

In this edition...

Infection control is major challenge for hospitals and medical practices. Nanosonics is set to roll out its lead product, a device to disinfect ultrasound probes. Its technology is non-toxic and can treat instruments that can't be disinfected by high temperature autoclave systems.

Pharmaxis is making steady progress with Bronchitol, with enrollment for one Phase III trial completed and another underway. The cystic fibrosis indication is now clearly established as primary market for Bronchitol.

We also provide a further update on the Progen/Avexa merger.

The Editors

Companies Covered: AVX, NAN, PGL, PXS

	Bioshares Portfolio
Year 1 (May '01 - May '02)	21.2%
Year 2 (May '02 - May '03)	-9.4%
Year 3 (May '03 - May '04)	70.0%
Year 4 (May '04 - May '05)	-16.3%
Year 5 (May '05 - May '06)	77.8%
Year 6 (May '06 - May '07)	17.3%
Year 7 (May '07 - May '08)	-36%
Year 8 (May '08 - current)	-35%
Cumulative Gain	35%
Av Annual Gain (7 yrs)	17.8%

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Bioshares

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Delivering independent investment research to investors on Australian biotech, pharma and healthcare companies.

Extract from *Bioshares* –

Why Progen Shareholders Should Vote Against the Progen-Avexa Merger

On December 22, 2008, the board of **Progen Pharmaceuticals** announced that it would proceed, subject to shareholder approval, with a merger with **Avexa**, developer of the HIV drug candidate, apricitabine (ATC). ATC is a nucleoside reverse transcriptase inhibitor (NRTI). The merger would, if agreed by shareholders, be effected through a court approved scheme of arrangement

Since the announcement of the merger, Melbourne-based cancer drug developer **Cytopia** has, along with a significant number of other Progen shareholders, requisitioned a shareholders meeting.

The Cytopia-led group of shareholders, constituting more than 18% of shareholders, is seeking to offer a full \$1.10 buy-back to shareholders (not capped, but subject to available net cash reserves), removal of the current board and replacement with three directors not associated with Cytopia. The Cytopia group has also asked for its meeting to be held at the same time as the meeting called to vote on the proposed merger of Progen with Avexa. The scheduled date of this meeting is March 11, 2009.

While the merger with Avexa may appear as a positive opportunity for Avexa shareholders, it is negative on several counts for Progen shareholders. Progen shareholders do not get the opportunity to be offered a full \$1.10 buy back, with the existing Progen board offering a \$1.10 per share capped at \$20 million.

A most perplexing issue for Progen shareholders are the capital requirements of the entity that results from a merger with Avexa. Merger documents indicate that the merged entity would require \$110 million to complete the current Phase III ATC study beyond the week 24 primary endpoint (expected mid-2010), complete extension studies following regulatory approval, conduct a second Phase III study and market launch preparations.

At issue are the economic merits of ATC. This compound was assessed by Lonergan Edwards as being worth between \$151.4 million to \$225.8 million. This valuation can be compared to a licensing transaction that was announced on February 6 in which **GlaxoSmithKline** licensed a non-nucleoside reverse transcriptase inhibitor (NNRTI) **IDX899** from **Idenix Pharmaceuticals** for a total deal value worth up to US\$450 million. This deal figure excludes the royalty stream that would flow to Idenix if **IDX899** reached the market.

IDX899 completed a Phase II study in 2008, achieving mean viral load reduction of 1.8 log¹⁰ [32 patients]. Avexa achieved a mean viral load reduction of 0.8 log¹⁰ in a Phase II trial [47 patients].

Cont'd over

IDX899 is designed to be orally administered *once a day*. ATC is also an orally delivered compound, but taken *twice a day*. This is a significant but arguably unfavourable point of difference for ATC in that a competitor compound has emerged with a potentially superior drug profile. It is one of a number of factors that explain, in our opinion, the niche potential for ATC. Other factors include the emergence of newer classes of drugs, including integrase inhibitors and CCR antagonists.

Progen shareholders can rightly ask if there can be any substantial net economic gains by further investing in a compound that will take another \$110 million to get to market and which does not appear to have taken as yet the interest of potential licensing partners. This is an issue about which there should be a properly informed debate.

A further issue for Progen shareholders is that of confidence in the existing Progen board. The Progen board has presided over the termination of a Phase III trial of PI-88, yet in our opinion has offered less than satisfactory reasons for the cessation of the development of PI-88.

We posed the following questions to the Progen board in *Bioshares* 293:

- 1. How many licensing proposals were rejected by the Progen board for PI-88 and what was the value and terms of those offers?*
- 2. Why was recruitment in the Phase III trial so difficult to achieve, given that a global contract research company was employed and that liver cancer is a disease that has a high prevalence?*
- 3. Was the Phase III trial protocol changed in such a way that recruitment was hampered?*
- 4. Was negative side effect data from the Phase II prostate cancer trial, released in February, a major contributing reason for the cessation of the Phase III trial?*
- 5. Were any senior executives of the firm found to responsible for the failure to progress the Phase III trial?*

It is reasonable for shareholders to expect fair and honest disclosure by boards of directors on matters of a material nature.

We maintain an **Avoid** recommendation on both stocks (Progen Pharmaceuticals and Avexa) in the context of proposed merger.

Bioshares

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How Bioshares Rates Stocks

For the purpose of valuation, *Bioshares* divides biotech stocks into two categories. The first group are stocks with existing positive cash flows or close to producing positive cash flows. The second group are stocks without near term positive cash flows, history of losses, or at early stages of commercialisation. In this second group, which are essentially speculative propositions, *Bioshares* grades them according to relative risk within that group, to better reflect the very large spread of risk within those stocks.

Group A

Stocks with existing positive cash flows or close to producing positive cash flows.

- Buy** CMP is 20% < Fair Value
- Accumulate** CMP is 10% < Fair Value
- Hold** Value = CMP
- Lighten** CMP is 10% > Fair Value
- Sell** CMP is 20% > Fair Value
(CMP–Current Market Price)

Group B

Stocks without near term positive cash flows, history of losses, or at early stages commercialisation.

Speculative Buy – Class A

These stocks will have more than one technology, product or investment in development, with perhaps those same technologies offering multiple opportunities. These features, coupled to the presence of alliances, partnerships and scientific advisory boards, indicate the stock is relative less risky than other biotech stocks.

Speculative Buy – Class B

These stocks may have more than one product or opportunity, and may even be close to market. However, they are likely to be lacking in several key areas. For example, their cash position is weak, or management or board may need strengthening.

Speculative Buy – Class C

These stocks generally have one product in development and lack many external validation features.

Speculative Hold – Class A or B or C

Sell

Corporate Subscribers: Pharmaxis, Cytopia, Arana Therapeutics, Starpharma Holdings, Cogstate, Xceed Biotechnology, Optiscan Imaging, Bionomics, ChemGenex Pharmaceuticals, Circadian Technologies, Biota Holdings, Stem Cell Sciences, Halcyon Pharmaceuticals, Peplin, BioMD, Impedimed, QRxPharma, Patrys, Labtech Systems, Hexima, Tyrian Diagnostics, Mesoblast, Atcor Medical

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