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# CogState Limited (CGS)

Speculative Buy

Expands Client Base with GlaxoSmithKline Clinical Deal

\$0.28

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## Key Points

CogState has executed a Phase 1 clinical trial deal with Glaxo SmithKline (GSK).

The deal is the first time CogState has seen its ClinIT cognition testing battery incorporated into a GSK CNS clinical trial.

Additional clinical trial contracts are expected in the coming months with both new and existing customers.

## Summary

Market Capitalisation (M)	\$12.2
Share Price	\$0.28
Valuation Per Share	\$0.39
Est. Cash (M) as at 6/4/06	\$3.2
Year High	\$0.30
Year Low	\$0.08
Market Cap: Cash Ratio	3.6
Market Cap: Cash Ratio (Sector)	14.2

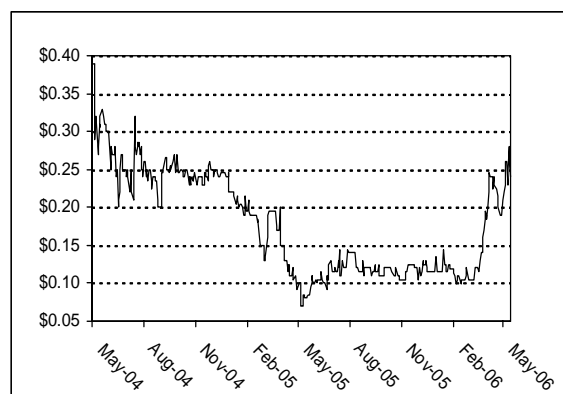
## Key Financials (A\$'000)

Year End	2005	2006	2007
	Actual	Est.	Est.
Revenue	1,525	2,535	4,532
Net Op. Rev	(2,302)	(1,811)	395
R&D Expenses	(260)	(275)	(289)
<b>EBITD</b>	<b>(2,783)</b>	<b>(2,224)</b>	<b>(23)</b>
EBIT	(2,897)	(2,276)	(99)
<b>NPAT pre Net R&amp;D</b>	<b>(2,308)</b>	<b>(1,600)</b>	<b>650</b>
<b>Reported Profit</b>	<b>(2,279)</b>	<b>(1,789)</b>	<b>361</b>
<b>Reported EPS (c)</b>	<b>(6.4)</b>	<b>(4.6)</b>	<b>0.8</b>
PE Ratio (x)	n/a	n/a	34.5
<b>EPS pre R&amp;D (c)</b>	<b>(6.5)</b>	<b>(4.1)</b>	<b>1.5</b>
PE Ratio pre R&D (x)	n/a	n/a	17.8

## Our View

- CogState now has contracted future revenues in excess of A\$2.3 million, the majority of which has been secured post the restructure of the business announced in the 2Q. Such deal flow continues to reinforce our view the turnaround in the business appears to be on track. One concern for investors has been the reliance on Pfizer for the bulk of CogState's ClinIT revenues (82% in FY05). Based on our analysis of Pfizer's known early stage clinical program (Phase 1 or 2), we believe it represents <5% of total current Phase 1/2 clinical trials in the key cognition testing markets of schizophrenia, epilepsy, depression and Alzheimer's disease. We therefore see substantial business development upside as CogState seeks to diversify its customer base further through additional deals with companies like GSK.
- We continue to believe the ClinIT franchise will be the key revenue and profit driver for CogState moving forward. We have examined GSK's CNS pipeline (see Appendix 1) and compared it to GSK's major pharma peers in CNS viz. Pfizer, Eli Lilly, J&J. Advantageously for CogState, GSK has the most solid R&D pipeline in indications amenable for cognition testing, as described above. Furthermore, GSK has traditionally utilised the services of Cambridge Cognition and Cognitive Drug Research (CDR) for its CNS cognition trials. In our view, this provides further independent validation of the usefulness of CogState's cognition testing battery in the clinical trial setting. GSK's CNS pipeline could be worth a maximum of US\$24.4 million in future cognition testing requirements (assuming all current drugs move to two pivotal Phase 3 trials). We therefore believe this will be the first in a series of contracts with GSK in the medium term for CogState.
- We had largely factored into our model further deals in the clinical trial space, which forms the majority of our FY06 (65.8%) and FY07 (82.1%) product revenue estimates. However, we consider the US\$0.5 million Japanese distribution deal announced back in March as largely unexpected and have upgraded our FY07 NPAT estimate by 136.8% to \$0.36 million. We have also upgraded our DCF valuation by 11.4% to \$0.39 per share (fully diluted). Though the stock has rallied 180% over the last eight weeks, CogState is still trading at a discount to our upgraded valuation. Management has also indicated strong desire to continue to reduce its reliance on Pfizer for the bulk of its ClinIT revenues through additional clinical trial deals with other pharmaceutical and/or biotech companies. We therefore continue with our Speculative Buy recommendation.

## Share Price Graph (A\$)



## Appendix 1

Brand/code	Generic	Indication	Stage	Sales potential (\$m)		Expected launch
				2007	2010	
Trexima	naproxen/ sumatriptan	Migraine	Phase III	20	126	2008
n/a	talnetant	Schizophrenia	Phase II	n/1	n/1	>2010
Avandia	rosiglitazone	Alzheimer's disease	Phase II	n/1	n/1	>2010
683699	alpha-4 integrin antagonist	Multiple sclerosis	Phase II	n/1	n/1	>2010
679769	NK1 antagonist	Depression	Phase II	n/1	n/1	>2010
597599	vestipitant/ paroxetine	Depression	Phase II	n/1	n/1	>2010
468816	glycine antagonist	Smoking cessation	Phase II	n/1	n/1	>2010
406381	COX-II inhibitor	Pain/Migraine	Phase II	n/1	n/1	>2010
372475	n/a	Depression	Phase II	n/1	n/1	>2010
n/a	radafaxine	Depression/RLS	Phase II	n/1	n/1	>2010
876008	CRF1 antagonist	Depression	Phase I	n/1	n/1	>2010
842166	CB2 agonist	Pain	Phase I	n/1	n/1	>2010
823296	NK1 antagonist	Depression	Phase I	n/1	n/1	>2010
773812	5HT antagonist	Schizophrenia	Phase I	n/1	n/1	>2010
742457	5HT antagonist	Schizophrenia	Phase I	n/1	n/1	>2010
705498	vanilloid antagonist	migraine	Phase I	n/1	n/1	>2010
644784	COX-II inhibitor	Pain	Phase I	n/1	n/1	>2010
406725	n/a	Migraine/Pain	Phase I	n/1	n/1	>2010
274150	n/a	Migraine	Phase I	n/1	n/1	>2010
189254	n/a	Alzheimer's disease	Phase I	n/1	n/1	>2010

Source: Business Insights

## CGS - Summary of Forecasts

CGS \$ 0.28

PROFIT & LOSS SUMMARY (A\$000s)				
Period	FY04A	FY05A	FY06E	FY07E
<b>Total Revenue</b>	<b>385</b>	<b>1,525</b>	<b>2,535</b>	<b>4,532</b>
<i>Growth (pcp)</i>	<i>n/a</i>	<i>296.1%</i>	<i>66.2%</i>	<i>78.7%</i>
<b>Net Operating Revenue</b>	<b>(2,187)</b>	<b>(2,302)</b>	<b>(1,811)</b>	<b>395</b>
Direct R&D Expenses	(41)	(260)	(275)	(289)
<b>EBITD</b>	<b>(2,098)</b>	<b>(2,783)</b>	<b>(2,224)</b>	<b>(23)</b>
Dep'n/Other Amort'n	(28)	(51)	(51)	(58)
<b>EBIT</b>	<b>(2,189)</b>	<b>(2,897)</b>	<b>(2,276)</b>	<b>(99)</b>
Net Interest	(130)	221	139	129
<b>Pre-Tax Profit</b>	<b>(2,319)</b>	<b>(2,676)</b>	<b>(2,137)</b>	<b>29</b>
Tax Expense	485	397	348	332
Minorities	0	0	0	0
<b>NPAT</b>	<b>(2,678)</b>	<b>(2,279)</b>	<b>(1,789)</b>	<b>361</b>
<i>Growth (pcp)</i>	<i>n/a</i>	<i>n/a</i>	<i>n/a</i>	<i>n/a</i>
Net Abnormals	0	0	0	0
<b>Reported Profit</b>	<b>(2,678)</b>	<b>(2,279)</b>	<b>(1,789)</b>	<b>361</b>
<b>NPAT pre Net R&amp;D</b>	<b>(1,849)</b>	<b>(2,308)</b>	<b>(1,600)</b>	<b>650</b>

PER SHARE DATA				
Period	FY04A	FY05A	FY06E	FY07E
<b>Reported EPS (c)</b>	<b>(9.4)</b>	<b>(6.4)</b>	<b>(4.6)</b>	<b>0.8</b>
<i>Growth (pcp)</i>	<i>n/a</i>	<i>n/a</i>	<i>n/a</i>	<i>n/a</i>
<b>EPS Pre-Net R&amp;D (c)</b>	<b>(9.5)</b>	<b>(6.5)</b>	<b>(4.1)</b>	<b>1.5</b>
<i>Growth (pcp)</i>	<i>n/a</i>	<i>n/a</i>	<i>n/a</i>	<i>n/a</i>
Dividend (c)	0.0	0.0	0.0	0.0
Franking	0%	0%	0%	0%
Gross CF per Share (c)	(9.7)	(5.9)	(2.7)	2.7
NTA per share (c)	41.0	9.7	4.3	4.2

KEY RATIOS				
Period	FY04A	FY05A	FY06E	FY07E
EBITD/Sales Margin %	-544.9%	-182.5%	-87.7%	-0.5%
EBIT/Sales Margin %	-568.6%	-190.0%	-89.8%	-2.2%
Current ratio (x)	25.7	6.9	2.0	1.5
Net Debt : Equity (%)	-5.3%	-29.2%	-111.5%	-151.7%
ROE (%)	n/a	-46.0%	-60.3%	16.5%
Dividend Payout Ratio (%)	0.0%	0.0%	0.0%	0.0%

VALUATION MULTIPLES				
Period	FY04A	FY05A	FY06E	FY07E
PE Ratio (x)	n/a	n/a	n/a	34.5
Dividend Yield (%)	0.0%	0.0%	0.0%	0.0%
EV/EBITD (x)	n/a	n/a	n/a	n/a
EV/EBIT (x)	n/a	n/a	n/a	n/a

CAPITAL RAISING ASSUMPTIONS				
Period	FY04A	FY05A	FY06E	FY07E
Shares Issued (m)	19.5	0.0	8.6	0.0
Issue Price (A\$)	0.5	0.00	0.10	0.00
Cash Raised (A\$m)	9.75	0.0	0.86	0.0

BALANCE SHEET SUMMARY				
Period	FY04A	FY05A	FY06E	FY07E
Cash	321	1,119	2,343	3,446
Receivables	122	344	627	1,297
Inventories	0	0	0	0
Investments	5,250	2,311	0	0
Other	46	47	28	0
<b>Total Current Assets</b>	<b>5,739</b>	<b>3,821</b>	<b>2,998</b>	<b>4,743</b>
Investments	0	0	0	0
Inventories	0	0	0	0
Property Plant & Equip	66	139	165	270
Intangibles	438	375	400	380
Deferred Tax Assets	34	55	38	38
Other	34	0	31	0
<b>Total Non-Current Assets</b>	<b>572</b>	<b>569</b>	<b>634</b>	<b>688</b>
<b>TOTAL ASSETS</b>	<b>6,311</b>	<b>4,390</b>	<b>3,632</b>	<b>5,431</b>
Accounts Payable	130	290	448	926
Revenue in Advance	0	107	896	1,853
Borrowings	0	0	0	0
Provisions	93	155	179	371
<b>Total Current Liab</b>	<b>223</b>	<b>552</b>	<b>1,524</b>	<b>3,150</b>
Borrowings	0	0	0	3
Provisions	0	8	8	8
Other	0	0	0	0
<b>Total Non-Current Liab</b>	<b>0</b>	<b>8</b>	<b>8</b>	<b>11</b>
<b>TOTAL LIABILITIES</b>	<b>223</b>	<b>560</b>	<b>1,532</b>	<b>3,161</b>
<b>TOTAL EQUITY</b>	<b>6,088</b>	<b>3,830</b>	<b>2,100</b>	<b>2,270</b>

CASH FLOW SUMMARY				
Period	FY04A	FY05A	FY06E	FY07E
<b>EBIT (excl Abs/Extr)</b>	<b>(2,189)</b>	<b>(2,897)</b>	<b>(2,276)</b>	<b>(99)</b>
Add: Depreciation	28	51	51	58
Change in Pay.	(150)	160	158	478
Change in Rev. in Ad.	0	107	789	957
Less: Tax paid	485	397	348	332
Net Interest	(130)	221	139	129
Change in Rec.	(3)	(222)	(283)	(670)
Change in Inv.	0	0	0	0
<b>Gross Cashflows</b>	<b>(1,896)</b>	<b>(2,120)</b>	<b>(1,074)</b>	<b>1,204</b>
Capex	(55)	(124)	(100)	(100)
<b>Free Cashflows</b>	<b>(1,951)</b>	<b>(2,244)</b>	<b>(1,174)</b>	<b>1,104</b>
Dividends Paid	0	0	0	0
<b>Net Cash Flow</b>	<b>(1,951)</b>	<b>(2,244)</b>	<b>(1,174)</b>	<b>1,104</b>

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