

Buy**Target price: € 16.50**

Price: € 12.70

11/07/06

10:00 a.m.

Last rating/Target Pr.:

Buy /€ 19.50

Last analysis:

08/08/2006

S&P rating: n.a.

Medical Technology

Number of shares:

3.3 m

Market capitalisation:

€ 41.3 m

Index: Tech All Share

Index weight: 0.08 %

Beta: 1.60

Accounting:

IFRS

Calendar: FY 2006

on 03/27/07

Dividend 2006e: 0.20

ISIN: DE0005659700

Bloomberg: EUZ GY

Reuters: EUZG.DE

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11/07/2006

Event: Comments on Q3 financials

Financials are strong, but SpondylAT outlook remains uncertain

EUZ has once again delivered a strong quarter in which profits were clearly above our expectations, although our sales expectations were not completely fulfilled.

The administrative court is now dealing with SpondylAT and BfArm is currently blocking additional negotiations on the design of a Phase III study for the drug candidate.

We are lowering our target price, using a risk discount, to €16.50; however, we are maintaining our Buy recommendation.

Share Data	EPS current €	EPS previous €	PSR	EV/EBITDA	PER
2005	0,51	-	0,9	7,3	24,7
2006e	0,76	0,76	0,8	5,5	16,6
2007e	0,91	0,91	0,7	4,6	14,0
2008e	1,15	1,15	0,6	4,1	11,0

Company Data	Revenues €m	EBITDA €m	EBIT €m	EBIT-Margin	Net Profit €m
2005	41.8	6.4	2.5	6.1 %	1.6
2006e	50.2	8.6	4.1	8.2 %	2.4
2007e	60.2	10.1	5.5	9.1 %	2.9
2008e	68.3	11.5	6.6	9.6 %	3.6

Please note the disclaimer on the last page of this study.

Valuation

Multiple-based valuation

- We continue to refrain from using a multiple-based valuation due to the paltry amount of data available on competitors.

Discounted cash flow valuation

- Our DCF is based upon the following assumptions:

DCF model - assumptions

Risk free interest rate	3,7 %
Market premium	5,5 %
Beta factor	1,60
Cost of equity	12,5 %
Cost of debt (after tax)	3,7 %
Equity ratio target	60,0 %
WACC	9,0 %
Terminal growth rate	1,0 %

Source: LBBW

- Here, we have only updated the risk free interest rate and the market risk premium to reflect current conditions.
- The DCF model is as follows:

Free Cashflow (€m)	2006e	2007e	2008e	2009e	2010e	2011e	2012e	2013e	2014e	2015e
Revenues	50,2	60,2	68,3	73,1	77,5	82,1	87,0	92,3	97,8	103,7
<i>Grwoth (yoy)</i>	<i>20,0 %</i>	<i>20,0 %</i>	<i>13,5 %</i>	<i>7,0 %</i>	<i>6,0 %</i>					
EBIT	4,1	5,5	6,6	8,0	9,7	9,9	10,4	11,1	11,7	12,4
<i>EBIT margin</i>	<i>8,2 %</i>	<i>9,1 %</i>	<i>9,6 %</i>	<i>11,0 %</i>	<i>12,5 %</i>	<i>12,0 %</i>				
Taxes	1,1	1,9	2,3	3,1	3,8	3,9	4,2	4,4	4,7	5,0
<i>Tax rate</i>	<i>29,3 %</i>	<i>37,2 %</i>	<i>36,5 %</i>	<i>40,0 %</i>						
Depreciation/Amortisation	4,5	4,7	4,9	5,2	5,4	5,7	6,1	6,5	6,8	7,3
<i>to revenues</i>	<i>8,9 %</i>	<i>7,8 %</i>	<i>7,2 %</i>	<i>7,1 %</i>	<i>7,0 %</i>					
Provisions	3,0	3,3	3,6	4,0	4,4	4,9	5,2	5,5	5,9	6,2
<i>to revenues</i>	<i>6,0 %</i>	<i>5,5 %</i>	<i>5,3 %</i>	<i>5,5 %</i>	<i>5,7 %</i>	<i>6,0 %</i>				
Change	-0,2	0,3	0,3	0,4	0,4	0,5	0,3	0,3	0,3	0,4
Cashflow from operating activities	7,2	8,6	9,6	10,5	11,7	12,2	12,7	13,4	14,2	15,1
Investments	3,3	3,6	4,0	4,4	4,8	4,9	5,2	5,5	5,9	6,2
<i>to revenues</i>	<i>6,6 %</i>	<i>6,0 %</i>	<i>5,8 %</i>	<i>6,0 %</i>	<i>6,2 %</i>	<i>6,0 %</i>				
Working Capital	12,2	15,1	16,4	17,8	19,4	20,5	21,8	23,1	24,5	25,9
<i>to revenues</i>	<i>24,3 %</i>	<i>25,0 %</i>	<i>24,0 %</i>	<i>24,4 %</i>	<i>25,1 %</i>	<i>25,0 %</i>				
Change	0,8	2,9	1,3	1,5	1,6	1,1	1,2	1,3	1,4	1,5
Free Cashflow	3,1	2,1	4,2	4,6	5,3	6,2	6,2	6,6	7,0	7,4

Source: LBBW

- It results in a fair value of €21.88.

Calculation of share value (€mn)	
Present value planned Free Cashflows	33,6
Present value Terminal Value	41,0
Enterprise Value	74,7
<i>Ratio Terminal Value to Enterprise Value</i>	<i>55,0 %</i>
Net financial debt	3,1
Minorities	0,3
Provisions for pensions	0,2
Fair value	71,1
Number of shares (mn)	3,3
Fair value per share (€)	21,88

Source: LBBW

- We have subjected this value to a sensitivity analysis that has led to the following result:

Sensitivity analysis		Discounting rate		
Value per share (€)		<i>8,0 %</i>	<i>9,0 %</i>	<i>10,0 %</i>
	<i>0,0 %</i>	22,34	20,47	18,92
Terminal value growth	<i>1,0 %</i>	24,14	21,88	20,05
	<i>2,0 %</i>	26,56	23,69	21,45

Source: LBBW

Recommendation

- We have left our forecasts unchanged. Q4 will probably be rather weak due to seasonality, which means that our forecasts are largely in-line with those of the company. Therefore, the numerically higher fair value is solely due to changes in the risk free interest rate and market risk premium parameters.
- We do not expect the market to fully move in the direction of this fair value within our investment horizon. Uncertainty about the future of the SpondylAT project (exact timing, definitive study design, reference benchmark of a possibly necessary comparative trial, pending administrative court decision on provisional conditional approval, etc.) is too great in our estimation.
- We have therefore applied a 25% discount to the calculated fair value and are lowering our previous target price of €19.50 to €16.50. Nevertheless, we are maintaining our Buy recommendation on EUZ shares.

Forecasts are unchanged

Uncertainty is extremely high concerning the SpondylAT project

Buy with a target price of €16.50

Development current business year

€mn	Q3 2005	Q3 2006e	Q 2006
Revenues	11,2	13,5	12,7
y-o-y		20,4 %	12,9 %
EBIT	0,6	0,9	1,7
y-o-y		42,9 %	167,9 %
<i>EBIT margin</i>	<i>5,6 %</i>	<i>6,7 %</i>	<i>13,3 %</i>
Net profit	0,2	0,5	0,7
y-o-y		163,2 %	289,5 %
<i>Net profit margin</i>	<i>-</i>	<i>3,7 %</i>	<i>5,8 %</i>
EPS (€)	0,06	0,14	0,22

Source: Eckert & Ziegler AG, LBBW

Sales below our expectations, but earnings above

BfArm is blocking negotiations on study design

Clarifying discussions to still occur before Christmas?

Study vs. a placebo is not advisable in our estimation

Emergency brake?

Weak Q4 is expected

- Sales were slightly below our expectations. However, the earnings level was considerably stronger than we expected. Here, the integration of the acquired businesses and the tapping of synergies apparently progressed better than we had assumed.
- The administrative court is currently concerned with the provisional conditional approval of the SpondylAT drug candidate and its cancellation by BfArm. As a consequence of this, BfArm reacted by blocking further negotiations on the study design of a Phase III study.

Outlook

- EUZ is hoping to hold additional clarifying discussions with BfArm possibly before Christmas. The idea of letting SpondylAT compete against a placebo in its Phase III study has not yet been abandoned by management.
- We believe, however, that EUZ would not do itself any favours by testing SpondylAT against a placebo, which is subject to BfArm approving such a study design at all. Following the latest decisions by the respective national healthcare authorities on the cost reimbursement of new drugs, economic concerns are moving increasingly to the forefront in decision-making on cost reimbursement. Given this, we believe that EUZ would be better off if it would test SpondylAT against a standard treatment, which would also enable it to argue with an economic advantage.
- If the danger possibly exists that SpondylAT is able to only display an efficacy advantage, but not a clear economic advantage versus the standard treatment, we believe that EUZ should “pull the plug” as quickly as possible and cancel the project.
- Q4 should be rather weak, which has also been stated by management. This is due in part to seasonal effects such as the Christmas holidays. Moreover, Q4 is also bonus season at EUZ, which negatively impacts quarterly profits.

Profit & Loss Account	2004	2005	2006e	2007e	2008e
€mn					
Revenues	35,5	41,8	50,2	60,2	68,3
Cost of Sales	-19,2	-23,3	-26,1	-31,3	-35,5
Gross Profit	16,3	18,5	24,1	28,9	32,9
<i>Margin</i>	<i>45,9%</i>	<i>44,2%</i>	<i>48,0%</i>	<i>48,1%</i>	<i>48,1%</i>
R&D Expenses	-0,4	-0,5	-0,5	-1,8	-1,9
G&A Expenses	-12,5	-16,2	-20,1	-21,7	-24,4
Other Income	0,0	0,8	0,7	0,0	0,0
EBITDA	7,2	6,4	8,6	10,1	11,5
<i>Margin</i>	<i>20,2%</i>	<i>15,4%</i>	<i>17,1%</i>	<i>16,9%</i>	<i>16,8%</i>
Depreciation and Amortisation	-3,7	-3,9	-4,5	-4,7	-4,9
EBIT	3,4	2,5	4,1	5,5	6,6
<i>Margin</i>	<i>9,7%</i>	<i>6,1%</i>	<i>8,2%</i>	<i>9,1%</i>	<i>9,6%</i>
Net Financial Income/Expense	0,2	-0,3	-0,4	-0,5	-0,4
EBT	3,6	2,2	3,8	5,0	6,2
<i>Margin</i>	<i>10,2%</i>	<i>5,3%</i>	<i>7,5%</i>	<i>8,3%</i>	<i>9,0%</i>
Income Taxes	-1,3	-0,7	-1,1	-1,9	-2,3
EAT	2,3	1,5	2,7	3,1	3,9
<i>Margin</i>	<i>6,5%</i>	<i>3,6%</i>	<i>5,3%</i>	<i>5,2%</i>	<i>5,7%</i>
Extraordinaries	1,1	0,0	0,0	0,0	1,0
Minorities	-0,1	0,1	-0,2	-0,3	-0,3
Net Profit	3,3	1,6	2,4	2,9	3,6
<i>Margin</i>	<i>9,4%</i>	<i>3,8%</i>	<i>4,8%</i>	<i>4,8%</i>	<i>5,3%</i>
Earnings per share before extraordinaries (€)	0,72	0,51	0,76	0,91	1,15
Earnings per share before minorities(€)	1,11	0,48	0,84	0,99	1,24
Earnings per share before extraordinaries and minorities (€)	0,75	0,48	0,84	0,99	1,24
Earnings per share (€)	1,08	0,51	0,76	0,91	1,15

Source: Eckert & Ziegler AG, LBBW

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