

26 August 2011

Genetic Technologies Limited

Solid progress

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.**

Market capitalisation:
A\$62.8m

Share Price:
A\$0.165

Price Target:
A\$0.46

Sector: BBG AP Pharm & Biotech
RIC: GTG.AX, GTG.AU
Priced at close 25 August 2011.
Source: IRESS

GTG110826

GTG posted a maiden full year profit yesterday, which we believe will be a key turning point and new investors will now be attracted to the name. The business is well cashed up and discussions with management suggest the roll out in US of the genetic test for non-familial breast cancer is progressing to plan. We have made no changes to our forecasts and maintain our Buy rating and price target of A\$0.46.

Key Forecasts

	FY10A	FY11A	FY12F	FY13F	FY14F
EBITDA (A\$m)	-4.7	1.1	3.0	11.7	22.8
Reported Net Profit (A\$m)	-9.5	0.9	3.1	12.7	24.4
Normalised Net Profit (A\$m) ¹	-9.5	0.9	3.1	12.7	24.4
Normalised EPS (¢) ¹	-2.5	0.2	0.7	2.9	6.9
Normalised EPS Growth (%)	nm	nm	209.1	313.2	140.2
Dividend Per Share (¢)	0.0	0.0	0.0	0.0	0.0
Dividend Yield (%)	0%	0%	0%	0%	0%
Normalised PE (x)	-7.19	80.05	25.90	6.27	2.61
EV/EBITDA (x)	-14.0	57.7	20.0	4.1	1.1
Price/Net Oper. CF (x)	-12.5	30.9	34.4	6.6	3.4

Source: Company data and RBS Morgans forecasts

GTG posts maiden profit and solid cash position

GTG posted a maiden profit of A\$0.9m, (compared with our forecast of A\$1.5m). Revenue was A\$18.3m (up 111% on pcp), mainly due to out-licensing activities, where 11 new licenses were granted during the year. Licensing fees and royalties were A\$13.6m (compared with A\$3.7m in pcp). Genetic testing services were A\$4.5m (compared with A\$4.9m in pcp). Net cash flows were A\$2.2m (compared with A\$1.8m in pcp). GTG finished the year with A\$5.1m in cash. Then subsequent to year end raised an additional A\$11.7m, so cash at 31 July was approx. A\$15m.

Key product launched in US

GTG has been focussing primarily on the acquisition and development of diagnostic products for cancer management. In June 2011 GTG launched BREVAGen™, the first validated non-familial breast cancer risk test, into the US market. BREVAGen™ was developed by studying genetic and clinical data from tens of thousands of women, and can help provide a clearer picture of an individual woman's risk of developing breast cancer. In the months immediately preceding the launch of the BREVAGen™, eight experienced Regional Business Managers were recruited to form the first members of the Phenogen Sciences US sales force. They are based in the US States of Texas (two), Washington, Connecticut, Ohio, Illinois, North Carolina and Missouri from where they service these and the surrounding States. The key assumptions we have made for BREVAGen in FY12 include; 1) approx 10,000 tests sold, 2) selling price A\$475 per test to GTG, and 3) an EBITDA loss of A\$2.6m, reflecting higher selling costs during early launch period.

Investment View – Price target of A\$0.46 unchanged

We have made no changes to our forecasts and our DCF valuation remains at A\$0.46. Our valuation is most sensitive to changes in the selling price of the BREVAGen™ test and rate of volume growth as the product penetrates the US market. The key risk relates to maintaining the momentum of the roll out of BREVAGen™ in the US.

Analysts

Scott Power
+61 7 3334 4884
scott.power@rbsmorgans.com

RBS Morgans Limited
(A.B.N. 49 010 669 726) AFSL235410
A Participant of ASX Group

www.rbsmorgans.com

Financials

- **Net cash position** as at 30 June 2011 was A\$5.1m. On 29th July 2011, GTG announced a placement of 60m shares at A\$0.195 raising A\$11.7m. As at 31 July the cash position was over A\$15m.
- **FY11 revenue** of A\$18.3m (up 111% on pcp) and NPAT was A\$0.9m. Licensing fees and royalties were A\$13.6m (compared with A\$3.7m in pcp). Genetic testing services were A\$4.5m (compared with A\$4.9m in pcp). Net cash flows were A\$2.2m (compared with A\$1.8m in pcp).

Valuation and Price Target

We have made no changes to our forecasts and our DCF valuation and price target remain at A\$0.46.

Key Assumptions:

- **DCF based valuation inputs** – Our 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 30 June 2011, GTG had A\$5.1m in cash. The capital raising of A\$11.7m in July 2011 which will be used to fund the establishment of the US sales and marketing efforts for BREVA Gen™. 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.
- **BREVA Gen™** - GTG launched BREVA Gen™ 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 BREVA Gen™ to take an 8% share of the target market by 2014; and our valuation assumes that sales rates will increase by 15% per year thereafter. So by 2018 we assume a market share of approximately 14%. We have priced the BREVA Gen™ test at A\$475 and assume a 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. Our valuation is most sensitive to changes in the price received for BREVA Gen™, a A\$10 increase in selling price increases our valuation by 1cps and if our sales growth rate increases from 15% to 20% from 2014, this increases our valuation by 4cps.
- **Genetic testing business** – Our model assumes that GTG's genetic testing business will grow at 3.5% per annum from a base of A\$6.2m.
- **Out-licensing program** - Our model assumes that GTG will receive A\$9m a year from their patent assertion program until 2021 – given the six year claim-back window for past infringements of its patents. These estimates are conservative considering GTG is looking to receive more than A\$10m for their IP licensing program in CY2011 alone. 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.

Risks

The risks that face GTG at this stage are primarily related to the execution of their business strategy. GTG's success will be closely tied to their ability to successfully rollout the BREVA Gen™ tests in the US. The funding risk associated with the roll out of product is acknowledged and until the market is properly penetrated the risk that additional capital will be required remains. A secondary risk relates to the ability of the IP assertion program to generate consistent revenue.

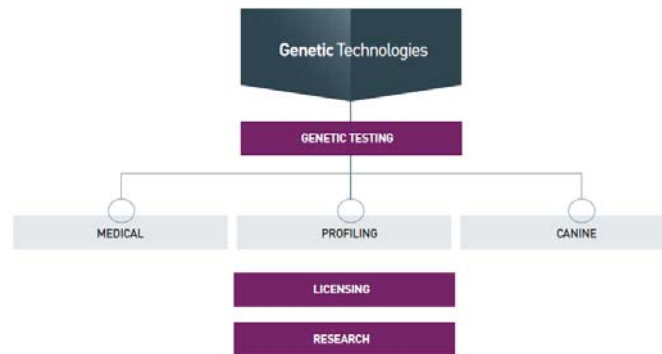
Recap on GTG

GTG has a three pronged business strategy that includes:

1. the expansion of its dominant commercial genetic testing business with a focus on oncology and cancer management;

2. the global commercialisation of its patents through an active licensing program; and
3. the commercialisation of its various research and development projects aimed at generating further intellectual property of global commercial significance, however focus on this is reducing.

Chart 1 : GTG's business structure



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. In January 2011, the NSW Police Force agreed to take up its option of extending the existing forensic services contract with a focus on "complex volume crime" testing. Processes and logistics were tested and formalised in February with maximum agreed volumes levels reached in March.
- Animal – GTG offers a range of canine DNA profiling, disease and trait tests for professional organisations, breeders and owners of household pets. The key products & services include: BITSA - a breed identification test; disease and trait tests; and DNA profiling/ parentage services.

Key product: BREVAGen™

The BREVAGen™ breast cancer risk stratification test is a novel genetic test panel that examines a patient's DNA to detect the absence or presence of certain common genetic variations (SNPs) associated with an increased risk for developing breast cancer. The test is designed to help physicians assess aggregate breast cancer risk from these genetic markers, plus factors from a standard clinical assessment based on a patient's family and personal history, thus giving a clearer picture of an individual woman's risk of developing breast cancer. The BREVAGen™ test may be especially useful for women at intermediate risk of developing breast cancer, including those who have undergone breast biopsies, as the test will provide information that can help

physicians recommend alternative courses of action, such as more vigilant, targeted surveillance or preventive therapy, on a personalized patient by patient basis.

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 and become the target market for GTG. A further target patient group is the 200,000 to 300,000 women who self identify as at risk due to having two or more first degree relatives with breast cancer, but whose BRCA test results are negative. The BRCA test identifies a gene responsible for familial or inherited breast cancer. Only 10% of women will return a positive BRCA test, leaving the remainder of women tested with inadequate information on which a clinician may make decisions regarding managing their care.

Chart 2 : Financial Summaries

	AIFRS 2010A	AIFRS 2011A	AIFRS 2012F	AIFRS 2013F	AIFRS 2014F	AIFRS 2015F	Closing price (A\$)	0.17	Price target (A\$)	0.46	
Income statement							Valuation metrics				
Divisional sales	10.0	18.3	20.2	32.1	53.2	59.0	Preferred methodology		Val'n (A\$)	\$0.46	
Total revenue	10.0	18.3	20.2	32.1	53.2	59.0	DCF valuation inputs				
EBITDA	-4.7	1.1	3.0	11.7	22.8	27.4	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%	
EBITA	-5.6	0.8	2.8	11.5	22.6	27.2	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)	198.7	
EBIT	-9.6	0.7	2.8	11.5	22.6	27.2	Equity (E/EV)	65.0%	Minority interest (A\$m)	0.2	
EBIT(incl associate profit)	-9.6	0.7	2.8	11.5	22.6	27.2	Debt (D/EV)	35.0%	Net debt (A\$m)	-5.0	
Net interest expense	-0.1	-0.1	-0.3	-1.1	-1.9	-3.3	Interest rate	5.43%	Investments (A\$m)	0.0	
Pre-tax profit	-9.5	0.9	3.1	12.7	24.4	30.4	Tax rate (t)	30.0%	Equity market value (A\$m)	203.5	
Income tax expense	0.0	0.0	0.0	0.0	0.0	0.0	WACC	14.5%	Diluted no. of shares (m)	440.9	
After-tax profit	-9.5	0.9	3.1	12.7	24.4	30.4			DCF valuation	\$0.46	
Minority interests	0.0	0.0	0.0	0.0	0.0	0.0					
NPAT	-9.5	0.9	3.1	12.7	24.4	30.4	Multiples	2011A	2012F	2013F	2014F
Significant items	0.0	0.0	0.0	0.0	0.0	0.0	Enterprise value (A\$m)	136.7	130.7	124.3	121.1
NPAT post abnormal	-9.5	0.9	3.1	12.7	24.4	30.4	EV/Sales (x)	7.5	6.5	3.9	2.3
							EV/EBITDA (x)	12.41	43.4	10.6	5.3
Cash flow statement	2010A	2011A	2012F	2013F	2014F	2015F	EV/EBIT (x)	185.3	46.8	10.8	5.4
EBITDA	-4.7	1.1	3.0	11.7	22.8	27.4	PE (pre-goodwill) (x)	73.4	23.7	5.7	3.0
Change in working capital	0.1	1.0	-0.7	-0.7	-0.9	-0.4	PEG (pre-goodwill) (x)	-1.7	0.3	-0.8	0.1
Net interest (pd)/rec	0.1	0.1	0.3	1.1	1.9	3.3					
Taxes paid	0.0	0.0	0.0	0.0	0.0	0.0	At target price	2011A	2012F	2013F	2014F
Other oper cash items	0.0	0.0	0.0	0.0	0.0	0.0	EV/EBITDA (x)	241.9	88.9	22.3	11.2
Cash flow from ops (1)	-4.5	2.2	2.6	12.2	23.7	30.3	PE (pre-goodwill) (x)	205.3	66.4	16.1	8.3
Capex (2)	-1.0	0.0	-0.3	-0.2	-0.2	-0.2					
Disposals/(acquisitions)	0.0	0.0	0.0	0.0	0.0	0.0	Comparable company data (x)	2011A	2012F	2013F	2014F
Other investing cash flow	0.0	0.0	0.0	0.0	0.0	0.0	Biota Holdings				
Cash flow from invest (3)	-1.0	0.0	-0.3	-0.2	-0.2	-0.2	EV/EBITDA	-3.3	-13.8	2.9	1.2
Incr/(decr) in equity	0.0	0.0	11.7	0.0	0.0	0.0	EV/EBIT	-2.7	-8.4	3.0	1.2
Incr/(decr) in debt	0.0	0.0	0.0	0.0	0.0	0.0	PE	na	na	8.0	5.1
Ordinary dividend paid	0.0	0.0	0.0	0.0	0.0	0.0	Acruz				
Preferred dividends (4)	0.0	0.0	0.0	0.0	0.0	0.0	EV/EBITDA	6.9	72.2	11.7	3.5
Other financing cash flow	0.0	0.0	0.0	0.0	0.0	0.0	EV/EBIT	7.1	115.6	12.9	3.6
Cash flow from fin (5)	0.0	-0.3	11.7	0.0	0.0	0.0	PE	10.7	111.9	21.7	6.9
Forex and disc ops (6)	0.0	0.0	0.0	0.0	0.0	0.0					
Incr/(decr) cash (1+3+5+6)	-5.5	1.9	14.0	12.0	23.5	30.0	Per share data	2011A	2012F	2013F	2014F
Equity FCF (1+2+4)	-5.5	1.9	14.0	12.0	23.5	30.0	No. shares	380.9	440.9	440.9	440.9
							EPS (cps)	0.2	0.7	2.9	5.5
Balance sheet	2010A	2011A	2012F	2013F	2014F	2015F	EPS (normalised) (c)	0.2	0.7	2.9	5.5
Cash & deposits	3.3	5.1	19.1	31.1	54.6	84.6	Dividend per share (c)	0.0	0.0	0.0	0.0
Trade debtors	0.8	0.7	1.7	2.6	4.4	4.8	Dividend payout ratio (%)	0.0%	0.0%	0.0%	0.0%
Inventory	0.0	0.0	0.0	0.0	0.0	0.0	Dividend yield (%)	0.0%	0.0%	0.0%	0.0%
Investments	0.5	0.0	0.0	0.0	0.0	0.0	Growth ratios	2011A	2012F	2013F	2014F
Goodwill	0.0	0.0	0.0	0.0	0.0	0.0	Sales growth	83.3%	10.4%	59.0%	65.8%
Other intangible assets	1.8	1.7	1.7	1.7	1.7	1.7	Operating cost growth	17.2%	0.0%	18.5%	49.4%
Fixed assets	3.0	2.0	0.9	1.0	1.0	1.0	EBITDA growth		242.6%	312.7%	96.1%
Other assets	0.0	0.0	0.0	0.0	0.0	0.0	EBITA growth		242.6%	312.7%	96.1%
Total assets	8.7	8.9	24.0	36.9	62.1	92.6	EBIT growth		278.4%	312.7%	96.1%
Short-term borrowings	0.0	0.1	0.0	0.0	0.0	0.0	NPAT growth		257.8%	313.2%	92.8%
Trade payables	1.2	1.1	1.4	1.7	2.5	2.6	Pre-goodwill NPAT growth		257.8%	313.2%	92.8%
Long-term borrowings	0.4	0.0	0.1	0.1	0.1	0.1	Pre-goodwill EPS growth		-46.9%	-11.5%	21.8%
Provisions	1.4	0.9	0.9	0.9	0.9	0.9	Normalised EPS growth		69.1%	-7.2%	21.8%
Other liabilities	0.0	0.0	0.0	0.0	0.0	0.0					
Total liabilities	3.0	2.1	2.4	2.7	3.5	3.6	Operating performance	2011A	2012F	2013F	2014F
Share capital	72.4	72.4	87.1	99.8	124.2	154.6	Asset turnover (%)	51.7	30.7	26.3	26.9
Other reserves	1.5	1.7	1.7	1.7	1.7	1.7	EBITDA margin (%)	6.0	14.9	36.6	42.9
Retained earnings	-68.4	-67.5	-67.5	-67.5	-67.5	-67.5	EBIT margin (%)	4.0	13.8	35.9	42.5
Other equity	0.0	0.0	0.0	0.0	0.0	0.0	Net profit margin (%)	4.7	15.2	39.5	45.9
Total equity	5.5	6.6	21.4	34.0	58.4	88.9	Return on net assets (%)	11.2	13.1	33.8	38.6
Minority interest	0.0	0.0	0.0	0.0	0.0	0.0	Net debt (A\$m)	-5.0	-19.0	-31.0	-54.5
Total shareholders' equity	5.5	6.6	21.4	34.0	58.4	88.9	Net debt/equity (%)	-76.2	-89.1	-91.1	-93.2
Total liabilities & SE	8.6	8.7	23.8	36.7	61.9	92.4	Net interest/EBIT cover (x)	6.2	9.3	10.1	12.2
							ROIC (%)				
							Internal liquidity	2011A	2012F	2013F	2014F
							Current ratio (x)	2.4	8.0	11.7	15.6
							Receivables turnover (x)	25.6	17.3	14.9	15.2
							Payables turnover (x)	14.9	13.6	13.2	14.6

Source: RBS Morgans forecasts



www.rbsmorgans.com

QUEENSLAND

BRISBANE – HEAD OFFICE (07) 3334 4888
BRISBANE – EDWARD STREET (07) 3121 5677
BUNDABERG (07) 4153 1050
BURLEIGH HEADS (07) 5520 8788
CAIRNS (07) 4222 0555
CALOUNDRA (07) 5491 5422
CAPALABA (07) 3245 5466
CHERMESIDE (07) 3350 9000
EMERALD (07) 4988 2777
GLADSTONE (07) 4972 8000
GOLD COAST (07) 5592 5777
IPSWICH (07) 3202 3995
MACKAY (07) 4957 3033
MILTON (07) 3114 8600
NOOSA (07) 5449 9511
REDCLIFFE (07) 3897 3999
ROCKHAMPTON (07) 4922 5855
SPRING HILL (07) 3833 9333
SUNSHINE COAST (07) 5479 2757
TOOWOOMBA (07) 4639 1277
TOWNSVILLE (07) 4725 5787
YEPPON (07) 4939 3021

NEW SOUTH WALES

SYDNEY – HEAD OFFICE (02) 8215 5000
SYDNEY – MACQUARIE STREET (02) 9125 1788
SYDNEY – PHILLIP STREET - LEVEL 33 (02) 8215 5111
SYDNEY – REYNOLDS EQUITIES (02) 9373 4452
ARMIDALE (02) 6770 3300
BALLINA (02) 6686 4144
BALMAIN (02) 8755 3333
CHATSWOOD (02) 8116 1700
COFFS HARBOUR (02) 6651 5700
GOSFORD (02) 4325 0884
HURSTVILLE (02) 9570 5755
MERIMBULA (02) 6495 2869
NEUTRAL BAY (02) 8969 7500

NEWCASTLE (02) 4926 4044
NEWPORT (02) 9998 4200
ORANGE (02) 6361 9166
PARRAMATTA (02) 9615 4500
PORT MACQUARIE (02) 6583 1735
SCONE (02) 6544 3144
WOLLONGONG (02) 4227 3022

VICTORIA

MELBOURNE – HEAD OFFICE (03) 9947 4111
MELBOURNE – FARRER HOUSE (03) 8644 5488
BERWICK (03) 9796 2676
BRIGHTON (03) 9519 3555
CAMBERWELL (03) 9813 2945
CARLTON (03) 9066 3200
GEELONG (03) 5222 5128
RICHMOND (03) 9916 4000
SOUTH YARRA (03) 9098 8511
TRARALGON (03) 5176 6055
WARRNAMBOOL (03) 5559 1500

ACT

CANBERRA (02) 6232 4999

SOUTH AUSTRALIA

ADELAIDE (08) 8464 5000
NORWOOD (08) 8461 2800

WESTERN AUSTRALIA

PERTH (08) 6462 1999

NORTHERN TERRITORY

DARWIN (08) 8981 9555

TASMANIA

HOBART (03) 6236 9000

DISCLAIMER - RBS MORGANS LIMITED

The information contained in this report is general advice only, and is made without consideration of an individual's relevant personal circumstances. RBS Morgans Limited ABN 49 010 669 726, its related bodies corporate, directors and officers, employees, authorised representatives and agents ("RBS Morgans") do not accept any liability for the results of any actions taken or not taken on the basis of information contained in this report, or for any errors or omissions contained within. It is recommended that any persons who wish to act upon this report consult with their RBS Morgans investment adviser before doing so. Those acting upon such information without advice do so entirely at their own risk.

This report was prepared as private communication to clients and is not intended for public circulation, publication or for use by any third party. The contents of this report may not be reproduced in whole or in part without the prior written consent of RBS Morgans. While this report is based on information from sources which RBS Morgans believes are reliable, its accuracy and completeness cannot be guaranteed. Any opinions expressed reflect RBS Morgans judgement at this date and are subject to change. RBS Morgans is under no obligation to provide revised assessments in the event of changed circumstances. This report does not constitute an offer or invitation to purchase any securities and should not be relied upon in connection with any contract or commitment whatsoever.

DISCLOSURE OF INTEREST

RBS Morgans may from time to time hold an interest in any security referred to in this report and may, as principal or agent, sell such interests. RBS Morgans may previously have acted as manager or co-manager of a public offering of any such securities. RBS Morgans' affiliates may provide or have provided banking services or corporate finance to the companies referred to in the report. The knowledge of affiliates concerning such services may not be reflected in this report. RBS Morgans advise that it may earn brokerage, commissions, fees or other benefits and advantages, direct or indirect, in connection with the making of a recommendation or a dealing by a client in these securities. Some or all of our Authorised Representatives may be remunerated wholly or partly by way of commission.

REGULATORY DISCLOSURES

RBS Morgans Corporate Limited was a participating broker to the Genetic Technologies Limited share placement in July 2011 and received fees in this regard.

RECOMMENDATION STRUCTURE

For a full explanation of the recommendation structure, refer to our website at https://www.rbsmorgans.com/research_disclaimer

If you no longer wish to receive RBS Morgans' publications please advise your local RBS Morgans office or write to RBS Morgans Limited, Reply Paid 202, Brisbane QLD 4001 and include your account details.