

# HALF YEARLY REPORT TO SHAREHOLDERS

December 2006



Dear shareholders,

There have been positive signs over the past few weeks that investor sentiment towards the biotechnology sector in Australia is improving. This is a welcome change after several years of the sector being out of favour.

The apparent return to favour can be attributed to several factors. I believe that the most important of these is the significant disparity in performance between the listed biotechnology sector and the rest of the market. Investors now realise that often the best prospect of achieving an abnormal return on their investment is to look for relatively undervalued sectors rather than continue to pour money into sectors and companies that have already delivered spectacular returns.

However, the increasingly attractive biotech sector fundamentals may provide a more significant basis for the upturn than the “weight of money” dynamic. The local sector is maturing in terms of management experience, the depth of product pipelines, the number of clinical trials under way and the amount of global licensing deals that have been completed. At the same time, share prices over the past six months have never been as depressed. The increased maturity of the sector has led to a lower risk profile for the stronger companies and, taking into account the depressed share prices, the value has never been better.

Biotech is one of the few global sectors that has not performed strongly over recent years. However, as noted in a recent CommSec report, biotech stocks have offered the best, if not the most stable, returns in the Australian market over the past 20 years. Since 1986, average annual returns including dividends from the biotech sector were 25.5% compared to 14.1% annual gains from the broader market. When you overlay the macro-environment in which almost every other sector has performed very strongly over the past couple of years, the conditions appear to favour a significant sector re-rating. The early signs are there with the recent acquisitions by overseas groups of several local companies at large premiums.

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Your fund is well placed to realise value in this upturn. History of the biotech sector has revealed that the length of time the window of strong performance is open tends to be relatively short. Our listed portfolio has no escrow restrictions, which means we are free to sell into any specific sector strength and begin to realise gains from these investments.

At the same time, an upturn in sentiment provides the opportunity to pursue public listings for our remaining unlisted portfolio.

We continue to search for new and attractive investment opportunities to add to the existing portfolio. We remain disciplined in this regard and have yet to find a compelling new investment opportunity within the constraints of our fund's investment policy.

On behalf of the Board of Biotech Capital, we thank you for your ongoing support.

Harry Karelis  
Managing Director

## Corporate Directory

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### BIOTECH CAPITAL

ASX Code: BTC  
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## COMPANY IN FOCUS: PHYLOGICA LTD (ASX CODE:PYC)

Phylogica is a drug discovery and development company working on novel therapies for a range of diseases including stroke, severe burns and inflammatory diseases such as rheumatoid arthritis. It has a very strong intellectual property position protecting what it calls 'Phylomers' – or small pieces of proteins. Phylogica has the ability to screen massive amounts of naturally occurring protein fragments to identify compounds that could potentially be developed into drugs.

At present, Phylogica has lead molecules in the area of burns and stroke. It also has external collaborations with groups such as Johnson & Johnson and Opsona (a Europe-based biotechnology company with a focus on identifying and developing anti-inflammatory drugs). Numerous discussions are underway with other companies seeking to access the company's technology.

The protein-based drugs space in which Phylogica operates has become very attractive to large pharmaceutical companies over the past year or so, such that many companies of similar size and stage to Phylogica have been acquired for considerably more than Phylogica's current market capitalisation.

Most recently, GlaxoSmithKline acquired UK-based Domantis plc, which is developing the next generation of therapeutic antibodies, for A\$575 million to gain access to its underlying antibody technology platform.

Domantis was established using intellectual property developed by Sir Greg Winter who was also involved in the earlier establishment of Cambridge Antibody Technology plc or "CAT" – a pioneer in the development of technologies to rapidly identify antibodies that could have therapeutic potential.

CAT itself was acquired by Astra-Zeneca for A\$1.75 billion. These major acquisitions provided investors with the strongest sign yet that the biologic drug space had moved into the mainstream.

In simple terms, this means that the pharmaceutical sector is finding it increasingly difficult to replenish their product pipelines with traditional compounds sourced via expertise in chemistry (termed "small molecules") and are now looking at the next generation of drugs being derived from biological sources such as antibodies, proteins and peptides.



It is not just pharmaceutical companies that are looking at the sector. Amgen Inc., one of the world's largest and most successful biotechnology companies acquired a company known as Avidia for more than A\$360 million.

Phylogica is firmly entrenched in the biological drugs sector and importantly has a strong proprietary position over its intellectual property.

The current focus of Phylogica is to expand the number of collaborations it has with international groups to better showcase the potential of the underlying technology platform. At the same time, it will progress with the development of in-house programs and seek to either out-license projects or continue along the path of pre-clinical development to maximise expected returns.

As the largest shareholder in Phylogica we believe there is potential for a significant increase in the value of the company as compounds sourced from Phylogica's library move into the clinic and demonstrate their therapeutic value.

## PORTFOLIO UPDATE

### Alchemia Ltd (ASX:ACL)

The logo for Alchemia Ltd, featuring the word "Alchemia" in a red, serif font.

Alchemia has core expertise in carbohydrate chemistry. Alchemia's technology makes it possible to explore, develop and exploit the potential of carbohydrates in drug discovery far more efficiently than has been previously possible.

The continual search for new classes of drugs by the biopharmaceutical industry provides the opportunity for the development of many new drugs by the company.

The company's lead drug is a synthetic version of the natural anti-clotting compound, heparin, which has many applications.

The company is also building a pipeline of products by applying its core expertise in carbohydrate chemistry.

Alchemia experienced a setback when their US marketing partner pulled out of a partnership, which will delay the launch of the synthetic heparin product. The company is seeking an alternative partner and expects to secure a new relationship in the medium term.

### Biocomm Services Pty Ltd

The logo for Biocomm Services Pty Ltd, featuring a stylized red and blue graphic above the word "BIOCOMM" in a bold, blue, sans-serif font.

Biocomm was formed several years ago to provide technology management and commercialisation expertise as well as seed funding for promising early stage projects.

During the last six months, the Board of Biocomm reviewed the strategic options available to the company and decided to focus solely on the development of its existing investments and discontinue its commercialisation consulting activities.

The Biocomm portfolio consists of:

- **Hatchtech**, which is developing a product for better treatment of head lice in humans that will later be extended to the treatment of lice that affect livestock.

Hatchtech expects this product to enter clinical trials in 2007.

- **CNS Bio**, a company developing novel therapies to provide more effective pain relief for cancer patients using combinations of existing drugs.
- **Cryptopharma**, which is a biopharmaceutical company developing anti-inflammatory compounds with potential for the treatment of asthma, pulmonary fibrosis and other chronic inflammatory diseases of the lung.

## Clinical Cell Culture Ltd (ASX:CCE)



Clinical Cell Culture (“C3”) is a tissue engineering company with a pipeline of products for the treatment of burns, wounds and other injuries that require skin replacement.

These products have significant advantages over those on the market, including rapid expansion when grown in the laboratory, decreased time to healing and greater ease of use, resulting in improved patient outcomes.

The company’s core technology has been developed into a disposable kit product known as ReCell. The core market for ReCell is the plastic and cosmetic surgery market and the largest geographic market is the USA.

C3 has weathered some regulatory setbacks over the past 12 months that culminated in a change in CEO. The company has recently successfully completed a \$14 million capital raising that will provide sufficient funds to achieve approvals in the key US market and to continue to grow revenues from its existing markets in over 40 countries, including Australia, Brazil, Canada, Germany, Italy, Japan and the United Kingdom.

Biotech Capital recently announced that it has sold its shares in C3 following further disappointing progress with product sales.

## Continance Control Systems Pty Ltd



Continance Control Systems Pty Ltd (“CCS”) Continance Control Systems is a medical device company formed to commercialise a new treatment for severe urinary incontinence, defined as the involuntary loss of urine from the bladder. The treatment will address a currently unmet medical need for large numbers of people for whom other surgical treatments have failed. The potential market is estimated to be in excess of US\$1 billion per annum.

CCS has combined intellectual property and science from the University of Melbourne with customised implantable stimulation technology developed by Cochlear Ltd, the world leader in cochlear implants.

The company has completed the implants of its first cohort of patients under a Safety & Feasibility trial – a significant milestone for an unlisted Australian implantable device company.

The trial was designed to explore the safety of the product and the feasibility of the surgery.

CCS is currently assessing data from these patients and modifying the system and implant procedure before proceeding to the next cohort of patients.

The company was recently awarded a \$3.8 million Commercial Ready Grant from the Federal Government and is looking to raise matching funds for this grant to accelerate the company’s development and achievement of milestones.

## Pacific Knowledge Systems Pty Ltd

### PACIFIC KNOWLEDGE SYSTEMS

Pacific Knowledge Systems (“PKS”) has commercialised artificial intelligence technology known as Ripple-Down-Rules into a product (LabWizard™) originally designed as a productivity tool for pathologists to assist in the interpretation of results. It is in use at a range of sites across Australia and overseas.

In addition to the pathology applications, the company has succeeded in developing new applications in both health and non-health areas.

PKS is in discussions with several groups regarding the development of applications across a range of uses.

The company continues to grow its revenue base toward its objective of becoming an attractive acquisition target for a multi-national group.

## Prima Biomed Ltd (ASX: PRR)



Melbourne-based Prima Biomed (“Prima”) is a biotechnology company developing technologies in the field of cell-based cancer immunotherapy that originated from research at the Austin Research Institute (now incorporated into the Burnet Institute).

Prima has a clear focus on ovarian cancer where it has recently announced the completion of a Phase 2a clinical trial. Final results are expected in Q1 2007 and, if positive, should provide the basis for a significant re-rating of the company’s share price.

## Starpharma Ltd (ASX:SPL)



Starpharma Holdings Limited is a world leader in the development of new classes of molecules known as dendrimers, which can be designed to have specific size, shape and properties, making them suitable for a variety of medical and non-medical applications.

company’s technology. Starpharma recently acquired outright its US subsidiary Dendritic Nanotechnologies Inc (DNT), as a result of which the giant Dow Chemical group became a substantial shareholder in Starpharma.

Changes have also been made to the Board and to the CEO as the company gears up to take full advantage of the numerous opportunities available.

Starpharma’s lead product is VivaGel™, a gel-based formulation of dendrimers under development as a vaginal microbicide to protect women from the sexually transmitted HIV and genital herpes.

The company has received significant funding from the US Government National Institute of Health to progress the clinical trials for both of these indications validating the strength of the

# Stem Cell Sciences plc (AIM: STEM)



Stem Cell Sciences ("SCS") Stem Cell Sciences is a global biotechnology company with established R&D operations in Australia, Japan and UK. The company has strong expertise and intellectual property in the stem cell biology of rodent and human cells derived from both embryonic and somatic (so called adult stem cell) sources. Over many years, the company has developed expertise in how to identify, isolate, grow and control these cells and has generated significant revenue since its inception.

SCS's business model combines near-term revenue generation through the application of stem cells and related reagents in drug discovery and research with the long-term development of a pipeline of cell-based therapies.

The company's headquarters are based in Edinburgh, giving SCS closer connections to its key collaborators and partners in the northern hemisphere.

It has recently strengthened the Board with the appointment of Mr David Dodd as Chairman.

David is based in the USA and has a tremendous track record in delivering shareholder returns over many years. He brings a wealth of commercial and corporate life sciences experience to the Group. He was President, Chief Executive Officer and Director of NASDAQ quoted Serologicals Corporation until it was acquired by the Millipore Corporation in July 2006.

During Mr Dodd's six-year leadership, the value of Serologicals Corporation increased from \$85 million to \$1.4 billion. We are delighted that David has joined the company as it moves to the next stage of significantly growing its product and service pipeline and growing revenues.

SCS recently announced that it is exploring the potential to raise capital and dual list on the Australian Stock Exchange.

## XRT Ltd



XRT was formed as a spinout company from the leading Australian research organisation, the CSIRO. XRT is a global pioneer in ultra-high resolution imaging based on its phase contrast imaging techniques. The

technology allows imaging of unparalleled quality in a range of medical and industrial applications.

XRT intends to list on the stock market in the United Kingdom at the appropriate time. Meanwhile, the company will consider acting on merger and acquisition opportunities where synergies exist if they are deemed to be in the best interests of shareholders.

To exploit fully the potential of its technology platform, the company is focused on the collaborative development of applications and has formed several partnerships, mainly with groups in the northern hemisphere.

The current focus is on the non-destructive industrial testing market where there is a clear demand for ways of examining structures in fine detail.



