

In this edition...

Selecting ten stocks (out of more than 100) that are expected to post great returns over a twelve month period is an ambitious undertaking in the world of biotech. Setbacks can appear unexpectedly and without warning, causing share prices to plummet.

Assuming things do go to plan, we expect our list of ten picks for 2011 to offer good returns, although some stocks may peak earlier in the year, enabling investors to lock in some profits and pick up stocks that have yet to run.

This year's selection includes Pharmaxis, which could do well if and when Bronchitol gains European approval, and Somnomed, a stock in the sleep medicine area which recently broke into profitability.

The Editors

Companies Covered: ACL, BTA, BNO, CUV, PYC, PXS, SHC, SOM, SRX, SPL

	Bioshares Portfolio
Year 1 (May '01 - May '02)	21.2%
Year 2 (May '02 - May '03)	-9.4%
Year 3 (May '03 - May '04)	70.0%
Year 4 (May '04 - May '05)	-16.3%
Year 5 (May '05 - May '06)	77.8%
Year 6 (May '06 - May '07)	17.3%
Year 7 (May '07 - May '08)	-36%
Year 8 (May '08 - May '09)	-7.3%
Year 9 (May '09 - May '10)	49.2%
Year 10 (May '10 - Current)	32.0%
Cumulative Gain	284%
Av Annual Gain (9 yrs)	18.5%

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Bioshares

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

The Bioshares Top 10 Picks for 2011

As measured by commercial deals, it was a stunning year for the Australian biotech sector in 2010. In the year ahead, positive sentiment and interest in the sector is set to continue and improve as biotech companies move through pivotal phases of their commercialisation pathways.

For investors looking at this sector, one point that must always be considered is that of locking in profits when times are good. The biotech sector is generally sentiment driven. This means that stocks generally become overbought at some period during the upswing, and are also oversold when sentiment turns sour. As a general rule when stocks double, investors should consider locking in some profits.

With this in mind, we take a look at our top 10 sector picks for 2011, with a focus on stocks that are due to move through major inflection points in 2011 or companies that expect to see strong operational growth. The investment mindset is to be on the lookout for stocks that will become the high achievers of 2011, in the way that Mesoblast and Acrux were in 2010.

The following 10 stocks have been selected from the **Bioshares Model Portfolio**, noting that **Somnomed** has been placed in the portfolio this week.

Extract from Bioshares –

Starpharma Holdings (SPL: \$0.84)
(Share price change in 2010: 20%)

Starpharma is carving up and carving out in as many ways as possible product and application opportunities from its dendrimer chemistry platform. Dendrimers are synthetic, branch like chemical structures that can be engineered very precisely. The addition of smaller functional groups on the periphery or even with the greater structure is what makes the chemistry so versatile.

Areas of application include in human and veterinary medicine, including drug delivery, for use in diagnostics, in water purification, in inks and coatings, in lab reagents, in cosmetics and with agricultural chemicals.

A feature of the Starpharma business model that makes it somewhat more attractive to investors is that has a low cash burn despite maintaining interests in many different programs. The company's net cash outflow (before new capital) was \$2.9 million in FY2009 and \$3.9 million in FY2010. Partners either pay Starpharma to complete work on their behalf or conduct development work at their own expense.

– Cont'd over

Summary – Bioshares Top 10 Picks for 2011

Company	Code	CMP	Cap'n (\$M)	Investment Thesis
Alchemia	ACL	\$0.73	\$140	Fondparinux approval expected shortly
Bionomics	BNO	\$0.34	\$108	Drivers from interim data from multiple clinical trials
Biota Holdings	BTA	\$1.28	\$231	Potential early traction for Inavir in Japan
Clinuvel Pharmaceuticals	CUV	\$2.14	\$65	EU regulatory approval submission
Pharmaxis	PXS	\$3.00	\$678	European approval and launch of Bronchitol in Europe
Phylogica	PYC	\$0.077	\$22	Expects to sign three more library access deals in 2011
Sunshine Heart	SHC	\$0.035	\$35	Completion and positive results from feasibility trial
Somnomed	SOM	\$0.94	\$38	Strong growth in unit sales to be maintained for FY2011
Starpharma Holdings	SPL	\$0.84	\$202	Platform technology base to continue to yield new partnerships, launch of condom microbicide product
Sirtex Medical	SRX	\$6.12	\$341	Shipping from Singapore facility to commence 2011 H1, return to strong sales growth

Starpharma has a drug delivery collaboration with **Eli Lilly**, with Eli Lilly's animal health division **Elanco**, with **Stiefel Laboratories** (part of **GlaxoSmithKline**), and also with an undisclosed partner. It also has an agricultural chemical collaboration with an undisclosed partner.

Starpharma is developing Vivagel initially as a microbicide for women to prevent the transmission of HIV and HSV.

A further product concept developed for Vivagel is for the treatment of bacterial vaginosis. Bacterial vaginosis is a common infection, affecting approximately one-third of the female adult population. The current treatment regime is the administration of antibiotics, however, high rates of recurrence are associated with antibiotic use. Starpharma commenced a dose ranging Phase II trial in 2010 in 132 patients. Two Phase III trials (200 patients in each trial) that would aim to establish the effectiveness of Vivagel in preventing recurrence of the infection, are also planned. Vivagel, used to suppress bacterial pathogens associated with vaginosis, may also be in conjunction with acute antibiotic treatment to break the recurring cycle.

However, the more interesting application from a revenue perspective is the application of Vivagel as a condom coating, the objective being the inactivation of HIV, HSV and HPV. Starpharma partnered with **SSL** to develop a condom coated with Vivagel in September 2008. In 2010, SSL was acquired by the consumer products group **Reckitt Benckiser** for £2.5 billion, with the acquisition posited by some analysts as an early strike on the forthcoming Vivagel coated condoms.

Starpharma anticipates receiving upwards of \$100^{*} in license income and royalty payments from this product line, with in excess of \$30 million of revenue a year if product inclusion is high in the SSL condom range. The market launch is expected this year.

Bioshares recommendation: **Speculative Buy Class A**

Bioshares

*(should read \$100 million)

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

Corporate Subscribers: Pharmaxis, Starpharma Holdings, Cogstate, Bionomics, ChemGenex Pharmaceuticals, Circadian Technologies, Biota Holdings, Halcygen Pharmaceuticals, Impedimed, QRxPharma, Patrys, LBT Innovations, Hexima, Mesoblast, Atcor Medical, BioMD, Tissue Therapies, Viralytics, Phosphagenics, Immuron

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