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CogState Limited (CGS)

Speculative Buy

Business Update Indicative of Strong Clinical Trial Testing Growth in FY08

$0.15

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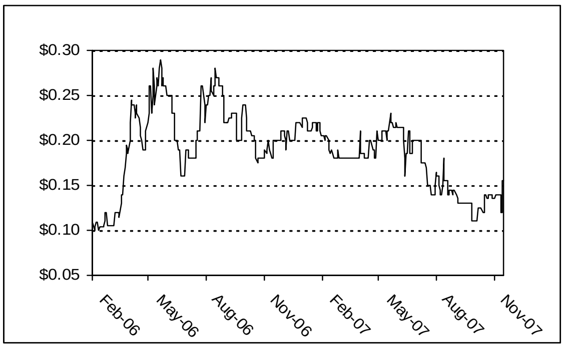
Summary

Market Capitalisation (M)	**$7.8**
Share Price	**$0.15**
Cash (M) as at 30/09/07	**$1.5**
Cash Burn Per Quarter (M) (est.)	$0.4
Market Cap.: Cash	5.2
Valuation Per Share & Price Target	$0.32
52 week low	$0.11
52 week high	$0.29
Ave Monthly Vol (year rolling)(M)	0.76

Key Financials (A$'000)

Year End	2006 Actual	2007 Actual	2008 Est.
Revenue	**2,433**	**2,605**	**4,100**
Net Op. Rev	(1,642)	(1,769)	(333)
R&D Expenses	(237)	(106)	(111)
EBITDA	**(2,023)**	**(1,980)**	**(519)**
EBIT	(2,099)	(2,072)	(605)
NPAT pre Net R&D	**(1,544)**	**(1,697)**	**(168)**
Reported Profit	**(1,603)**	**(1,653)**	**(280)**
Reported EPS (c)	**(4.1)**	**(3.7)**	**(0.6)**
PE Ratio (x)	**n/a**	**n/a**	**n/a**
ROE (%)	-46.3%	-70.6%	-14.8%

Share Price Graph (A$)



Key Points

CogState has announced a new clinical trial contract (Phase 2b) with an undisclosed international pharmaceutical company in excess of A$0.7m, recognised over 2 years.

Business update indicated the company has contracted on a further 4 contracts since AGM in late October worth $1.2m.

Value of 10 signed contracts of $2.0m thus far during FY08, up 76.1% on pcp and 1.6% ahead on total value of contracts signed for all of FY07.

Average size of contracts increased from $0.12m in FY07 to $0.2m thus far in FY08.

Our View

- The contract win for CogState continues to indicate to us that the Company's business model of selling computerised cognition testing services (ClinIT, Datapoint®) for global pharmaceutical companies running central nervous system (CNS) clinical trials is bearing fruit. As we have indicated previously, the model is now evolving to the extent that: (1) the Company continues to be awarded contracts with new pharmaceutical companies, thereby diversifying its customer base (depth); (2) Recognition of the testing service has seen more sizeable and later clinical stage contracts (i.e. Phase 2 and beyond versus Phase 1), allowing for recognition of greater revenues over longer periods and (3) repeat business from existing customers (breadth). Given the importance of the clinical trial process and pharmaceutical companies' reticence to change protocols post initial efficacy trials (i.e. Phase 2), we view reasonable barriers to entry for contracted trials CogState can execute at this stage of clinical development.
- While the Company does suffer from a lack of annuity style revenues for its services, we note from a cash flow perspective, up to 80% of the value of the contract is collected as cash within the first 12 weeks and CogState operates within an oligopolistic market structure for computerised testing. We have previously estimated that 12 of the world's top CNS pharmaceutical companies have the potential to contract approximately US$40m in computerised cognition testing services based on existing pipelines, with a maximum potential of US$119m, assuming seamless transition of all drugs through the various stages of clinical testing.
- We are forecasting an FY08 NPAT loss of $0.28m, a significant reduction on FY07. However, we expect the Company to report a maiden 2H08 NPAT, assisted by a 2H R&D tax rebate. While CogState's new Phase 2b trial contract and FY08 business update is indicative of strong growth in the business, we are not adjusting our FY08 expectations, which were predicated on significant revenue growth on pcp due to favourable trends identified in 2H07, and CogState's differentiated and advantageous product offering to pharmaceutical customers. Moreover, there is a growing recognition and acceptance of computerised cognition testing in pharmaceutical clinical trials. Sizeable director buying post capital raise (see important disclaimer) and AGM continues to highlight confidence in the business model. We maintain our Speculative Buy recommendation and DCF valuation (fully diluted) and price target of $0.32.

CGS - Summary of Forecasts

CGS $ 0.15

PROFIT & LOSS SUMMARY (A$000s)				
Period	**FY06A**	**FY07A**	**FY08E**	**FY09E**
Total Revenue	**2,433**	**2,605**	**4,100**	**5,303**
Growth (pcp)	*59.6%*	*7.1%*	*57.4%*	*29.4%*
Net Operating Revenue	**(1,642)**	**(1,769)**	**(333)**	**794**
Direct R&D Expenses	(237)	(106)	(111)	(117)
EBITDA	**(2,023)**	**(1,980)**	**(519)**	**537**
Dep'n/Other Amort'n	(76)	(92)	(86)	(92)
EBIT	**(2,099)**	**(2,072)**	**(605)**	**445**
Net Interest	144	105	75	140
Pre-Tax Profit	**(1,955)**	**(1,967)**	**(530)**	**585**
Tax Expense	352	314	250	263
Minorities	0	0	0	0
NPAT	**(1,603)**	**(1,653)**	**(280)**	**848**
Growth (pcp)	*29.6%*	*n/a*	*83.1%*	*n/a*
Net Abnormals	0	0	0	0
Reported Profit	**(1,603)**	**(1,653)**	**(280)**	**848**
NPAT pre Net R&D	**(1,544)**	**(1,697)**	**(168)**	**965**

PER SHARE DATA				
Period	**FY06A**	**FY07A**	**FY08E**	**FY09E**
Reported EPS (c)	**(4.1)**	**(3.7)**	**(0.6)**	**1.6**
Growth (pcp)	*n/a*	*n/a*	*-85.1%*	*-396.2%*
EPS Pre-Net R&D (c)	**(3.9)**	**(3.8)**	**(0.3)**	**1.9**
Growth (pcp)	*n/a*	*n/a*	*-91.3%*	*-659.9%*
Dividend (c)	0.0	0.0	0.0	0.0
Franking	0%	0%	0%	0%
Gross CF per Share (c)	(3.6)	(3.0)	0.4	1.6
NTA per share (c)	6.9	2.7	3.6	5.3

KEY RATIOS				
Period	**FY06A**	**FY07A**	**FY08E**	**FY09E**
EBITD/Sales Margin %	-83.2%	-76.0%	-12.7%	10.1%
EBIT/Sales Margin %	-86.3%	-79.5%	-14.8%	8.4%
Current ratio (x)	4.7	2.3	2.1	2.4
Net Debt : Equity (%)	-85.9%	-78.9%	-105.9%	-103.1%
ROE (%)	-46.3%	-70.6%	-14.8%	31.6%
Dividend Payout Ratio (%)	0.0%	0.0%	0.0%	0.0%

VALUATION MULTIPLES				
Period	**FY06A**	**FY07A**	**FY08E**	**FY09E**
PE Ratio (x)	n/a	n/a	n/a	9.2
Dividend Yield (%)	0.0%	0.0%	0.0%	0.0%
EV/EBITD (x)	n/a	n/a	n/a	6.4
EV/EBIT (x)	n/a	n/a	n/a	7.7

CAPITAL RAISING ASSUMPTIONS				
Period	**FY06A**	**FY07A**	**FY08E**	**FY09E**
Shares Issued (m)	8.6	0.0	7.4	0.0
Issue Price (A$)	0.10	0.00	0.135	0.00
Cash Raised (A$m)	0.86	0.0	1.0	0.0

BALANCE SHEET SUMMARY				
Period	**FY06A**	**FY07A**	**FY08E**	**FY09E**
Cash	2,661	1,250	2,333	3,264
Receivables	434	204	362	775
Pre Paymenrs	22	25	25	25
Inventories	0	0	0	0
Investments	0	0	0	0
Other	77	215	215	215
Total Current Assets	3,194	1,694	2,935	4,278
Investments	0	0	0	0
Inventories	0	0	0	0
Property Plant & Equip	170	215	229	237
Intangibles	402	401	401	401
Deferred Tax Assets	46	47	47	47
Other	0	0	0	0
Total Non-Current Assets	618	663	677	685
TOTAL ASSETS	**3,812**	**2,357**	**3,612**	**4,964**
Accounts Payable	279	433	724	929
Revenue in Advance	302	159	402	516
Borrowings	0	0	0	0
Deferred Tax Liabilities	2	3	2	2
Provisions	93	139	241	310
Total Current Liab	676	734	1,370	1,758
Borrowings	0	0	0	7
Provisions	39	39	39	39
Other	0	0	0	0
Total Non-Current Liab	39	39	39	46
TOTAL LIABILITIES	**715**	**773**	**1,409**	**1,804**
TOTAL EQUITY	**3,096**	**1,584**	**2,203**	**3,160**

CASH FLOW SUMMARY				
Period	**FY06A**	**FY07A**	**FY08E**	**FY09E**
EBIT (excl Abs/Extr)	**(2,099)**	**(2,072)**	**(605)**	**445**
Add: Depreciation	76	92	86	92
Change in Pay.	(11)	154	291	205
Change in Rev. in Ad.	195	(143)	243	114
Less: Tax paid	352	314	250	263
Net Interest	144	105	75	140
Change in Rec.	(90)	230	(158)	(412)
Change in Inv.	0	0	0	0
Gross Cashflows	(1,433)	(1,320)	183	847
Capex	(108)	(137)	(100)	(100)
Free Cashflows	(1,541)	(1,457)	83	747
Dividends Paid	0	0	0	0
Net Cash Flow	**(1,541)**	**(1,457)**	**83**	**747**

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