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CogState Limited (CGS)

Speculative Buy

Brings Lundbeck A/S on Board with a Cognition Testing Deal

\$0.26

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Key Points

CogState has struck a clinical trial deal with Lundbeck A/S (OMX:LUN).

The deal is the first for CogState with Lundbeck, who specialise exclusively on treatments for CNS diseases.

CogState's contracted future revenue now stands at \$2.3m, with approximately \$1.6m to be recognised in FY07.

Summary

Market Capitalisation (M)	\$11.1
Share Price	\$0.26
Valuation Per Share	\$0.39
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	4.1
Market Cap: Cash Ratio (Sector)	14.2

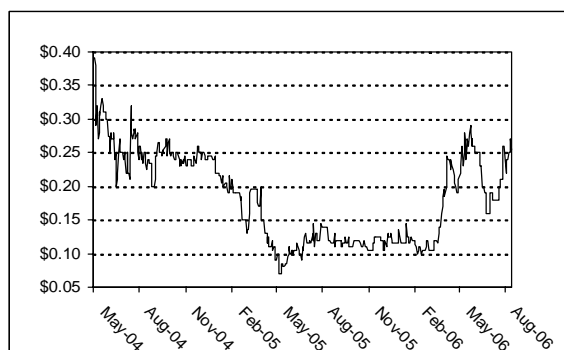
Our View

- CogState has executed another important deal, this time with a pure play CNS pharma company that possesses a portfolio of marketed and in development drugs right in the sweet spot for CogState's ClinIT cognition testing battery. Lundbeck booked CY05 revenues of A\$2.1b and has a market cap of A\$7.0b. Lundbeck has launched four new CNS drugs over recent years, with Ciprexel[®] already a blockbuster (see Appendix 1). The deal with Lundbeck did not include a value nor did it articulate for what drug (or clinical stage) ClinIT was being applied to. However, examining news flow released by the Company it is plausible the drug in question could be AA21004 (Phase 2), Gaboxadol (Phase 3) or the recently approved Azilect[®] (Phase 4). CogState has previously indicated average contract sizes are US\$20-60k (Phase 1), US\$80-90k (Phase 2) and US\$300-350k (Phase 3). We believe a Phase 4 is likely to be in the range \$US350k+.
- The deal also demonstrates CogState's ability to diversify its revenue base away from Pfizer. Lundbeck has eight compounds in various stages of clinical development, all of which are applicable for ClinIT testing (see Appendix 2). Assuming all compounds in the make to market, in our view the portfolio has an approximate unadjusted value of A\$7.7m in maximum exploitable cognition testing contracts. This compares with our estimate of GlaxoSmithKline's (GSK's) CNS pipeline of A\$32.5m, with whom CogState also recently partnered for a clinical trial. From a cash flow perspective, the business model is attractive as (on average) between 60-80% of CogState's contract value with partners is collected as cash within the first 3 months and revenue recognised progressively over the life of the contract.
- CogState's revised business strategy, which seeks to embed ClinIT in CNS trials, continues to impress. CogState indicated FY06 cash burn was \$0.8m, down 32.6% from FY05, with sales revenues of \$2.1m up 102.4% pcp. We remain comfortable that further deals will be announced through FY07 and have largely factored this into our model. We note a further \$1.4m in further contracts recognised within FY07 is required to hit our ClinIT product sales estimates for FY07. ClinIT forms the majority of our FY06 (65.8%) and FY07 (82.1%) product revenue estimates. We have not altered our financial model, and maintain our FY07 NPAT of \$0.4m. CogState is currently trading on 29.4x our forecast FY07 EPS, with estimated free cash flows of \$1.0m. CogState trades at a 33.3% discount to our DCF valuation of \$0.39. We therefore continue with our Speculative Buy recommendation.

Key Financials (A\$'000)

Year End	2005	2006	2007
	Actual	Est.	Est.
Total Revenue	1,525	2,544	4,556
Net Op. Rev	(2,302)	(1,802)	419
R&D Expenses	(260)	(275)	(289)
EBITD	(2,783)	(2,224)	(23)
EBIT	(2,897)	(2,276)	(99)
NPAT pre Net R&D	(2,308)	(1,592)	674
Reported Profit	(2,279)	(1,781)	386
Reported EPS (c)	(6.4)	(4.5)	0.9
PE Ratio (x)	n/a	n/a	29.4
EPS pre R&D (c)	(6.5)	(4.1)	1.5
PE Ratio pre R&D (x)	n/a	n/a	16.8

Share Price Graph (A\$)



Appendix 1

Lundbeck Marketed Products

Compound	Indication	CY05 Sales (A\$m)
Cipralext	Depression	1434
Ebixa	Alzheimer's Disease	250
Azilect	Parkinson's Disease	1.4*
Serdolect	Schizophrenia	n/a**

* Launched in Europe 2H CY05; ** Launched Jan 2006; Source: Lundbeck

Appendix 2

Lundbeck Development Pipeline

Compound	Indication	Phase 1	Phase 2	Phase 3	NDA	Launch	ClinIT Suitable?	Max. Potential CinIT Value (A\$'000)
Escitalopram	OCD					2007	yes	400
Gaboxadol	Sleep Disorder					2008	yes	754
Bifeprunox	Schizophrenia				2008	2008+	yes	754
Desmoteplase	Stroke				2008+		yes	754
AA21004	Depression				2008+		yes	1220
31-130	Psychosis				2008+		yes	1260
AA24530	Depression				2008+		yes	1260
AA34893	Depression				2008+		yes	1260
Total								7662

Source: Lundbeck, Taylor Collison estimates

CGS - Summary of Forecasts

CGS \$ 0.26

PROFIT & LOSS SUMMARY (A\$000s)					
Period	FY04A	FY05A	FY06A	FY07E	FY08E
Total Revenue	385	1,525	2,544	4,556	5,385
Growth (pcp)	n/a	296.1%	66.8%	79.1%	18.2%
Net Operating Revenue	(2,187)	(2,302)	(1,802)	419	1,138
Direct R&D Expenses	(41)	(260)	(275)	(289)	(303)
EBITD	(2,098)	(2,783)	(2,224)	(23)	622
Dep'n/Other Amort'n	(28)	(51)	(51)	(58)	(100)
EBIT	(2,189)	(2,897)	(2,276)	(99)	504
Net Interest	(130)	221	147	153	212
Pre-Tax Profit	(2,319)	(2,676)	(2,129)	54	716
Tax Expense	485	397	348	332	0
Minorities	0	0	0	0	0
NPAT	(2,678)	(2,279)	(1,781)	386	716
Growth (pcp)	n/a	-24.3%	21.9%	n/a	85.8%
Net Abnormals	0	0	0	0	0
Reported Profit	(2,678)	(2,279)	(1,781)	386	716
NPAT pre Net R&D	(1,849)	(2,308)	(1,592)	674	1,020

PER SHARE DATA					
Period	FY04A	FY05A	FY06A	FY07E	FY08E
Reported EPS (c)	(9.4)	(6.4)	(4.5)	0.9	1.6
Growth (pcp)	n/a	n/a	n/a	n/a	n/a
EPS Pre-Net R&D (c)	(9.5)	(6.5)	(4.1)	1.5	2.3
Growth (pcp)	n/a	n/a	n/a	n/a	n/a
Dividend (c)	0.0	0.0	0.0	0.0	0.0
Franking	0%	0%	0%	0%	0%
Gross CF per Share (c)	(9.7)	(5.9)	(2.5)	2.6	3.1
NTA per share (c)	41.0	9.7	4.9	4.8	6.3

KEY RATIOS					
Period	FY04A	FY05A	FY06A	FY07E	FY08E
EBITD/Sales Margin %	-544.9%	-182.5%	-87.4%	-0.5%	11.5%
EBIT/Sales Margin %	-568.6%	-190.0%	-89.5%	-2.2%	9.4%
Current ratio (x)	25.7	6.9	2.1	1.6	1.6
Net Debt : Equity (%)	-5.3%	-29.2%	-114.2%	-146.5%	-157.6%
ROE (%)	n/a	-46.0%	-57.8%	15.9%	25.2%
Dividend Payout Ratio (%)	0.0%	0.0%	0.0%	0.0%	0.0%

VALUATION MULTIPLES					
Period	FY04A	FY05A	FY06A	FY07E	FY08E
PE Ratio (x)	n/a	n/a	n/a	29.4	15.8
Dividend Yield (%)	0.0%	0.0%	0.0%	0.0%	0.0%
EV/EBITD (x)	n/a	n/a	n/a	n/a	10.2
EV/EBIT (x)	n/a	n/a	n/a	n/a	12.6

CAPITAL RAISING ASSUMPTIONS					
Period	FY04A	FY05A	FY06A	FY07E	FY08E
Shares Issued (m)	19.5	0.0	8.6	0.0	0.0
Issue Price (A\$)	0.5	0.00	0.10	0.00	0.00
Cash Raised (A\$m)	9.75	0.0	0.86	0.0	0.0

BALANCE SHEET SUMMARY					
Period	FY04A	FY05A	FY06A	FY07E	FY08E
Cash	321	1,119	2,662	3,700	4,972
Receivables	122	344	538	1,297	1,768
Inventories	0	0	0	0	0
Investments	5,250	2,311	0	0	0
Other	46	47	28	0	0
Total Current Assets	5,739	3,821	3,227	4,997	6,741
Investments	0	0	0	0	0
Inventories	0	0	0	0	0
Property Plant & Equip	66	139	165	270	320
Intangibles	438	375	400	380	361
Deferred Tax Assets	34	55	38	38	38
Other	34	0	31	0	0
Total Non-Current Assets	572	569	634	688	719
TOTAL ASSETS	6,311	4,390	3,861	5,684	7,460
Accounts Payable	130	290	448	926	1,263
Revenue in Advance	0	107	896	1,853	2,526
Borrowings	0	0	0	0	0
Provisions	93	155	179	371	505
Total Current Liab	223	552	1,524	3,150	4,294
Borrowings	0	0	0	3	6
Provisions	0	8	8	8	8
Other	0	0	0	0	0
Total Non-Current Liab	0	8	8	11	14
TOTAL LIABILITIES	223	560	1,532	3,161	4,308
TOTAL EQUITY	6,088	3,830	2,330	2,524	3,151

CASH FLOW SUMMARY					
Period	FY04A	FY05A	FY06A	FY07E	FY08E
EBIT (excl Abs/Extr)	(2,189)	(2,897)	(2,276)	(99)	504
Add: Depreciation	28	51	51	58	100
Change in Pay.	(150)	160	158	478	337
Change in Rev. in Ad.	0	107	789	957	673
Less: Tax paid	485	397	348	332	0
Net Interest	(130)	221	147	153	212
Change in Rec.	(3)	(222)	(194)	(759)	(471)
Change in Inv.	0	0	0	0	0
Gross Cashflows	(1,896)	(2,120)	(975)	1,138	1,373
Capex	(55)	(124)	(100)	(100)	(100)
Free Cashflows	(1,951)	(2,244)	(1,075)	1,038	1,273
Dividends Paid	0	0	0	0	0
Net Cash Flow	(1,951)	(2,244)	(1,075)	1,038	1,273

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