Stock Picks for FY18.

Our analysts share their outlook and top stock picks for FY18.

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www.bellpotter.com.au

1300 0 BELLS (1300 023 557)

info@bellpotter.com.au

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Financials.

TS Lim

There is something for everyone in our top three picks for FY2018, with two of them not being the major banks.

While we remain positive on the banking sector as a whole – given margin upside from recent asset and liability repricing to offset higher funding costs and the impact of the recently-imposed bank levy as well as stable asset quality – we believe APRA is on the verge of introducing what should constitute "unquestionably strong" capital requirements. These will probably provide some short term headwinds (more sentiment than anything else) and have far greater implications for the majors than the regionals, although the former's respective DRP mechanisms at current settings should be sufficient to generate almost half of any required incremental CET1 capital.

As such, NAB and ANZ given their lower mortgage books and stronger capital positions should be better placed than WBC and CBA. We note that APRA will also likely give the major banks sufficient time, perhaps 2-3 years, to get to the required CET1 capital benchmark.

Be that as it may, we believe the diversified players have better prospects than the majors in the next 12-18 months. This view is due to better top line growth (MQG being an asset manager and with sizeable offshore exposures, SUN buoyed by GWP growth and NAB although a major bank being in the SME/business banking sweet spot), potential for further productivity and efficiency gains and capital management flexibility.

Financials.

TS Lim

Macquarie Group (MQG)

MQG's long term value lies in its ability to understand risk and adapt both its strategy and business mix to changing market conditions. This has enabled the company to transform itself and push for higher and more sustainable revenues in the process. The more obvious benefits of the transformation are the higher margin and capital efficiencies achieved that have resulted in higher profit contributions and Group ROE in return for lower volatility. Our estimates suggest this transformation occurs on average once every 4-5 years for annuity-style revenue components such as net interest income and base fees. Performance fees have some annuity-style characteristics, given the timeline of AUM growth and pipeline of realisation – and taking ~9 years to stabilise in the first round but with the next increment taking a much lower 3 years. Other fees and commissions were first rebased after four years but appears to have stabilised at ~$1.5bn while capital markets facing M&A fees and trading income also show a level of sustainability.

National Australia Bank (NAB)

NAB is a well-diversified financial services organisation providing a comprehensive range of retail and wholesale banking products and services. The bank largely operates in Australia (under the NAB umbrella brands) and in New Zealand (under the BNZ brand) and remains a leader in SME/business banking.

NAB's turnaround and de-risking phase is complete following the demerger and IPO of CYB. The bank is now focused on the lower risk, capital efficient Australian and New Zealand retail, business and corporate banking market space. Our investment strategy is predicated upon NAB improving its NIM (through repricing and pricing discipline), maintaining tight cost management and lifting its overall ROE to levels that are closer to those of its major bank peers (i.e. of 12-15%). NAB remains our top major bank pick, underpinned by effective management execution, capital resilience and a no-nonsense approach to maximising ROE and "Jaws".

Buy, Price Target $33.60

Suncorp Group (SUN)

Ongoing productivity and efficiency initiatives aside, we believe SUN's next strategic move will be the divestment of its sub-scale life business. This continues to be a capital drag on the Group generating an estimated 4-5% ROE in 2016 (vs. ~8% in general insurance and higher through-the-cycle, and 10% in banking at the minimum with upside risk in earnings in a rising rate environment). The divestment notion remains our long-held view and is consistent with CEO & MD Michael Cameron's value-creating philosophy while at GPT (while also in line with recent MQG and NAB transactions and to be followed by ANZ by the end of calendar year 2017).

The potential benefits to SUN include reduced earnings volatility, improved capital efficiency (freeing up ~$1.5bn capital tied up in the life business either to be redeployed into higher ROE businesses such as mortgages or returned to shareholders), improved Group returns (we estimate SUN's 10% sustainable ROE target will be achieved ~2 years earlier through divestment and capital initiatives, pro-forma spot ROE to increase by ~90bp to ~9.3%) and re-rating prospects, maintained ability to provide wealth solutions to existing customers and the removal of public and regulatory scrutiny in the life insurance space. Overall, we remain positive on SUN given: (1) stable asset quality and margin upside from home loan repricing in banking; (2) better top line prospects and further productivity and efficiency gains in general insurance; and (3) enhanced capital management flexibility from the likely sale of its sub-scale life business within 12 months.

Buy, Price Target $15.75

Diversified Financials.

Lafitani Sotiriou

Strength in global indices over the first half of Calendar 2017 continues to leave the sector in a strong position, with shifting trends in the advice landscape continuing to show a move towards independence and renewed focus on differentiation.

We continue to hold a net-overweight view of the sector whilst remaining cautious of some, with a Sell on AMP and PTM.

BT Investment Management (BTT)

BTT continues to show signs of a company that remains firmly within its growth phase. The company remains focused on growing its international presence, whilst further expanding its investment capabilities to deliver a diverse high value product offering. We believe BTT's strategy remains supportive of our double digit EPS growth forecast, and we continue to rate the stock as one of our top picks in the sector.

Buy, Price Target $15.00

Challenger (CGF)

We remain positive on CGF's outlook, with a number of catalysts expected to support company over the medium-term. These include: the Federal Government progressing the introduction of both Deferred Lifetime Annuities (DLAs) and Comprehensive Income Products for Retirement (CIPRs), now called MyRetirement; The rollout of CGF annuities on AMP and BT platforms; and further maturity of the company's MS Primary relationship. We believe CGF is entering a new stage for annuities sales growth and remains well placed to benefit from these structural changes.

Buy, Price Target $14.70

Janus Henderson Group (JHG)

Following the Merger of Janus Capital and Henderson Group, JHG is a true Global powerhouse fund manager. We anticipate JHG to deliver meaningful revenue synergies arising from expanded cross-border distribution opportunities and shared expertise in US & UK/Europe markets. With at least US $110m in pre-tax cost saving expected to be realised post-merger, and forecast double digit EPS growth for CY18e & CY19e, we believe JHG is a compelling opportunity over the medium term.

Buy, Price Target $57.50

Discretionary Retail & Intellectual Property.

Sam Haddad

We believe the near-term cyclical outlook is challenging for the discretionary retail sector.

Throughout most of 2014-2016, the positive wealth effect, fuelled primarily by rising house prices in NSW/VIC coupled with low interest rates and a steady employment market, supported a strong consumer appetite to spend. However, the recent slowing in house price growth and a growing unease in the housing cycle, has seen this wealth effect lose its steam. We believe this points to a reduced consumer appetite to spend (with a greater focus towards paying down household debt). In such an environment, retailers will likely need to deploy increased promotional strategies to drive foot traffic through stores. In addition to these cyclical challenges, domestic retailers also face headwinds from Amazon's market entry.

As a general thematic, we believe there is scope to prosper in an environment with Amazon for those retailers that are: market leaders in their category; adopt an effective omni-channel strategy; and preferable own their own brands.

Super Retail Group (SUL)

Super Retail Group Limited (SUL) is a specialty retailer operating in the automotive parts and accessories market along with the leisure and recreational goods market. The stock has recently been under pressure on market concerns surrounding the arrival of Amazon and the challenging consumer outlook. While we believe a discount to market is warranted in an environment with Amazon, we think that the current discount (of circa 30%) is excessive considering: 1) SUL's Auto division represents ~47% of group earnings which we believe is less prone to disruption; 2) the opportunity for SUL to build on its leading market position centred around an omni-channel capacity; and 3) the turnaround momentum underway in SUL's Leisure division. From a cyclical perspective, while SUL's Sports and Leisure divisions are subject to changes in the retail environment, we consider Auto as relatively defensive. At a trading FY17/FY18 PE of 11.9x/10.4x, we believe SUL's valuation is undemanding. SUL also offers an attractive FY18 fully franked yield of 5-6%.

Premier Investments (PMV)

Premier Investments (PMV) is an investment company whose major investment is in discretionary retailer Just Group. Just Group operates specialty retail brands Just Jeans, Jay Jays, Portman's, Jacqui E, Peter Alexander, Dotti and Smiggle. PMV's stock price has been under pressure due to difficult market conditions in apparel (since October 2016), and like other retail stocks, market concerns surrounding the arrival of Amazon and the challenging consumer outlook. We see the current cyclical softness in apparel as an opportunity to build exposure to PMV's Smiggle global growth thematic. We believe the Smiggle brand can become a global brand given its leverage to youth education and hence universal appeal across cultures. The growth opportunity for Smiggle is significant with the brand yet to enter major regions such as Continental Europe and North America. We also like PMV given Just Group owns all its brands which serves as stronger defence against Amazon. Backing out PMV's net cash and investments in Breville and Myer, PMV's Just Group currently trades at an implied FY18 EV/EBITDA multiple of ~8x which we believe is undemanding.

IPH Limited (IPH)

IPH Limited (IPH) wholly owns Spruson & Ferguson, Pizzeys, Fisher Adams Kelly Callinans, Cullens and Practice Insight. IPH is the leading Intellectual Protection (IP) services group in the Asia-Pacific region employing >450 staff. We believe IPH's share price has bottomed and currently represents an attractive, timely opportunity to Buy. We believe the key negative issues that have recently weighed on the stock are now behind (i.e. share overhang from escrowed shares removed and AIA impacts cycled), and believe a number of positives now lie ahead. The key positive factors we see include: 1) the resumption of solid growth in IPH Asia; 2) integration synergy benefits from recent acquisitions to flow from 2HFY18/FY19; and 3) EPS accretive acquisitions in Asia and new secondary markets. Overall, we believe IPH is a high quality business with attractive operating attributes in a structurally growing industry and accordingly believe the stock's trading FY18 PE of ~15x is undemanding. The stock also offers an attractive FY18 yield of 5-6%.

Technology.

Chris Savage

We are positive on the technology sector in Australia as, in an environment of low interest rates and low growth, we believe there are a number of good quality stocks in the sector with reasonable to strong growth outlooks.

We also believe there is reasonable value in the sector and, while some of the larger and higher profile stocks now have forward PE ratios >30x, there are some smaller and lower profile stocks – but still of good quality and with strong growth outlooks – with forward PE ratios of around 20x or less. Our goal is to find good quality tech stocks with strong growth outlooks and preferably a global presence that are currently trading on forward PE ratios of around 20x or less and that, over time, can re-rate up to around 30x or more as has happened with stocks like Technology One (TNE) and Altium (ALU).

Integrated Research (IRI)

Integrated Research (IR) is a software company that has one key product – called Prognosis – which monitors the performance of a customer's computer network. The company has many of the attributes we look for in a tech company: global presence, leading market position, high quality customers, large recurring revenue, long history, barriers to entry, strong balance sheet and good management. The stock is currently trading on an FY18 PE ratio of c.22x which we believe is reasonable given we forecast average annual EPS growth of approximately 20% over the next three years (FY18-FY20). We believe IR has as good an outlook as Technology One and Altium and so believe the stock deserves to trade on a forward PE ratio of around 30x or more.

Buy, Price Target $3.75.

Appen (APX)

Appen is a services company that provides language data and services to enterprise and government customers. The company has many of the attributes we look for in a tech company – global presence, leading market position, high quality customers, long history, barriers to entry, strong balance sheet and good management – and also provides exposure to the key thematic of speech being increasingly used as an interface. The stock is currently trading on a CY17 PE ratio of c.23x which we believe is reasonable given we forecast average annual EPS growth of approximately 25% over the next three years (CY17-CY19). We believe Appen deserves to trade on a forward PE ratio of between 25-30x given its key exposure to the speech thematic and leading global market position.

Buy, Price Target $4.30.

Adacel Technologies (ADA)

Adacel is a software company that has two key products – air traffic control (ATC) simulation systems and air traffic management (ATM) automation systems. The company is by far the leading global provider of the former and more of a niche provider of the latter. The demand outlook for both products is positive given there is a global shortage of air traffic controllers (and hence need for more ATC simulation systems) and there are various modernisation programs to improve ATM systems globally. The stock is currently trading on an FY18 PE ratio of c.17x which we believe is cheap given we forecast average annual EPS growth of >25% over the next three years (FY18-FY20). We believe Adacel deserves to trade on a forward PE ratio of between 25-30x given it is a software company with a leading global market position and a high level of recurring revenue.

Buy, Price Target $3.00.

Resources.

David Coates

The Resources sector overall has been a mixed bag over the course of 2HFY17.

The broader Metals and Mining Index is down approximately 3% over the half year after a strong start in January which kicked the year off with a 6.8% gain over the month. This was driven by strong commodity price performances, particularly for copper, iron ore, nickel and gold. We also saw continuation of interest in specific thematics such as renewable energy/lithium-ion batteries as the cobalt price began to take off (now up 78% ytd), and the consolidation of significant gains in lithium prices over the last 18 months. While we remain positive on the resources sector, we view positive price catalysts for some metals as being relatively long-dated, with the exception of copper and gold where we see potential for tight supply (copper) and a declining US$ and the safe haven trade as supportive for gold.

Pantoro Limited (PNR)

PNR is a growing gold production company, operating its flagship, 100% owned, Halls Creek Project (including the Nicolsons Gold Mine) in the Kimberley Region of Western Australia. Extremely competitive capital efficiency combined with high grades at Nicolsons delivered positive free cash flows in 2HFY17 despite the project being in being in ramp-up. We have seen a number of company-specific catalysts delivered in CY17, including production growth and cost reductions, debt reduction and a major Reserve and Resource upgrade to support a longer mine life. We visited the site during the June quarter and came away convinced of further growth potential and the capability of the management team to deliver.

Buy, Price Target $0.31/sh

Regis Resources (RRL)

RRL is a well-established gold producer with three main producing mines at its Duketon operations in Western Australia and a development project in NSW. Currently producing at around 300-330kozpa at All-In-Sustaining-Costs (AISC) of A$974/oz (FY17 ytd), RRL has an extremely robust balance sheet (debt free, cash of $114.5m as at end March) and a track record of class-leading returns to shareholders, having paid out 13% of revenues in FY16 and on track for a similar proportion in FY17 (BPe 14cps total dividend) for a forecast yield of 3.7% at current prices. RRL has 10Mtpa of processing capacity at Duketon and is now driving production growth via the discovery of higher grade satellite deposits. We view this as an extremely attractive strategy, setting RRL apart from many of its peers.

Buy, Price Target $3.95/sh

Fortescue Metals Group (FMG)

We have recently upgraded FMG to a Buy on the back of re-emergence of value in the stock. We view the balance sheet as very robust, operating costs at the bottom of the cost curve which we expect to maintain strong free cash flows and dividend payments through the price cycle. Other valuation metrics look undemanding. Our current base case assumptions (iron ore US$59-US$60/t) put FMG on a PER of 6.2x in FY18 and FY19 and paying fully-franked dividends with yields around 6%. While increased supply is dampening the iron ore price outlook, steel prices and production remain robust and key manufacturing PMI's continue to show growth. We also see production cost support, with the removal of 100Mt of the most expensive production still placing the top of the cost curve above US$50/t.

Buy, Price Target $5.55/sh

Resources.

Peter Arden

FAR Limited (FAR)

FAR continues to advance its important interests in and around one of the world's largest oil discoveries in the past few years in offshore Senegal. Besides its strategic 15% interest in the Rufisque, Sangomar and Sangomar Deeps (RSSD) JV, which contains the large SNE and FAN oil fields, it has major interests in two highly prospective neighbouring areas. Successful appraisal of the SNE field over the past year has shown it is likely to contain around 1 billion barrels of recoverable oil that is economic at current prices with further exploration upside in nearby targets. We expect the current dispute over pre-emptive rights in the RSSD JV to be resolved in FAR's favour but it is weighing on the FAR share price.

Speculative Buy, V $0.27/sh

Gold Road Resources (GOR)

GOR has had positive exploration results on multiple fronts across its large Yamarna tenement that confirm its highly prospective nature, vindicating the very large ($30m in 2017) exploration effort, so it was not surprising that Gold Fields moved quickly recently to lift its stake in GOR to the 10% limit allowed under the JV arrangement. Signing of the A$298m EPC contract for Gruyere confirms development of the very attractive, low risk and high quality project is on track to have forecast annual average gold production of at least 270koz at a low average AISC of A$945/oz from late in 2018.

Speculative Buy, V $1.01/sh

Galaxy Resources (GXY)

GXY has recently begun to sell Mt Cattlin lithium concentrates at the very much higher 2017 prices of at least US$830/t while it continues to fine tune production parameters, lifting output past the current rate of 160ktpa and recoveries towards the targeted rate of 70% by year end (recently running at 54%). We estimate Mt Cattlin is now generating strong and growing cash flow. With its high calibre brine operations team, GXY is progressing development of its high quality Sal de Vida brine project in Argentina and it has also resumed development studies on the high grade James Bay Spodumene Project in Ontario, Canada.

Speculative Buy, V $3.35/sh

Agriculture & FMCG.

Jonathan Snape

Investments in the Agricultural & FMCG sector should be considered high risk and come with volatility. For this reason we tend to focus on stocks where we see either: a structural uplift in ROIC through the cycle (A2M, SM1) or cyclical growth stories (HUO).

The a2Milk Company (A2M)

The success of A2M in the IMF category has transformed the business, allowing A2M to internally fund both its geographical expansion and product diversification strategy. A2M is a unique business that is achieving strong levels of earnings growth while generating high levels of operating cash realisation. Looking forward we see the scope for any sign of success in the US & UK fresh dairy markets, the potential launch of IMF products in the UK & US and the extension of the adult nutrition product range as levers to create further value for investors. When adjusted for US losses (which we view as start-up investment costs) and the value of the SM1 stake, A2M is trading at an FY18e EV/EBITDA of ~14x a level broadly consistent with its peer group, while offering materially stronger near term earnings growth outlook.

Synlait Milk (SM1)

Our favourable view on SM1 is supported by: (1) a continued transition in sales mix towards high margin canned IMF products (via supply agreements with A2M & Munchkin); (2) exposure to the benefits of a capital expenditure program targeted at using a greater proportion of the available milk supply in value added products; (3) an acceleration in operating cash generation, we believe is underestimated by the market; and (4) undemanding valuation metrics, with SM1 trading at a ~40% discount to its broader IMF peer group and a ~50% discount to A2M (despite providing similar operating leverage to growing sales of a2Platinum).

Huon Aquaculture (HUO)

Our Buy rating on HUO is supported by: (1) completion of a significant investment in the asset base to deliver volume growth towards ~25,000t fish well in advance of near term volume forecasts; (2) a reduction in operating costs from more normal growing conditions and the benefit of the recent capex program (likely to emerge in 2H17e/1H18e); (3) a more favourable pricing environment with tighter domestic and global supply in FY17-18e; and (4) the scope to further expand capacity beyond the existing 27,000-28,000t level with a modest new capital commitment.

Healthcare & Biotech.

John Hester

Among the large market capitalisation stocks CSL and Cochlear have dominated performance during the first six months of 2017. The common factor between these two organisations is their outstanding intellectual property base coupled with high quality management.

Also performing well are Sonic Healthcare and Resmed, albeit both face revenue challenges from an increasingly tough reimbursement regime, particularly in the United States.

The underperformers in the sector include Primary Healthcare and Healthscope. Primary continues to face major challenges with its business model and poor reimbursement growth from Medicare, while Healthscope appear to have suffered from low volume growth in hospital admission.

Both listed private health insurers had outstanding profit growth in 1H17. Since then both Medibank and NIB Holdings have warned of normalisation in hospital claims inflation and this has driven some pull back in valuation. Nevertheless, in our view valuations are reasonable given the growth outlook for the private health insurance sector.

Amongst the small cap stocks including biotech's many of the stocks under research coverage have continued to deliver progress in the clinic. Standouts include Starpharma, Viralytics and Mesoblast each of which have short term price catalysts. Outside of biotechnology stocks, Paragon Care remains on our Buy list as is DorsaVi. DorsaVi has underperformed more recently, however, the recent launch of its second generation sensor should be a significant catalyst for earnings growth in FY18.

Healthcare & Biotech.

John Hester

Paragon Care (PGC)

PGC is in the midst of a long term industry roll up of the medical supplies industry which we believe has several years to run. We like PGC because of its diverse customer base and non-cyclical growth profile. In addition the company is yet to see the best of revenue synergies from more recent acquisitions. The full year result in FY17 is expected to deliver 13% EPS growth driven through a combination of organic growth and acquisitions. Second half EPS growth should be significantly stronger than 1H17 as sales and earnings are strongly skewed to the back half of the fiscal year. In our view the company will continue to make highly EPS accretive acquisitions, which together with the strong organic growth make this a standout.

We maintain our Buy recommendation on PGC with a target price of $1.

iSelect (ISU)

iSelect is new to our key picks list and this follows our recent initiation of coverage. Following a turbulent period post its listing in 2013, the company has now stabilised revenues, divested non core assets and is once again on a growth trajectory.

ISU is a technology play. It is a market leader in the online comparison website industry with key products being private health insurance, telco and now general/life insurance sales. As these latter verticals grow, the reliance on health insurance will be further diluted. The major catalyst for short term earnings growth should be the commencement of end to end services in insurance broking following the company's recent admission to the Insurance Brokers Network of Australia. This will vastly expand the product offering in the insurance sector leading to revenue growth.

We have a Buy recommendation on ISU and a price target of $2.38.

Viralytics (VLA)

VLA has continued to deliver promising clinical trial results since the start of 2017. The company has identified a niche market in patients whose cancer has relapsed following treatment with first line therapies. In this 'checkpoint refractory' group results from the ongoing MITCI study indicate a best response rate of 33% and a disease control rate of 67%. Admittedly these results are in small patient numbers in a single arm study, however, if these efficacy results are sustained, then we believe it likely that a phase II accelerated approval study could commence in calendar 2018. There is also potential for Cavatak to be granted breakthrough status ahead of an approval study and this would expedite the review process.

Numerous global pharmaceutical companies have checkpoint inhibitor drugs either approved or in late stage development. We believe either of these groups is a potential development partner for VLA. Alternatively, the company is also considering funding an approval study from its own resources. We maintain our Speculative Buy recommendation on VLA with a price target of $2.33.

Healthcare & Biotech.

Tanushree Jain

We continue to believe that the fundamentals and demographic trends for the healthcare and biotech sector remain strong for 2017. We also believe that some of the other factors especially on the political front in US which caused a lot of volatility and pressure on the sector in 2016 have abated.

Most recently in the US the 21st Century Cures Act was signed by President Obama into law. This legislation aims to increase funding for medical research, speed the development and approval of innovative treatments including regenerative medicines, cancer, mental health and fight opioid abuse. We believe all 4 of these disease areas will remain key areas of growth and licensing activity and all the companies who have made our Top pick list are targeting one or more of these areas and we expect high partnering interest for their promising assets.

Drug pricing was the key concern for the industry last year. We believe government price controls are less likely, however we do believe the scrutiny on drug pricing will not go away. Amidst this backdrop we believe that it will no longer be possible for companies to rely on exorbitant price increases to bolster their revenues. Large pharmas continue to be struggling with dwindling pipelines and revenue erosion from expiry of patents on their blockbuster products resulting in competition from low priced generics. There remains talks about tax reform in the US, which would allow US companies to repatriate their overseas cash at a lower tax rate which if eventuates may provide these companies with a much larger war chest to be able to aggressively go after the most promising innovation.

As a consequence we continue to expect cash rich companies to keep looking for promising, innovative products outside their company and expect licensing and M&A activity to continue in 2017 which bodes well for the outlook for the ASX listed biotechs and healthcare stocks we cover. Companies likely to attract suitors will be those that are truly innovative, target diseases that are particularly likely to increase in incidence with rising ageing population and areas with unmet need with relatively limited competition and those that have the ability to cut down on healthcare costs and offer an expedited path to regulatory approval.

Healthcare & Biotech.

Tanushree Jain

In view of these factors we believe 4 ASX listed biotech stocks stand out as potential winners and are our Top picks for 2H2017.

Medical Developments International (MVP)

MVP is a specialist health care company with pain relief and respiratory device products. Its flagship product Penthrox (a self-inhaled, fast acting, non-narcotic analgesic for emergency trauma pain treatment) has been used for several years in Australia and is in the initial stages of global expansion. Emergency trauma pain is a growing and underserved market with emergency departments across the globe seeing increased utilisation, which is putting pressure on these departments. There is also increased focus in the US around curbing the epidemic of opioid drug abuse and finding non-narcotic alternatives such as Penthrox to treat pain. The stock has had a good start in 2017 and we continue to see a lot more upside to the stock. In the near term we expect the European market to be the key revenue growth driver for the company. UK and Ireland roll out of Penthrox is gaining momentum, with the second order from partner Galen received earlier in the year. Roll out is accelerating (38 formulary approvals with 5 being major trauma centres as of March 2017) and Penthrox should be approved in more than 50% of the target UK hospital accounts and 75% of Ireland hospitals by end of CY17. Also, in 1H17, Penthrox was included in clinical practice guidelines for all ambulances in Ireland as front line analgesia for moderate pain, which should allow for its wider adoption across Ireland ambulance services. For rest of Europe, partner Mundipharma launched the product in France and Belgium in Feb'17. The company continues to move towards its target to sell Penthrox in an additional 40 countries by 2019. To that end regulatory progress has been made in Canada with partner Purdue driving the process and the company has also signed a distribution deal for the Russian market earlier in the year. Regulatory approval for the rest of Europe is expected to commence during FY18 which will trigger additional milestone payments for the company. Looking further we see Penthrox's entry into the much larger US market in FY20 representing further long term growth and upside. We also see US space chamber business driving revenue growth in 2H17 at the back of deals signed with Walmart, Kmart, Costco and other pharmacy chains in US in 1H17.

We see key near term re-rating catalysts for the stock as additional regulatory approvals for European markets and IND approval by FDA for clinical trials of Penthrox in the US.

Buy, Price Target $7.56/sh

Healthcare & Biotech.

Tanushree Jain

Mesoblast (MSB)

Mesoblast is a biotechnology company commercialising the therapeutic use of mesenchymal lineage cells (MPCs and MSCs) – a kind of adult stem cell. It is the leading allogeneic regenerative medicine player with one of the most diversified pipelines and several products in late stage. Despite the recent stock price pullback following a significant rally in the share price since end of 2016, we continue to believe the company's turnaround prospects are strong based on upcoming clinical and commercial catalysts. Mesoblast remains one of our Top stock picks for 2017 based on a) Data is accumulating across various disease indications that MSB's cells seem to have optimal response in patients with advanced disease state and that a single dose has durable outcomes, suggesting a disease modifying treatment rather than symptomatic. We have seen durable benefits now in Congestive Heart failure (CHF), chronic low back pain due to disc degeneration and biological refractory Rheumatoid Arthritis; b) The company has one commercial product for GvHD (Graft vs. host disease) approved and launched in Japan. While revenues are small from it at this stage, we understand the launch has exceeded expectations of partner JCR and within 1 year from launch the product has achieved its first sales milestone. What is noteworthy is that the rare disease product has also achieved a high reimbursement rate in Japan; c) Top line results from Phase 3 trial for GvHD in children are due in 4QCY17 and based on the futility analysis at interim point we believe likelihood of success is high with potential launch expected in US in FY19; d) Discussions with Mallinckrodt on GvHD and back pain product are advanced and we continue to expect a near term positive conclusion to negotiations (early 3QCY17). A deal will provide non-dilutive funding, reduce burn related to those 2 products, provide back end milestone payments and royalties and serve as further validation for the company; e) 12 month data from Phase 2 Rheumatoid arthritis trial is due next quarter (3QCY17). We are looking for partnering discussions to take on a serious note on this product if we continue to see durable benefits at this time point (so far both 12 weeks and 39 weeks data was positive and better than existing treatments); f) In US 21st century Cures Act was signed into law. This created the new designation RMAT (Regenerative Medicine Advanced Therapy) to accelerate the development and review process for regenerative medicines including cell therapy which target serious or life threatening conditions. This creates a pro-regulatory environment for cell therapies. MSB's CHF asset is the key program we believe which can benefit from the accelerated pathway offered by this designation; g) Recent futility interim look on Phase 3 CHF trial (Class 3 and class 2 heart failure patients) on efficacy endpoint from 270 patients was successful and partnering negotiations are ongoing for this asset; h) There is another key trial in CHF ongoing (Stage IV end stage CHF). This is being run and funded by the US NIH. The trial is expected to complete by mid-CY17 with results in 4QCY17. Based on results and discussions with FDA this Phase 2B trial could be sufficient for the company to get conditional approval and get faster to the market.

Buy, speculative, Valuation $3.69/sh

Starpharma (SPL)

Starpharma is a Melbourne-based platform company commercialising the science of nanoscale polymers called dendrimers. Its proprietary dendrimer technology is versatile with wide applicability across the pharmaceuticals sector. In drug delivery the company is focused on oncology (cancer). Events over the last 6 months have transformed the company and we believe its pharmaceutical pipeline is approaching key inflexion points which can drive a significant re-rating. SPL's strong cash position of ~A$60.7m and sharpened focus on its core high value add pharmaceuticals business (drug delivery and VivaGel portfolio), following recent sale of its agrochemical business underpins its future growth. We believe the company is self-funded now and its strengthened balance sheet will assist it in ongoing partnering negotiations for VivaGel Bacterial Vaginosis (BV) and allow it to accelerate development of its internal DEP drug delivery candidates. Results from VivaGel R-BV Phase 3 trials are expected in July'17. We expect a marketing application for BV treatment to be submitted to the FDA in 3QCY17. SPL has engaged a US bank to assist it with a competitive process ongoing on partnering BV. We expect a licensing deal for BV in 3QCY17 will lead to further cash injection and allow SPL to focus on the drug delivery business. Results from Phase 1 DEP docetaxel trial are expected in mid CY17, with a Phase 2 to start later this year targeting 1-2 cancer types. DEP cabazitaxel is expected to move to Phase 1 trials in 2HCY17 and DEP irinotecan into Phase 1 in 1HCY18, which will add further value to the business. We also are encouraged between the deepening ties between AstraZeneca (AZN) and SPL. SPL received an A$2.6m milestone recently from AZN on completion of pre-clinical studies on the first drug candidate under their partnership. We expect presentation of data on this candidate towards the end of CY17 followed by the drug moving into Phase 1 trials which would trigger another milestone to SPL. We speculate that the AZN/SPL drug is a dual BCL-2/xl inhibitor being targeted at a broad range of blood cancers. This is a well validated target, hampered by a narrow therapeutic window and on-target bone marrow toxicities. If we are correct we believe this candidate has the potential to become a valuable asset for AZN given their focus and increased investment on building up their blood cancer pipeline. Progress of this asset towards the clinic therefore bodes well for SPL/AZN's long term collaboration and AZN's interest in SPL.

Buy, speculative, Valuation $1.17/sh

Bionomics (BNO)

Bionomics is an Adelaide based drug discovery company with a deep pipeline of products targeting oncology, CNS (including mental health and mood disorders) and valuable technology platforms. We continue to see deep value in this stock and believe it has strong re-rating prospects. The company also has a strong cash position with ~A$50m at end of March'17. The company has two strategic collaborations with Big Pharma Merck & Co with a potential combined value to Bionomics of more than US$600M and a pipeline of drug candidates with a series of near term catalysts both in terms of clinical progress and partnering opportunities. BNO's CNS franchise received a further validation earlier this year with partner Merck moving their Alzheimer's candidate into Phase 1 trials which triggered a US$10m milestone to BNO. Merck is also a shareholder with 4.5% stake. BNO's lead drug with blockbuster potential is BNC210 targeting anxiety and related disorders. Results from a Phase 2 trial in General Anxiety Disorder with BNC210 in September last year were impressive and demonstrated its safety and importantly showed that the drug outperformed both placebo and active control lorazepam and met both primary efficacy endpoints and secondary endpoints related to defensive behaviour. Trial was conducted by Kings College London team. We expect partnering interest for this asset to be high. No major breakthrough has happened in anxiety over the last decade and promising assets such as BNC210 are scarce. We expect this asset to be partnered in 2HCY17 with interest from multiple parties likely to result in a high value deal. A PTSD (Post Traumatic Stress Disorder) trial with BNC210 is also ongoing which is due to report in CY18. On the oncology side, BNC101 targeting LGR5+ cancer stem cells is in a Phase 1 colon cancer trial which is due to report in 3QCY17. This is another interesting asset (comes out of a Biogen Idec Spin off which BNO acquired) which we believe has high potential value both as monotherapy and in combination with immunotherapy targets. The other oncology asset BNC105 is also moving towards gathering more data and potentially a partner. We believe its value as a combination treatment with checkpoint inhibitors is underappreciated. A combination trial with Keytruda (Merck's anti-PD1) in melanoma is due to start soon and we also expect other IO companies to be interested in exploring combination of their IO assets with this drug. BNC105 has a unique mechanism of action and data presented at the AACR has shown it can induce changes in tumour microenvironment, which implies it can prime tumours for enhanced response to the checkpoints. Novartis is funding a biomarker study with this asset and separately Norris Cancer Centre in US is starting an investigator initiated trial for this in CLL (Chronic Lymphocytic Leukemia).

Buy, speculative, Valuation $0.88/sh

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Disclosures

TS Lim owns 125 shares in MQG.

TS Lim owns 368 shares in SUN.

Sam Haddad owns 5,000 shares in SUL.

David Coates owns 1,400 shares in RRL.

Jonathan Snape owns 22,500 shares in A2M.

Lafitani Sotiriou owns 5,800 shares in BTT.

Lafitani Sotiriou owns 5000 shares in CGF.

Peter Arden owns 49,500 shares in Gold Road Resources.

Bell Potter Securities acted as Co-manager in the NAB Capital Notes 2 offer in May 2016 and received fees for that service.

Bell Potter Securities acted as Lead manager of the 2016 Capital Raising for Viralytics (VLA) and received fees for that service.

Bell Potter Securities acted as Lead manager for PGC's 2015 capital raise and received fees for that service.

Bell Potter Securities acted as lead managers in ISU's on market buy back in 2016 and 2017 and received fees for that service.

Bell Potter Securities acted as a Lead Manager for FAR's placement of $60m in April 2016 and received fees for that service.

Bell Potter Securities acted as lead manager and underwriter in the March 2017 placement for MSB and received fees for that service.

Bell Potter Securities acted as joint lead manager in the December 2015 placement for SPL and received fees for that service.

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The stocks of resource companies without revenue streams from product sales should always be regarded as speculative in character. Since most exploration companies fit this description, the speculative designation applies to all exploration stocks. The fact that the intellectual property base of an exploration company lies in science and is generally only accessible to the layman in a limited summary form adds further to the riskiness with which investments in exploration companies ought to be regarded. Stocks with 'Speculative' designation are prone to high volatility in share price movements. Exploration and regulatory risks are inherent in exploration stocks. Exploration companies engage in exploration programs that usually have multiple phases to them where positive results at some stages are not indicative of ultimate exploration success and even after exploration success, there is often insufficient economic justification to warrant development of an extractive operation and there is still significant risk that even a development project with favourable economic parameters and forecast outcomes may fail to achieve those outcomes. Investors are advised to be cognisant of these risks before buying such a stock.

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