

30 March 2009

Produced and issued by: RBS Equities (Australia) Limited*

Buy

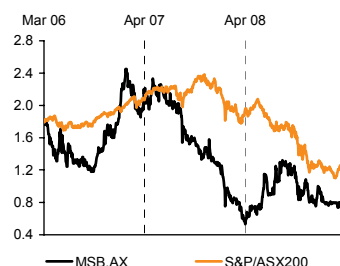
Target price
A\$1.40 (from A\$1.45)

Price
A\$0.80

Short term (0-60 days)
n/a

Price performance

	(1M)	(3M)	(12M)
Price (A\$)	0.80	0.90	0.61
Absolute (%)	0.0	-11.1	32.2
Rel market (%)	-8.9	-13.3	93.4
Rel sector (%)	2.9	9.1	65.2



Market capitalisation
A\$91.37m (US\$63.93m)

Average (12M) daily turnover
A\$0.10m (US\$0.08m)

RIC: MSB.AX, MSB AU
Priced at close of business 25 Mar 2009.
Source: Bloomberg

Analysts

Dr David Stanton

Zara Lyons

RBS Equities (Australia) Limited, ABN
84 002 768 701, AFS Licence 240530
Level 29, RBS Tower, 88 Phillip Street,
Sydney NSW 2000, Australia

<http://www.abnamroresearch.com>

Mesoblast

Completes equity raising

MSB has announced the successful closure of the equity raising that forms the funding package for the expansion of MSB's clinical programs focusing on bone and cartilage regenerative programs for spinal vertebral disc disease. Our EPS forecasts decrease by 0.4c in FY09F and 0.6c in FY10F. Buy maintained.

Key forecasts

	FY07A	FY08A	FY09F	FY10F	FY11F
EBITDA (A\$m)	-7.90	-8.69	-9.07	-9.86	8.57
Reported net profit (A\$m)	-8.73	-10.1	-10.8	-11.5	4.07 ▼
Normalised net profit (A\$m) ¹	-8.73	-10.1	-10.8	-11.5	4.07 ▼
Normalised EPS (c) ¹	-8.20	-8.81	-8.70	-8.02 ▼	2.69
Normalised EPS growth (%)	-7.61	7.45	-1.23	-7.79	n/a
Dividend per share (c)	0.00	0.00	0.00	0.00	0.00
Dividend yield (%)	0.00	0.00	0.00	0.00	0.00
Normalised PE (x)	n/m	n/m	n/m	n/m	29.70
EV/EBITDA (x)	n/m	n/m	n/m	n/m	7.26
Price/net oper. CF (x)	-10.4	-17.0	-12.1	-12.9 ▲	14.90
ROIC (%)	-135	-73.0	-53.3	-71.4	67.90

Use of ▲ ▼ indicates that the line item has changed by at least 5%.

1. Pre non-recurring items and post preference dividends

Accounting standard: IFRS

Source: Company data, ABN AMRO forecasts

year to Jun, fully diluted

MSB closes equity raising

MSB has announced the successful closure of the equity raising that forms the funding package for the expansion of MSB's clinical programs focusing on bone and cartilage regenerative programs for spinal vertebral disc disease. The final price was A\$0.72 per share. A total of 15.02m ordinary shares are to be issued to raise A\$10.81m.

EPS decreases by 0.4cps in FY09F and by 0.6cps in FY10F

The major near-term opportunity for MSB relates to an indication for MSB's osteoinductive adult mesenchymal precursor cells (MPCs). MSB has issued data showing that MSB's MPCs achieved a statistically significant improvement in cervical fusion rates compared to Medtronic's osteoconductive bulking agent (MasterGraft Granules). This has also been presented recently at a number of prestigious orthopaedic meetings. Given the recent issues with Medtronic's osteoinductive rhBMP product (also used in cervical fusion operations), we continue to believe a significant opportunity exists with MSB's MPCs being potentially useful over the medium term in anterior cervical interbody fusion operations. In our previous forecasts for MSB we had assumed a A\$20m capital raising in FY09F. As a result of this capital raising, EPS decreases by 0.4cps in FY09F and by 0.6cps in FY10F.

Buy maintained, target price declines 3.4% to A\$1.40

We have also updated our healthcare comparables. As a result of our changes, our DCF-based valuation and 12-month target price for MSB have fallen by 3.4% to A\$1.40.

Important disclosures can be found in the Disclosures Appendix.

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MSB's MPCs may address the gap in the market for cervical fusion

In July 2008, the US FDA issued a statement that the safety and effectiveness of Medtronic's rhBMP in the cervical spine had not been demonstrated and as a result these products were not approved by the FDA for this use. We estimate the anterior interbody cervical spine fusion market for BMPs is worth cUS\$325m. As a result of the FDA decision, we believe there is currently no synthetic bone graft approved for anterior interbody cervical spine fusions. For the medium term, MSB's MPCs may address this gap in the market.

EPS decreases by 0.4cps in FY09F and by 0.6cps in FY10F

We have updated our healthcare comparables. As a result of our changes, our DCF-based valuation and 12-month target price for MSB have fallen 3.4% to A\$1.40, and EPS decreases by 0.4cps in FY09F and by 0.6cps in FY10F. Changes to our forecasts are seen below.

Table 1 : Changes to forecasts

	FY09F			FY10F			FY11F		
	Prev	Rev	Diff	Prev	Rev	Diff	Prev	Rev	Diff
EBIT (A\$m)	-9.2	-9.2	0.0	-10.0	-10.0	0.0	7.0	7.0	0.0
NPAT (A\$m)	-10.6	-10.8	-0.2	-11.1	-11.5	-0.3	4.3	4.1	-0.2
EPS (c)	-8.3	-8.7	-0.4	-7.4	-8.0	-0.6	2.7	2.7	-0.0
DPS (c)	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Net op cash flow (A\$m)	-8.8	-8.8	0.0	-9.5	-9.5	0.0	9.0	9.0	0.0

Source: RBS estimates

Target price and risks

On an industry-wide basis, the chances of getting a product to market from the Phase II stage have shown to be in the order of 30%. Hence, we believe the risk that MSB will be unable get a product to market is considerable. MSB's patent position is strong, but we think the company is unlikely to be cash-flow-positive before FY11. Hence, we see MSB as an opportunity for investors with a higher risk appetite.

Table 2 : Updated timeline and probability of MSB's opportunities

Trial stage	Preclinical	Investigational New Drug application	Phase II trials	Clinical III trials
General time until cashflow	7 years+	5-7 years	3-5 years	1-2 years
General probability of product getting to market	c10%	c10-20%	c30%	c70%
Cost of trials	cA\$1m	cA\$2-3m	cA\$10m	cA\$50m
MSB products - indications and stages of development				
Spinal Fusion (cervical/lumbar)				
Long bone fractures				
Congestive Heart failure (via Angioblast)				
Heart attack (via Angioblast)				
Osteoarthritis knee				
Knee cartilage tears				
Peripheral arterial disease (via Angioblast)				
Other indications				

Source: Company data, ABN AMRO estimates

MSB – financial summary

Year to 30 Jun (A\$m)	AIFRS 2007A	AIFRS 2008A	AIFRS 2009F	AIFRS 2010F	AIFRS 2011F	Closing price (A\$)	0.80	Price target (A\$)	1.40
Income statement						Valuation metrics			
Divisional sales	0.0	0.0	0.0	0.0	30.7	Preferred methodology	DCF	Val'n (A\$)	\$ 1.40
Total revenue	0.7	0.0	0.2	0.2	30.8	DCF valuation inputs			
EBITDA	-7.9	-8.7	-9.1	-9.9	8.6	Rf	5.25%	10-year rate	5.25%
Associate income	-1.7	-2.1	-2.1	-2.1	-2.1	Rm-Rf	6.00%	Margin	2.0%
Depreciation	-0.1	-0.2	-0.2	-0.2	-1.5	Beta	1.50	Kd	7.25%
EBITA	-8.0	-8.8	-9.2	-10.0	7.0	CAPM (Rf+Beta(Rm-Rf))	14.2%	Ke	14.2%
Amortisation/impairment	0.0	0.0	0.0	0.0	0.0	E/EV*Ke+D/EV*Kd(1-t)		NPV cash flow (A\$m)	160.1
EBIT	-8.0	-8.8	-9.2	-10.0	7.0	Equity (E/EV)	100.0%	Minority interest (A\$m)	0.0
EBIT(incl associate profit)	-9.7	-11.0	-11.3	-12.1	4.9	Debt (D/EV)	0.0%	Net debt (A\$m)	-14.1
Net interest expense	0.9	0.9	0.5	0.7	0.9	Interest rate	7.25%	Investments (A\$m)	0.0
Pre-tax profit	-8.7	-10.1	-10.8	-11.5	5.8	Tax rate (t)	30.0%	Equity market value (A\$m)	174.2
Income tax expense	0.0	0.0	0.0	0.0	-1.7	WACC	14.2%	Diluted no. of shares (m)	124.2
After-tax profit	-8.7	-10.1	-10.8	-11.5	4.1			DCF valuation (A\$)	1.40
Minority interests	0.0	0.0	0.0	0.0	0.0				
NPAT pre significant items	-8.7	-10.1	-10.8	-11.5	4.1	Multiples	2008A	2009F	2010F
Significant items	0.0	0.0	0.0	0.0	0.0	Enterprise value (A\$m)	77.3	75.0	68.9
Reported NPAT	-8.7	-10.1	-10.8	-11.5	4.1	EV/Sales (x)			62.3
						EV/EBITDA (x)	-8.9	-8.3	7.3
Cash flow statement	2007A	2008A	2009F	2010F	2011F	EV/EBIT (x)	-8.7	-8.1	8.9
EBITDA	-7.9	-8.7	-9.1	-9.9	8.6	PE (normalised) (x)	-9.1	-9.2	29.7
Change in working capital	0.0	0.0	0.3	0.3	0.4	PEG (normalised) (x)			
Net interest (pd)/rec	0.9	0.8	0.5	0.7	0.9				
Taxes paid	0.0	0.0	0.0	0.0	-1.7	At target price	2008A	2009F	2010F
Other oper cash items	0.0	0.0	0.0	0.0	0.0	EV/EBITDA (x)	-16.8	-15.8	15.3
Cash flow from ops (1)	-8.2	-5.4	-8.2	-8.8	8.1	PE (normalised) (x)	-15.9	-16.1	52.1
Capex (2)	-0.1	-0.1	-0.1	-0.1	-1.5				
Disposals/(acquisitions)	-3.9	-6.4	-0.2	0.0	0.0	Comparable company data (x)	2009F	2010F	2011F
Other investing cash flow	-0.3	0.3	0.0	0.0	0.0	Alchemia	EV/EBITDA	-4.8	-12.5
Cash flow from invest (3)	-4.3	-6.2	-0.3	-0.1	-1.5	Year to 30 Jun	EV/EBIT	-4.0	-8.6
Incr/(decr) in equity	16.8	13.6	10.8	15.0	0.0		PE	-5.5	-5.1
Incr/(decr) in debt	0.0	0.0	0.0	0.0	0.0		PEG	-1.6	-1.5
Ordinary dividend paid	0.0	0.0	0.0	0.0	0.0	Tissue Therapies	EV/EBITDA	-3.8	-7.8
Preferred dividends (4)	0.0	0.0	0.0	0.0	0.0	Year to 30 Jun	EV/EBIT	-3.8	-7.8
Other financing cash flow	0.0	0.0	0.0	0.0	0.0		PE	-2.8	-8.0
Cash flow from fin (5)	16.8	13.6	10.8	15.0	0.0		PEG		12.2
Forex and disc ops (6)	0.0	0.0	0.0	0.0	0.0				
Inc/(decr) cash (1+3+5+6)	4.3	2.0	2.3	6.1	6.6	Per share data	2008A	2009F	2010F
Equity FCF (1+2+4)	-8.3	-5.5	-8.3	-8.9	6.6	No. shares	114.2	134.3	151.3
						EPS (cps)	-8.8	-8.7	-8.0
Balance sheet	2007A	2008A	2009F	2010F	2011F	EPS (normalised) (c)	-8.8	-8.7	-8.0
Cash & deposits	12.1	14.1	16.4	22.5	29.1	Dividend per share (c)	0.0	0.0	0.0
Trade debtors	0.5	0.1	0.1	0.2	0.2	Dividend payout ratio (%)	0.0	0.0	0.0
Inventory	0.0	0.0	0.0	0.0	0.0	Dividend yield (%)	0.0	0.0	0.0
Investments	7.7	12.8	13.0	13.0	13.0				
Goodwill	0.0	0.0	0.0	0.0	0.0	Growth ratios	2008A	2009F	2010F
Other intangible assets	0.8	0.5	0.4	0.3	0.3	Sales growth	na	na	na
Fixed assets	0.2	0.2	0.2	0.2	0.2	Operating cost growth	10.0%	4.3%	8.7%
Other assets	0.0	0.1	0.1	0.1	0.1	EBITDA growth	10.0%	4.3%	8.7%
Total assets	21.2	27.8	30.2	36.3	42.9	EBITA growth	11.1%	4.2%	8.6%
Short-term borrowings	0.0	0.0	0.0	0.0	0.0	EBIT growth	11.1%	4.2%	8.6%
Trade payables	0.7	1.6	1.9	2.3	2.7	Norm. NPAT growth (pre GW)	15.3%	7.4%	6.0%
Long-term borrowings	0.0	0.0	0.0	0.0	0.0	Norm. NPAT growth	15.3%	7.4%	6.0%
Provisions	0.0	0.0	0.0	0.0	0.0	Norm. EPS growth (pre GW)	7.4%	-1.2%	-7.8%
Other liabilities	0.0	0.0	2.1	4.2	6.4	Norm. EPS growth	7.4%	-1.2%	-7.8%
Total liabilities	0.7	1.6	4.0	6.5	9.1				
Preference shares						Operating performance	2008A	2009F	2010F
Hybrid equity	0.0	0.0	0.0	0.0	0.0	Asset turnover (%)	0.0	0.0	0.0
Share capital	37.4	51.0	61.8	76.8	76.8	EBITDA margin (%)	na	na	na
Other reserves	1.6	3.8	3.8	3.8	3.8	EBIT margin (%)	na	na	na
Retained earnings	-18.5	-28.6	-39.4	-50.8	-46.8	Net profit margin (%)	na	na	na
Other equity	0.0	0.0	0.0	0.0	0.0	Return on net assets (%)	-33.8	-35.2	-33.7
Total equity	20.5	26.2	26.2	29.8	33.8	Net debt (A\$m)	-14.1	-16.4	-22.5
Minority interest	0.0	0.0	0.0	0.0	0.0	Net debt/equity (%)	-53.8	-62.6	-75.6
Total shareholders' equity	20.5	26.2	26.2	29.8	33.8	Net interest/EBIT cover (x)	9.7	17.3	14.7
Total liabilities & SE	21.2	27.8	30.2	36.3	42.9	ROIC (%)	-73.0	-53.3	-71.4
						Internal liquidity	2008A	2009F	2010F
						Current ratio (x)	9.1	4.1	3.5
						Receivables turnover (x)	na	0.0	0.0
						Payables turnover (x)	na	5.2	4.7

Source: RBS estimates, company data

Recommendation structure

Absolute performance, short term (trading) recommendation: A Trading Buy recommendation implies upside of 5% or more and a Trading Sell indicates downside of 5% or more. The trading recommendation time horizon is 0-60 days. For Australian coverage, a Trading Buy recommendation implies upside of 5% or more from the suggested entry price range, and a Trading Sell recommendation implies downside of 5% or more from the suggested entry price range. The trading recommendation time horizon is 0-60 days.

Absolute performance, long term (fundamental) recommendation: The recommendation is based on implied upside/downside for the stock from the target price. A Buy/Sell implies upside/downside of 10% or more and a Hold less than 10%. For UK Small/Mid-Cap Analysis a Buy/Sell implies upside/downside of 10% or more, an Add/Reduce 5-10% and a Hold less than 5%. For UK-based Investment Funds research the recommendation structure is not based on upside/downside to the target price. Rather it is the subjective view of the analyst based on an assessment of the resources and track record of the fund management company. For listed property trusts (LPT) or real estate investment trusts (REIT) the recommendation is based upon the target price plus the dividend yield, ie total return.

Performance parameters and horizon: Given the volatility of share prices and our pre-disposition not to change recommendations frequently, these performance parameters should be interpreted flexibly. Performance in this context only reflects capital appreciation and the horizon is 12 months. Sector relative to market: The sector view relative to the market is the responsibility of the strategy team. Overweight/Underweight implies upside/downside of 10% or more and Neutral implies less than 10% upside/downside. Target price: The target price is the level the stock should currently trade at if the market were to accept the analyst's view of the stock and if the necessary catalysts were in place to effect this change in perception within the performance horizon. In this way, therefore, the target price abstracts from the need to take a view on the market or sector. If it is felt that the catalysts are not fully in place to effect a re-rating of the stock to its warranted value, the target price will differ from 'fair' value.

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The tables below show the distribution of ABN AMRO's recommendations (both long term and trading). The first column displays the distribution of recommendations globally and the second column shows the distribution for the region. Numbers in brackets show the percentage for each category where ABN AMRO has an investment banking relationship.

Long Term recommendations (as at 30 Mar 2009)		
	Global total (IB%)	Asia Pacific total (IB%)
Buy	469 (5)	306 (0)
Add	0 (0)	0 (0)
Hold	383 (1)	236 (0)
Reduce	0 (0)	0 (0)
Sell	170 (1)	102 (1)
Total (IB%)	1022 (3)	644 (0)

Source: ABN AMRO

Trading recommendations (as at 30 Mar 2009)		
	Global total (IB%)	Asia Pacific total (IB%)
Trading Buy	3 (0)	3 (0)
Trading Sell	3 (0)	3 (0)
Total (IB%)	6 (0)	6 (0)

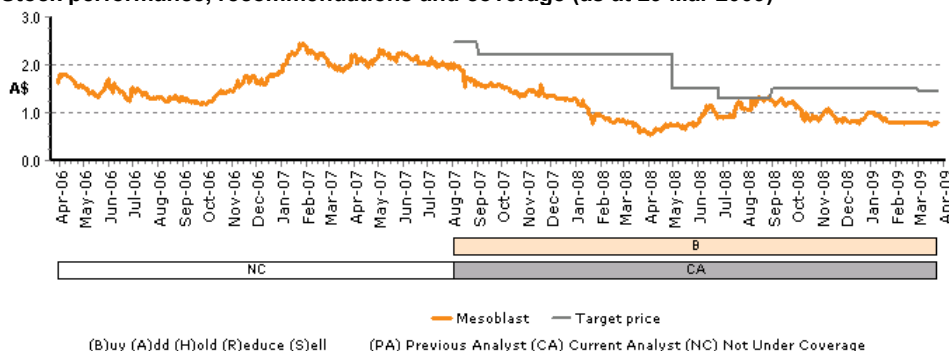
Source: ABN AMRO

Valuation and risks to target price

Mesoblast (RIC: MSB.AX, Rec: Buy, CP: A\$0.800, TP: A\$1.400): Our valuation of MSB is based on a discounted cash flow model, from which we derive our target price. Upside risks include the faster-than-expected progression to production of MSB's MPC technology, while downside risks include the lack of scalability of the manufacturing process.

Mesoblast coverage data

Stock performance, recommendations and coverage (as at 29 Mar 2009)



Trading recommendation history (as at 30 Mar 2009)

Date	Rec	Analyst
	n/a	

Source: ABN AMRO

Dr David Stanton started covering this stock on 2 Aug 07

New recommendation structure from 7 November 2005

Source: ABN AMRO

Regulatory disclosures

Subject companies: **MSB.AX**

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