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Bioshares

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Edition 582

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

Extract from Bioshares –

Top Six Stock Picks – 2015

Companies covered: ACW, CUV, CGS,
IIL, IMC, SOM, VLA

| | Bioshares Portfolio |
|---------------------------------|---------------------|
| Year 1 (May '01 - May '02) | 21.2% |
| Year 2 (May '02 - May '03) | -9.4% |
| Year 3 (May '03 - May '04) | 70.6% |
| Year 4 (May '04 - May '05) | -16.3% |
| Year 5 (May '05 - May '06) | 77.8% |
| Year 6 (May '06 - May '07) | 17.4% |
| Year 7 (May '07 - May '08) | -36% |
| Year 8 (May '08 - May '09) | -7.4% |
| Year 9 (May '09 - May '10) | 50.2% |
| Year 10 (May '10 - May '11) | 45.4% |
| Year 11 (May '11 - May '12) | -18.0% |
| Year 12 (May '12 - May '13) | 3.1% |
| Year 13 (May '13 - May '14) | 26.6% |
| Year 14 (May '14 - current) | 2.4% |
| Cumulative Gain | 361% |
| Av. Annual gain (14 yrs) | 16.3% |

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Viralytics, VLA, \$0.285 (Cap. \$52 million)

Viralytics looks like one of the most undervalued biotechs on the Australian market. The company is working in the hot drug development area of cancer immunotherapy.

Viralytics raised \$27 million this year from specialist biotech funds and has delivered positive Phase II data in a melanoma trial. The data is similar to that achieved by Biovex, which was acquired by Amgen for up to US\$1 billion.

The future of cancer treatment is moving towards using the body's immune system to treat cancer. Checkpoint inhibitors, such as Merck's expected blockbuster drug Keytruda which was launched in September, are expected to pave the way for immune modulating cancer treatments. But it is expected that using a combination of approaches that utilise the immune system will provide the most optimal safe and effective treatments in the future.

Viralytics has shown that its drug candidate, CAVATAK, which deploys the *coxsackievirus* (a virus linked to the common cold) is effective as a monotherapy in a Phase II study.

In preclinical studies it has shown that combining its drug with a checkpoint inhibitor that even stronger results can be achieved.

Logically, the next step for Viralytics is to conduct combination clinical trials of CAVATAK with checkpoint inhibitors. Such a trial will start early in 2015 in Oregon in 26 patients with late stage melanoma. It will be an open label study and the combination therapy will be with the Bristol-Myers Squibb drug Yervoy, the first checkpoint inhibitor to reach the market (in 2011). Yervoy is generating sales now of more than US\$1 billion a year.

In this combination trial, CAVATAK will be injected directly into the tumour, the same as the Phase II study completed. The company is also conducting an intravenously-delivered drug trial in the UK in solid tumours with preliminary results in early 2015.

The other advantage for Viralytics (and Innate Immunotherapeutics) is that its treatment is classified as a biologic therapy, thereby providing the company with extended market exclusivity.

Bioshares recommendation: Speculative Buy Class B

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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. For both groups, the rating “Take Profits” means that investors may re-weight their holding by selling between 25%-75% of a stock.

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

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