

Headlines

ECO Animal Health: Reason for comment: Final results (delayed comment): Opinion No recommendation (unchanged)

Service Power Technologies: Reason for comment: General comment on bid approach No recommendation (unchanged, but see text)

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ECO Animal Health

Share Price: 140p
Market Cap: £65m
(EAH.L)

Progressing towards the big numbers!

We calculate that the continuing business, under IFRS accounting, but excluding foreign exchange profits, generated small pre tax profits for the year to March 2009. There are differing opinions on whether IFRS EPS should be adjusted for amortisation. We are firmly in the no adjustment camp, but we discuss that later. It is obvious that the historic level of profits (and certainly not cash flow which is still negative) do not justify the current share price. However, revenues are likely to increase in the current year and the growth rate could accelerate over the following two years as new drug registrations are obtained particularly for Aivlosin (AIV) in the major US market. In addition to that, there is the possibility that a research programme on AIV, discussed later in this comment, could change the Group out of all recognition and possibly within a couple of years - which would be very quick for a drug! But the **chances of success are mathematically very low**. We do not have full coverage on EAH and only keep a watching brief, thus we continue with a formal No Recommendation opinion. However, if we did have full coverage and also had a speculative buy category, which we do not, we might have used that opinion!

Substantive points

We consider that the following were the significant points to arise from the results and our meeting with management.

- Revenues from AIV are growing rapidly in ROW ex EU and US.
- Distributors are now in place in the EU prior to the main selling season which should increase current year revenues.
- US registration for AIV in swine is expected in calendar 2010 and should have its first impact on revenues in the next financial year to March 2011.
- The current registration programme in the EU is complete.
- There has been some slippage in registrations for companion animals which are now expected in 2011.
- Work on AIV for other indications in other animals is likely to occur.
- The Group's continuing businesses traded profitably after amortisation charges, which we do **not** consider should be added back, of £2.5m.
- It is likely that amortisation will equate with capitalised expenses in the current year.
- It is possible that the use of AIV as an antiviral agent could be proven (or not) within 2 two years.

Amortisation and IFRS

Under IFRS drug registration costs and development costs should be capitalised when there is some certainty of commercial application. In addition, the premium over net assets, paid for any acquisition, should be split between intangible assets such as brand names, drug registrations (if applicable) and amongst others customer lists and the balance goodwill. Under IFRS goodwill is not amortised but other intangibles are amortised over their useful lives. We consider that it is acceptable to adjust profits and EPS for acquired intangible amortisation on the basis that this may have previously been expensed and therefore reduced acquired assets. However, for self capitalised R & D and registration, we do not consider that applicable especially when there is a continued capitalisation policy as there is with EAH. In the year to March 2009, EAH amortised £2.5m and capitalised £3.8m – a £1.3m outflow.

At present, there is only one broker which publishes estimates and we understand that they take the opposing view, but publish both adjusted and unadjusted numbers. In the current year, we understand that amortisation will approximately equate with capitalised expenditure at some £3.0m. In EPS terms the difference in adjusted, against unadjusted, EPS would be approximately 5p assuming no tax and capital diluted for all outstanding options. Unadjusted consensus are for EPS of 2.5p and 4.9p for the years to March 2010 and 2011 respectively. It is, however, realistic to project a substantial increase in revenues, profits and EPS in 2012 as there should be a full effect from AIV in the US and the possibly the first sales from companion animal registrations for that important market.

Aivlosin as an antiviral agent

On 8 May, the company announced that Dr David Brown and his team at the Virology Division of the Department of Pathology at the University of Cambridge have been awarded a grant of £500,000 by the Medical Research Council to investigate the inhibition of influenza viruses by macrolide antibiotics.

It can be seen at www.enterprise.cam.ac.uk/uploads/File/MarketingSheets/Bro-1752-06.pdf that Drs David Brown and Amanda Stuart have reported that in vitro studies have shown that AIV has reduced the number of infected cells in studies on PRRS (porcine reproductive and respiratory syndrome). That virus is thought to be costing the US pig industry \$600m p.a. In addition, it has been found that it reduces the number of effected cells by other viruses such as **human** and equine influenza viruses.

The website states that potential (**not yet proven**) uses include PRRS, Influenza, Hepatitis C, Ebola, SARS CoV and Coxsackie B3 and B5. It does act as a bacterial treatment, but may also act in viral infections.

The author of this report is a generalist, not a pharmaceutical specialist. So he asked Franc Gregori, of Charles Stanley Securities, for the possible success ratios. He gave the following comment, pre-clinical research has a 1:100 chance of success. Once it had got through animal models (in vivo), that rose to 1:20. If you are an institutional investor and would like to ask him for more, please do not hesitate to call on 0207 149 6601. His off the cuff comment was that if it were to work in the potential infections, mentioned in the Cambridge Enterprise fact sheet, this could be a very big product indeed!

We understand from the company that in some (less regulated countries) vets have used AIV as a treatment for PRRS. The chances of failure may, therefore, be lower than indicated above! In our view, there are three possible outcomes: failure (high), leads to an animal antiviral in addition to the current antibacterial use (low) and the optimum that it has human uses (very low). As an animal antiviral, it could have very significant value. As a Human antiviral, it could lead to a complete change in the possible value of the group.

Conclusion

Although the current market capitalisation is not justified on current (or probably near term) profitability, AIV has substantial longer term potential. In addition, there are companion animal drugs in the course of registration and there is the possibility (probability) of AIV use in other indications for other animals – cattle for example.

There is a low probability of the use of AIV as an antiviral. Although a low probability, that could be huge! That said, we hope this comment was of interest, but it is comment not full coverage and, as such, we continue with a formal **No Recommendation** opinion.

Analyst: Robert Corden

The author of this comment, namely Robert Corden, has a holding in EAH.

Service Power Technologies

Share Price: 6.88p

Market cap: £13.0m

(SVR.L)

Higher risk as pre profitability

Another well kept secret!

In the seven trading days following 24 July, the share price had risen by over 50% from 4p to 6.25p prior to the announcement of an approach at a price that the directors considered too low.

The fundamental question for shareholders is whether future profitability and cash flow could justify a share price higher than that currently ruling. In this context, we recently contacted the company to request a meeting at which we could discuss the business model and prospects in detail with a potential aim of re-initiating full coverage. The reason was that we 'hoped' the business model could justify a substantially higher share price, but, in our view, consensus estimates (the only published estimates are those of the house broker) were such that this was far from obvious.

We were offered such a meeting at the time of the interim results which last year were published on 28 August. Until we have such a meeting, we are unable to come to a firm decision on whether the current price is justified by trading prospects and therefore continue with a formal No Recommendation opinion. However, we considered that we should write to give an idea of our thinking and why, if we were correct, the share price could still be at an attractive level.

Our thinking

We have over a long period believed that SVR had world class software which delivers substantial cost savings to users together with a very significant benefit to those users' customers in terms of quality of services. The problem has been with the execution of a successful sales strategy. The prime reason, for our optimism, was the change in management which led to a focused sales strategy rather than software development using a 'better mouse trap' philosophy.

The current situation is that there is a dedicated and, we understand, high powered sales force of nine people in place. We would 'guess' that the absolute minimum target for each would be incremental gross (and net) margin of £100,000 per annum and probably, given the market opportunity, a decent multiple of that. Mathematically, that incremental margin would increase PBT by £0.45m per year at £100,000 target (£0.9m if the target were £200,000). If our assumptions were correct, then within two years incremental profits could be £0.9m on minimum targets (£1.8M on £200,000 targets and so on).

If we were to assume that the Group were currently at breakeven, then reported PBT for 2010/2011 could rise in round numbers to £1.0m to £2.0m. **Those numbers are very substantially higher than consensus.** Given that, when companies are trading at breakeven, the growth rate on breakthrough can be very high, we would expect the shares to be highly rated. The current enterprise value is in round numbers £10m net of cash. The earlier 'guesses' of potential profits, if these were correct, could, therefore, justify a significantly higher share price over time.

Conclusion

Until we have had a meeting and obtained a fuller understanding of the business model and the opportunity, we have no reality on whether our 'guesses' could be correct OR NOT!

We, therefore, continue with a **No Recommendation** opinion. But it is our 'guess' of the potential which has led to the author of this comment having a small holding in the shares of SVR.

Analyst: Robert Corden

The author of this report, namely Robert Corden, has a personal account position in the shares of ServicePower.

FTSE 350 Highest Forecast Yield with Cover > 2x

Stock	Price	Yield	Cover	Stock	Price	Yield	Cover
1. INTERSERVE	211p	8.2%	2.4x	11. AMLIN	340p	5.4%	2.2x
2. AVIVA	356p	7.1%	2.2x	12. CARILLION	270p	5.2%	2.5x
3. BEAZLEY	99p	6.8%	2.2x	13. EUROMONEY INSTL.INVEST	252p	5.1%	2.4x
4. MORGAN SINDALL	624p	6.5%	2.1x	14. GREENE KING	430p	5.1%	2.1x
5. REXAM	230p	6.1%	2.0x	15. BAE SYSTEMS	312p	5.0%	2.6x
6. UNITED BUSINESS MEDIA	427p	5.9%	2.0x	16. WILLIAM HILL	167p	4.9%	2.5x
7. LEGAL & GENERAL	62p	5.8%	3.4x	17. REED ELSEVIER	434p	4.9%	2.2x
8. FRIENDS PROVIDENT GROU	70p	5.7%	2.2x	18. INTERNATIONAL POWER	253p	4.7%	2.4x
9. DAIRY CREST	336p	5.7%	2.2x	19. STAGECOACH GROUP	140p	4.6%	2.3x
10. MELROSE	127p	5.5%	2.1x	20. TUI TRAVEL	247p	4.6%	2.2x

Yield and cover based on consensus dividend and earnings estimate for first forecast year
Source: IBES/Thomson Datastream

FTSE 350 Lowest Forecast PE

Stock	Price	PE	Stock	Price	PE
1. YELL GROUP	30p	1.0x	11. MARSTON'S	95p	6.7x
2. PUNCH TAVERNS	117p	2.6x	12. BEAZLEY	99p	6.8x
3. INTERSERVE	211p	5.0x	13. ST.JAMES'S PLACE	188p	6.9x
4. ENTERPRISE INNS	160p	5.1x	14. PREMIER FOODS	41p	7.0x
5. LEGAL & GENERAL	62p	5.1x	15. LADBROKES	168p	7.1x
6. AVIVA	356p	6.3x	16. MORGAN SINDALL	624p	7.4x
7. PRUDENTIAL	469p	6.3x	17. OLD MUTUAL	96p	7.5x
8. NATIONAL EXPRESS	367p	6.5x	18. CARILLION	270p	7.6x
9. MOUCHEL GROUP	174p	6.6x	19. BAE SYSTEMS	312p	7.7x
10. GAME GROUP	156p	6.6x	20. FRIENDS PROVIDENT GROUP	70p	7.8x

PE based on consensus earnings estimate for first forecast year
Source: IBES/Thomson Datastream

FTSE 350 Lowest Forecast Price to Book Value

Stock	Price	Price to Book Value	Stock	Price	Price to Book Value
1. YELL GROUP	30p	0.2x	11. BODYCOTE	160p	0.7x
2. PUNCH TAVERNS	117p	0.2x	12. PREMIER FOODS	41p	0.7x
3. BARRATT DEVELOPMENTS	214p	0.3x	13. INTERMEDIATE CAPITAL GP.	245p	0.7x
4. ENTERPRISE INNS	160p	0.5x	14. ROYAL BANK OF SCTL.GP.	49p	0.7x
5. MILLENNIUM & CPTH.HTLS.	298p	0.5x	15. NOVAE GROUP	295p	0.7x
6. MARSTON'S	95p	0.5x	16. BRIT INSURANCE HOLDINGS	195p	0.7x
7. TAYLOR WIMPEY	39p	0.6x	17. AVIVA	356p	0.7x
8. FRIENDS PROVIDENT GROUP	70p	0.6x	18. VODAFONE GROUP	124p	0.7x
9. F&C ASSET MANAGEMENT	73p	0.7x	19. SIG	131p	0.8x
10. SMITH (DS)	79p	0.7x	20. CHAUCER HOLDINGS	43p	0.8x

Price to book value based on consensus book value estimate for first forecast year
Source: IBES/Thomson Datastream

FTSE 350 Lowest Price to Cash Flow

Stock	Price	Price to Cash Flow	Stock	Price	Price to Cash Flow
1. YELL GROUP	30p	0.7x	11. GO-AHEAD GROUP	1283p	3.4x
2. ASHTEAD GROUP	74p	1.7x	12. MELROSE RESOURCES	303p	3.5x
3. PUNCH TAVERNS	117p	2.1x	13. MITCHELLS & BUTLERS	279p	3.6x
4. NATIONAL EXPRESS	367p	2.1x	14. MARSTON'S	95p	3.6x
5. MORGAN CRUCIBLE	140p	2.1x	15. UNITED UTILITIES GROUP	450p	3.7x
6. FIRST GROUP	346p	2.5x	16. SEVERN TRENT	978p	3.9x
7. RANK GROUP	76p	2.5x	17. STAGECOACH GROUP	140p	3.9x
8. BT GROUP	129p	2.7x	18. REXAM	230p	3.9x
9. BARRATT DEVELOPMENTS	214p	2.9x	19. CARILLION	270p	4.0x
10. ARRIVA	475p	3.2x	20. TAYLOR WIMPEY	39p	4.0x

Cash flow defined as net income plus depreciation, amortisation, provisions and net working capital
Price to cash flow based on consensus cash flow estimate for first forecast year
Source: IBES/Thomson Datastream

Prices are as at close on 5 August 2009

FTSE 350 Lowest PEG Ratio

Stock	Price	PE	PEG	Stock	Price	PE	PEG
1. BRIT INSURANCE HOLDINGS	195p	9.4x	0.20	11. BODYCOTE	160p	38.7x	0.37
2. MELROSE RESOURCES	303p	22.5x	0.21	12. AMLIN	340p	8.3x	0.38
3. BEAZLEY	99p	6.8x	0.22	13. COOKSON GROUP	373p	20.9x	0.40
4. CHAUCER HOLDINGS	43p	10.1x	0.23	14. RENISHAW	431p	37.4x	0.43
5. NOVAE GROUP	295p	21.8x	0.25	15. SMITH (DS)	79p	14.4x	0.44
6. INTERMEDIATE CAPITAL GP.	245p	20.7x	0.25	16. DRAX GROUP	426p	8.6x	0.47
7. EASYJET	303p	37.7x	0.31	17. DANA PETROLEUM	1391p	29.2x	0.47
8. INVESTEC	403p	11.9x	0.33	18. KESA ELECTRICALS	139p	19.8x	0.48
9. GKN	110p	68.8x	0.36	19. AVIVA	356p	6.3x	0.51
10. HISCOX	302p	8.6x	0.37	20. MORGAN CRUCIBLE	140p	10.9x	0.52

PEG calculated by dividing PE ratio based on first forecast year earnings estimate by growth rate of earnings from between year 1 and year 3

All earnings taken after goodwill and exceptionals

Source: IBES/Thomson Datastream

FTSE 350 Best Stock Performance Over Last Month

Stock	Price	1m	6m	12m	Stock	Price	1m	6m	12m
1. GALIFORM	60p	+69%	+380%	+88%	11. FERREXPO	179p	+40%	+192%	-30%
2. COOKSON GROUP	373p	+53%	+109%	-60%	12. SIG	131p	+39%	+36%	-69%
3. MONEYSUPERMARKET COM	73p	+52%	+30%	-28%	13. LLOYDS BANKING GROUP	93p	+38%	+24%	-61%
4. KAZAKHMYS	954p	+51%	+233%	-26%	14. STHREE	220p	+38%	+21%	+4%
5. MORGAN CRUCIBLE	140p	+49%	+39%	-30%	15. CARPETRIGHT	769p	+37%	+87%	+29%
6. INCHCAPE	28p	+47%	+332%	-37%	16. VEDANTA RESOURCES	1865p	+36%	+204%	-21%
7. BARRATT DEVELOPMENTS	214p	+46%	+173%	+84%	17. MONDI	273p	+35%	+56%	-3%
8. TRAVIS PERKINS	797p	+44%	+200%	-21%	18. YELL GROUP	30p	+34%	-37%	-21%
9. CHARTER INTL.	614p	+43%	+48%	-29%	19. DSG INTERNATIONAL	28p	+34%	+70%	-28%
10. LOGICA	109p	+42%	+59%	-2%	20. EURASIAN NATRES.CORP.	898p	+34%	+134%	-6%

Source: Thomson Datastream

FTSE 350 Worst Stock Performance Over Last Month

Stock	Price	1m	6m	12m	Stock	Price	1m	6m	12m
1. WILLIAM HILL	167p	-16%	-9%	-26%	11. EVOLUTION GROUP	135p	-7%	+45%	+45%
2. AUTONOMY CORP.	1240p	-12%	+7%	+21%	12. RANDGOLD RESOURCES	3653p	-7%	+18%	+52%
3. REXAM	230p	-10%	-21%	-36%	13. DE LA RUE	833p	-7%	-14%	-1%
4. MORGAN SINDALL	624p	-9%	+13%	+8%	14. DECHRA PHARMACEUTICAL	421p	-6%	-1%	+1%
5. LADBROKES	168p	-8%	-15%	-37%	15. CAPITA GROUP	666p	-6%	-3%	-7%
6. UNITED UTILITIES GROUP	450p	-8%	-20%	-35%	16. ST.JAMES'S PLACE	188p	-6%	-1%	-16%
7. SEVERN TRENT	978p	-8%	-11%	-30%	17. REDROW	196p	-5%	+29%	+21%
8. RATHBONE BROTHERS	770p	-8%	+5%	-5%	18. REED ELSEVIER	434p	-5%	-20%	-28%
9. QINETIQ GROUP	131p	-7%	-19%	-36%	19. NOVAE GROUP	295p	-5%	-6%	+5%
10. CHEMRING GROUP	2012p	-7%	-13%	-12%	20. HOCHSCHILD MINING	277p	-5%	+78%	-5%

Source: Thomson Datastream

Global Index Performance

Index	Level	1m	6m	12m	Index	Level	1m	6m	12m
FTSE 100	4647	+10%	+10%	-15%	FRANCE CAC 40	3459	+11%	+13%	-21%
FTSE 250	8266	+12%	+29%	-9%	DAX 30 PERFORMANCE	5353	+14%	+19%	-18%
FTSE SMALL CAP	2466	+11%	+38%	-11%	TOPIX	950	+3%	+21%	-24%
FTSE ALL SHARE	2381.4	+10%	+12%	-14%	MSCI PACIFIC EX JP	1097	+12%	+34%	-8%
S&P 500 COMPOSITE	1003	+12%	+19%	-22%	MSCI EUROPE	995	+10%	+15%	-19%
DOW JONES INDUSTRIALS	9281	+12%	+15%	-20%	MSCI WORLD	758	+10%	+19%	-21%
NASDAQ COMPOSITE	1993.1	+11%	+29%	-15%					

Source: Thomson Datastream

Prices are as at close on 5 August 2009

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