

Portfolio

Blips on the radar that could make it big

Everyone wants to know the health or biotech stock that will show explosive growth. **Trevor Hoey** thinks he may have found a couple.

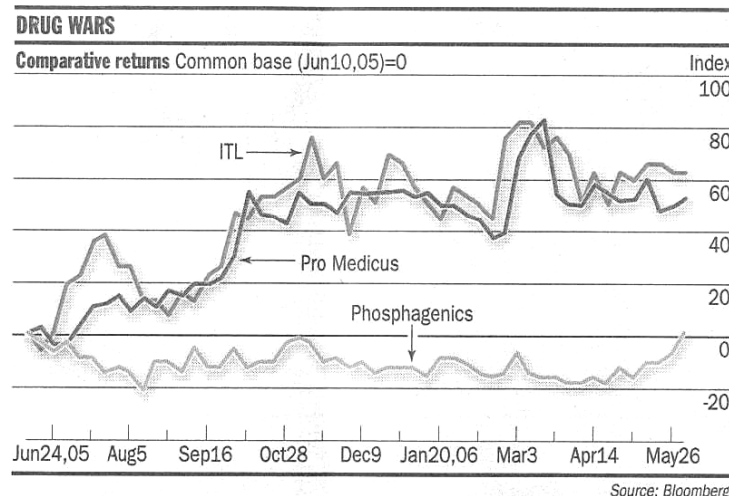
Looking beyond the blue-chip companies in the health and biotechnology sector, it is difficult to find an investment proposition with a real prospect of earnings.

Those in this category invariably trade on high multiples, and the share prices of emerging prospects tend to bolt before most investors are aware that they are shifting from promising to profitable.

Pharmaxis is a good example of how "earnings visibility" can put a rocket under the share price.

After listing in 2003, its share price made little progress until in 2005 it was established that it should become earnings-per-share positive by 2008. Preclinical testing, clinical trials, regulatory approvals and patent issues are part of the grind in the biotechnology sector.

The wait for the bottom-line impact didn't deter investors, who chased Pharmaxis's share price from 40¢ to a seemingly unrealistic



\$3. Having retreated to \$2, the company is trading on a price-earnings ratio of about 30 relative to HTM Wilson's forecast earnings for 2007-08. This still seems fairly high, but is well below the analysts' target price of \$3.84.

So where is the next Pharmaxis? IBA Health and Pro Medicus have made a bit of a charge lately, but there are a few other stocks that may have crept under the radar.

ITL designs and manufactures

medical devices and procedure packs that are used in more than 200 hospitals. ITL listed on the Australian Stock Exchange in 2003, and 2004-05 was an unprofitable year, albeit slightly and due mainly to a business restructure that appears to have had an immediate impact on earnings.

In the six months to December 2005, ITL made a net profit of \$905,000, representing earnings per share of 0.9¢. Research house

Intersuisse forecasts full-year earnings per share of 3.25¢, with a modest P/E ratio of about nine.

Probably of more significance is ITL's acquisition of Malaysian health care company Heal Marketing in January 2006.

The benefits of acquiring Heal were evident in the \$6 million contract awarded to ITL in May by Malaysia's high-profile Prince Court Medical Centre.

While the Heal acquisition will be earnings per share accretive in 2005-06, its full-year impact along with management's forecast of organic growth of 20 per cent should make for a healthy 2006-07 performance. Intersuisse is forecasting a net profit of \$3.6 million, which reflects a P/E ratio of 7.6.

Phosphagenics may come under scrutiny fairly soon. BBY analyst Dennis Hulme picks the company as one of the sector's emerging prospects. Hulme believes that Phosphagenics' stable revenue-earning neutraceutical division, which helps fund its product development operations, is a bonus.

The company's front-line developments are its transdermal insulin and morphine applications that can be delivered through the skin without disrupting the skin (as

is the case with the injected method). The prospect of a share of the \$US10 million (\$13.4 million) anti-diabetic market adds blue-sky appeal to the stock.

BBY forecasts that Phosphagenics will deliver a net profit of \$25 million — earnings per share of 4.6¢ — in the year ended December 2007. This reflects a P/E ratio of about six relative to the company's recent trading range. Profit growth of more than 50 per cent is expected in 2008.

In November 2005, Orbis Global Equity Fund topped up its stake in Phosphagenics from 7.5 per cent to 11.1 per cent. This occurred just after Phosphagenics clinched a development agreement with ALZA, a wholly owned subsidiary of Johnson & Johnson. BBY has faith in the company's ability to extract a strong royalty-based earnings stream from its new technology from 2009.

Phosphagenics' neutraceutical business, which targets heart-related conditions by lowering cholesterol, should provide substantial earnings growth and the cash flow it needs.

A recent agreement with Nestlé Nutrition will be significant in terms of breaking into the food and beverages market if Nestlé uses the company's Phospha E product.