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CHEMGENEX SERIOUSLY UNDERVALUED

[MARC SINATRA'S BIOGUIDE: CHEMGENEX](#)

Chemgenex's share price has been steadily rising since its low of 36 cents in the middle of last year. A recent brief period of weakness was abruptly turned around when two venture capital companies purchased more than 20 percent of the company.

One of the companies is the San Francisco-based Alta Partners, which has nearly \$US2 billion under management. The other is the GBS Venture Partners, arguably the best credentialed life science venture capital company in Australia.

GBS managing director Brigitte Smith says the company's lead compound for haematological cancers Ceflatonin and strong management are the main reasons behind her company's investment.

Given the increases in Chemgenex's share price both before and after the entry of these two significant shareholders on to the registry, it seems reasonable to ask if the company still represents good value.

Overview: Chemgenex Pharmaceuticals is based in Geelong and Menlo Park, California. It is a fully integrated life science research and development company developing therapeutics in the areas of cancer, diabetes and obesity, and depression. Chemgenex's strategy is to leverage its expertise in molecular biology to identify and pursue drug development projects in which genetic variation plays a major role. The most advanced compound, Ceflatonin, is currently in phase II/III trials (essentially, a small phase III trial suitable for registration purposes) for chronic myeloid leukaemia. Another compound, Quinamed, is in a phase IIa trial for prostate, breast and ovarian cancers.

Financials: Market cap \$124 million; Chemgenex is in the process of raising up to another \$21 million via a placement to institutional investors and a rights offer to eligible shareholders. Chemgenex chief executive officer Dr Greg Collier believes this raising will see the company through to 2009.

Directors: chairman, Brett Heading; managing director and chief executive officer, Dr Greg Collier; president and executive director, Dr Dennis Brown; non-executive directors, Elmar Schnee, Patrick Burns, Daniel Janney and Dr Geoff Brooke.

Management: vice president of operations, Dr James Campbell; chief financial officer and company secretary, Rick Merrigan; vice president of oncology, Dr Ian Nisbet; senior director of finance, Tina Herbert.

Chemgenex's directors are particularly strong in the area of venture capital, while management expertise is evenly spread across required disciplines.

Technology: Chemgenex has two main broad technologies that it applies. The Express platform is a suite of proprietary and non-proprietary technologies used for target discovery and validation. Express includes an animal model for gene discovery. Chemotyping is Chemgenex's method of choosing which compounds to develop further. It consists of gene expression array profiling and a range of screening assays to determine which biochemical pathways a drug affects. Underlying these technologies are expertise in molecular biology, significant research relationships and high level computing power.

Products in development:

- 1) Ceflatonin for chronic myeloid leukaemia – completing phase II/III late 2007;
- 2) Ceflatonin for myelodysplastic syndrome – currently in phase II/III;
- 3) Ceflatonin for acute myeloid leukaemia – commencing phase II;
- 4) Quinamed for prostate, breast and ovarian cancer – awaiting phase IIa results;
- 5) CXS-299 for solid tumours – commencing phase I in the next 12 months.

Ceflatonin is currently in phase II/III studies for chronic myeloid leukaemia (CML) patients, who have the T315I point mutation and have failed Gleevec therapy. A complementary trial with patients who have failed two tyrosine kinase inhibitors is scheduled to commence by July. Previous efficacy studies have demonstrated Ceflatonin activity in a number of patient groups using a range of markers. Ceflatonin has US Food and Drug Administration orphan drug status for the treatment of CML and fast track status for patients with the point mutation.

Quinamed has previously been examined in a phase I/II study of 32 patients where, according to Chemgenex, “meaningful responses to Quinamed therapy were observed in patients with prostate, ovarian, breast and colon cancers”. On the basis of these results, ovarian and breast cancer were added to the phase IIa prostate cancer trial that had already commenced.

CXS-299 is a platinum anti-cancer agent with improved activity in cells with the wild type (normal) p53 gene. This is important because cancer drug resistance is more severe in cancers with wild type p53 genes.

Product markets: Frost and Sullivan have estimated the market potential of Ceflatonin for CML at \$336 million, acute myeloid leukaemia (AML) at \$396 million and myelodysplastic syndrome (MDS) at \$630 million. A number of other companies have compounds in development for each of these indications, however Chemgenex appears to be clearly leading the field in resistant CML and is the only company developing a non-kinase inhibitor. Head-to-head competition between currently marketed products and those in development is not likely to be as severe as it seems because many of these drugs are likely to work well in combination with one another or in cancers resistant to other drugs.

The markets for prostate, breast and ovarian cancers range between \$1.9-3.3 billion. Quinamed will be limited to only part of these markets as it is likely to have little impact on some cancer patients as indicated by the previous phase I/II study.

Verdict: Using some fairly conservative numbers - \$80 million a year in revenue, revenue commencing in two years, 20% discount rate, 50% chance of regulatory approval – in a back of the envelope calculation, the present value of Ceflatonin to Chemgenex for the treatment of CML alone is approximately \$139 million. When you consider that the company's market cap is only \$124 million and the possible additional revenue from sales of Ceflatonin for MDS and AML, and Quinamed for solid tumours, a market capitalisation of well in excess of \$200 million does not seem unreasonable. Even despite the recent run up in Chemgenex's share price, scope appears to exist for further very significant rises in the future.

Chemgenex closed down half a cent or 0.68 percent at 73.5 cents.

The author and editor own shares in Chemgenex Pharmaceuticals.

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