

14th January 2010

Verona Pharma*: Year End Trading Update - Buy at 15.875p with a 38.2p target price

Verona Pharma the respiratory and inflammatory diseases drug discovery and development Company has today released an end of financial year trading update which confirms that it is on track to deliver the stated business plan.

The company successfully raised £2.8 million (net of expenses) during December and this further strengthened an already strong balance sheet. We estimate the company closed the year with a net cash balance of £3.7 million, which is more than sufficient to secure the first licensing agreement (for RPL554) and actively fund the development of VRP700.

On 8 January 2010, Verona received the final quality assured study report for RPL554 from the Centre for Human Drug research at Leiden University for the phase I/IIa trial of RPL554; the company's novel asthma and allergic rhinitis (hay fever) treatment. This report further strengthens the company's hand in ongoing licensing discussions with major pharmaceutical companies with expertise in the respiratory area, particularly those with good inhalation device and formulation skills. We continue to anticipate a licensing agreement during 2010.

Development work on Verona's other compounds continues and as a result of the collaboration work with GlycoMar in the NAIPS area, four new composition of matter patents have been filed further strengthening the company's intellectual property portfolio. These novel products have been identified from a number of marine sources that have shown significant anti-inflammatory activity with clinical potential.

Meanwhile the company has prepared regulatory documents for submission to the EU, as well as national and local authorities in Italy, for a clinical proof of concept trial to commence during early 2010 for its novel cough suppression compound, VRP700. The trial, if successful, will result in a sustained programme designed to maximise VRP700's clinical value as well as to discover a new generation of compounds with similar mechanisms of action.

Key Data

EPIC	VRP
Share Price	15.875p
Spread	15.75p - 16p
NMS	10,000
Total Number of issued shares	238.747m
Market Cap	£37.9 million
12 Month Range	3.125p - 19p
Net Cash	£3.7 million (est.)
Market	AIM
Website	www.veronapharma.com
Sector	Pharmaceuticals
Contact	Clive Page Chairman 020 7863 3300

We continue to value this company on the basis of a conservative Discounted Cash Flow model, which assumes positive Stage 1-3 data and commercialisation of only one product by 2016, RPL554. However in terms of medium term revenues from the lead product, we anticipate a £10 million upfront payment and milestone payments totalling £50 million over 5 years (but these could be up to £100 million and possibly over 4 years not 5). In addition, our valuation assumes that RPL554 captures 7.5% of a £12 billion market and Verona earns an 8% royalty on those sales. Having risk weighted these assumptions at 70% to allow for the relatively early stage of development we are maintaining our estimate of Verona's Net Present Value at 38.2p.

However, we will reduce this discount rate once a partner for RPL554 is secured, which would increase materially our estimate of the NPV. Furthermore, our target price attaches little value to the other less advanced compounds within the portfolio, which could, in due course, be equally as significant.

Consequently, with the shares trading at 15.875p, and with our risk adjusted DCF target price of 38.2p, we reiterate our recommendation of **BUY**.

Forecast Table

Year to 31 December	Sales (£m)	Pre-Tax Profit (£m)	Earnings Per Share (p)	Price Earning Ratio	Dividend (p)	Yield (%)
2007A	0.00	(1.22)	(0.84)	N/A	0.0	0.0
2008A	0.00	(1.34)	(0.66)	N/A	0.0	0.0
2009E	0.00	(1.48)	(0.68)	N/A	0.0	0.0
2010E	10.00	8.54	3.58	4.4	0.0	0.0

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