

## Buy

**Important:** The above recommendation has been made on a 12 month view and may not suit your investment needs or timeframe. The basis it is prepared on is summarised on the last page of this report.

**PLEASE CONTACT YOUR ADVISER TO DISCUSS THIS GENERAL RECOMMENDATION BEFORE ACTING ON IT.**

## Low-Mod Volatility

TP A\$0.33

GTG120228

### RBS Refiner

Price (close 28 Feb)	A\$0.12
6M high/low	A\$0.22/0.10
Market cap	A\$55.7m
Av (12M) turnover	A\$35.3m
Freefloat	100.0%
Reuters	GTG.AX
Bloomberg	GTG.AU
Net debt (cash) 31 Dec	(A\$12.6m)
3yr EPS CAGR 12-14F	na
Income (2013F div yield)	na

Source: Bloomberg

### Key events

Date	Event
2QCY12	Quarterly report

Source: RBS Morgans

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# Genetic Technologies (GTG)

## Steady progress

GTG posted a 1HFY12 result which was below our forecast. GTG has finished the period with a solid cash position of A\$12.6m. We have downgraded our FY12 and FY13 forecasts reflecting a slower sales ramp up of BREVAGen™ and lower licensing revenue. BREVAGen has now launched across seven discrete territories in the US and traction is expected to increase with the recently secured CLIA certification enabling additional key territories (California and Florida) to be targeted. Also GTG continues to make progress with health insurers to enable wider adoption of the test. Buy recommendation maintained.

### Event: 1HFY12 result below forecast and solid cash position

GTG posted a 1HFY12 loss of A\$3.3m, which was below our forecast, however better than the pcp of a loss of A\$4.2m. Operating expenses were A\$3.5m (pcp A\$5.3m). The cash position is solid at A\$12.6m. Other key highlights included: 1) the pilot launch of BREVAGen™ commenced in June 2011 in seven territories across the US where more than 1,320 test kits were placed across 246 targeted obstetric and gynaecologic practice accounts, representing a 68% acceptance rate among targeted accounts, where 125 tests had been ordered by December; and 2) the receipt of official CLIA Certification from CMS for its Melbourne based facility, enabling BREVAGen™ to enter the key markets of California and Florida.

### Forecasts: downward revision to reflect slower BREVAGen ramp up

We have made a number of downward revisions to our forecasts, which are detailed overleaf. The main reasons for the changes include: 1) lower BREVAGen™ sales ramp of 875 tests (from 9,860 tests), 12,000 tests (from 34,289 tests) and 24,000 (from 78,261 tests) in FY12, FY13 and FY14 respectively. Offsetting these lower sales volumes is a higher selling price per test of A\$600 (was A\$475). Our original sales volume expectations have proven to be far too aggressive and we will look to upgrade once we have greater clarity on traction across the territories is gained, and 2) a lower licensing revenue from the assertion program in FY12, now expecting A\$5.8m (was A\$9.4m).

### Valuation – although lowered valuation, significant upside exists

As a result of change to forecasts our DCF valuation and price target have reduced to A\$0.33 (was A\$0.46). The key risk to our price target is a lower take up of BREVAGen™ tests than forecast. The share price has been weak over the last two months, however we believe the market will re-rate GTG upon solid quarterly reports indicating traction across key territories in the US and revenue being received from the assertion program.

### Key Forecasts

	FY10A	FY11A	FY12F	FY13F	FY14F
EBITDA (A\$m)	-4.7	1.1	-4.3	4.5	6.8
Reported Net Profit (A\$m)	-9.5	0.9	-4.0	5.0	7.6
Normalised Net Profit (A\$m) <sup>1</sup>	-9.5	0.9	-4.0	5.0	7.6
Normalised EPS (¢) <sup>1</sup>	-2.5	0.2	-0.9	1.1	5.4
Normalised EPS Growth (%)	nm	nm	-503.3	224.6	377.1
Dividend Per Share (¢)	0.0	0.0	0.0	0.0	0.0
Dividend Yield (%)	0%	0%	0%	0%	0%
Normalised PE (x)	-4.79	53.37	-13.23	10.62	2.23
EV/EBITDA (x)	-9.2	36.9	-9.5	8.1	4.2

Source: Company Data and RBS Morgans

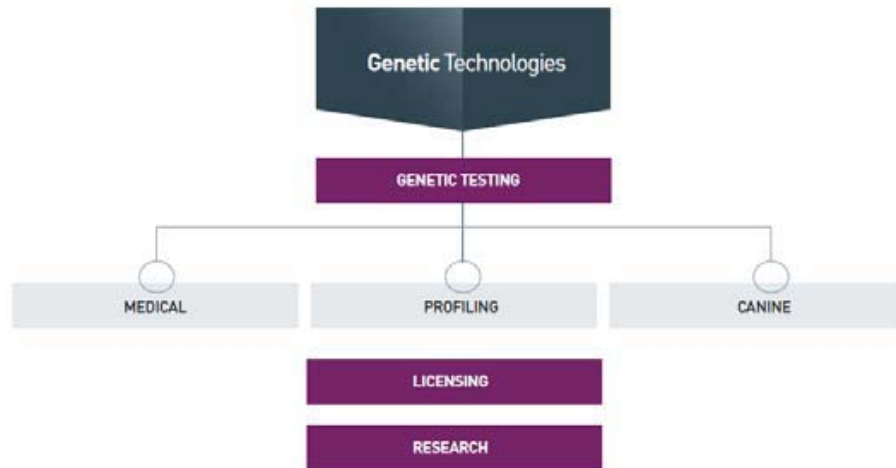
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[Important disclosures regarding companies that are the subject of this report and an explanation of recommendations and volatility can be found at the end of this document.](#)

## Recap on Genetic Technologies (GTG)

GTG has a three pronged business strategy that includes:

- the expansion of its dominant commercial genetic testing business with a focus on oncology and cancer management;
- the global commercialisation of its patents through an active licensing program; and
- the commercialisation of its various research and development projects aimed at generating further intellectual property of global commercial significance. However focus on this strategy has reduced over recent times.



Source: Company Data – Annual Report 2010

## Genetic and diagnostic testing

GTG has an established genetic testing business with high quality facilities and contracted operational revenues. The key testing areas are:

- **Medical** – GTG offer diagnostic tests that determine a patient’s genetic disposition to disease and support clinical decisions for surveillance or treatment options. The key products & services include: BRCA1 and BRCA2 testing - a breast and ovarian cancer test; BREVAGen™ - a non-familial breast cancer risk assessment test; a familial test for colon cancer and epilepsy; and diagnostic & targeted therapy tests for cancer. In 2011, GTG gained certification of its Australian laboratory under the US Clinical Laboratories Improvements Amendments (CLIA), regulated by the Centers for Medicare and Medicaid (CMS). GTG’s Melbourne laboratory is the only lab in Australia, and one of very few outside the US to secure this approval. CLIA certification will enable GTG’s Australian laboratory to offer compliant high-complexity medical testing services to US patients via its wholly owned US subsidiary Phenogen Sciences Inc. Under the CLIA certification, GTG may also add further cancer management products in development to its test menu without need for further regulatory applications.
- **Profiling** – GTG offers genetic testing for paternity (legal & non-legal), forensics (government & private) and specialised DNA profiling tests. The key products & services include: GTG and Silbase paternity brands; forensic DNA testing; My Ancestors Genes - an Ancient DNA test; and ACTN3 Sports Gene Test.
- **Animal** – GTG offers a range of canine DNA profiling, disease and trait tests for professional organisations, breeders and owners of household pets.

## Investment View: Valuation and Price Target

Following the changes to our forecasts our DCF valuation and price target has reduced to A\$0.33 (was A\$0.46). The key changes are contained in Table 1.

	Old 2012F	New 2012F	Old 2013F	New 2013F	Old 2014F	New 2014F
Revenue	20.2	10.9	32.1	23.0	53.2	30.4
% change		-45.9%		-28.4%		-42.9%
EBITDA	3.0	-4.3	11.7	4.5	22.8	6.8
% change		-242.7%		-61.9%		-70.1%
EBIT	2.8	-4.5	11.5	4.2	22.6	6.6
% change		-260.7%		-63.2%		-70.8%
NPAT	3.1	-4.0	12.7	5.0	24.4	7.6
% change		-229.0%		-60.8%		-68.8%
EPS (¢)	0.7	-0.9	2.9	1.1	5.5	1.7
% change		-229.5%		-61.0%		-68.6%
DPS (¢)	0.0	0.0	0.0	0.0	0.0	0.0

Source: RBS Morgans

### Key Assumptions:

- DCF based valuation inputs – Our A\$0.33 (was A\$0.46) valuation is based on a WACC of 14.47%, risk free rate of 5.75%, risk premium of 7.0%, beta of 1.3x, and long-term growth rate of 4%. We have applied no value to GTG's product pipeline, providing further upside potential.
- Cash position – As at 31 December 2011, GTG had A\$12.6m in cash. The capital raising of A\$11.7m in July 2011 was used to fund the establishment of the US sales and marketing efforts for BREVAGen™. We believe this will be sufficient to fund the operations to sustainable profitability. Management has indicated a desire to pursue additional M&A opportunities, which we will factor into forecasts when they arise.
- BREVAGen™ - GTG launched BREVAGen™ in US in June 2011. In the US, there are 1.6 million biopsies taken every year for breast cancer and about 1 million of these are indeterminate from a disease management standpoint. We expect BREVAGen™ to take a 2.5% or 24,000 tests (was 8% or 78,261 tests) share of the target market by 2014; and our valuation assumes that sales rates will increase by 15% per year thereafter. Consequently by 2018 we assume a market share of approximately 9% (was 14%). We have priced the BREVAGen™ test at A\$600 (was A\$475) and assume an EBITDA margin of 40%. Further upside relates to achieving market share in the niche BRCA negative market which is estimated at 200,000 to 300,000 women.
- Genetic testing business – Our model assumes that GTG's genetic testing business will remain flat in FY12 at A\$4.6m and grow at 3.5% per annum from a base of A\$6.2m in FY13.
- Out-licensing program - Our model assumes that GTG will receive A\$9m a year from their patent assertion program until 2021, (except for FY12 where we have assumed revenue of A\$5.8m) – given the six year claim-back window for past infringements of its patents. We assume 40% of this revenue is paid as a success fee to the law firm undertaking the assertion program. We have only accounted for the US-targeted assertion program. More revenue will be received through a similar program targeted at EU companies, and less of this revenue (15%) will be paid in legal fees. Furthermore, we expect that the company will receive an average of A\$0.4m per year in royalty revenue.

## Chart 1 : Financial Summaries

Financial Summaries	AIFRS 2010A	AIFRS 2011A	AIFRS 2012F	AIFRS 2013F	AIFRS 2014F	AIFRS 2015F	Closing price (A\$)	0.12	Price target (A\$)	0.33	
<b>Income statement</b>							<b>Valuation metrics</b>				
Divisional sales	10.0	18.3	10.9	23.0	30.4	52.2	Preferred methodology		Val'n (A\$)	\$0.33	
Total revenue	10.0	18.3	10.9	23.0	30.4	52.2	<b>DCF valuation inputs</b>				
EBITDA	-4.7	1.1	-4.3	4.5	6.8	22.6	Rf	5.75%	10-year rate	5.75%	
Associate income	0.0	0.0	0.0	0.0	0.0	0.0	Rm-Rf	7.00%	Margin	2.0%	
Depreciation	0.9	0.3	0.2	0.2	0.2	0.2	Beta	1.30	Kd	5.43%	
EBIT	-5.6	0.8	-4.5	4.2	6.6	22.4	CAPM (Rf+Beta(Rm-Rf))	14.9%	Ke	15.5%	
Amortisation/impairment	4.1	0.1	0.0	0.0	0.0	0.0	E/EV*Ke+D/EV*Kd(1-t)		NPV cash flow (A\$m)	142.7	
EBIT (incl associate profit)	-9.6	0.7	-4.5	4.2	6.6	22.4	Equity (E/EV)	65.0%	Minority interest (A\$m)	0.2	
Net interest expense	-0.1	-0.1	-0.3	-0.7	-1.0	-1.4	Debt (D/EV)	35.0%	Net debt (A\$m)	-5.0	
Pre-tax profit	-9.5	0.9	-4.0	5.0	7.6	23.8	Interest rate	5.43%	Investments (A\$m)	0.0	
Income tax expense	0.0	0.0	0.0	0.0	0.0	0.0	Tax rate (t)	30.0%	Equity market value (A\$m)	147.5	
After-tax profit	-9.5	0.9	-4.0	5.0	7.6	23.8	<b>WACC</b>	14.5%	Diluted no. of shares (m)	440.9	
Minority interests	0.0	0.0	0.0	0.0	0.0	0.0			<b>DCF valuation</b>	<b>\$0.33</b>	
NPAT	-9.5	0.9	-4.0	5.0	7.6	23.8	<b>Multiples</b>	<b>2011A</b>	<b>2012F</b>	<b>2013F</b>	<b>2014F</b>
Significant items	0.0	0.0	0.0	0.0	0.0	0.0	Enterprise value (A\$m)	116.8	110.9	104.4	101.2
NPAT post abnormals	-9.5	0.9	-4.0	5.0	7.6	23.8	EV/Sales (x)	6.4	10.1	4.5	3.3
							EV/EBITDA (x)	106.1	-25.9	23.4	14.8
							EV/EBIT (x)	158.4	-24.6	24.7	15.3
<b>Cash flow statement</b>	<b>2010A</b>	<b>2011A</b>	<b>2012F</b>	<b>2013F</b>	<b>2014F</b>	<b>2015F</b>	<b>At target price</b>	<b>2011A</b>	<b>2012F</b>	<b>2013F</b>	<b>2014F</b>
EBITDA	-4.7	1.1	-4.3	4.5	6.8	22.6	EV/EBITDA (x)	191.1	-49.4	46.1	29.2
Change in working capital	0.1	1.0	-0.1	-0.7	-0.2	-1.3	PE (pre-goodwill) (x)	148.8	-36.9	29.6	19.4
Net interest (pd)/rec	0.1	0.1	0.3	0.7	1.0	1.4	PEG (pre-goodwill) (x)	-1.2	-0.2	-1.5	0.3
Taxes paid	0.0	0.0	0.0	0.0	0.0	0.0					
Other oper cash items	0.0	0.0	0.0	0.0	0.0	0.0	<b>Comparable company data (x)</b>	<b>2011A</b>	<b>2012F</b>	<b>2013F</b>	<b>2014F</b>
Cash flow from ops (1)	-4.5	2.2	-4.1	4.5	7.6	22.7	Biota Holdings				
Capex (2)	-1.0	0.0	-0.3	-0.2	-0.2	-0.2	EV/EBITDA	-2.4	-5.9	4.4	1.1
Disposals/(acquisitions)	0.0	0.0	0.0	0.0	0.0	0.0	EV/EBIT	-2.0	-4.8	5.7	1.2
Other investing cash flow	0.0	0.0	0.0	0.0	0.0	0.0	PE	na	na	14.9	5.0
Cash flow from invest (3)	-1.0	0.0	-0.3	-0.2	-0.2	-0.2	AcruX				
Incr/(decr) in equity	0.0	0.0	11.7	0.0	0.0	0.0	EV/EBITDA	6.9	72.3	12.0	3.6
Incr/(decr) in debt	0.0	0.0	0.0	0.0	0.0	0.0	EV/EBIT	7.2	115.6	13.2	3.7
Ordinary dividend paid	0.0	0.0	0.0	0.0	0.0	0.0	PE	10.7	74.4	21.7	7.0
Preferred dividends (4)	0.0	0.0	0.0	0.0	0.0	0.0					
Other financing cash flow	0.0	0.0	0.0	0.0	0.0	0.0	<b>Per share data</b>	<b>2011A</b>	<b>2012F</b>	<b>2013F</b>	<b>2014F</b>
Cash flow from fin (5)	0.0	-0.3	11.7	0.0	0.0	0.0	No. shares	380.9	440.9	440.9	440.9
Forex and disc ops (6)	0.0	0.0	0.0	0.0	0.0	0.0	EPS (cps)	0.2	-0.9	1.1	1.7
Incr/(decr) cash (1+3+5+6)	-5.5	1.9	7.3	4.3	7.4	22.5	EPS (normalised) (c)	0.2	-0.9	1.1	1.7
Equity FCF (1+2+4)	-5.5	1.9	7.3	4.3	7.4	22.5	Dividend per share (c)	0.0	0.0	0.0	0.0
							Dividend payout ratio (%)	0.0%	0.0%	0.0%	0.0%
							Dividend yield (%)	0.0%	0.0%	0.0%	0.0%
<b>Balance sheet</b>	<b>2010A</b>	<b>2011A</b>	<b>2012F</b>	<b>2013F</b>	<b>2014F</b>	<b>2015F</b>	<b>Growth ratios</b>	<b>2011A</b>	<b>2012F</b>	<b>2013F</b>	<b>2014F</b>
Cash & deposits	3.3	5.1	12.4	16.7	24.1	46.6	Sales growth	83.3%	-40.2%	110.3%	32.3%
Trade debtors	0.8	0.7	0.9	1.9	2.5	4.3	Operating cost growth	17.2%	-11.5%	21.8%	27.3%
Inventory	0.0	0.0	0.0	0.0	0.0	0.0	EBITDA growth		-652.3%	-194.1%	55.9%
Investments	0.5	0.0	0.0	0.0	0.0	0.0	EBITDA growth		-652.3%	-194.1%	55.9%
Goodwill	0.0	0.0	0.0	0.0	0.0	0.0	EBIT growth		-710.0%	-194.1%	55.9%
Other intangible assets	1.8	1.7	1.7	1.7	1.7	1.7	NPAT growth		-566.8%	-224.6%	52.9%
Fixed assets	3.0	2.0	0.9	1.0	1.0	1.0	Pre-goodwill NPAT growth		-566.8%	-224.6%	52.9%
Other assets	0.0	0.0	0.0	0.0	0.0	0.0	Pre-goodwill EPS growth		-46.9%	-11.5%	21.8%
<b>Total assets</b>	<b>8.7</b>	<b>8.9</b>	<b>16.6</b>	<b>21.8</b>	<b>29.8</b>	<b>54.1</b>	Normalised EPS growth		69.1%	-7.2%	21.8%
Short-term borrowings	0.0	0.1	0.0	0.0	0.0	0.0	<b>Operating performance</b>	<b>2011A</b>	<b>2012F</b>	<b>2013F</b>	<b>2014F</b>
Trade payables	1.2	1.1	1.2	1.5	1.9	2.4	Asset turnover (%)	51.7	21.4	29.9	29.4
Long-term borrowings	0.4	0.0	0.1	0.1	0.1	0.1	EBITDA margin (%)	6.0	-39.2	19.4	22.4
Provisions	1.4	0.9	0.9	0.9	0.9	0.9	EBIT margin (%)	4.0	-41.2	18.4	21.7
Other liabilities	0.0	0.0	0.0	0.0	0.0	0.0	Net profit margin (%)	4.7	-36.6	21.7	25.1
<b>Total liabilities</b>	<b>3.0</b>	<b>2.1</b>	<b>2.2</b>	<b>2.5</b>	<b>2.9</b>	<b>3.4</b>	Return on net assets (%)	11.2	-31.4	21.9	24.5
Share capital	72.4	72.4	80.1	85.1	92.7	116.4	Net debt (A\$m)	-5.0	-12.4	-16.7	-24.1
Other reserves	1.5	1.7	1.7	1.7	1.7	1.7	Net debt/equity (%)	-76.2	-86.5	-86.3	-89.5
Retained earnings	-68.4	-67.5	-67.5	-67.5	-67.5	-67.5	Net interest/EBIT cover (x)	6.2	-14.9	5.7	6.6
Other equity	0.0	0.0	0.0	0.0	0.0	0.0	ROIC (%)				
<b>Total equity</b>	<b>5.5</b>	<b>6.6</b>	<b>14.3</b>	<b>19.3</b>	<b>26.9</b>	<b>50.7</b>	<b>Internal liquidity</b>	<b>2011A</b>	<b>2012F</b>	<b>2013F</b>	<b>2014F</b>
Minority interest	0.0	0.0	0.0	0.0	0.0	0.0	Current ratio (x)	2.4	5.6	6.7	8.2
Total shareholders' equity	5.5	6.6	14.3	19.3	26.9	50.7	Receivables turnover (x)	25.6	13.9	16.5	13.9
Total liabilities & SE	8.6	8.7	16.6	21.8	29.8	54.1	Payables turnover (x)	14.9	12.9	13.4	13.6

Source: RBS Morgans

#### QUEENSLAND

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BURLEIGH HEADS	(07) 5520 8788
CAIRNS	(07) 4222 0555
CALOUNDRA	(07) 5491 5422
CAPALABA	(07) 3245 5466
CHERMSIDE	(07) 3350 9000
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SYDNEY – LEVEL 33	(02) 8216 5111
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SYDNEY – REYNOLDS EQUITIES	(02) 9373 4452
WOLLONGONG	(02) 4227 3022

#### ACT

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MELBOURNE	(03) 9947 4111
BERWICK	(03) 8762 1400
BRIGHTON	(03) 9519 3555
CAMBERWELL	(03) 9813 2945
CARLTON	(03) 9066 3200
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GEE LONG	(03) 5222 5128
RICHMOND	(03) 9916 4000
SOUTH YARRA	(03) 9098 8511
TRARALGON	(03) 5176 6055
WARRNAMBOOL	(03) 5559 1500

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#### NORTHERN TERRITORY

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nil

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