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Marc Sinatra's Bio-Guide Brief: Chemgenex - ASX's Most Undervalued Stock

Last May, I put a valuation of $5.50 on Chemgenex shares with an 18-month time frame for that valuation to be met.

Today, Chemgenex announced that it had completed what is the first real Australian submission of a new drug application (NDA) to the US Food and Drug Administration for its lead compound Omapro (formerly known as omacetaxine). But three months from my self-imposed deadline, Chemgenex shares are trading at 66 cents.

While it is true that this milestone is more process than a major value creation point, it is a significant achievement and a marker of what should be a much higher share price.

This is particularly so, given how difficult it is to get to NDA submission, as evidenced by Progen and Novogen ceasing their phase III trials and Neuren's Glypromate failing its phase III trial. Not to mention the premiums that even moderately successful phase III trials can bring, as evidenced by the 70 percent premium bid for Peplin.
It has been suggested that I look at Chemgenex through rose-colored glasses and given how overweight I am in Chemgenex shares, the argument may have some merit.

But Chemgenex's basic equation remains the same:
1.) There are 5000 identified chronic myeloid leukaemia (CML) patients worldwide carrying the T315I mutation for which Chemgenex is seeking approval to market Omapro;
2.) Regulatory approval seems as certain as it has been for any drug given Chemgenex's data and the extraordinary amount of independent data demonstrating the efficacy of Omapro like compounds in treating CML; and
3.) A conservative price estimate for Omapro of $US30,000 per year per patient, based on the price of Gleevec.

That gives a market size of $US150 million year, which translates into a profit of $US75 million based on a 50 percent free cash-flow. Based on profit multiples of 15-25 times, this gives a share price of $US5.75 ($A6.70) to $US9.50 ($A11.00) once a profit of $US75 million is achieved. But these are back-of-the-envelope numbers and Chemgenex isn't making $US75 million a year.

The numbers can be refined by factoring-in that about 80 percent of T315I carriers are likely to benefit from Omapro and licencing the product in Europe will see some value slip to the licensee, while the fact that first Omapro sales are a year away will reduce net present value. On the other hand, the drug is likely to cost more than $US50,000 a year, rather than $US30,000, based on the prices of second line CML treatments Sprycel and Tasigna.

While my view of Omapro for T315I indication remains the same, I have become less bullish on Omapro's chances for success as a treatment in patients who have failed two tyrosine kinase inhibitors (TKIs) and acute myeloid leukaemia (AML).

I believe most CML patients who have failed two TKIs, will simply go on to the remaining TKI they haven't failed, while Chemgenex's failure to produce results so far from its long running AML trial suggests, as does previous independent research, that AML is a tough indication for Omapro.

A new bright spot, however, is the potential use of Omapro for the treatment of minimum residual disease in CML patients being treated with Gleevec. An indication for which some independent data provides support and one that that would see Omapro used in a combination therapy.

If I were to completely revalue Chemgenex, I might temper my previous valuation a little bit, not based on what is written above, but mainly on the basis of the capital raising Chemgenex undertook at 43 cents per share earlier this year. I certainly didn't factor a capital raising at that price into my previous valuation.

All in all, I still believe Chemgenex to be the most undervalued listed life science company on the Australian stock exchange and should currently trading about $5.00.

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Marc Sinatra and Biotech Daily editor David Langsam both hold Chemgenex stock.

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