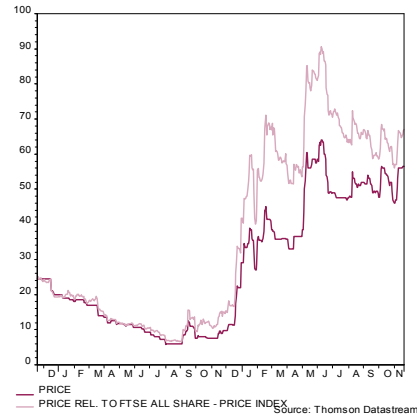


24 November 2009

**Price/Target:** 56p/100p  
**Mkt Cap:** £28m  
**Net Cash/(Debt) (FY1)** £0m



Dec	2009A	2010E	2011E
PBT	(0.5)	(0.3)	0.4
EPS (p)	(0.9)	(0.5)	0.9
DPS (p)	0.0	0.0	0.0
P/E (x)	-	-	63.2x

## FuturaGene (FGN.L)

**Buy**

### Popular poplar

**FuturaGene's could play a vital role in future energy policy. If the world is to generate power from biomass and preserve indigenous forests, it must ensure that its existing commercial plantations are as productive as possible. FuturaGene's yield-enhancing genetic technology can potentially quadruple poplar tree yields.**

### The UK's energy policy will strain the timber market

The public is increasingly aware that biofuels and bioenergy come with an environmental cost. In the last few weeks, the Times and Independent have published scathing articles about the UK's biomass energy policy. Several woodchip and coal/wood co-fired power stations are planned in the UK, which is already the world's second-largest net importer of timber.

Sceptics claim that diverting wood to power generation will push up timber prices to the detriment of other industries, and that the carbon emitted when transporting wood long distances negates the carbon saved by burning wood instead of coal. Deforestation is another topic on the environmentalist agenda: in many parts of the world, demand for timber is leading to indigenous forests being cleared to make way for commercial plantations, in many cases for oil palms, whose products are used for both food and biodiesel.

### Boosting forestry yields is a conservational imperative

Field trials show that FuturaGene's yield-enhancing genetic technology can potentially quadruple the yield of short rotation poplar plantations. We believe the company will play a vital role in the long-term development of the biofuel industry and the company is initiating a conventional poplar breeding operation to establish an early presence in this growing market.

### Valuation and recommendation

The biofuel industry will grow substantially as the world weans itself off fossil fuels, but it has proved a tricky field for investors thus far: biofuel producers have suffered margin pressure from rising feedstock costs and falling fuel prices, and plants that rely on government subsidies are vulnerable to shifts in public opinion.

FuturaGene has a stake in biofuel growth with no exposure to volatile production margins. We expect the risk discount inherent in FuturaGene's share price will diminish over the next few years, leading to dramatic returns for today's investors.

EVO Securities makes markets in FuturaGene

EVO Securities is broker and/or advisor and has in the last twelve months acted as broker and/or advisor or provided investment banking services, for which it has received compensation within the next three months

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**Philip Sparks**

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### Existing customers

FuturaGene has various partnerships in the forestry and agriculture sectors, the most advanced of which is its relationship with Suzano, the second-largest eucalyptus grower in Brazil. Suzano intends to plant trees with FuturaGene’s technology as soon as it has the necessary permits from the Brazilian authorities. FuturaGene is also working with: the largest supplier of alfalfa seeds in the US; a leading developer and supplier of seedlings for China’s forestry industry; a biotech with access to the US corn market; and one of Thailand’s largest forestry companies.

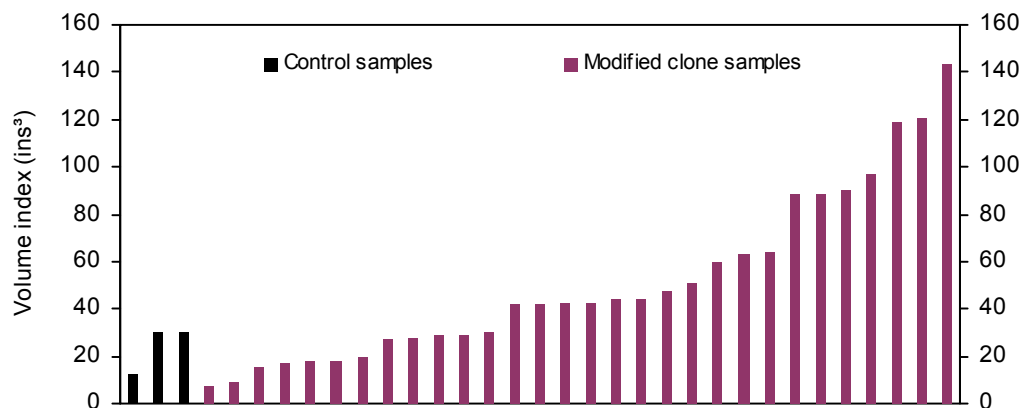
Partner	Crop	End market
Suzano	Eucalyptus	Pulp & Paper
AA Alliance	Eucalyptus	Pulp & Paper
China Academy of Forestry - RITF	Eucalyptus	Pulp & Paper
China Academy of Forestry	Poplar	Biopower & Biofuel
Forage Genetics	Alfalfa	Cattle feed
Targeted Growth	Corn	Biofuel

Source: FuturaGene

### FuturaGene’s poplar strategy

Field trials of FuturaGene’s technology applied to poplar have been extremely encouraging. The following chart shows the results of a two-year demonstration field trial of modified hybrid poplar in the USA. After two years growth, the most successful elite modified clones yielded over 4x the plant material of the unmodified control samples. Higher poplar yields will enable greater woodchip production from smaller land areas closer to the end user, thereby alleviating many of the environmental concerns about biomass generation.

#### Two-year poplar volume index field trial in the US



Source: FuturaGene

The US is eager to boost its poplar output, both as a feedstock to biomass power generators and bioethanol fuel processors. FuturaGene has initiated discussions with a potential joint venture partner about establishing a poplar operation in the US. FuturaGene intends to set up a venture with a US nursery to supply seedlings to the fast-growing US poplar industry. It has been working on poplar technology in-house and with the Hebrew University since 1997, has a development relationship with the China Academy of Forestry and has recently announced a new development agreement with Purdue University, which has received US federal matching funds.

The joint venture will produce conventionally-bred poplar varieties which have been selected for their fast growth rates. Once the US authorities have approved FuturaGene's modified poplar for deployment, the venture will sell modified seedlings. Contracts will be structured along the lines of a technology license, with plantation owners paying FuturaGene an annual royalty on the wood sales generated by the plants. Although the upside will be substantially enhanced once the modified varieties are approved for sale, the FuturaGene intends for the venture to be profitable on conventional seedlings.

One geographical market on the target list is the Mississippi delta in the US South, where grants are available to encourage reforestation. The waters of the Gulf of Mexico experience large algal blooms each year, fed by fertiliser residue that washes down the Mississippi delta. Algal blooms destroy marine life, so there is a significant advantage for the Mississippi fuel-crop industry to focus on poplar coppices instead of fertiliser-intensive corn farms.

### **Valuation and recommendation**

Industrial timber production accounts for around 2% of global GDP. This means that the value-creation potential of FuturaGene's technology should be measured in the billions of dollars, dwarfing the company's £28m market cap. The technology has a conservation value too. If, for example, the world's existing eucalyptus planters achieved a 25% yield boost instead of expanding their land holdings, it would preserve 5m hectares of indigenous forest.

FuturaGene's low share price reflects a large discount for the perceived regulatory and financing risks: FuturaGene is currently assessing its financing options, and Suzano is awaiting approval from the Brazilian authorities to deploy the world's first commercial plantation using FuturaGene plantation. We have little doubt that a fully-funded FuturaGene with regulatory approval would have a share price many times greater than 56p. The risk/reward ratio looks highly attractive, hence our Buy recommendation and 100p near-term target price.

### ***Examples of recent press coverage on the UK's biomass policy***

*The Times, November 16 2009*

<http://www.timesonline.co.uk/tol/news/environment/article6918024.ece>

*The Independent, October 25 2009*

<http://www.independent.co.uk/environment/green-living/who-says-its-green-to-burn-woodchips-1808994.html>

## Income Statement

Year to 31 Dec (GBPm)	2007A	2008A	2009E	2010E
<b>TURNOVER</b>				
Group turnover	<u>0.0</u>	<u>0.0</u>	<u>0.0</u>	<u>1.0</u>
<b>PROFIT</b>				
Group operating profit	<u>(1.6)</u>	<u>(1.6)</u>	<u>(0.5)</u>	<u>(0.3)</u>
Operating margin				
Net finance income	0.1	0.0	0.0	0.0
Reported PBT	<u>(1.5)</u>	<u>(1.6)</u>	<u>(0.5)</u>	<u>(0.3)</u>
<b>EARNINGS</b>				
Tax	0.0	0.0	0.0	0.0
Effective tax rate	0.0%	0.0%	0.0%	0.0%
Attributable profit for the year	<u>(1.5)</u>	<u>(1.6)</u>	<u>(0.5)</u>	<u>(0.3)</u>
No. of shares - period end	42.1	43.4	50.2	50.2
Average no. of shares - basic	42.1	43.4	50.2	50.2
Average no. of shares - diluted	42.1	43.4	50.2	50.2
Reported EPS - basic	(3.6p)	(3.6p)	(0.9p)	(0.5p)
Adjusted EPS - diluted	(3.6p)	(3.6p)	(0.9p)	(0.5p)

Source: EVO Securities

## Cash Flow

Year to 31 Dec (GBPm)	2007A	2008A	2009E	2010E
<b>OPERATING ACTIVITIES</b>				
Operating profit	(1.6)	(1.6)	(0.5)	(0.3)
Depreciation	0.0	0.0	0.1	0.1
Profit from fixed asset sales	(0.0)	(0.0)	(0.0)	0.0
Receivables (increase) / decrease	0.1	(0.1)	0.0	0.0
Payables increase / (decrease)	(0.1)	0.2	0.1	0.1
Interest	0.1	0.0	0.0	0.0
Tax (paid)	0.0	0.0	0.0	0.0
Cash generated by operating activities	<u>(1.5)</u>	<u>(1.5)</u>	<u>(0.3)</u>	<u>(0.1)</u>
<b>INVESTING ACTIVITIES</b>				
Purchase of property, plant and equipment	(0.0)	(0.1)	(0.1)	(0.1)
Disposal of property, plant and equipment	0.0	0.0	0.0	
Cash used in investing activities	<u>(0.0)</u>	<u>(0.1)</u>	<u>(0.1)</u>	<u>(0.1)</u>
<b>CHANGE IN NET CASH</b>				
Cash flow from continuing operations	(1.5)	(1.5)	(0.4)	(0.1)
Net change in cash and cash equivalents	<u>(1.5)</u>	<u>(1.5)</u>	<u>(0.4)</u>	<u>(0.1)</u>
Opening cash and cash equivalents	0.0	2.1	0.6	0.2
Closing cash and cash equivalents	<u>2.1</u>	<u>0.6</u>	<u>0.2</u>	<u>0.1</u>
Closing gross debt	0.0	0.0	0.0	0.0
Closing net cash	<u>2.1</u>	<u>0.6</u>	<u>0.2</u>	<u>0.1</u>

Source: EVO Securities

## Balance Sheet

Year to 31 Dec (GBPm)	2007A	2008A	2009E	2010E
<b>BALANCE SHEET SUMMARY</b>				
Property, plant and equipment	0.1	0.2	0.2	0.2
Trade receivables	0.1	0.2	0.2	0.2
Trade payables	(0.7)	(1.0)	(1.1)	(1.2)
Unadjusted capital employed	<u>(0.6)</u>	<u>(0.6)</u>	<u>(0.7)</u>	<u>(0.8)</u>
Cash and cash equivalents	2.1	0.6	0.2	0.1
Gross debt	0.0	0.0	0.0	0.0
<b>Net assets</b>	<u><b>1.5</b></u>	<u><b>(0.0)</b></u>	<u><b>(0.5)</b></u>	<u><b>(0.8)</b></u>
<b>CAPITAL AND RESERVES</b>				
Called up share capital	0.2	0.2	0.2	0.2
Share premium account	18.8	19.0	19.0	19.0
Other non-distributable reserves	2.6	2.5	2.5	2.5
Retained earnings	(20.1)	(21.7)	(22.1)	(22.4)
Total equity	<u>1.5</u>	<u>(0.0)</u>	<u>(0.5)</u>	<u>(0.8)</u>

Source: EVO Securities

## Disclosures

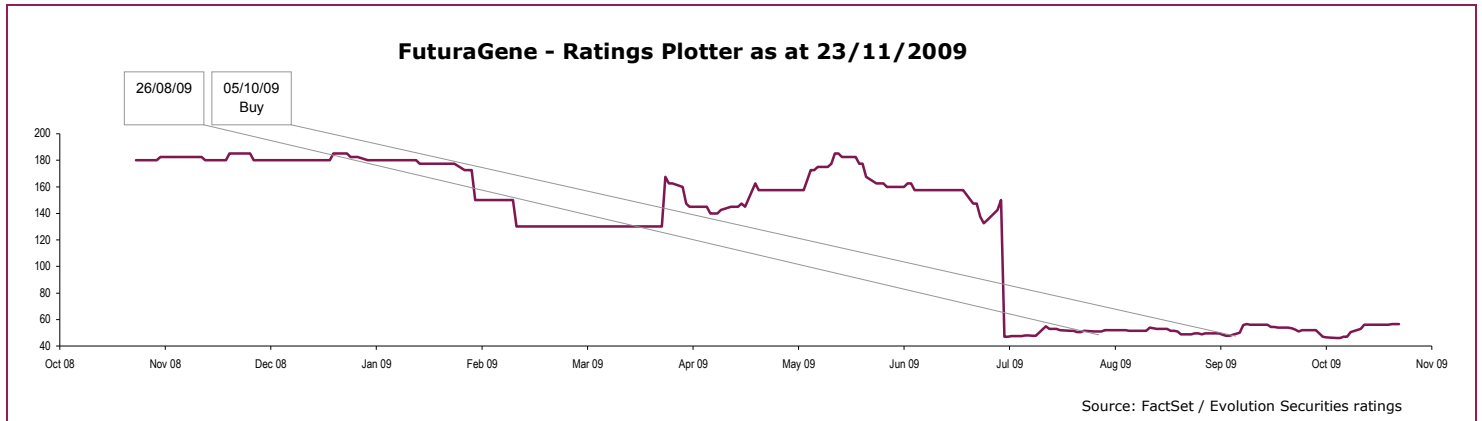
**Analyst details**

**Philip Sparks - Research Analyst**

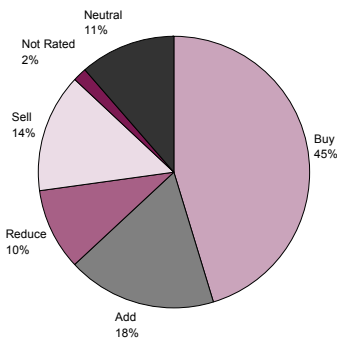
FuturaGene◆◎	OMG◆◎	Sepura◎	Imagination Technologies◎
Ashtead Group◎	Plant Health Care◆◎	Turbotec◆◎	Cohort
Billing Services Group◆◎	Prosperity Minerals◆◎	Waterman◆◎	
Henry Boot◆◎	PSPI◆◎	Ceres Power◎	
Interior Services Grp◎	ROK◎	West Pioneer Properties◆◎	

Key: ■ Analyst has financial interest, ▣ Analyst has material interest, ★ Analyst is a director, ◆ Analyst has a business interest, ♦ EVO Securities is broker and/or advisor and has in the last twelve months acted as broker and/or advisor or provided investment banking services, for which it has received compensation within the next three months, ◇ EVO Securities is no longer broker and/or advisor, but has in the last twelve months acted as broker and/or advisor or provided investment banking services, for which they have received compensation or are expecting compensation within the next three months, ◎ EVO Securities makes markets in the company, † EVO Securities has shareholdings in the Company in excess of 5%, ✖ The Company has shareholdings in Evolution Group plc in excess of 5%

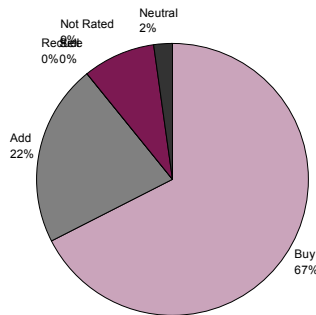
**Recommendation history chart** (for the last 12 months to previous days close)



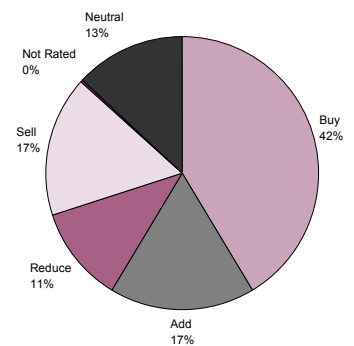
% of recommendations (all stocks)



% of recommendations (corporate stocks)



% of recommendations (non-corporate stocks)



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We have three main ratings: Buy, Neutral and Sell; and we have two intermediate ratings: Add and Reduce.

Buy is defined as a stock where we expect excess positive performance;

Sell is where we expect excess negative performance;

Neutral is where we don't expect excess performance;

Add and Reduce are where we expect positive and negative performance respectively but not excessively so.

"Excess" means more than the local relevant market adjusted for individual stock risk. If there is a conflict between the target price and the recommendation, and there may be when prices have moved significantly, the recommendation takes precedence over the price target.

Previous recommendation until 9 June 2009 was:

**Buy:** Expected to outperform the FTSE All-Share Index by 10% or more in the next 12 months

**Add:** Expected to outperform the FTSE All-Share Index by up to 10% in the next 12 months

**Reduce:** Expected to underperform the FTSE All-Share Index by up to 10% in the next 12 months

**Sell:** Expected to underperform the FTSE All-Share Index by 10% or more in the next 12 months

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