

BUY: Still have our nose in this little trough

We maintain our BUY rating and \$1.66 price target. Anatara's recent stock underperformance has simply reflected a slow quarter for news in the lead-up to a significant inflection point in the 2H. Behind the scenes, Zoetis' evaluation work with Detach is ongoing and we are comfortable that Anatara has done the work in supporting that. If Zoetis does exercise its option to license Detach, then we see potential valuation upside to \$2.50 per share. Zoetis is already calling out a negative impact on their medicated feed additive sales just three months into the Veterinary Feed Directive rules coming into force, which switched key swine and cattle products from over-the-counter to prescription only. Zoetis has led the industry on the "antibiotic stewardship" issue and we think it has genuine intentions towards making Detach available to producers.

Key points

A snort of relief following Anatara's news update. We remain confident that Zoetis will make a decision later this year on whether to sign an exclusive licence to commercialise Anatara's product, Detach. Detach is a non-antibiotic agent being developed as an over-the-counter product to reduce the incidence and severity of diarrhoea and enhance growth rates in livestock. Zoetis' evaluation phase is in its 14-month, encompassing field trials and other work in at least three species including swine. Zoetis' option is worldwide.

Opportunity validated by Zoetis' sales drop-off. Zoetis appears committed to finding non-antibiotic agents to help producers respond to the largely consumer-driven movement to minimise antibiotic use in the human food chain. Their 1Q17 financial results revealed an 11% fall (v pcp) in medicated feed additive sales, management calling out the early impact of US producers implementing the Veterinary Feed Directive (VFD) changes that went into force in January. A number of Zoetis' important swine products now require veterinarian supervision (no longer available over the counter). Zoetis believes the VFD rule will have a ~US\$50m impact (reported ~US\$500m global sales in 2016). For reference, we estimate that Detach represents a ~US\$40-50m annualised sales opportunity for Zoetis, assuming that it is approved as an over-the-counter product in major markets. Elanco's Kavault (launched in 2016 for the piglet diarrhoea indication) is an antibiotic product and subject to the VFD restrictions.

Anatara going direct in Australia. Anatara has retained ANZ rights, where market access looks routine, given the degree of industry consolidation, obviating the need for a local distributor. The relocation of the APVMA to Armidale may cause some disruption to the review of Anatara's marketing application, but we remain confident about an approval and launch towards the end of this year. We model a Detach launch in 2H18 with year-3 sales at ~\$20m, which implies 60% penetration of the ANZ swine markets and very early US/EU market adoption under a Zoetis licensing model.

Valuation and sensitivity. Target price is based on risk-adjusted DCF. We have "risked" the Zoetis option as 60% probable. If Zoetis confirms plans for the US and major EU countries, our valuation would increase to \$2.50 per share (~40% upside). Note that our model currently has nothing in it for Asian countries (produces >50% of commercially weaned piglets, worldwide).

Risks and catalysts

Risks: a) technical and execution risks, principally in relation to field trials; b) pace of market adoption once launched; c) industry responses to product.

Catalysts: a) Zoetis evaluation success; b) regulatory changes restricting or antibiotic use in animal production; c) ANZ, US and EU commercialisation progress.

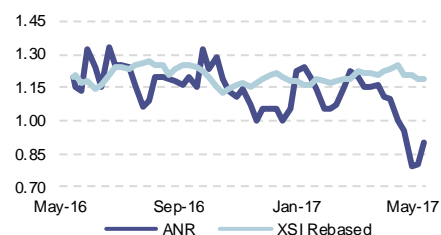
Recommendation	BUY
12-mth target price (AUD)	\$1.66
Share price @ 07-Jun-17 (AUD)	\$0.95
Forecast 12-mth capital return	74.9%
Forecast 12-mth dividend yield	0.0%
12-mth total shareholder return	74.9%

Market cap	\$47m
Enterprise value	\$42m
Shares on issue	49m
Sold short	
ASX 300 weight	n/a
Median turnover/day	\$0.0m

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12-mth price performance (\$)



	1-mth	6-mth	12-mth
Abs return (%)	-13.5	-15.9	-25.0
Rel return (%)	-10.9	-19.7	-24.3

Key changes

		25-Feb	After	Var %
NPAT:	FY17F	-2.1	-2.1	0.0%
norm	FY18F	0.8	0.8	0.0%
(\$m)	FY19F	4.2	4.2	0.0%
EPS:	FY17F	-4.0	-4.0	0.0%
norm	FY18F	1.5	1.5	0.0%
(cps)	FY19F	7.7	7.7	0.0%
DPS:	FY17F	0.0	0.0	0.0%
(cps)	FY18F	0.0	0.0	0.0%
	FY19F	0.0	0.0	0.0%
Price target:		1.66	1.66	0.0%
Rating:		BUY	BUY	

Price target		
	Valuation	PT (\$/shr)
DCF methodology		
WACC (%)	12.8	
Terminal growth assumption (%)	5.0	
Risk adjustment (%)	60.0	
PV of forecast FCFs (\$m)	40.5	
PV of terminal value (\$m)	36.1	
Enterprise value (\$m)	76.7	
Net debt/(cash) (\$m)	-5.4	
Equity value (\$m)	82.1	

DCF valuation (\$/share)	1.66
Target price (\$/share)	1.66

Interims (\$m)				
Half-year (AUD)	Dec 15	Jun 16	Dec 16	Jun 17
	1HA	2HA	1HE	2HE
Sales revenue	0.2	2.1	1.9	0.6
EBITDA	-1.2	0.1	-0.6	-1.7
EBIT	-1.2	0.1	-0.6	-1.7
Net profit	-1.2	0.5	-0.4	-1.7
Norm EPS	-3.0	0.8	-0.8	-3.1
EBIT/sales (%)	-733.6	5.2	-29.4	-290.5
Dividend (c)	0.0	0.0	0.0	0.0
Franking (%)	0.0	0.0	0.0	0.0

Financial stability			
Year-end June (AUD)	FY16A	FY17F	FY18F
Net debt	-6.4	-5.4	-6.0
Net debt/equity (%)	<0	<0	<0
Net debt/EV (%)	<0	<0	<0
Current ratio (x)	31.3	41.2	11.7
Interest cover (x)	3.1	11.7	<0
Adj cash int cover (x)	1.8	14.0	<0
Debt/cash flow (x)	0.0	0.0	0.0
Net debt (cash)/share (\$)	<0	<0	<0
NTA/share (\$)	0.2	0.2	0.2
Book value/share (\$)	0.2	0.2	0.2
Payout ratio (%)	0	0	0
Adj payout ratio (%)	0	0	0

EPS reconciliation (\$m)				
	FY16A		FY17F	
	Rep	Norm	Rep	Norm
Sales revenue	2	2	3	3
EBIT	-1.1	-1.1	-2.3	-2.3
Net profit	-0.7	-0.7	-2.1	-2.1
Notional earn	0.0	0.0	0.0	0.0
Pref/conv div	0.0	0.0	0.0	0.0
Profit for EPS	-0.7	-0.7	-2.1	-2.1
Diluted shrs (m)	47	55	52	52
Diluted EPS (c)	-1.5	-1.3	-4.0	-4.0

Returns				
	FY16A	FY17F	FY18F	FY19F
ROE (%)	-8	-17	7	29
ROIC (%)	-14	-24	9	43
Incremental ROE	17	-46	-513	135
Incremental ROIC	16	-81	-557	419

Key assumptions								
Year-end June (AUD)	FY13A	FY14A	FY15A	FY16A	FY17F	FY18F	FY19F	FY20F
Revenue growth (%)		-100.0			10.8	80.9	110.7	99.8
EBIT growth (%)	132.1	363.6	124.1	-44.4	113.2	-133.5	441.7	202.5
NPAT growth (%)	133.4	365.4	108.1	-59.7	189.8	-139.2	415.1	200.6
EPS growth (%)	122.0	-98.5	-96.5	-80.4	205.2	-137.2	415.1	200.6
EBIT/sales (%)	-414.1			-47.1	-90.7	16.8	43.2	65.4
Tax rate (%)	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
ROA (%)	-257.7	-81.9	-34.4	-7.7	-12.0	3.5	15.8	37.6
ROE (%)	66.1	-104.4	-32.8	-5.4	-12.3	4.3	18.5	43.4

Profit and loss (\$m)								
Year-end June (AUD)	FY13A	FY14A	FY15A	FY16A	FY17F	FY18F	FY19F	FY20F
Sales revenue	0.0	0.0	0.0	2.3	2.5	4.6	9.6	19.3
EBITDA	-0.2	-0.9	-1.9	-1.1	-2.3	0.8	4.2	12.6
Depn & amort	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
EBIT	-0.2	-0.9	-1.9	-1.1	-2.3	0.8	4.2	12.6
Net interest expense	0.0	0.0	-0.1	-0.4	-0.2	-0.1	-0.1	-0.1
Tax	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Minorities/pref divs	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Equity accounted NPAT	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Net profit (pre-sig items)	-0.2	-0.9	-1.8	-0.7	-2.1	0.8	4.2	12.7
Abns/exts/signif	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Reported net profit	-0.2	-0.9	-1.8	-0.7	-2.1	0.8	4.2	12.7

Cash flow (\$m)								
Year-end June (AUD)	FY13A	FY14A	FY15A	FY16A	FY17F	FY18F	FY19F	FY20F
EBITDA	-0.2	-0.9	-1.9	-1.1	-2.3	0.8	4.2	12.6
Interest & tax	0.0	0.0	0.0	0.4	0.0	0.1	0.1	0.1
Working cap/other	0.0	0.2	0.0	0.4	-0.3	-0.2	-0.9	-1.0
Operating cash flow	-0.2	-0.6	-1.9	-0.3	-2.5	0.6	3.3	11.8
Maintenance capex	0.0	0.0	4.0	0.0	0.0	0.0	0.0	0.0
Free cash flow	-0.2	-0.6	2.1	-0.3	-2.5	0.6	3.3	11.8
Dividends paid	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Growth capex	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Invest/disposals	0.0	0.0	-4.0	0.0	0.0	0.0	0.0	0.0
Other inv flows	0.0	0.0	-4.6	-3.9	1.6	0.0	0.0	0.0
Cash flow pre-financing	-0.2	-0.6	-6.6	-4.2	-1.0	0.6	3.3	11.8
Funded by equity	0.0	1.8	7.0	9.1	0.0	0.0	0.0	0.0
Funded by debt	0.2	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Funded by cash	0.0	-1.1	-0.4	-4.9	1.0	-0.6	-3.3	-11.8

Balance sheet summary (\$m)								
Year-end June (AUD)	FY13A	FY14A	FY15A	FY16A	FY17F	FY18F	FY19F	FY20F
Cash	0.1	1.1	1.5	6.4	5.4	6.0	9.3	21.1
Current receivables	0.0	0.0	0.1	0.1	0.2	0.2	0.8	1.3
Current inventories	0.0	0.0	0.0	0.0	0.3	1.4	3.0	5.2
Net PPE	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Investments	0.0	0.0	0.0	7.4	5.9	5.9	5.9	5.9
Intangibles/capitalised	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Other	0.0	0.0	4.1	0.0	0.0	0.0	0.0	0.0
Total assets	0.1	1.1	5.6	13.9	11.8	13.5	19.0	33.5
Current payables	0.0	0.2	0.1	0.4	0.2	1.1	2.4	4.2
Total debt	0.3	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Other liabilities	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Total liabilities	0.4	0.2	0.1	0.4	0.3	1.2	2.4	4.2
Minorities/convertibles	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Shareholder equity	-0.3	0.8	5.5	13.5	11.5	12.3	16.6	29.3
Total funds employed	0.1	0.8	5.5	13.5	11.5	12.3	16.6	29.3



Anatara Lifesciences (ANR)

Business description

Anatara Lifesciences Limited (ANR) is an emerging animal health company with plans to enter the market with a product for preventing diarrhoea in piglets. If regulatory changes in the pork industry press towards the withdrawal of antibiotics from pig production, then the demand for alternative diarrhoea control and growth promotion strategies should increase. This Australian company is developing a product called Detach, which is a natural product extracted from pineapple stems. Anatara plans to register a new formulation of Detach for the Australian market in 2017, before exploring international commercialisation opportunities. The company is also developing related products for human use.

Investment thesis

Our research suggests that a non-antibiotic product for diarrhoea management is of interest to the pork industry. We think Detach will find support in the Australian market if Anatara's field trials are successful and the product is approved by the APVMA. Accelerated take-up in the Australian market during 2017/8 could be a leading indicator of robust demand elsewhere. The ability to explore human use applications in disease areas such as inflammatory bowel syndrome and diarrhoea could dramatically lift our valuation.

Revenue drivers

- Product approval and market penetration
- Milestone and royalty payments from partners
- Access to new markets and applications

Margin drivers

- Modest R&D expense
- Virtual model based primarily on product licensing or partnering

Key issues/catalysts

- Successful completion of field trials with favourable results on both clinical efficacy and production characteristics
- Regulatory approvals
- Regulatory changes discouraging or banning the use of antibiotics in animal production
- Corporate arrangements for US and European product
- Sales progress
- Non-dilutive funding inflows

Risk to view

- Lack of demand for product, once approved and launched
- Adverse regulatory settings (approvals, industry settings)
- Access to equity capital may be required

Balance sheet

- Anatara reported ~\$11.7m cash and investments as at the end of 1H17

Board

- Mel Bridges (Executive Chairman)
- Iain Ross (Non-Executive Director)
- Tracie Ramsdale (Non-Executive Director)
- Jay Hetzel (Non-Executive Director)
- Paul Grujic (Non-Executive Director)
- Stephen Denaro (Company Secretary)

Management

- Mel Bridges (CEO)
- Tracey Mynott (CSO)
- Mike West (COO)
- Damian Wilson (Head Global Business Development)

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Recommendation structure and other definitions

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