



BUY \$1.15

Mesoblast (MSB)

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Growing Places

Company Data

ASX Code	MSB
Price	\$1.15
12 month price target	\$3.20
Implied return	178%
Shares on issue	119.3m
Market capitalisation	\$137.1m
12 Month price range	\$1.15 - \$2.49
Monthly turnover	2.3m

Cash Flow Summary

Yr to 30 June	2007A	2008F	2009F	2010F
Receipts	0.7	0	24.5	26.0
Interest	0.9	0.5	0.2	0
Oper. Cash Inflow	1.6	0.5	24.7	26.0
Oper. Cash Out	(9.7)	(14.0)	(29.1)	(34.2)
Net Oper Cash	(8.1)	(13.5)	(4.5)	(8.2)
Net Inv. Cashflow	(4.3)	(5.5)	(1.2)	0
Net Fin. Cashflow	16.7	13.4	0	0
Inc/(Dec) Cash	4.3	(5.6)	(5.7)	(8.2)
Opening Cash	7.9	12.2	6.6	0.9
Closing Cash	12.2	6.6	0.9	(7.3)

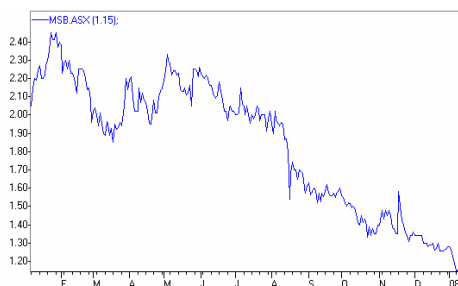
Board of Directors

Brian Jamieson	Chairman (Non-Exec)
Silviu Itescu	Founder & CSO
Michael Spooner	Non-Exec. Dir.
Donal O'Dwyer	Non-Exec. Dir.
Byron McAllister	Non-Exec. Dir.

Major Shareholders

Silviu Itescu	34.3%
AMP	11.6%
Thorney Holdings	7.8%
Portfolio Partners	5.0%

Share Price Chart



Source: Iress Market Technology

Expect Good Growth From Stem Cells

In December 2007, MSB raised \$13.4m at \$1.28 per share to further expand its program of Phase-II clinical trials using allogeneic ("off-the-shelf") stem cells for various orthopaedic applications. These will build on the existing Phase-II trials that are already in progress (spinal fusion by MSB and heart attack by Angioblast in which MSB has a 39.2% stake) which are expected to provide interim data during 1Q 2008.

In addition to validation and expansion of product opportunities for MSB's stem cells from clinical trial results, the company is well positioned to deliver on corporate activities that should deliver significant value to MSB shareholders including:

- External valuation of Angioblast via US listing or other event
- Establishment of partnerships or licensing arrangements

MSB's share price declined significantly (35%) during the mid-August market crash and, as with many stocks in the sector, is yet to recover. However, we remain confident that the progress of the company's clinical development program and the potential for corporate activity over the next 12 months will provide significant value drivers for MSB.

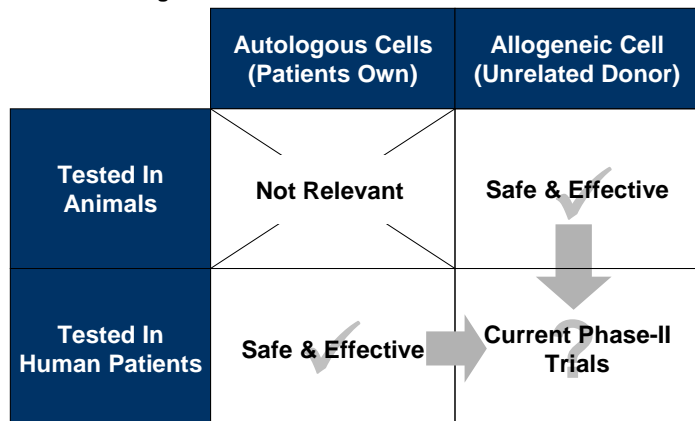
We view the current share price weakness as a compelling buying opportunity as several announcements expected that could trigger a rapid re-rating to the pre-August price levels of around \$2.00. Furthermore, we continue to believe that a price of \$3.20 would be supported should the Phase-II trials confirm the safety and efficacy of MSB's allogeneic MPCs in humans.

Getting Clinical With Allogeneic Stem Cells

The Phase-II trials that MSB and Angioblast are currently undertaking are particularly significant as they are the first time that MSB's allogeneic (unrelated) stem cells are being used in humans to achieve therapeutic outcomes. Should the results from these trials demonstrate that MSB's stem cells are both safe and provide therapeutic benefit, they will validate MSB's business model of high-margin, high-volume, off-the-shelf, cell-based therapeutics.

While it is never possible to predict the outcome of clinical trials, the data from testing MSB's stem cells in animals and humans has been very encouraging:

Figure 1: How Existing Data Relates To MSB's Phase-II Clinical Trials



SOURCE: Lodge Analysis

The Phase-II trials effectively complete the final piece of the jigsaw in terms of showing that allogeneic cells are safe and therapeutically effective in human patients.

From a commercial perspective, this could put MSB in a leading position in terms of cellular therapies. Embryonic stem cells currently have limited therapeutic applications as they are immunogenic (ie: you can only use your own cells), multipotent and proliferative (potentially can form cancers) and are also currently difficult to source ethically.

While a number of other companies around the world are developing adult stem cell-based therapeutics (Eg: Osiris, Aastrom, Arthersys, Cytori and Neuronyx), the technologies that these companies use does not achieve the purity and/or expansion of adult stems cells that MSB can generate. Thus, validation of safety and efficacy in the Phase-II trials will put MSB in an extremely competitive position and, in our view, justify a significant re-rating of the stock.

Strong News Flow From The Clinic

Two Phase-II allogeneic (unrelated donor) stem cell trials are currently in progress using MSB's stem cells (spinal fusion with MSB and heart attack with Angioblast). Interim data from both these trials is expected in 1Q 2008. The initial Phase-II trials are relatively small (40 patients) and are primarily focused on safety. However, as all patients will receive stems cells, it may be possible to get an initial indication of efficacy by comparison with historical recovery data from similar patients.

In 1Q 2008, MSB is planning to file an IND application for use of their adult stem cells to heal long bone fractures. This follows the 10 patient Phase-I trial that was undertaken using autologous cells at the Royal Melbourne Hospital which demonstrated strong bone regeneration and eliminated the need for a second operation to harvest bone tissue from the patient's hips. In addition, Angioblast is planning to file an IND for Congestive Heart Failure (CHF) during 1Q 2008.

With the funds from the recent capital raising, MSB is expected expand its pipeline to include cartilage regeneration applications. Interim results from a preclinical sheep trial for vertebral disc cartilage are scheduled for early 2008. In addition, full safety data from MSB's preclinical knee osteoarthritis trial should allow the company to file an IND application in mid-2008.

The interim data from the animal trials for knee osteoarthritis have indicated that MSB's stem cells can increase the thickness of cartilage by 10%-15% (when compared with the standard treatment of hyaluronic acid (HA)) and the cartilage is significantly stronger. To put this result in context, the normal rate of cartilage loss in osteoarthritis patients is ~5% per year. Thus to generate an increase in cartilage thickness of 10%-15% after only 3 months is, from a therapeutic perspective, a very significant outcome.

MSB's results compare very favourably with the recent results from Osiris (NASDAQ: OSIR). In their announcement of 1-year data from a Phase I/II trial using their adult stem cells to treat patients with osteoarthritis of the knee, they reported a reduction in pain but, unlike their report on interim results, made no mention of improvements to baseline cartilage. Thus, we believe MSB is in a competitive position for this commercially attractive market.

We are expecting MSB's preclinical and clinical trials for various therapeutic applications of their adult stem cells to generate significant news flow in early 2008:

Table 1: Anticipated MSB News Flow From Trials

Timing	Announcement
Mesoblast Clinical Trials	
1Q 2008	Interim data from allogeneic spinal fusion Phase-II clinical trial
1Q 2008	IND application for long bone fracture Phase-II clinical trial
1Q 2008	Interim data from preclinical (sheep) vertebral disc cartilage trial
2Q 2008	IND application for knee osteoarthritis Phase-II clinical trial
Angioblast Clinical Trials	
1Q 2008	Interim data from allogeneic heart attack Phase-II clinical trial
1Q 2008	IND application for congestive heart failure Phase-II clinical trial

SOURCE: Company announcements

The significant, anticipated expansion of MSB's pipeline combined with results from several clinical and preclinical trials provide multiple opportunities for a significant re-rating of MSB, particularly given the impact that the mid-August crash has had on the current share price.

Potential Double Whammy From Angioblast

At the AGM, MSB's Chairman implied that Angioblast is actively exploring transactions that would place an independent, external valuation on MSB's sister company, Angioblast. MSB's chairman made particular mention that Angioblast intends to seek additional funding for its clinical development programs either through an independent capital raising, partnership/co-development arrangement, or an Initial Public Offering in the US.

In this context, it is worth noting that in October 2007, Robert Campbell, the former Vice-Chairman of Johnson & Johnson, joined Angioblast's Board of Directors. While this, in itself, is a strong endorsement of Angioblast's and MSB's adult stem cell technology, we envisage that such an appointment would also be viewed very favourably by US investors.

Following completion of the \$8.5m investment by MSB into Angioblast that was approved at the 2006 AGM, MSB will have a 39.2% shareholding in Angioblast. We believe that an independent valuation of Angioblast has the potential to deliver value to MSB shareholders from two perspectives:

1. **Provide a dollar value for MSB's 39.2% shareholding in Angioblast**
2. **Provide benchmark for the comparable MSB valuation**

While there has no indication of the anticipated valuation at which Angioblast will seek additional investment, Osiris Therapeutics (NASDAQ: OSIR), a comparable US-listed adult stem cell company, currently has an enterprise (ie: ex-cash) value of US\$330M. Thus, we would expect that Angioblast could be able to secure additional financing with a valuation in excess of US\$150–200M. This would value MSB's shareholding in Angioblast at \$60–80M and also provide a good benchmark for a market re-rating of MSB itself.

Ready To Deal

Since listing in late 2004, MSB has successfully addressed many of the technical risk-factors relating to their technology including scaled-up GMP production, and demonstration of safety and efficacy in humans and animals. With these addressed, we believe the company is now well-positioned to secure commercial deals with third parties.

MSB's adult stem cell technology provides a strong platform for establishing multiple deals. First, the technology lends itself to a wide range of different applications each of which can provide the basis for a licensing or partnership deal. Second, in the clinic MSB's stem cells will be used in conjunction with a delivery technology: support matrices for orthopaedic applications and catheters for Angioblast's cardiac applications. As the combination with MSB's stem cells will create products that will enhance sales of the delivery technologies, we believe MSB and Angioblast are now in a strong position to establish attractive partnerships or licensing deals with delivery companies.

We are expecting that either MSB or Angioblast will establish at least one deal around its adult stem cell technology during the course of 2008. This will not only provide external validation of the technology by an independent, expert third party but will also give some guidance on the potential value of MSB's technology to partners.

Greater Independence With Non-Executive Chairman

Following the announcement in July 2007 that Mr Michael Spooner would be stepping down from his role as Executive Chairman of MSB (but continue on as a Non-Executive Director), Mr Brian Jamieson has been appointed as Non-Executive Chairman effective from 22 November 2007. Mr Jamieson has extensive experience in life sciences and other sectors with Director roles in Sigma Pharmaceuticals, Bionic Ear Institute, Care Australia, Oxiana and Tattersalls. He has also previously been CEO of the law firm Minter Ellison and the accounting firm KPMG.

We believe the appointment of a Non-Executive Chairman is a positive move for the company particularly with regards to providing comfort for MSB shareholders that transactions and interactions involving Angioblast are done on an independent and arm's-length basis. This will be particularly important for MSB shareholders should Angioblast seek external investment in the next 12-months.

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Hold: Expected Total Return between 0% and 15% over a 1 year period.

Sell: Expected Total Return less than 0% over a 1 year period.

Analyst Verification**The analyst holds shares in Mesoblast Ltd (MSB)**

I verify that I Matthijs Smith, have prepared this research report accurately and that any financial forecasts and recommendations that are expressed are solely my own personal opinions. In addition, I certify that no part of my compensation is or will be directly or indirectly tied to the specific recommendation or financial forecasts expressed in this report.

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