

Fundamental

Research Corp.

Investment Analysis for Intelligent Investors

Siddharth Rajeev, B.Tech, MBA, CFA
Analyst

Daniel Iwata, BA
Associate

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Avagenesis Corp. (TSXV: VVA) – New Patents / Gearing Up to Commence Beta Unit Sales

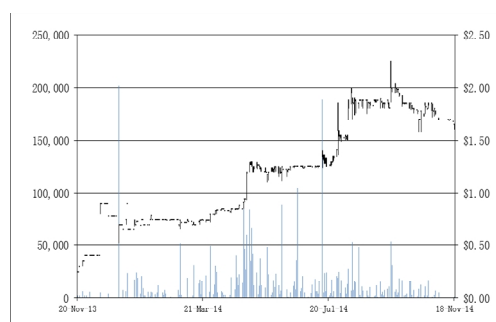
Sector/Industry: Biotechnology

www.avagenesis.com

Market Data (November 19, 2014)

Current Price	C\$1.65
Fair Value	C\$2.40
Rating*	BUY
Risk*	4 (Speculative)
52 Week Range	C\$0.40 – C\$2.25
Shares O/S	50.81 million
Market Cap	\$83.83 million
Current Yield	N/A
P/E (forward)	N/A
P/B	54.1x
YoY Return	N/A
YoY TSXV	-14.9%

*See back of report for rating and risk definitions



Investment Highlights

- Avagenesis Corp. (“company”, “VVA”, “Avagenesis”) recently received patent approvals from three new jurisdictions - Russia, Japan, and South Korea. South Korea and Japan are Avagenesis’ key target markets.
- Since initiating coverage on July 18, 2014, at \$1.28 per share, VVA’s shares hit an all-time high of \$2.25 per share. The shares are currently up 29%.
- Management indicated that users of the trial units in the U.S. and Asia are providing positive feedback.
- Management believes they can commence sales of their beta units next year.
- The company continues to be selective in their disclosures. Details of the rollout plan are yet to be announced.
- Avagenesis reported a net loss of \$3.77 million (EPS: -\$0.08) in FY2014 (12 months ended June 2014), compared to \$1.07 million (EPS: -\$0.03) in FY2013. The increase in net loss was primarily due to one-time listing fees of \$1.05 million, and research and development fees related to product development.
- Balance sheet remains strong, with \$1.72 million in cash, \$1.55 million in working capital, and no debt.
- We are maintaining our fair value estimate and BUY rating.

Key Financial Data (FYE: June 30) / C\$		2012		2013		2014
Cash	\$	1,314,708	\$	593,434	\$	1,720,945
Working Capital	\$	1,365,260	\$	536,397	\$	1,550,147
Total Assets	\$	1,451,572	\$	778,207	\$	1,840,652
Revenues		-		-		-
Net Income	\$	(840,382)	\$	(1,074,511)	\$	(3,773,980)
EPS	\$	(0.03)	\$	(0.03)	\$	(0.08)

Overview

In our initiating report, dated July 18, 2014, we discussed Avagenesis' background and its focus on commercializing a patented and patent pending device. Management believes the system can facilitate low cost, quick and efficient extraction of stem cells from fat tissues for use in the stem cell research and cosmetic market. The following points outline the key potential benefits of the system. Further details are presented in our initiating report.

- *The system takes approximately 60 minutes compared to three to four hours for existing manual methods.*
- *After fat is loaded in disposable kits, the process is fully automated, which saves on having to use skilled labor to process the tissue.*
- *Lowers the risk of contamination due to the closed system and lesser time of manual handling.*
- *Standardizes the process for collection of stem cells, which is beneficial to the research community who need controlled procedures to maintain consistency.*
- *The system does not need to be sterilized after each use because disposable kits and tubes are used.*
- *Management is forecasting that the upfront cost of the system (for end users) will be lower than alternative systems on the market.*
- *The device is very compact compared to competitive products.*

In May 2014, the company started shipping their units, for beta testing, to various potential clients in the U.S. and Asia. Our discussions with management indicated that they have been receiving positive feedback from the users. Details of the test results are yet to be disclosed.

The company has commenced the process for CSA / ISO certifications. **Management indicated to us that they believe they can commence sales by early 2015.**

Details of management's expected product pricing and manufacturing costs were presented in our initiating report.

New Patents

In October 2014, the company announced that it had received patent approvals from three new jurisdictions - Russia, Japan, and South Korea. **We believe this is very encouraging as South Korea and Japan have strong markets for aesthetic procedures, and therefore, are Avagenesis' key target markets.**

In total, the company now has seven patents - one in Russia, one in Japan, one in South Korea, one in the U.S., two in Australia, and one in Singapore.

Material Agreements

Avagenesis had entered into an agreement with the Industrial Technical Research Institute of Taiwan ("ITRI"), in March 2011, to create and validate a first-generation device, by utilizing ITRI's expertise in adipose tissues, and Avagenesis' expertise in cell isolation. ITRI will receive up to 18% of the all the net profits from the sale of the device in certain Asia Pacific Rim countries. The country names were not disclosed.

Financials

As mentioned in our initiating report, the company also has a licensing agreement with Oceans Ingenuity Inc. The License Agreement is effective until at least 2028. Oceans Ingenuity Inc. is owned by VVA management.

The main terms of the license are as follows:

- *All revenues will be shared 95% : 5%, and all sublicensing revenues will be shared 70% : 30%, between VVA and Oceans.*
- *From April 1, 2011, to March 31, 2013, quarterly payments of \$50k (\$200k p.a.) were payable by VVA to Oceans.*
- *From April 1, 2013, to March 31, 2015, quarterly payments of \$25k (\$100k p.a.) are payable by VVA to Oceans.*
- *From April, 1, 2015, to December 31, 2028, quarterly payments of \$50k (\$200k p.a.) are payable by VVA to Oceans.*

Avagenesis has yet to start generating revenues. As shown in the table below, they reported a net loss of \$3.77 million (EPS: -\$0.08) in FY2014 (12 months ended June 2014), compared to \$1.07 million (EPS: -\$0.03) in FY2013.

Income Statement			
		2013	2014
YE - June 30			
Revenues		-	-
Expenses			
General and administrative	\$	564,811	\$ 1,112,567
Research and development	\$	518,976	\$ 1,623,176
Listing Cost			\$ 1,047,605
Total Expenses	\$	1,083,787	\$ 3,783,348
Interest income	\$	9,787	\$ 8,538
Foreign exchange income	\$	(511)	\$ 830
Net Income	\$	(1,074,511)	\$ (3,773,980)
EPS	\$	(0.03)	\$ (0.08)

The increase in net loss was primarily due to **one-time listing fees of \$1.05 million**, and an increase in General and Administrative (“G&A”) and Research and Development (“R&D”) expenses.

- **G&A expenses increased from \$0.56 million to \$1.11 million.** The increase was primarily due to the addition of employees, which resulted in higher management fees (paid to Oceans Ingenuity for seven full-time, and two part-time employees), as shown in the table below.

	Year ended June 30, 2014 (Audited)	Year ended June 30, 2013 (Audited)
Management fees	\$ 630,304	\$ 328,690
Marketing and business development	143,330	86,699
Professional fees	139,670	57,391
Offices and miscellaneous	199,263	92,031
Total	\$ 1,112,567	\$ 564,811

- **R&D expenses increased from \$0.52 million to \$1.62 million.** The following table shows the allocation:

	Year ended June 30, 2014 (Audited)	Year ended June 30, 2013 (Audited)
Wages and benefits	\$ 44,167	\$ 64,815
License fees	100,000	175,000
Assembly set up costs	560,000	-
Research and development, other	919,009	279,162
Total	\$1,623,176	\$ 518,976

R&D expenses included costs related to product development activities such as - engineering costs related to finalizing the device design, lab samples, reagents, disposable bag design, and patent development support. Management expects a significant reduction in R&D expenses next year as a significant portion of the past year's expenses were one-time expenses related to product development.

The company has not provided any guidance on their estimates for G&A and R&D expenses in FY2015.

We will start reporting our revenue and EPS projections once the company achieves commercial sales.

The following table shows a summary of cash flows. Free cash flows were negative \$2.74 million in FY2014, versus negative \$1.02 million in FY2013.

	2013	2014
Cash from Operating activities	-\$1,016,922	-\$2,744,270
Cash from Investment Activities	-	\$151,781
Cash from Financing Activities	\$295,648	\$3,720,000
Net Increase (Decrease) in Cash	-\$721,274	\$1,127,511
Free Cash Flow (FCF)	-\$1,016,922	-\$2,744,270

The company maintains a strong balance sheet with no debt. As of June 30, 2014, the company had \$1.72 million in cash, and \$1.55 million in working capital.

(FYE: June 30) C\$	2013	2014
Cash + cash equivalents + ST Inv.	\$593,434	\$1,720,945
Working Capital	\$536,397	\$1,550,147
Total Assets	\$778,207	\$1,840,652
Debt	-	-
Long-Term Debt	-	-

We do not foresee any need for external financing in the near-term.

Avagenesis has no outstanding options or warrants.

Valuation and Rating

We have maintained all of our valuation inputs and assumptions. As a result, our fair value estimate of \$2.40 per share remains unchanged. We also maintain our BUY rating, and risk rating of 4 (Speculative).

Risks

The following risks, though not exhaustive, will cause our estimates to differ from actual results:

- The company is in the development stage, and has yet to generate any revenues.
- There is no assurance that the market will accept their products.
- The sales of the device for clinical applications may require regulatory approvals that may not be obtained at the expected time/costs or at all.
- VVA does not own the technology and only has the worldwide exclusive license for human adipose tissues.
- As the company intends to operate in multiple countries, it will be exposed to exchange rate risks.
- Ethical concerns related to the use of stem cells may negatively affect public perception and regulatory approval regarding VVA's technology.
- There is competition from other companies for fully automated stem cell processing and isolation systems. There is also competition from life science companies selling related products.
- There is limited academic research to confirm whether stem cell cosmetic procedures maintain long term benefits over traditional cosmetic surgeries.
- As shares are tightly held, the average daily trading volume of VVA's shares has been low since the company went public.

Fundamental Research Corp. Equity Rating Scale:

Buy – Annual expected rate of return exceeds 12% or the expected return is commensurate with risk

Hold – Annual expected rate of return is between 5% and 12%

Sell – Annual expected rate of return is below 5% or the expected return is not commensurate with risk

Suspended or Rating N/A— Coverage and ratings suspended until more information can be obtained from the company regarding recent events.

Fundamental Research Corp. Risk Rating Scale:

1 (Low Risk) - The company operates in an industry where it has a strong position (for example a monopoly, high market share etc.) or operates in a regulated industry. The future outlook is stable or positive for the industry. The company generates positive free cash flow and has a history of profitability. The capital structure is conservative with little or no debt.

2 (Below Average Risk) - The company operates in an industry where the fundamentals and outlook are positive. The industry and company are relatively less sensitive to systematic risk than companies with a Risk Rating of 3. The company has a history of profitability and has demonstrated its ability to generate positive free cash flows (though current free cash flow may be negative due to capital investment). The company's capital structure is conservative with little to modest use of debt.

3 (Average Risk) - The company operates in an industry that has average sensitivity to systematic risk. The industry may be cyclical. Profits and cash flow are sensitive to economic factors although the company has demonstrated its ability to generate positive earnings and cash flow. Debt use is in line with industry averages, and coverage ratios are sufficient.

4 (Speculative) - The company has little or no history of generating earnings or cash flow. Debt use is higher. These companies may be in start-up mode or in a turnaround situation. These companies should be considered speculative.

5 (Highly Speculative) - The company has no history of generating earnings or cash flow. They may operate in a new industry with new, and unproven products. Products may be at the development stage, testing, or seeking regulatory approval. These companies may run into liquidity issues, and may rely on external funding. These stocks are considered highly speculative.

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