AVACTA GROUP LTD

ACQUISITION OF LAUNCH DIAGNOSTICS AND FUNDRAISE

18.10.2022

Ticker:	**AVCT.L**
Price (p):	**99.0**
Shares in issue (m):	**263.7**
Market cap. (£m):	**261.1**

https://aimchaos.com/category/investment-notes/

Introduction

This morning, Avacta Group ('Avacta') announced a fundraise of up to £64m gross, as well as the acquisition of a major in-vitro diagnostic ('IVD') distribution business. We consider the overall transaction to be transformational for Avacta, which we think will be reflected in the share price in due course.

Firstly, the fundraise. Avacta completed an equity placing this morning for approximately £7.0m gross, at a placing price of 95.0p. We believe that the funds came largely from existing shareholders in the Company, and from a small number of new investors. Simultaneously, an open offer to raise up to a further £2m from qualifying shareholders was announced, which will close in three weeks.

Additionally, Avacta announced that it is issuing a £55m convertible bond to Heights Capital Ireland ('HCI'), which is a division of the global proprietary trading group, Susquehanna International Group. It has a five-year term (maturing in October 2027), a coupon of 6.5% per annum (paid quarterly), and will be amortised over the life of the bond (20 equal payments, made quarterly). Avacta has the choice, each quarter, to make both the interest payment, and the amortisation repayment, in cash or in shares. The bond has a conversion price set at 118.75p, being a 25% premium to the equity placing price.

As we explain in more detail on pp.2-3, this is not the sort of 'death spiral finance' typically seen being offered to cash-strapped companies in the lower tiers of London's AIM market, but an institutional grade convertible bond, provided by a major, high quality investor.

In tandem with these fundraising activities, Avacta announced the acquisition of Launch Diagnostics ('Launch') for £24m cash upfront (as well as potential earn-out payments, related to COVID-19 product sales). Launch is a leading distributor of IVD products in the UK and France. The business was founded in 1990, and now distributes over 4,000 products from 31 suppliers to over 500 active customers. Headquartered in Kent, Launch has approximately 70 full-time employees. In FY 2021, it recorded adjusted EBITDA of £8.5m on revenues of £32.8m.

The acquisition marks the commencement of a new 'consolidator' strategy for Avacta Diagnostics, which will be fuelled by further M&A. The deal is transformational for the division, and lays the foundations for Avacta Diagnostics' goal of becoming a major, fully integrated IVD player in Europe.

However, whilst the acquisition of Launch is transformational for Avacta Diagnostics, we retain our view that Avacta *Therapeutics* offers the greater value upside for shareholders. Accordingly, the majority of this note is dedicated to discussing developments in the latter division – notably, the AVA6000 Phase 1a trial and the pre|CISION platform.

We consider today's news to be a hugely positive step forward for the group. It removes all funding concerns for both divisions for the foreseeable future (we estimate a cash position, post-completion of transaction, of circa £44m); it supercharges the growth prospects for Avacta Diagnostics; and it provides Avacta Therapeutics with much greater flexibility going forward, with regards to the development of its pre|CISION prodrugs.

The Transaction and Fundraise

Acquisition of Launch Diagnostics

Today, Avacta announced a fundraise of up to £64m gross, which is comprised of a £55m convertible bond, a £7m equity placing, and an open offer of up to £2m. The net proceeds will be used as a war chest for a new M&A-led strategy for the Diagnostics division, as well as for working capital for the wider group.

Avacta Diagnostics will be making its first acquisition immediately. Launch Diagnostics ('Launch'), the largest in-vitro diagnostics ('IVD') medical device distributor in the UK, is being acquired for £24m cash, up front. Avacta will also be obliged to pay the vendor a 50% share of gross margin on sales of COVID-19 test products exceeding £2m per annum for three years (capped at an aggregate £13m).

Launch was founded in 1990, and now distributes over 4,000 products from 31 suppliers to over 500 active customers. Headquartered in Kent, Launch has approximately 70 full-time employees. In FY 2021, it recorded adjusted EBITDA of £8.5m on revenues of £32.8m. However, £18.5m of that revenue total was comprised of COVID-19 test products.

Avacta's valuation of Launch is based on a 1.35x multiple of FY 2021 sales – including 100% of core sales (i.e. non-COVID-19 related business) of £14.2m, and 20% of COVID-19 product sales of £18.5m. Coincidentally, in 2019 (the last year before COVID-19 sales began) Launch recorded total revenue of £17.6m, which at 1.35x sales would also amount to a valuation of £24m.

Equity fundraise (placing and open offer) of up to £9m gross

Avacta has raised £7m via an equity placing at a price of 95.0p. It has also announced an open offer to raise up to a further £2m from existing shareholders. The open offer closes in three weeks.

Convertible bond of £55m gross from Heights Capital, a division of Susquehanna

Heights Capital Ireland ('HCI') has provided a five-year unsecured convertible bond to Avacta, with a principal amount of £55m. Avacta is to receive 95% of the principal, being £52.25m.

The bond matures in October 2027 and has a coupon of 6.5% per annum (£3.6m), paid quarterly (£0.89m).

The bond will be amortised in quarterly repayments over the five years to maturity (equating to 20 instalments of equal-sized repayments). Each quarterly repayment will amount to £2.75m.

Avacta has the decision each quarter, of paying both the £2.75m amortisation payment, and the £0.89m coupon, either in cash or in shares (the latter would be at a 10% discount to the prevailing share price).

Finally, the bond has a conversion price of 118.75p, being a 25% premium to the placing price of 95.0p. HCI can opt to convert the bond into new equity in Avacta at any point after completion of the transaction (which will be this coming Thursday). If the bond is converted in full (excluding any amortisation and coupon payments), HCI would be issued with 46.3 million new ordinary shares.

HCI is a division of Susquehanna International Group ('SIG'), the global proprietary trading firm. Founded 35 years ago and still owned and run by its co-founders, SIG is highly secretive and shuns the limelight – despite being one of the world's largest privately held financial services firms. The managing director, Jeff Yass, is one of the world's richest men, with a fortune estimated to be as high as $30bn.

SIG's bread and butter activities consist of options trading and market making, but it also has subsidiaries dedicated to private equity, venture capital and structured capital. Its Heights Capital Management division (of

which HCI is an affiliate), launched in 1996, is a private equity firm focusing on PIPE investments (private investments in public equity) in emerging growth companies. It has a particular focus on biotech and technology businesses.

The best example of Susquehanna's long-term investing capacity is its 15% stake in ByteDance, the owner of social media platform TikTok. SIG initially invested $3m into ByteDance in 2012, the year that the business was founded. With ByteDance (still privately held) now valued in the range of $300bn to $400bn, SIG's stake is worth between $45bn and $60bn.

Given the current volatility in, and dismal outlook for, global financial markets, it is unsurprising that HCI wants downside protection for such a sizeable investment, relative to the current market capitalisation of Avacta. This protection comes in the form of the debt structure. Avacta must repay the bond, and make interest payments, over a five-year period. Total annual interest payments (including the 6.5% pa coupon and the amortisation 'fee' of £2.75m, spread equally across five years) equate to a yield of 7.89% on the principal – which we consider to be highly attractive for a corporate bond provided to a loss-making junior biotech, in this environment of rapidly rising interest rates and economic gloom.

HCI pays for this downside protection in the form of a conversion price that is set at a 25% premium to the equity placing price completed today.

There are, in short, three scenarios for the outcome of the bond that existing shareholders need be mindful of:

1) In our ***base case scenario***, the mechanism of action of Avacta's pre|CISION platform is proved in man, in the next couple of months. As we detail on pp.12-15, the platform (if proved) could essentially lead to a new class of treatment for cancer, and one that has a very real possibility of being the *leading* class of treatment for many types of tumour. As such, we believe (and our opinion is that management also believes) that a significant rerating in Avacta's current valuation may be approaching.

In this base case scenario, it would be reasonable to assume that HCI will convert the entire bond into shares, at the conversion price of 118.75p, and become a major shareholder in Avacta (holding approximately 15% of the enlarged share capital).

2) In our ***bull case scenario***, HCI would *not* convert the bond immediately after positive news and a rerating of the shares, but would simply receive coupon payments and bond repayments each quarter, either in cash or in shares, at higher share prices than the conversion price. This scenario would likely only continue for several quarters at most, as quite obviously HCI would enjoy the largest monetary return by converting as many shares as possible at the lowest possible price (i.e. the remainder of the outstanding bond at the conversion price of 118.75p). The reason why HCI might not convert the bond as soon as possible, in the event of a rapidly increasing share price following positive AVA6000 P1a data, is that there would still be not inconsiderable risk in the clinical development process and in getting pre|CISION prodrugs to market. A 15% equity stake in a lossmaking junior biotech – even with world class biotechnology platforms – is a risky investment, regardless.

3) In our ***bear case scenario***, the AVA6000 P1a trial is either unsuccessful in proving the mechanism of action of the pre|CISION platform, and Avacta's share price drops below the current level; or else the mechanism of action *is* proved successfully, yet the market refuses to ascribe any increase in value to it and the share price drops anyway. In either of these cases, quarterly payments become more burdensome for Avacta, as making payments in shares (as opposed to cash) at lower share prices would dilute existing equity holders considerably more. HCI may be inclined to sell the shares that it is issued each quarter in order to recover its principal investment, which would weigh further upon the share price.

Balance Sheet, post-transaction

We assume Avacta's current net cash position (pre-transaction) was approximately £10m. Following the issuance of the £55m bond and completion of the £7m equity placing (£58m net of fees, in total), and completion of the acquisition (including payment of £24m cash to the vendor of Launch), we estimate that Avacta will have a cash balance of approximately £44m.

This does not include any of the potential proceeds that could be raised via the open offer to existing shareholders, which could be up to a further £2m.

The investors in the £7m equity placing will be issued with 7.38 million shares, or 2.8% of the enlarged share capital (excluding convertible bond and open offer shares)

In our aforementioned base case scenario in which HCI converts its bond in full, HCI would be issued with 46.3 million shares, or 15.0% of the would-be enlarged share capital of 309.0 million.

Assuming a full conversion of HCI's bond at the conversion price of 118.75p, this week's fundraise (excluding the open offer) will raise £62m gross at an average price of 115.5p. This is a premium of 11.5% to the average closing share price of 103.6p over the previous 20 trading days, prior to the announcement of the transaction.

Were Avacta not to make any further acquisitions in its Diagnostics division, and assuming both the quarterly interest and amortisation payments (totalling £3.64m) are made in newly issued shares, the current cash balance of £44m would provide working capital for the enlarged group through to end 2024.

Building an Integrated Diagnostics Business

Avacta's current Diagnostics division

Avacta's existing Diagnostics division is comprised of circa 50 staff, based in Wetherby, UK. In the several years running up to 2020, the division offered Affimer reagents to the pharma industry in a wide variety of diagnostic and research applications. It was involved in paid-for technology evaluations and custom Affimer services projects with a multitude of potential customers. Originally, the division's primary strategy was to convert these evaluations into (very high margin) licensing agreements that would deliver long-term royalties to Avacta. In early 2020, however, management realised that the average timeframe for a potential customer to carry out a thorough evaluation of the desired Affimer reagent was much longer than initially anticipated (in reality around two years). As such, in order to accelerate growth, the Diagnostics division fast-tracked the design, development and launch of an in-house, in-vitro diagnostic ('IVD') product range, powered by Avacta's proprietary Affimers. The product range was branded 'AffiDX'.

The first of Avacta Diagnostics' proprietary IVD products was the AffiDX SARS-CoV-2 Antigen Lateral Flow Test ('LFT'). Having commenced development of the LFT in April 2020 during the UK's first COVID-19 national lockdown, Avacta was able to commercially launch it in June 2021, following registration of its CE Mark in both the UK and the EU for professional use only. Subsequently, in December 2021, it became the first SARS-CoV-2 LFT to receive a CE Mark for use as a consumer self-test, again both in the UK and EU.

Unfortunately, shortly after this milestone achievement, Avacta was forced to pull the LFT from the market in January this year, as its performance in detecting the Omicron variant (that was becoming rampant across the globe in December 2021) dropped significantly in comparison to its performance in detecting other variants.

Nevertheless, the data generated in the clinical validation of Avacta's AffiDX LFT (against all variants prior to Omicron) demonstrated that it was one of the most accurate rapid antigen tests for SARS-CoV-2 in the world. This was largely as a result of the use of Avacta's proprietary Affimers in the LFT.

As part of its pivot to developing in-house products using Affimer regents, Avacta was required to secure ISO 13485 Certification. The ISO 13485 standard defines the comprehensive requirements for quality management for a developer and legal manufacturer of diagnostic products and medical devices. It is a globally recognised benchmark for quality in the medical device industry: securing it was key for Avacta Diagnostics in progressing its new strategy of in-house product development.

Based on the Company's latest communication, the next three proprietary, AffiDX-branded products that the Diagnostics division intends to launch will be diagnostic applications for stress, sepsis and anaemia, respectively.

It is important to note that even with the strategic pivot in 2020, Avacta remained a product developer, with no manufacturing or distributing capacity. The whole saga of the development of the AffiDX SARS-CoV-2 LFT – especially the difficulties in securing both manufacturing and distribution partners – brought to light the weaknesses in the revamped business model of being solely a product developer.

New M&A-led strategy to rapidly build Avacta Diagnostics into an integrated player

In September 2021, Avacta appointed a new chief operating officer, Craig Slater. He was given the task of scaling the Diagnostics business rapidly, which led to the development of a proposed merger and acquisition strategy for the division. The strategy has been in development for over a year, and the acquisition of Launch is likely to be only the beginning of Avacta Diagnostics' expansion.

The new strategy was stated in the transaction RNS today:

"*To build… an integrated IVD business with global reach that has the advantage of Avacta's proprietary Affimer platform to differentiate its immunodiagnostic products in a competitive market.*"

Beyond Launch, the team has already established a "*pipeline of potential acquisitions in the European diagnostics sector.*"

With circa £44m in the bank following the fundraise and completion of the transaction, Avacta has considerable firepower to rapidly press on with its new strategy as market consolidator in Europe.

Avacta intends to focus on immunodiagnostics and molecular diagnostics (and will avoid getting involved in large scale, yet low margin, clinical chemistry). It will focus on providing products both to professional customers, and into the consumer market.

Molecular diagnostic sales (using the massively expanded installed base of PCR machines, in the wake of the pandemic) and LFT sales will be a core focus.

Wider market conditions also make the time ripe for a consolidator strategy

In May this year, the EU's new In-Vitro Diagnostic Regulations ('EU IVDR') came into force. This has imposed strict regulatory burdens on product development, resulting in increased cost and time to market. To develop a product from scratch and bring to market could take at least two years, under the new laws. There are also new regulatory burdens for distributors of IVD products, such as Launch.

The IVD markets in the EU and the UK are fragmented, with very many small, independent players. With the EU IVDR now in force, these players are coming under increased pressure. As such, Avacta believes there is an ideal opportunity for a consolidator to move in and build out a vertically integrated IVD champion in Europe.

First acquisition: Launch Diagnostics[1]

Launch was founded in 1990. Headquartered in Longfield, Kent, it has operational hubs in Ireland, Belgium and Luxembourg, as well as warehouse facilities in the UK and logistics facilities in Norther France. Launch has approximately 70 full time employees, 60% of whom work in commercial roles, and 40% in technical positions.

The business does not develop products in-house, but operates as a distributor of products for 31 suppliers. The product range, consisting of over 4,000 items, is incredibly diverse and comprises innovative IVD devices, reagents and equipment.[2]

Launch's contracts are typically for 3-5 year terms, and often considerably longer. It boasts a repeat business rate of an extremely impressive 95%. Over the course of its 32 years of operating, it has established very strong relationships with both customers and suppliers, and its senior management team has extensive market knowledge and experience. A new managing director, selected out if this senior management team, will be taking the reins from the current MD and founder of Launch (who is retiring and selling his shareholding to Avacta).

The enlarged Avacta Diagnostics, post-transaction

Upon completion of the acquisition, Avacta Diagnostics will be transformed from solely an IVD developer, into a major developer-distributor operating in the UK and France. As the Company stated in today's RNS:

"*It would have control of key elements of the value chain from product IP to customer relationships and the Company's existing, unique Affimer platform will help differentiate its immunodiagnostic products in a competitive market.*"

[1] www.londonstockexchange.com/news-article/AVCT/proposed-acquisition-of-launch-diagnostics/15676698
(See section entitled, *Background and rationale for the acquisition of Launch Diagnostics*)
[2] www.launchdiagnostics.com/products/

We consider Launch to be an ideal first acquisition for Avacta Diagnostics' new consolidator strategy. It is a reasonably priced deal, and the business will act as a solid foundation for the accelerated build out of the enlarged Avacta Diagnostics in the UK and Northern Europe. Although we have not seen any broker forecasts, based on historical numbers we think the enlarged Avacta Diagnostics could be looking to generate free cash flow of circa £2m to £2.5m in 2023, on revenue of circa £20m.[3] We exclude any COVID-19 related sales from our estimates.

The existing Avacta Diagnostics business, which is developing a number of proprietary, Affimer-powered LFTs, will now have a leading distributor in the UK and France through which its products will become available to hundreds of active customers. In light of the very high quality of Avacta's AffiDX SARS-CoV-2 LFT (at least, prior to the emergence of the Omicron variant), we believe that the AffiDX LFT range now has a real possibility of generating very considerable value over the medium to long term.

The enlarged business is now positioned to make further bolt-on acquisitions in the UK and Europe, to further extend and enhance vertical integration.

[3] www.find-and-update.company-information.service.gov.uk/company/02427295/filing-history

Update on Avacta Therapeutics

AVA6000 update

For a detailed explanation of AVA6000 and the pre|CISION platform, please see our April 2022 note.[4]

Since April, the ongoing Phase 1a ('P1a') trial for AVA6000 – named ALS-6000-101 – has progressed extremely well. On 29 June, the Safety Data Monitoring Committee ('SDMC') recommended that the trial proceed with a second dose escalation. A third cohort ('C3') of patients was launched, with the dose increased to 160mg/m², an increase of 33.3% over the dose level of 120mg/m² used in Cohort 2 ('C2').

Only 64 days later, on 1 September, the SDMC recommended a further dose escalation of 25% to 200mg/m², and the launch of Cohort 4 ('C4'). This current dosing level is now 2.5x greater than the 80mg/m² dose used in the first cohort ('C1').

The speed at which C3 was completed was very impressive. C1 lasted for 176 days before the launch of C2; and C2 took 146 days to complete.

There are several reasons why cohort progression has been able to accelerate from C3 onwards:

i) The SDMC requires data from only two doses per patient.

ii) Patients 2 and 3 can be dosed simultaneously (whereas in C1 and C2, patient 3 could only be dosed after the SDMC was happy with the data from patient 2).

iii) Patients 2 and 3 can receive their first doses, after patient 1 has received only one dose (and successfully completed the 21 day observation period).

Taking these three points into account, we can deduce that C3 was completed in the fastest time possible, to the very day. Patients 2 and 3 received their first doses only 21 days after patient 1 received his/hers; and no patients withdrew from the cohort, or had any of their doses delayed.

From this, we can perceive that patient recruitment across the UK hospitals is now very efficient: patients were lined up to commence as soon as practicable, following the nod from the SDMC. We believe that this is the primary reason why the US hospitals have yet to come online. The existing hospitals recruiting patients in the UK are already supplying all the patients required in the P1a part of the study.

We can also perceive that there were no patient withdrawals, as was certainly the case in C1, and we also believe to be the case in C2. This provides very strong grounds for assuming that the safety and tolerability profile of AVA6000 – even at C3's dosing level of 160mg/m2, being twice that of the dose used in C1 – is exceptional.

Using this best-case scenario timeline, we estimate that C4 would complete on Thursday 3 November (being the 21st day of the observation period after the second doses of patients 2 and 3). However, it is important to stress 'best-case'. We do not know if patients 2 and 3 have even been dosed yet (let alone, when). Moreover, the patients taking part in the P1a study are extremely ill – often terminal. There are several reason why a patient that started in C4 (or any other cohort, for that matter) may withdraw from the study before completion. In this case, other patients must be sourced. That is the nature of Phase 1 oncology trials: the trial will takes as long as it takes.

Besides the two dose escalations in the P1a trial itself, there has been one other significant development for AVA6000 since April. On 5 September, Avacta announced that AVA6000 had received Orphan Drug

[4] www.aimchaos.files.wordpress.com/2022/04/avacta-group-precision-platform-3.pdf

Designation ('ODD') from the US Food and Drug Administration ('FDA') for treatment of soft tissue sarcoma ('STS').

The ODD status provides various incentives for drug developers addressing rare diseases, which are defined as conditions affecting fewer than 200,000 people each year in the US. STS falls into this category: the American Cancer Society estimates that in the US in 2022, approximately 13,190 new STS cases will be diagnosed, and about 5,130 people are expected to die of the disease.

ODD incentives include:

- Seven years of market exclusivity in the US
- Tax credits (50% of the cost of conducting human clinical trials)
- Federal research grants

Additional contact with, and support from, the FDA could also potentially facilitate a fast-track approval process for AVA6000 for STS in the US – which would of course be incredibly valuable to Avacta.

Is it working?

We attempted to answer this question in detail on pp.8-10 of our April 2022 note. To repeat the introduction:

Let us consider the question itself: is AVA6000 working? Very basically, the answer is conditional on two sets of biological reactions regarding the pre|CISION substrate component of the AVA6000 molecule.

1) The pre|CISION substrate **must not** be hydrolysed either by freely circulating FAPα in the human body, or by other enzymes closely related to FAPα. This will ensure enhanced ***safety and tolerability*** relative to standard doxorubicin, as healthy tissues will no longer be harmed by active doxorubicin.

2) The pre|CISION substrate **must** be hydrolysed by FAPα in the tumour microenvironment. This will result in **anti-tumour activity**.

If both of these are occurring, AVA6000 has a high probability of 'working' in human patients. [There are in fact several more important questions that Avacta's CEO explained recently to investors – but for the lay investor, these two are the most critical.] [5]

In the April note, we explained how the launch of C2 and the 50% increase in dose over that which was used in C1, was very strong evidence that the safety and tolerability data of AVA6000 is excellent.

This view has been validated by two further dose escalations since April (C3 and C4). Avacta's management has emphasised that it is encouraged by the safety and tolerability data, in multiple RNSs:

Neil Bell, CDO (29 June 2022): "*The recommendation from the SDMC to initiate dosing in Cohort 3 with 160mg/m2 of AVA6000 is* ***an endorsement of the emerging safety and tolerability profile*** *in the patients enrolled in this study to date.*"

Dr Alastair Smith, CEO (1 September 2022): "*We are very much encouraged by this recommendation from the SDMC to move onto the fourth dose cohort in our ongoing ALS-6000-101 Phase 1 dose escalation study.* ***This very positive progress reflects the safety profile and tolerability*** *demonstrated in patients enrolled in the study to date.*"

There is little doubt now that the patients being dosed with AVA6000 – a modified version of one of the most powerful chemotherapies on the market – are experiencing drastically reduced side effects.

With regards to the second component – *is the substrate being cleaved in the tumour microenvironment ('TME'), releasing active doxorubicin there?* – we suggested in our April note that one could *infer* that this was occurring, both through the science (see pp.9-10) and through various activities and events that had occurred (pp.10-12).

We will now add several more events and activities to that list:

- **AVA6000 is granted Orphan Drug Designation by the FDA for soft tissue sarcoma**
  This was granted on 1 September. The FDA's guidance is that any ODD request will receive a response within 90 days of submission.[6] It also guides that all data, including *clinical* data (if there are any), must be submitted in an ODD request.[7]

[5] avacta.wistia.com/medias/kv40kul5b2 (from 02:53)
[6] www.fda.gov/files/about%20fda/published/FDA%27s-Orphan-Drug-Modernization-Plan.pdf
[7] www.accessdata.fda.gov/scripts/cdrh/cfdocs/cfcfr/CFRSearch.cfm?fr=316.20

The earliest that Avacta could have submitted its ODD request to the FDA for AVA6000 targeting STS would have been in the first week of June. By that point in time, it would have been sitting on almost 10 months of clinical data.

The obvious question is: would the FDA have granted ODD, were the PK data (and possibly biopsy data) looking poor?

- **Avacta is now developing a FAPi PET imaging tool**

In the presentation at the AGM in June, management revealed that the Company is working on the development of a FAPi PET imaging system. The system will enable the identification of FAP-rich tissues, and would therefore be an ideal diagnostic tool alongside the suite of pre|CISION prodrugs.

A position emission tomography ('PET') scan is an imaging test that can be used to detect certain diseases. The scan uses a dye that contains radioactive drug, that acts as a tracer. Typically, the tracers are injected (sometimes swallowed or inhaled) into the patient's body. Certain organs and tissues then absorb the tracer. The tracer collects in areas that have high levels of metabolic or biochemical activity. A PET scanner detects the tracers – they show up as bright spots on the scan. This can be used to pinpoint the location of disease.

A FAPi PET imaging tool would work by attaching Avacta's pre|CISION substrate to the tracer molecule. This radioactive payload would be deposited and light up, only once FAPα in the TME has cleaved the attached substrate.

In June when Avacta announced this project to the market, AVA6000 had been in the clinic for over ten months. The Company would have had a very good idea (or, more likely, concrete evidence) of whether the pre|CISION substrate attached to doxorubicin in the AVA6000 molecule, was being cleaved by FAPα in the TME.

If Avacta were *not* confident that the substrate was being cleaved by FAPα as intended for the AVA6000 molecule, then it would be an extremely odd decision for the Company to proceed with the development of a diagnostic product that relied on the exact same technology.

- **Avacta's management is presenting at the IPCO Theranostics FAP Summit in November**

The International Centers for Precision Oncology ('ICPO') Foundation's "*main objective is to foster communication between patients, medical experts, industry and governments and to build an international community bringing Precision Oncology and Targeted Isotope Imaging and Therapy to growing numbers of patients worldwide*."[8]

Next month Avacta's Chief Scientific Officer, Fiona McLaughlin, is presenting the pre-clinical development data for AVA6000 at an ICPO summit dedicated to FAPα. The summit's tagline is, "*Targeting the Tumour Microenvironment and Beyond*."

Whilst Fiona's presentation will focus on the 'pre-clinical development' of AVA6000, in our view it would be quite ridiculous for Avacta to be spending time presenting this data, if the *clinical* data generated to data were not similarly positive.

[8] www.icpo.foundation/objectives/

A 'working' pre|CISION platform: a new class of therapy for cancer?

As far as we are aware, there is no other therapy in clinical development that uses FAPα as a *cleaving* mechanism. There are numerous drugs in the clinic that use FAPα as a biomarker – a target to *bind* to – but that is a very different mechanism of action to Avacta's AVA6000 and other future pre|CISION prodrugs. We detailed the mechanism of action for pre|CISION prodrugs on pp3-4 of our April note.

To appreciate the potential of the pre|CISION platform, we must first understand the closest form of competition: the antibody-drug conjugate ('ADC'). The ADC is a relatively new class of targeted cancer therapy. The first ADC was approved by the FDA in 2000; by end 2021, there were 14 approved ADCs on the market worldwide.

An ADC is comprised of three components:

i) Targeting moiety

This is the monoclonal antibody (or antibody mimetic) itself, the role of which is to localise the drug conjugate to the tumour, to deliver the drug payload (or 'warhead') specifically to cancer cells. The antibody targets a specific antigen that is overexpressed on the surface of cancer cells. The most commonly targeted antigens are the proteins, HER2, trop2, nectin4 and EGFR.

Once the ADC binds to the antigen on the surface of the cancer cell, it triggers internalization of the antibody, together with the drug payload (or 'warhead').

ii) Linker

The linker physically binds the targeting moiety to the warhead. In conventional ADCs, the linker is designed to be cut by certain enzymes *after* the drug conjugate is internalised by the cancer cell, thus releasing its warhead inside the cell. This is a similar technology to Avacta's pre|CISION substrate, in that the linker renders the warhead inert whilst it moves through the body and bypasses healthy tissue.

iii) Warhead

This is a powerful anti-cancer agent, such as a chemotherapy. It remains inactive when attached to the targeting moiety via the linker; but, once internalised and released inside the cell's cytoplasm, has a cytotoxic activity (i.e. cell-killing).

ADCs are significantly more targeted, and have a higher efficacy, than conventional chemotherapies. However, the class of therapy nevertheless comes with several major challenges:[9]

- ***Unavoidable side effects***

  Severe side effects (grade 3 or higher) are common with ADCs. The most notable are:

  i) ***blood toxicity***, including neutropenia, thrombocytopenia, leukopenia, and anaemia;

  ii) ***hepatotoxicity*** (i.e. chemical-driven liver damage);

  iii) ***gastrointestinal reaction*** (including nausea, vomiting, diarrhoea, abdominal cramps).

  These three types of side effect are all believed to be related to premature release of cytotoxic payloads in the blood circulation.

  iv) ***nephrotoxicity*** (i.e. toxicity in the kidneys). This can be caused by the immune response induced by the antibody component of the ADC.

[9] www.nature.com/articles/s41392-022-00947-7#:~:text=3%2C%20the%20target%20antigens%20of,and%20CD79b%20in%20hematological%20malignancies

v) ***interstitial lung disease ('ILD')***. Whilst it remains unclear, it has been speculated that ILD might be associated with the uptake of the ADC in healthy lung cells, and the subsequent payload release from the ADC. [The lungs enjoy abundant blood flow and long retention – more so than other organs – and as such, are more under threat from undesirable uptake of ADCs.]

- ***Drug resistance***
  ADCs target an antigen expressed on the tumour cell itself, such as HER2 expression on breast tumours. One defence mechanism that tumour cells have is that, when faced with long-term exposure to an ADC, they will reduce the expression of the antigen that the ADC targets.[10] This decrease in cell-surface antigen reduces the amount of antibody binding, and thus the amount of ADCs that are internalised.

- ***Large size causes issues with drug penetration***
  ADCs have a much greater molecular weight than traditional cytotoxic drugs such as chemotherapies. Accordingly, drug penetration into tumour cells is comparatively lower. Only a small part of ADC input into patients actually end up reaching and being internalised by tumour cells.

- ***Complex pharmacokinetic profiles***
  ADCs are highly complex drugs, being combinations of both biologics (the antibody) and cytotoxic payload. After administration of an ADC, three main forms may be present in the systemic circulation: the intact ADC, the naked antibody, and the free cytotoxic payload. This makes it difficult to establish PK and PD models, and to design new ADCs.

Despite these major challenges, the ADC class is growing rapidly, with many billions of dollars being invested into its development and commercialisation by Big Pharma. Various works of market research suggest that the global ADC market will enjoy a compound annual growth rate of as high as 25% over the next five years, to $14.4bn pa.[11]

So, how would Avacta's pre|CISION prodrugs compare? First and foremost, it must be stressed that ***no clinical data have yet been made publicly available*** by Avacta for its first prodrug in the clinic, AVA6000. Accordingly, the below is conjecture, based on the assumption that the mechanism of action of AVA6000 successfully proved in pre-clinical studies, and the accompanying extraordinary data generated in those animal models, can be replicated in human studies.

However, assuming that it *can* be… We believe that pre|CISION prodrugs would enjoy a number of key advantages over ADCs.

To address the major challenges facing ADCs, in order of the above:

- ***Unavoidable side effects***
  The exquisite specificity of the pre|CISION substrate to FAPα should dramatically reduce the probability of the severe side effects numbered i) to iii) above, that ADCs can cause. This is due to the fact that there will be a significantly lower probability of premature release of the payload (chemotherapy) in the bloodstream.

[10] e.g. in the case o HER2-overexpressing breast cancer cells: www.pubmed.ncbi.nlm.nih.gov/32248641/
[11] www.researchandmarkets.com/reports/5446216/antibody-drug-conjugates-global-market-rep
www.globenewswire.com/en/news-release/2022/07/15/2480505/0/en/Antibody-Drug-Conjugates-ADC-Market-Set-for-Promising-Growth-Forecast-to-Reach-USD-14-4-Billion-by-2027-BlueWeave-Consulting.html

With regards to the fourth side effect – toxicity in the kidneys – pre|CISION prodrugs do not have an antibody component. An accidental immune response – at least through binding of an antigen – would not be possible.

The probability of ILD occurring should also be significantly lower, again as a result of the very high specificity of the substrate to FAPα (of which there is barely a trace, on the surface of healthy lung cells).

- ***Drug resistance***
  FAPα is expressed on tumour cells in some cases, but more so on the activated fibroblasts in the tumour microenvironment. As such, mutation by tumour cells in order to reduce FAPα expression on their cell surfaces, as a defence mechanism against long-term exposure to FAP-activated pre|CISION prodrugs, will not be particularly effective. [The FAPα in the TME will remain over-expressed, and thus will cleave the substrate and release the active chemotherapy, *regardless* of FAPα reduction/mutation on the tumour cell surface itself.]

- ***Large size causes issues with drug penetration***
  Chemotherapy molecules are a small fraction of the size of ADCs. They easily enter cells via passive diffusion. Internalisation of a large protein (i.e. a monoclonal antibody) is not an issue that chemotherapies must contend with.

- ***Complex pharmacokinetic profiles***
  Chemotherapies are very well understood drugs, with years – and in some cases, decades – of real-world experience. Yes, modifying a chemotherapy with the pre|CISION substrate does increase the complexity of the PK and PD models, but with only two components (linker and warhead) in comparison to the three of an ADC, they remain much simpler molecules to design, develop, track and understand.

The pre|CISION platform may well face its own major challenges. Indeed, we reiterate that no data has yet been shared with the market by Avacta for its first prodrug, AVA6000 – except to acknowledge that three dose escalations have now occurred. From this, we can only be sure that the safety and tolerability of the drug has already been substantially enhanced, relative to standard doxorubicin.

Nevertheless, we have provided the above comparisons between ADCs and Avacta's prodrugs in order to demonstrate how a 'working' pre|CISION platform could ultimately change the face of targeted therapy for cancer.

Technically, a working pre|CISION platform would *not* be considered a new class of therapy for cancer. The mechanism of action for the cytotoxic payloads would remain unchanged. However, the modification made to standard chemotherapies via the attachment of the pre|CISION substrate would have such a profound impact, not only on the safety and tolerability profile of the drug, but also on the efficacy (as a much higher proportion of the administered prodrug would be entering into cancer cells, compared to the standard version of the drug), that we believe pre|CISION *would* be looked upon by the industry as a new type of therapy.

Overleaf, we have copied a page from our April note, to emphasise the position of power that Avacta would find itself in, ***if*** data from the AVA6000 P1a trial demonstrates not only enhanced safety and tolerability (which has already been achieved), but also activation of doxorubicin in the TME and resultant anti-tumour activity.

To summarise: in our view, the entity with control over a *working* pre|CISION platform (currently Avacta) *could* hold the power to eventually dominate the global chemotherapy market. How?

- Provided the controller of the platform had deep pockets, they could push a dozen pre|CISION prodrugs into pre-clinical and clinical development, simultaneously.

- For those drugs that were already off-patent (doxorubicin, paclitaxel, docetaxel, oxaliplatin, irinotecan, pemetrexed, gemcitabine, capecitabine), the controller could develop these prodrugs as wholly owned assets.

- For those drugs still on-patent, they could license the pre|CISION substrate to the current patent holders / brand owners of those drugs, and receive royalties on future sales; or else they could actively develop the prodrugs with those existing owners, in joint ventures.

- The route to market for pre|CISION prodrugs would be significantly faster and cheaper than it is for novel drugs such as ADCs, as they would not be required to go through Phase 3 trials (which involve many hundreds more patients than Phase 1 and 2 trials).

- The clinical development risk for pre|CISION prodrugs would similarly be significantly lower than it is for novel drugs: the mechanisms of action of the standard chemotherapies being modified are well understood already, and boast many years of clinical data. Drug efficacy is not being questioned. Rather, it is the (enhanced) delivery aspect of the prodrug that is being tested.

- Moreover, given that AVA6000 (the first prodrug that would have been brought through clinical development successfully) would have already provided the proof of concept for pre|CISION in humans, the clinical development risk of subsequent prodrugs would be reduced even further.

- Because of the licensing agreement with Bach BioSciences, no other entity would be permitted to develop pre|CISION prodrugs. During this time, each newly created prodrug could be brought to market, patented and branded by the controller of pre|CISION.

- Each prodrug would rapidly displace the competition from the market: why would any standard chemotherapy continue to be used, assuming costs were comparable?

- Not only would the controller of pre|CISION have an opportunity to dominate the existing market, but it could *multiply* the size of that existing market. Those patients who were already eligible for chemotherapy, could now enjoy a much higher maximum lifetime cumulative exposure; and those patients who were not (namely, the sick and old), could now be eligible for chemotherapy as well.

Frankly, we believe it highly improbable that Avacta will be the entity to achieve this. It does not yet have the financial resources nor the operational scale to realise that vision. However, it is possible that Avacta *could* remain independent by raising considerable cash through a combination of equity raises (a NASDAQ IPO already beckons) and out-licensing deals of pre|CISION prodrugs in the pipeline. In doing so, it could retain 100% of the majority of its assets, and start to push them into pre-clinical development.

More realistically though, it is our view that Big Pharma will be watching Avacta's AVA6000 P1a trial very closely. As we have attempted to explain in our April note, the greatest challenge – the creation of the substrate that is specific *only* to FAPα, and not to any closely related enzyme – has already been achieved. If the P1a trial provides positive data on early efficacy / anti-tumour activity, then Avacta has an extraordinarily valuable platform technology on its hands.

A platform that could revolutionise treatment efficacy *and* patient experience, multiply the target market, and reset the clocks on patents and exclusivity – and all that with a lower clinical risk, lower cost and shorter development timeline than developing novel drugs.

Analysis of Recent Developments

Today's acquisition, fundraise and newly stated M&A-led strategy has certainly come out of the blue, at least for us as shareholders. It is fair to say that the large majority of shareholders are invested in Avacta due to the blue-sky potential of its Therapeutics division, and especially due to the ongoing AVA6000 trial and the potential validation of the pre|CISION platform, in the very near term. As such, we pose the three questions that we think will be of most concern to shareholders in the immediate term, and provide our own answers.

1) Is the transaction a hedge against pre|CISION failing, or worse, a pivot before calamitous news from the AVA6000 trial?

No. We put these questions to management on the roadshow, and were told unequivocally that were anything alarming occurring in the AVA6000 P1a trial that the market was not yet aware of, such a transaction would be highly unethical – and the Nomad would not likely permit it.

[We would go one step further. We would suggest that were PK / biopsy data to materialise in the coming weeks, revealing that doxorubicin were *not* activating in the TME, then the conducting of the fundraise (whilst stating to prospective investors that all was still going well in the AVA6000 P1a trial) would arguably amount to fraud.]

It was therefore very pleasing to see management reiterate this in today's RNS:

"*Avacta's Therapeutics division* ***continues to make good progress as expected in the clinical development of AVA6000****, its first therapeutic product based on its proprietary pre|CISION technology as it progresses with the fourth cohort of patients in the phase 1 dose escalation study ALS-6000-101.*"

Shareholders must remember that whilst all the attention since the pulling of the SARS-CoV-2 LFT in January this year has been on AVA6000 and Avacta Therapeutics, there still resides considerable inherent value in Avacta's Diagnostics business. As we have attempted to explain in this note, the surest way of realising this value is through building out an integrated business through which Affimer-powered IVD products can be distributed across the globe.

In fact, as we detail overleaf, we feel that there are a numerous major benefits that today's acquisition and fundraise bring to Avacta.

2) Why now?

Many Avacta shareholders may today be questioning, "*Why did Avacta not wait until after it published Phase 1a data before raising cash? It would likely have been able to carry out a standard equity placing at a much higher share price than 95p*!"

We estimate that prior to completion of the fundraise, Avacta had a net cash balance of circa £10m. Whilst this would be sufficient to see the Company through to Mach/April next year, in the current environment it would be madness for a management team to permit cash balances to drop below a six-month runway.

This is especially the case given that the dose escalation phase of the P1 trial is ongoing. There is a reasonable possibility that P1a may continue for several more months yet. C4 may endure patient withdrawals, for example; and/or Avacta may decide to progress P1a beyond C4 into a fifth and even a sixth cohort, in its quest to find the maximum tolerated dose ('MTD').

Were either of these scenarios to occur, Avacta would be running on fumes by completion of P1a, and the market would punish the Company's share price accordingly.

Besides the necessity of increasing the Company's working capital position to ease market concerns for the foreseeable, there is the other very obvious reason for raising finance: to pay for the acquisition of Launch, and to provide a war chest for further potential M&A activity in the Diagnostics division. Avacta evidently is very keen to secure Launch. With the vendor wanting to complete on the transaction now, Avacta would not have wanted to miss out on the acquisition, because a competing predator was able to pay up before it could.

Finally, there would have been the possibility that, even were excellent AVA6000 P1a data to be announced in November/December, the share price may have spiked temporarily, then been sold off aggressively. The market would have known that Avacta would have to raise immediately on the back of P1a data, and would be ahead of the Company.

3) Why the convertible bond?

Global financial markets are currently in turmoil. For micro-cap and small-cap companies listed on public exchanges, raising a large sum of cash through a conventional equity placing – at a reasonably fair valuation (i.e. not a 20%+ discount to the prevailing share price) – is a near-impossibility. Small-cap brokers in London are presently laying off staff and considering M&A, simply to survive. [12]

Susquehanna is a very secretive organisation. As it is wholly owned by its founders and employees – and only manages the funds of its founders and employees – it is difficult to calculate its assets under management across its numerous divisions. Given that the value of its stake in ByteDance alone is valued at ~$50bn, we believe its total AUM may be in the low hundreds of billions of dollars.

Susquehanna evidently sees considerable upside potential in Avacta, given the size of the bond it is providing to the Company at relatively attractive terms.

Nevertheless, Susquehanna did not become a global player in the financial markets by not acting prudently. The AIM All-Share is down 35% YTD; the NASDAQ 100 is down 32%. The mean return YTD of the 122 companies listed on the LSE that are classified as being in the Health Care industry comes in at -41%.

A £55m gross investment in standard equity at the placing price would have resulted in HCI owning 18.1% of the enlarged share capital of Avacta. That is a difficult position to exit from in a bull market, let alone during the worst spell global equity markets have faced since the Great Financial Crisis of 2007/08.

Structuring the investment as a convertible bond gives HCI a degree of downside protection. It will receive principal repayments each quarter over the next five years, along with the 6.5% pa coupon. Nevertheless, if Avacta's share price crashes (which would likely occur in the event of the pre|CISION platform 'failing'), it would be difficult for HCI to make an attractive return on its investment.

Put simply, Susquehanna stands to benefit infinitely more, financially, were Avacta's share price to appreciate rapidly, than were it to plunge. It has the option of becoming a 15% shareholder in the Company (at an average purchase price of 118.75p) by converting the bond in full. But it will likely only exercise this option once it appears highly probable that the pre|CISION platform will become a commercial success, and once Avacta's share price has rerated substantially.

It also goes without saying that Susquehanna would have carried out extensive due diligence on Avacta, before placing this very large, calculated bet.

Retail shareholders in Avacta may be spooked by the 'convertible' nature of the bond. That is understandable, given the numerous charlatan outfits that provide 'death spiral finance' to micro-cap companies that are desperate for cash.

[12] e.g. news.sky.com/story/diamonds-panmure-gordon-plots-merger-with-listed-rival-finncap-12723327

Susquehanna certainly is no charlatan outfit. We have demonstrated in this note that it will happily hold an investment for a decade or more, without selling. [In fact, in ByteDance it has arguably held onto the best performing individual equity investment of the last decade, worldwide – and not sold.] This is a quality institutional bond, issued by a company that we believe will be pushing for midcap status in the coming years.

Finally, it is worth pointing out the following, regarding the conversion price of the bond. At the conversion price of 118.75p, Avacta would be welcoming on board a major name as a 15% cornerstone investor at only a 6% discount to the share price at the start of 2022 – a year in which many of Avacta's peers have more than halved in value, and in which Avacta itself pulled the only product in its portfolio that had the potential to generate significant revenues, from the market. Upon converting the bond, Susquehanna would be investing at a pre-new money valuation of £312m, and that for a company that had not publicly revealed *any* clinical data at the time of announcing the bond and agreeing the conversion price.

Given all of these circumstances, we feel that this deal is highly attractive for existing Avacta shareholders.

……

With those three questions answered, let us turn to the *positives* of the transaction and fundraise. We consider the combined news to be nothing short of transformational for Avacta. It bring numerous major benefits to the Company:

i) Platform in place to build a leading Diagnostics business in Europe

Launch instantly transforms Avacta Diagnostics into a £20m+ per annum revenue business. Management has identified several strategies to grow Launch in the near-term. Meanwhile the existing Avacta Diagnostics business, which is developing a number of proprietary, Affimer-based LFTs, will now have a leading distributor in the UK and France through which its products will become available to hundreds of active customers. This should accelerate the division's growth further in the medium term. More importantly, however, the transaction and fundraise mark the beginning of a buy-and-build strategy to achieve vertical integration for the division. With the bolstered cash pile, the enlarged business is well positioned to make further bolt-on acquisitions in the UK and Europe.

ii) Enhanced balance sheet removes concerns over working capital for the foreseeable future

We estimate that following completion of the acquisition and receipt of the placing and bond proceeds, Avacta will have gross cash of circa £44m. This provides a sizeable war chest for Avacta to continue with its M&A strategy in its Diagnostics division; but more importantly in our view, it provides a cash run way for Avacta to end 2024. Had Avacta not raised any capital whatsoever, and released outstanding data from the AVA6000 P1a trial in November or December, the share price would likely have fallen back quickly after an initial major spike. Cash is king in the market right now: even in the event of world-beating data, the share price would likely struggle to rally to anything even near to fair value, if the Company did not have a strong balance sheet.

Today's news has removed that concern entirely. If the P1a data is as shareholders hope, the share price will be free to run.

iii) Enhanced balance sheet provides Therapeutics division with a greater range of options

Besides an M&A war chest for the Diagnostics division and working capital for the enlarged group, the fortified balance sheet also opens up options for the Therapeutics division.

With regards to its lead clinical asset, AVA6000, the Company will now be able to fully fund Phase 1b ('P1b'), which should commence shortly after P1a completes. We estimate that this may cost in the

region of £5m. The cash injection would also enable Avacta to commence a Pivotal Phase 2 study following a successful completion of P1b, which we estimate would cost circa £20m in total.

Whilst we believe that retaining 100% control of AVA6000 up to the point of marketing approval has been Avacta' goal for some time now, we had thought that the licensing out of the second most advanced asset in the pre|CISION pipeline, AVA3996, was a distinct possibility.

With the large cash injection, Avacta now has the option of self-funding and managing the remaining pre-clinical work required for AVA3996; the submission(s) of an IND/CTA to the FDA/MHRA; and even the bringing of the drug into a P1 trial towards the next of next year – in order to retain 100% ownership.

[AVA3996 is a modified version of the proteasome inhibitor, bortezomib. Avacta has stated that not only could a successfully developed pre|CISION prodrug version of bortezomib win significant market share for the treatment of the blood cancer multiple myeloma, but that it could also be used to treat solid cancers such as pancreatic. To quote the Company from its 2021 Annual Report: "*Pancreatic cancer exhibits the highest level of FAP activity of any solid tumour and therefore a FAPa-activated drug could have significant potential in this area of high unmet need.*"

Pancreatic is one of the most aggressive and deadliest types of cancer, and is notoriously difficult to treat. For this reason, junior biotech tends to avoid it as a target. We feel that in specifically highlighting that a successfully developed AVA3996 could potentially be a treatment for *pancreatic*, Avacta is making a very bold statement about the potential of the asset and the exceptional tumour-targeting capability of the pre|CISION platform.]

Finally, the strengthened balance sheet will enable Avacta Therapeutics to accelerate the in-vitro and pre-clinical development of the next several pre|CISION prodrugs in the pipeline.

iv) Facilitates ability to formally split the business in two, at a later date

Whilst management has not openly suggested that it will happen, we believe that today marks the first step towards formally splitting Avacta Therapeutics and Avacta Diagnostics into two standalone entities. With the acquisition of Launch, Avacta Diagnostics has become a £20m+ business overnight, with a strategy to rapidly grow through both organic and acquisitive means.

A formal split would be preferable to the majority of investors (especially US-based investors), as it would both simplify the investment thesis for each business, and would (we believe) enable the market to ascribe a higher aggregate valuation to the standalone businesses. In short, we feel that such corporate action would be highly value accretive for existing holders.

In this theoretical scenario, we envisage the £55m bond remaining with AIM-listed Avacta Diagnostics, and Avacta Therapeutics raising a large sum of cash via an IPO onto NASDAQ.

v) Improves defensive capabilities, against potential takeover attempts

On the other hand, unless or until the above scenario plays out, the acquisition and bolstered balance sheet will play an important passive role in making the overall Avacta Group a more difficult target to acquire. £20m+ revenues per annum, and set to grow rapidly; the Diagnostics division on an M&A spree, to further build out its footprint; a Group cash runway for over two years; and a potential supportive cornerstone investor (holding 15% of the equity) in Susquehanna, should it convert the bond…

Avacta has just significantly enhanced its protection against a lowball bid, in the event of a hostile takeover on the back of positive AVA6000 P1a data.

Concluding Remarks

We believe that Avacta could be sitting on a platform that is akin to an entirely new class of cancer treatment, that could quite literally revolutionise the treatment of the disease. The pre|CISION platform could be proved to work in man (both enhanced safety and tolerability, *and* evidence of efficacy) within just a handful of weeks from now. This is the key reason that most shareholders are invested in Avacta.

Nevertheless, Avacta's other division, Diagnostics, holds considerable value – most notably in its global exclusive rights to use Affimers in all IVD applications until patent expiry (in the 2030s). Despite Avacta's failure to successfully commercialise any of them, its Affimer-powered COVID-19 products *did* assist in demonstrating the numerous benefits of Affimers over the industry standard, monoclonal antibodies. With a leading IVD distributor in the UK and EU now bolted on to the Diagnostics division, Avacta has an ideal conduit through which to bring its unique Affimer-powered products to market. The new M&A-led 'consolidator' strategy appears a wise move to further realise the value in the Diagnostics division.

Whilst we can envisage a scenario in which Avacta continues to build out both its divisions, becoming a major integrated player in the health care industry in the long term, we think it more probable that ultimately the two businesses will be formally split up.

With regards to the issuance of the £55m convertible bond to Susquehanna, we believe that it could either turn out to be a genius move by Avacta, or else a complete disaster for shareholders. The outcome will almost exclusively be determined by the upcoming AVA6000 P1a data, which should land before year end.

In reality, today's news boils down to this, for shareholders: does one trust Avacta's management team and board? If AVA6000 has replicated the astonishing pre-clinical data, in the P1a clinical trial, and pre|CISION is proved to work in man, then the Company's valuation is very likely set for an immense rerating. In this case, Avacta's management will indeed be lauded as geniuses. Raising £55m gross at a premium of 22% to Avacta's YTD average share price of 97.3p, and a premium of 14.7% to the average price of the past 20 sessions – in these vile market conditions – would be an extraordinary feat.

As noted above, CEO Alastair Smith *again* stated today that "*good progress as expected*" was being made in the AVA6000 P1a trial. It is reasonable to state that Avacta's (and the Board's) credibility would be irreversibly shattered, if poor AVA6000 data were published in the next two months.

We trust that Avacta's management team is *not* unethical, but on the contrary, very honourable. As an example, it pulled the AffiDX LFT from the market at the beginning of the year, when competitors with products that performed equally poorly in detecting Omicron, did not.

Thus we consider today's news to be a superb development for the group in numerous ways, and take it as yet another strong inference that the growing AVA6000 data is looking exceptional.

As always: Avacta is an early-clinical-stage biotech, developing oncology drugs. This is an exceptionally risky line of work, littered with failures. We consider the current risk/reward profile to be incredibly attractive, hence our oversized positioning in the stock. However, this does not remove the fact that Avacta remains a high risk investment.

Disclosure

The author of this paper, Myles McNulty, is a private investor. He holds shares in Avacta Group.

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