440	972
<i>Growth (pcp)</i>	14.9%	29.6%	n/a	120.9%
Net Abnormals	0	0	0	0
Reported Profit	(2,278)	(1,603)	440	972
NPAT pre Net R&D	(2,307)	(1,544)	490	1,024

PER SHARE DATA				
Period	FY05A	FY06A	FY07E	FY08E
Reported EPS (c)	(6.4)	(4.1)	1.0	2.2
<i>Growth (pcp)</i>	-53.5%	n/a	n/a	120.9%
EPS Pre-Net R&D (c)	(6.5)	(3.9)	1.1	2.3
<i>Growth (pcp)</i>	0.0%	n/a	n/a	109.1%
Dividend (c)	0.0	0.0	0.0	0.0
Franking	0%	0%	0%	0%
Gross CF per Share (c)	(5.9)	(3.6)	2.4	2.5
NTA per share (c)	9.7	6.9	6.3	8.4

KEY RATIOS				
Period	FY05A	FY06A	FY07E	FY08E
EBITD/Sales Margin %	-182.5%	-83.2%	0.5%	16.2%
EBIT/Sales Margin %	-189.9%	-86.3%	-1.2%	14.0%
Current ratio (x)	6.9	4.7	2.4	2.5
Net Debt : Equity (%)	-29.2%	-85.9%	-113.6%	-113.3%
ROE (%)	-45.9%	-46.3%	14.0%	26.7%
Dividend Payout Ratio (%)	0.0%	0.0%	0.0%	0.0%

VALUATION MULTIPLES				
Period	FY05A	FY06A	FY07E	FY08E
PE Ratio (x)	n/a	n/a	23.3	10.5
Dividend Yield (%)	0.0%	0.0%	0.0%	0.0%
EV/EBITD (x)	n/a	n/a	283.7	6.4
EV/EBIT (x)	n/a	n/a	n/a	7.4

CAPITAL RAISING ASSUMPTIONS				
Period	FY05A	FY06A	FY07E	FY08E
Shares Issued (m)	0.0	8.6	0.0	0.0
Issue Price (A\$)	0.00	0.10	0.00	0.00
Cash Raised (A\$m)	0.0	0.86	0.0	0.0

BALANCE SHEET SUMMARY				
Period	FY05A	FY06A	FY07E	FY08E
Cash	1,119	2,661	3,635	4,629
Receivables	344	434	780	1,062
Pre Payments	0	22	0	0
Inventories	0	0	0	0
Investments	2,311	0	0	0
Other	47	77	0	0
Total Current Assets	3,821	3,194	4,414	5,691
Investments	0	0	0	0
Inventories	0	0	0	0
Property Plant & Equip	139	170	256	302
Intangibles	375	402	382	363
Deferred Tax Assets	55	46	46	46
Other	0	0	0	0
Total Non-Current Assets	569	618	684	711
TOTAL ASSETS	4,390	3,812	5,098	6,403
Accounts Payable	290	279	743	1,012
Revenue in Advance	107	302	743	759
Borrowings	0	0	0	0
Deferred Tax Liabilities	0	2	2	2
Provisions	155	93	371	506
Total Current Liab	552	676	1,859	2,278
Borrowings	0	0	0	0
Provisions	8	39	39	39
Other	0	0	0	0
Total Non-Current Liab	8	39	39	39
TOTAL LIABILITIES	560	715	1,898	2,317
TOTAL EQUITY	3,830	3,096	3,200	4,085

CASH FLOW SUMMARY				
Period	FY05A	FY06A	FY07E	FY08E
EBIT (excl Abs/Extr)	(2,896)	(2,099)	(52)	753
Add: Depreciation	51	76	56	102
Change in Pay.	160	(11)	464	269
Change in Rev. in Ad.	107	195	441	16
Less: Tax paid	397	352	332	0
Net Interest	221	144	160	218
Change in Rec.	(222)	(90)	(346)	(282)
Change in Inv.	0	0	0	0
Gross Cashflows	(2,119)	(1,433)	1,074	1,095
Capex	(124)	(108)	(100)	(100)
Free Cashflows	(2,243)	(1,541)	974	995
Dividends Paid	0	0	0	0
Net Cash Flow	(2,243)	(1,541)	974	995

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Taylor Collison Limited **Sharebrokers and Investment Advisers**

A.B.N. 53 008 172 450

AFSL No. 247083

Participant of the Australian Stock Exchange Group

Level 2, 12 Pirie Street

Adelaide, South Australia, 5000

G.P.O. Box 2046, Adelaide, South Australia, 5001

Telephone: 08 8217 3900 Facsimile: 08 8231 3506

Email: broker@taylorcollison.com.au

Level 2, 55 Hunter Street

Sydney, New South Wales, 2000

G.P.O. Box 4261, Sydney, New South Wales, 2001

Telephone: 02 9232 1688 Facsimile: 02 9232 1677

Email: sydney1@taylorcollison.com.au

www.taylorcollison.com.au

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