Zacks Small-Cap Research

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Stellar Biotech (SBOT-NASDAQ)

SBOT: JV With Neovacs Offers Full Product Life Cycle Opportunity

Current Recommendation	**Buy**
Prior Recommendation	N/A
Date of Last Change	11/24/2015
Current Price (01/26/16)	$5.77
Target Price	**$13.00**

OUTLOOK

KLH is a high molecular weight protein derived from the blood of the scarce Giant Keyhole Limpet. KLH has become the carrier protein of choice in immunotherapies, ramping interest in which has fueled demand for this protein. Stellar's proprietary aquaculture (Giant Keyhole Limpet farms) and production facilities are the only source in the world capable of supplying commercial-scale quantities of the high quality KLH protein. Stellar just signed a collaboration agreement which could increase its production capacity 10-fold. The company has KLH supply and collaboration agreements supporting customer clinical trials. Additional supply agreements and, eventually to supply commercialized immunotherapies, could substantially steepen the revenue curve.

SUMMARY DATA

52-Week High	**$10.81**
52-Week Low	**$5.30**
One-Year Return (%)	**-37.47**
Beta	**1.62**
Average Daily Volume (sh)	**18,426**
Shares Outstanding (mil)	**8**
Market Capitalization ($mil)	**$47**
Short Interest Ratio (days)	**2.51**
Institutional Ownership (%)	**0**
Insider Ownership (%)	**11**
Annual Cash Dividend	**$0.00**
Dividend Yield (%)	**0.00**
5-Yr. Historical Growth Rates	
Sales (%)	**39.6**
Earnings Per Share (%)	**N/A**
Dividend (%)	**N/A**
P/E using TTM EPS	**N/A**
P/E using 2016 Estimate	**N/A**
P/E using 2017 Estimate	**N/A**
Zacks Rank	**N/A**

Risk Level	**Above Avg.,**
Type of Stock	**Small-Growth**
Industry	**Med-Biomed/Gene**

ZACKS ESTIMATES

Revenue
(in millions of $)

	Q1 (Dec)	Q2 (Mar)	Q3 (Jun)	Q4 (Sep)	Year (Sep)
2015	0.2 A	0.2 A	0.2 A	0.2 A	0.8 A
2016	0.2 E	0.2 E	0.3 E	0.4 E	1.2 E
2017					1.7 E
2018					2.7 E

Earnings per Share

	Q1 (Dec)	Q2 (Mar)	Q3 (Jun)	Q4 (Sep)	Year (Sep)
2015	-$0.17 A	-$0.05 A	$0.06 A	-$0.19 A	-$0.36 A
2016	-$0.21 E	-$0.17 E	-$0.18 E	-$0.19 E	-$0.76 E
2017					-$0.75 E
2018					-$0.71 E

Zacks Projected EPS Growth Rate - Next 5 Years % **N/A**

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SBOT JV with Neovacs: Opportunity to Participate in Manufacture and Sale of KLH-Based Vaccines

The January 20th announcement that Stellar and Neovacs S.A. expect to form a joint venture ("Neostell SAS") affords SBOT the opportunity to move from just a KLH supplier to a manufacturer and seller of KLH-based vaccines. The companies have had an ongoing relationship through a supply agreement whereby Stellar has supplied KLH for Neovacs' Kinoid vaccine candidates targeting certain autoimmune disorders.

Per the terms of the supply agreement, originally penned in 2008 and recently expanded, Stellar supplies KLH as a carrier molecule for two of Neovacs' Kinoid vaccines under development for the treatment of Lupus and Crohn's disease.

Neovacs' lead candidate, IFNa-Kinoid, completed a phase I/IIa study (n=28) for lupus in 2011. Results showed IFNa-Kinoid was well tolerated and patients experienced a strong immune response with a significantly higher production of binding antibodies compared to TNF Kinoid in humans. A phase IIb study, which is expected to include approximately 166 patients and began patient enrollment in September 2015, is being conducted in Europe, Latin America and Asia. Neovacs expects results of this study to be available in Q1 2017. In addition a phase IIa study is expected to begin in the U.S. - potentially sometime in 2016. Stellar/Neovacs recently expanded the supply agreement to ensure sufficient KLH quantities are available to support these upcoming studies as well as a potential future commercial launch. In addition, the agreements call for Neovacs to pay Stellar for maintaining a dedicated colony of limpets. Neovacs accounted for 15% of SBOT's total 2015 revenue.

And SBOT has supply agreements with other companies as well including Amaran/OBI Pharma and Araclon which are developing KLH-based cancer and Alzheimer's candidates, respectively. And we think (although neither company has verified) SBOT also has a supply agreement with AXON Neuroscience for their early-stage Alzheimer's program. See our December 16th Note for additional background on these relationships.

And while these supply agreements are important for several reasons, including validation of the quality and sustainability of supply of SBOT's KLH as well as providing some early revenue and offering potential to supply KLH for an eventual approved therapy, this new JV offers the additional upside of participating in KLH-based vaccine sales and manufacturing. The JV will not only produce and commercialize Neovacs' vaccines (assuming eventually approved), it will also seek to supply and manufacture KLH-based products for third parties. Per terms, the JV will be owned 30% by SBOT and 70% by Neovacs. Additional specifics are still being negotiated.

The JV is expected to be consummated upon positive results of Neovacs' IFNa-Kinoid phase IIb study in Lupus. The most recent timeline was that results are expected in Q1 2017. Per Neovacs' Jan 21st press release, the JV is expected to be located in Paris, France and will hire between 50 and 100 employees.

Neovacs has been making other preparations in anticipation of their Lupus vaccine ultimately gaining regulatory approval. This includes tapping 5M Euros in incremental funding to advance clinical development of this candidate and entering a licensing agreement with CDK Pharmaceutical for commercialization purposes. If all goes well, IFNa Kinoid-Lupus could gain regulatory approval in S. Korea sometime in 2017 and launch in that country in 2018.

We view this JV announcement as another endorsement for the quality and sustainability of the source of KLH that SBOT provides. It also provides the opportunity for SBOT to participate in the full product cycle from supply, manufacturing and sales/royalties – which broadens the scope and breathe of SBOT operations and revenue opportunities. We also think eventual consummation of the investment in the JV may be a harbinger of initiation of build-out of SBOT's expanded aquaculture facilities in Baja California (Mexico) through an agreement penned with Ostiones Guerrero SA de CV in July 2015. And finally, we think this JV is another step in progress towards exploiting the expected rapid growth of immunotherapies, superiority of KLH as a carrier protein and SBOT's position as the only company in the world capable of supplying commercial-scale quantities of the high quality KLH protein.

We reiterate our Buy recommendation and $13/share price target.

Stellar Biotechnologies

	2015 E	Q1 E	Q2 E	Q3 E	Q4 E	2016 E	2017 E	2018 E	2019 E
Contract Svcs	$195.0	$50.0	$55.0	$60.0	$65.0	$230.0	$365.0	$485.0	$630.50
YOY Growth	*1.6%*	*-16.7%*	*22.2%*	*33.3%*	*44.4%*	*17.9%*	*58.7%*	*32.9%*	*30.0%*
Product Sales Total	$563.7	$137.3	$160.9	$278.4	$347.4	$924.0	$1,373.4	$2,185.0	$2,542.2
YOY Growth	*292.7%*	*-10.1%*	*12.8%*	*146.9%*	*123.2%*	*63.9%*	*48.6%*	*59.1%*	*16.3%*
Grant Revenue	$0.0	$0.0	$0.0	$0.0	$0.0	$0.0	$0.0	$0.0	$0.0
YOY Growth	-	-	-	-	-	-	-	-	-
Total Revenues	$758.7	$187.3	$215.9	$338.4	$412.4	$1,154.0	$1,738.4	$2,670.0	$3,172.7
YOY Growth	*103.9%*	*-11.9%*	*15.1%*	*114.5%*	*105.5%*	*52.1%*	*50.6%*	*53.6%*	*18.8%*
Cost of Sales	$840.2	$214.8	$226.1	$305.0	$363.1	$1,109.0	$1,547.3	$2,105.4	$2,286.3
Gross Income	($81.6)	($27.5)	($10.2)	$33.4	$49.3	$45.0	$191.0	$564.6	$886.5
Gross Margin	*-10.7%*	*-14.7%*	*-4.7%*	*9.9%*	*12.0%*	*3.9%*	*11.0%*	*21.1%*	*27.9%*
R&D	$1,029.5	$366.0	$388.0	$542.0	$577.0	$1,873.0	$2,788.0	$3,358.0	$3,540.0
% R&D	*135.7%*	*195.4%*	*179.7%*	*160.2%*	*139.9%*	*162.3%*	*160.4%*	*125.8%*	*111.6%*
SG&A	$3,227.5	$944.0	$902.0	$912.0	$1,015.0	$3,773.0	$3,945.0	$4,118.0	$4,310.0
% SG&A	*425.4%*	*504.0%*	*417.8%*	*269.5%*	*246.1%*	*326.9%*	*226.9%*	*154.2%*	*135.8%*
Operating Income	($4,338.5)	($1,337.5)	($1,300.2)	($1,420.6)	($1,542.7)	($5,601.0)	($6,542.0)	($6,911.4)	($6,963.5)
Operating Margin	*-571.8%*	*-714.1%*	*-602.2%*	*-419.8%*	*-374.1%*	*-485.4%*	*-376.3%*	*-258.9%*	*-219.5%*
Total Other Inc. (Exp.)	$1,532.4	($392.0)	($141.0)	($96.0)	($98.0)	($727.0)	$0.0	$0.0	$0.0
Pre-Tax Income	($2,806.1)	($1,729.5)	($1,441.2)	($1,516.6)	($1,640.7)	($6,328.0)	($6,542.0)	($6,911.4)	($6,963.5)
Taxes	$36.8	$9.0	$9.0	$9.0	$9.0	$40.0	$40.0	$40.0	$40.0
Tax Rate	-	-	-	-	-	-	-	-	
Net Income	($2,842.9)	($1,738.5)	($1,450.2)	($1,525.6)	($1,649.7)	($6,368.0)	($6,582.0)	($6,951.4)	($7,003.5)
YOY Growth	*-66.3%*	*29.4%*	*240.3%*	*-428.8%*	*7.3%*	*124.0%*	*3.4%*	*5.6%*	
Net Margin	*-374.7%*	*-928.2%*	*-671.7%*	*-450.8%*	*-400.0%*	*-551.8%*	*-378.6%*	*-260.4%*	
EPS	($0.36)	($0.21)	($0.17)	($0.18)	($0.19)	($0.76)	($0.75)	($0.71)	($0.67)
YOY Growth	*-67.9%*	*26.9%*	*220.4%*	*-407.7%*	*0.0%*	*112.2%*	*-1.3%*	*-5.2%*	
Diluted Shares O/S	7,957	8,100	8,450	8,500	8,550	8,400	8,800	9,800	10,500

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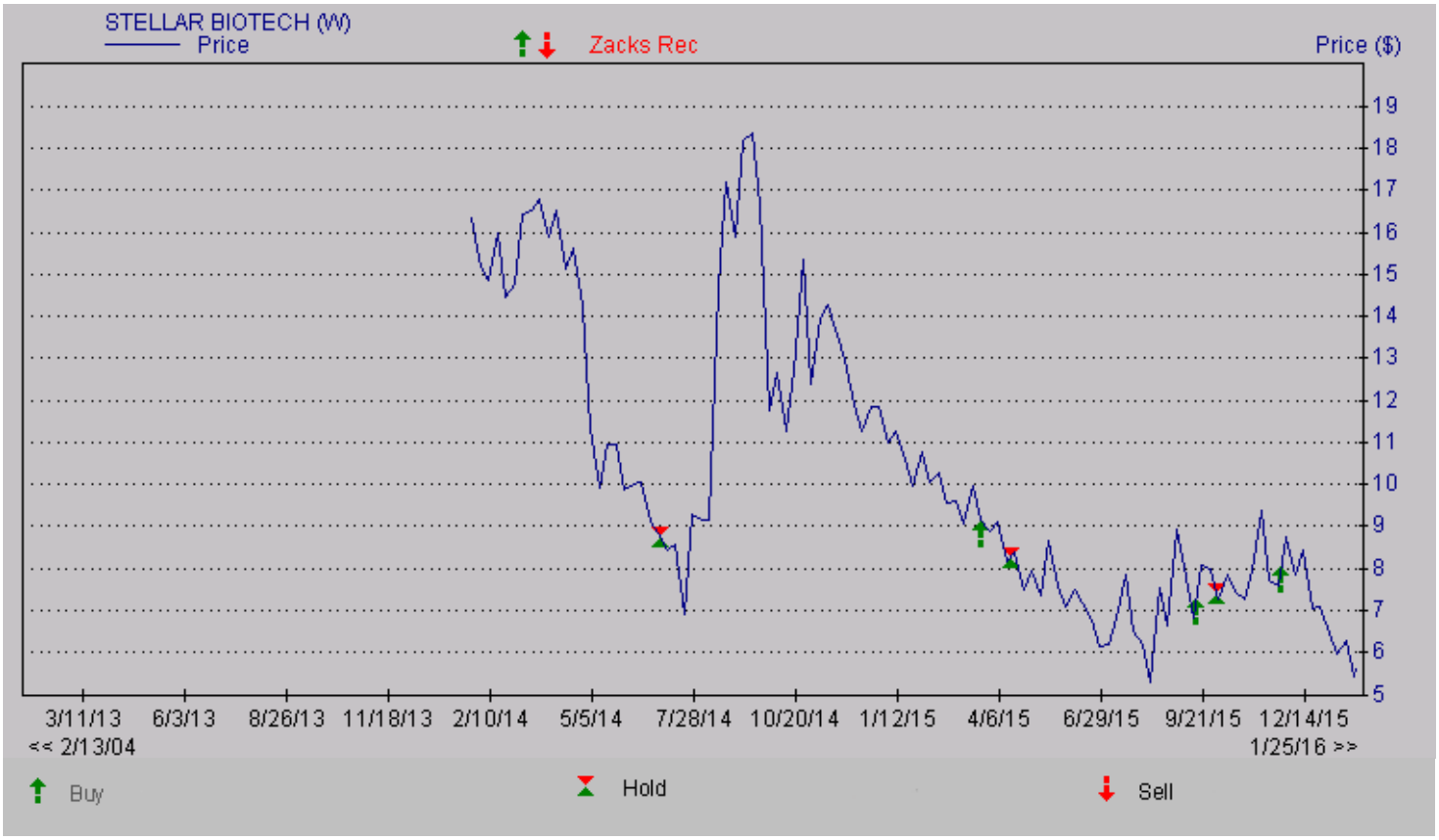

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