

ViroPharma

Biotechnology
U.S.
June 6, 2008

First Call Note

HOLD

Current Price
\$10.99

Target Price
\$11.70
(Previous: \$10.00)

Market capitalization
\$926.5 million

Shares outstanding
84.3 million

12-month high/low
\$15.00/\$7.11

Reuters VPHM.O
Bloomberg VPHM
NBI 832.40

VPHM: Improving Pipeline Outlook, But Facing Major Near-Term Binary Event; Raising Target Price To \$11.70, Downgrading To Hold

■ ViroPharma reported a number of data points in the past week, prompting us to review our thesis on the stock. On the positive side, enrollment completed in the Phase 3 Camvia (maribavir) trial for stem cell transplantation (SCT). We believe ViroPharma is on target to finish this registration trial in November. Additionally, the company published positive findings from its Phase 2 Camvia SCT trial in the journal *Blood* (top-line data was previously presented at the ASH 2006 meeting); Camvia significantly lowered CMV re-infection rates compared to placebo (Placebo: 57%; Camvia: 15% [100mg twice a day, p=0.001], 30% [400mg once a day, p=0.051], 15% [400mg twice a day, p=0.002]). Furthermore, three (11%) placebo patients developed CMV disease compared to no Camvia patients. This data improves our assessment on Camvia's prospect. Since the Phase 3 trial is utilizing a successful dose (100mg twice a day), we believe the chance of success has a good basis. Consequently, we raise our assigned valuation of Camvia from \$200 million to \$350 million, roughly in line with the value of a Phase 3 product near developmental completion and with a good chance of success.

■ On the negative side, FDA has scheduled a meeting of the Advisory Committee for Pharmaceutical Science and Clinical Pharmacology for July 23, during which a key point of discussion will likely be the approval pathway of generic drugs where the branded drug is not absorbed. We believe this will have key implications for the approvability of generic Vancocin. While we cannot rule out the meeting ends up being a non-binding pontification, it is possible the FDA may use the panel as a cover, with the intention to approve a generic drug. This could become a binary event, with an unfavorable recommendation leading to substantial downside potential to ViroPharma's stock, especially considering the recent run-up of the stock. The stock has recently decoupled from the company's cash level at which it previously traded. In our view, the risk/reward balance is now different compared to before because of this upcoming binary event. **Therefore, we take a cautious stance and downgrade the stock to Hold from Buy.**

■ We do want to point out several potential positives: 1) if generics do not enter the market, ViroPharma stands to add about \$20 million/quarter to its balance sheet, which should accordingly be reflected in its valuation; 2) if ViroPharma acquires a meaningful product, the stock may increase significantly; and 3) if Camvia succeeds by year-end 2008, the stock may rise further, in our view. We may revisit our thesis again after the FDA advisory panel meeting on July 23.

■ Assuming no generic entrance in 1H08, the cash balance should grow to approximately \$640 million. Including \$350 million as value for Camvia, we arrive at a total value of \$990 million, which when fully diluted results in our new price target of \$11.70, up from \$10.00.

YEAR-END DEC	EPS (\$)	P/E (x)	DIVIDEND (\$)	YIELD (%)
2006A	0.95	11.6	NA	NA
2007A	1.21	9.1	NA	NA
2008E	0.92	11.9	NA	NA
2009E	1.06	10.4	NA	NA

Note: EPS are non-GAAP.

Alex To., M.D.
Senior Biotech Analyst
212-698-3146

VALUATION

Assuming no generic entrance in 1H08, the cash balance should grow to approximately \$640 million. Including \$350 million as value for Camvia, we arrive at a total value of \$990 million, which when fully diluted results in our new price target of \$11.70, up from \$10.00.

RISK

The FDA may approve generic oral vancomycin based on the proposed *in vitro* requirement for bioequivalence, potentially opening the market to greater Vancocin competition.

As in any drug in development, Camvia may not meet Phase 3 endpoints.

Camvia may not be well received in a transplant market that already has Valcyte and Cytogam.

ViroPharma may not succeed in acquiring or in-licensing other drugs, or it may acquire or in-license drugs that are unlikely to succeed in clinical development and/or the market, leading to poor market reception as reflected in its stock price. It may also overpay for such acquisitions.

A total of \$250 million of the cash on ViroPharma's balance sheet is in convertible debt, which carries a very favorable coupon (2%). If there are any events that can be construed as material changes in ViroPharma's corporate structure, convertible bond holders may elect to redeem the bonds before their 2017 maturity date. ViroPharma's cash balance could be lowered and working capital can diminish.

At any given time, the following risks could affect our valuation of the subject company:

Clinical: Failures of late-stage and early-stage products and delays in clinical development could occur. Uncertainty regarding the timing, efficacy, and safety aspect of new products and long-term safety issues could emerge after approval.

Competition, new health treatments: Newer, better products could displace existing drugs. More knowledge about a disease could make a drug less used. A firm could be out-marketed by rivals. Generic competition and pricing pressure could erode prices and margins. New developments in health treatments or new non-diagnostic products could reduce or eliminate demand for a product.

Environmental: Changes in environmental regulations, stringent environmental laws, and potential exposure to environmental liabilities could have a negative effect.

Litigation: Outcomes of intellectual property litigation could cause product sales to be halted — these lawsuits are common in the healthcare industry. Third parties may claim that products that a company has sought FDA approval to market or is currently marketing may infringe on the third parties' proprietary rights and patents.

Management/financial: A company could be adversely affected by inability to control costs, management's lack of experience, the discontinuation of partnerships, continued financial losses, insufficient capital to fund its clinical pipeline, inability to raise additional capital or favorable terms, the influence of large shareholders, and disruptions in connection with changes to executive management and board membership.

Manufacturing: Manufacturing controls may be weak, and manufacturing licenses could become suspended. If the current Good Manufacturing Practices are not maintained, the FDA could refuse to approve marketing applications.

Marketing/R&D: The timing of R&D milestones, failure to successfully commercialize early-stage drug candidates, and limited marketing infrastructure could affect sales.

Patents: A generic could enter the market through natural patent expiry or a loss of a challenged patent in the courts. A company could be unsuccessful in protecting intellectual property and proprietary rights. The government could change patent laws at any time.

Payer: Insurance companies and the government may not pay for a company's product. The success of many products depends on Medicare reimbursement. Should any changes occur in Medicare reimbursement codes, product sales could be affected.

Pipeline: There is no guarantee that any investigational product will make it through the regulatory process. A company could have insufficient capital to fund its clinical pipeline.

Product launch hiccups: Risks associated with a new product launch include higher than expected costs, lower than expected sales/overestimated demand for products, and lack of customer acceptance. There could also be limited uptake due to patient non-compliance.

Product liability: All products have side effects, and companies are often liable for damage due to side effects, which may emerge after approval. Product liability claims are possible related to the testing, manufacturing, marketing, and use of a company's products.

Product withdrawal: Unforeseen side effects could cause drugs to be pulled from the market.

Regulatory: The FDA may not approve a product, manufacturing, or an indication, and can change a product's label. The government may not like a firm's marketing practices and penalize it. Manufacturing sites could be deemed unsuitable. Legislative or regulatory reform of the healthcare system and drug industry could affect the ability to sell products profitably.

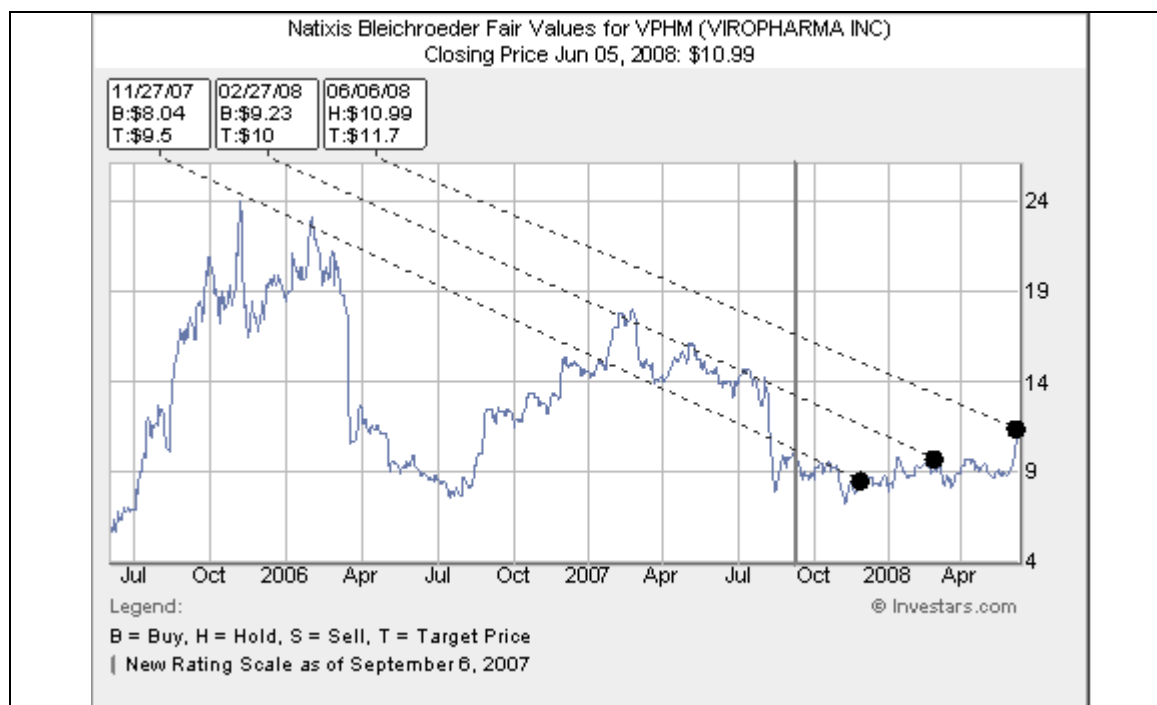
Third-party manufacturers: Companies without manufacturing facilities may have to rely on contract manufacturers to manufacture their products and product candidates for clinical trials and commercial sales. These relationships may be difficult to build and maintain.

INCOME STATEMENT (\$ MILLION, EXCEPT EPS)

				2008					2009							
	2005A	2006A	2007A	Q1A	Q2E	Q3E	Q4E	2008E	Q1E	Q2E	Q3E	Q4E	2009E	2010E	2011E	2012E
Revenues																
Net Vancocin sales	125.85	166.62	203.77	50.94	59.60	48.87	49.36	208.76	60.41	65.25	58.72	62.83	247.22	300.70	351.50	387.69
Net Camvia sales	—	—	—	—	—	—	—	—	—	—	—	—	—	7.71	20.11	30.42
Milestone, license, and other revenue	6.56	0.56	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00
Total revenues	\$132.42	\$167.18	\$203.77	\$50.94	\$59.60	\$48.87	\$49.36	\$208.76	\$60.41	\$65.25	\$58.72	\$62.83	\$247.22	\$308.41	\$371.61	\$418.11
Costs and Expenses																
Cost of sales	18.03	18.98	8.93	1.92	2.68	2.12	2.24	8.96	2.38	2.52	2.67	2.83	10.40	13.17	16.68	21.12
Research and development	10.61	19.16	35.87	14.97	12.52	12.71	13.08	53.27	13.09	13.74	14.43	15.15	56.41	68.81	83.92	102.25
Marketing, general and administrative	10.48	24.56	37.05	12.85	12.52	12.71	13.92	51.99	15.03	15.03	16.24	17.54	63.84	85.62	110.14	147.59
Intangible amortization and acquisition of technology rights	5.16	5.67	6.12	1.69	1.74	1.79	1.84	7.06	1.90	1.96	2.02	2.08	7.95	8.95	10.07	11.33
Total costs and expenses	\$44.27	\$68.38	\$87.97	\$31.42	\$29.45	\$29.32	\$31.08	\$121.27	\$32.40	\$33.25	\$35.35	\$37.60	\$138.60	\$176.55	\$220.82	\$282.29
Operating income (loss)	\$88.15	\$98.81	\$115.80	\$19.52	\$30.15	\$19.55	\$18.27	\$87.49	\$28.01	\$32.00	\$23.37	\$25.24	\$108.62	\$131.86	\$150.79	\$135.82
Other Income (Expense)																
Interest income	2.01	9.85	24.27	6.31	6.34	6.69	7.04	26.38	7.39	7.74	8.09	8.44	31.66	37.26	42.86	48.46
Interest expense	(11.30)	(0.69)	(4.40)	(1.42)	(1.42)	(1.42)	(1.42)	(5.68)	(1.42)	(1.42)	(1.42)	(1.42)	(5.68)	(5.68)	(5.68)	(5.68)
Income (loss) before income tax expense (benefit)	75.90	108.53	135.67	24.41	35.07	24.82	23.89	108.19	33.98	38.32	30.04	32.26	134.60	163.45	187.98	178.60
Income tax expense (benefit)	-37.81	41.86	40.31	6.96	9.82	6.95	6.69	30.42	11.55	13.03	10.21	10.97	45.76	55.57	63.91	60.72
Net income (loss)	\$113.71	\$66.67	\$95.35	\$17.45	\$25.25	\$17.87	\$17.20	\$77.77	\$22.43	\$25.29	\$19.83	\$21.29	\$88.84	\$107.88	\$124.07	\$117.88
Shares used in computing net income (loss) per share, Diluted	57.61	70.34	80.89	84.27	84.44	84.61	84.78	84.53	83.90	83.90	83.90	83.90	83.90	83.90	83.90	83.90
Net income (loss) per share, Diluted	\$2.02	\$0.95	\$1.21	\$0.22	\$0.30	\$0.21	\$0.20	\$0.92	\$0.27	\$0.30	\$0.24	\$0.25	\$1.06	\$1.29	\$1.48	\$1.40

Source: Company data, Natixis Bleichroeder Inc. estimates

TARGET PRICE HISTORY



Full reports of covered companies are available on request.

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NBI RATING DEFINITIONS	% OF STOCKS COVERED	% IB SERVICES
BUY: potential return is >15% above the current price	64%	17%
HOLD: potential return is -15% to +15% of the current price	31%	5%
SELL: potential return is >15% below the current price	5%	0%

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[CONTINUED FROM BACK PAGE]

Healthcare

Dr. Ashim Anand	Medical Devices, U.S.	ashim.anand@blr.natixis.com	1-212-698-3141
Jim Chen	Biotechnology, U.S.	jim.chen@blr.natixis.com	1-212-698-3168
Dr. Corey Davis	Specialty Pharmaceuticals, U.S.	corey.davis@blr.natixis.com	1-212-698-3153
Uy Ear	Specialty Pharmaceuticals, U.S.	uy.ear@blr.natixis.com	1-212-698-3149
Sylvain Goyon	Pharmaceuticals, Europe	sylvain.goyon@sec.natixis.com	33-1-58-55-0462
Philippe Lanone	Pharmaceuticals, Europe	philippe.lanone@sec.natixis.com	33-1-58-55-0503
Jon LeCroy, M.D.	Pharmaceuticals, Biotechnology, U.S.	jon.lecroy@blr.natixis.com	1-212-698-3185
Oren Livnat	Specialty Pharmaceuticals, U.S.	oren.livnat@blr.natixis.com	1-212-698-3182
Sébastien Malafosse	Pharmaceuticals, Europe	sebastien.malafosse@sec.natixis.com	33-1-58-55-8460
Cédric Moreau	Pharma, Healthcare Services and Equipment, Europe	cedric.moreau@sec.natixis.com	33-1-58-55-0360
Béatrice Muzard	Pharmaceuticals, Europe	beatrice.muzard@sec.natixis.com	33-1-58-55-0513
Hugo Ong	Biotechnology, U.S.	hugo.ong@blr.natixis.com	1-212-698-3167
Ethan Roth	Medical Devices, U.S.	ethan.roth@blr.natixis.com	1-212-698-3195
Stephen B. Shankman	Healthcare Services, U.S.	stephen.shankman@blr.natixis.com	1-212-698-3148
Alex To, M.D.	Biotechnology, U.S.	alex.to@blr.natixis.com	1-212-698-3146
Katherine Wearne	Pharmaceuticals, Biotechnology, U.S.	katherine.wearne@blr.natixis.com	1-212-698-3151
Joshua Zable	Medical Devices, U.S.	joshua.zable@blr.natixis.com	1-212-698-3147

Hotels and Tourism, Catering, Leisure Supplies

Geoffrey d'Halluin	Hotels and Tourism, Europe	geoffrey.dhalluin@sec.natixis.com	33-1-58-55-0536
Sarah Emsellem	Hotels and Tourism, Leisure Supplies, Europe	sarah.emsellem@sec.natixis.com	33-1-58-55-0362
André Juillard	Hotels and Tourism, Catering, Europe	andre.juillard@sec.natixis.com	33-1-58-55-0547

Industrials, Chemicals and Gases, Delivery Services

Clément Célérier	Chemicals and Gases, Europe	clement.celerier@sec.natixis.com	33-1-58-55-0506
Bernard Foglino	Delivery Services, Europe	bernard.foglino@sec.natixis.com	33-1-58-55-9093

Information Technology Services, Software

Richard Maxime Beaudoux	Software, IT Services, Europe	richard-maxime.beaudoux@sec.natixis.com	33-1-58-55-0348
Gwénaél Giard	Software, IT Services, Europe	gwénael.giard@sec.natixis.com	33-1-58-55-0496
Thomas le Quang	Software, IT Services, Europe	thomas.lequang@sec.natixis.com	33-1-58-55-3762

Luxury Goods, Cosmetics and Personal Care

Shamina Bhaidjy	Luxury Goods, Cosmetics and Personal Care, Europe	shamina.bhaidjy@sec.natixis.com	33-1-58-55-0491
Tamare Evren	Luxury Goods, Europe	tamare.evren@sec.natixis.com	33-1-58-55-0545
Loïc Morvan	Luxury Goods, Cosmetics and Personal Care, Europe	loic.morvan@sec.natixis.com	33-1-58-55-9691

Media and Entertainment

Johann Choux	Publishing, Support Services, Other Media, Europe	johann.choux@sec.natixis.com	33-1-58-55-0457
Chris Ferris	Media and Entertainment, U.S.	chris.ferris@blr.natixis.com	1-212-698-3478
Alan Gould, CFA	Media and Entertainment, U.S.	alan.gould@blr.natixis.com	1-212-698-3158
Richard Houbbron	Advertising, Publishing, Other Media, Europe	richard.houbbron@sec.natixis.com	33-1-58-55-0502
Mathieu Mouly	Radio and TV, Europe	mathieu.mouly@sec.natixis.com	33-1-58-55-0626
Charlotte Ruelland	Radio and TV, Europe	charlotte.ruelland@sec.natixis.com	33-1-58-55-0523
Jeffrey Shelton, CFA	Media and Entertainment, U.S.	jeffrey.shelton@blr.natixis.com	1-212-698-3152

Telecommunications Equipment and Services, Electronic Equipment, Semiconductors

Eric Beaudet	Telecommunication Services, Europe	eric.beaudet@sec.natixis.com	33-1-58-55-0537
Jacques de Greling	Telecommunication Services, Europe	jacques.degreling@sec.natixis.com	33-1-58-55-0483
Stéphane Houré	Semiconductors, Europe	stephane.houri@sec.natixis.com	33-1-58-55-0365
Franck Maccary	Telecom Equipment, Europe	franck.maccary@sec.natixis.com	33-1-58-55-0507
Benoît Maynard	Telecommunication Services, Europe	benoit.maynard@sec.natixis.com	33-1-58-55-0511
Gilbert Soubie	Semiconductors, Europe	gilbert.soubie@sec.natixis.com	33-1-58-55-0366

Technical and Graphical Analysis

Eckart Mildenstein	Graphical Equity Market Analysis	eckart.mildenstein@blr.natixis.com	1-530-756-8682
John Roque	Technical Analysis, U.S.	john.roque@blr.natixis.com	1-212-698-3065
Adolfo Rueda, CMT	Technical Analysis, U.S.	adolfo.rueda@blr.natixis.com	1-212-698-3482

TRANSATLANTIC EQUITY RESEARCH

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Aerospace/Defense

Olivier Brochet	Aerospace/Defense	olivier.brochet@sec.natixis.com	33-1-58-55-9038
Antoine de Montille	Aerospace/Defense	antoine.montille@sec.natixis.com	33-1-58-55-9659

Automotive

Alexis Albert	Automotive Components, Truck Makers, Europe	alexis.albert@sec.natixis.com	33-1-58-55-0459
Georges Dieng	Automotive Components, Car Makers, Europe	georges.dieng@sec.natixis.com	33-1-58-55-0534
Michael Foundoukidis	Automotive Components, Car Makers, Europe	michael.foundoukidis@sec.natixis.com	33-1-58-55-0492

Banking, Insurance, Financial Services, REITs

Guy Akouvi	Insurance, Europe	guy.akouvi@sec.natixis.com	33-1-58-55-0634
Pascale Decque	Banks, Northern and Southern Europe	pascale.decque@sec.natixis.com	33-1-58-55-0485
Alex Koagne	Banks, Northern and Southern Europe	alex.koagne@sec.natixis.com	33-1-58-55-0439
Sébastien Lemaire	Banks, Northern and Southern Europe	sebastien.lemaire@sec.natixis.com	33-1-58-55-0632
Christophe Ricetti	Banks, Northern and Southern Europe	christophe.ricetti@sec.natixis.com	33-1-58-55-0522
Benoît Valleaux	Insurance, Europe	benoit.valleaux@sec.natixis.com	33-1-58-55-9680
Elisabeth Zrihen	Insurance, Europe	elisabetht.zrihen@sec.natixis.com	33-1-58-55-0426

Construction & Concessions, Real Estate

Marlène Benon	Real Estate, Europe	marlene.benon@sec.natixis.com	33-1-58-55-0539
Athmane Benzerroug	Construction & Concessions, Europe	athmane.benzerroug@sec.natixis.com	33-1-58-55-0541
Charles Cuny	Real Estate, Europe	charles.cuny@sec.natixis.com	33-1-58-55-9641
Rafic El Haddad	Building Materials, Europe	rafic.elhaddad@sec.natixis.com	33-1-58-55-0489
Bernard Foglino	Support Services, Europe	bernard.foglino@sec.natixis.com	33-1-58-55-9093
Grégoire Thibault	Construction & Concessions, Europe	gregoire.thibault@sec.natixis.com	33-1-58-55-6608

Consumer Goods, Retailing

Pierre-Edouard Boudot	Food Retailing, Europe	pierre-edouard.boudot@sec.natixis.com	33-1-58-55-0524
Boris Bourdet	Non Food Retailing, Europe	boris.bourdet@sec.natixis.com	33-1-58-55-0508
Claudie Casimir	Food Retailing, Europe	claudie.casimir@sec.natixis.com	33-1-58-55-0339
Olivier Lebrun	Consumer Goods, Europe	olivier.lebrun@sec.natixis.com	33-1-58-55-9171

Energy, Commodities, Utilities

Julie Arav	Utilities, Europe	Julie.arav@sec.natixis.com	33-1-58-55-0705
Céline Chérubin	Utilities, Europe	celine.cherubin@sec.natixis.com	33-1-58-55-0633
Cyril Francin	Utilities, Europe	cyril.francin@sec.natixis.com	33-1-58-55-0363
Julien Laurent	Energy Equipment and Services, Europe	julien.laurent@sec.natixis.com	33-1-58-55-0538
Baptiste Lebacq	Oil, Energy Equipment and Services, Europe	baptiste.lebacq@sec.natixis.com	33-1-58-55-9102
Catherine Leveau	Oil, Energy Equipment and Services, Europe	catherine.leveau@sec.natixis.com	33-1-58-55-0505
Houston Netherland	Exploration and Production, U.S.	houston.netherland@blr.natixis.com	1-713-751-1637
Philippe Ourpatian	Utilities, Europe	philippe.ourpatian@sec.natixis.com	33-1-58-55-0516
Anne Pumir	Oil, Energy Equipment and Services, Europe	anne.pumir@sec.natixis.com	33-1-58-55-0520
Roger Read, CPA	Oil Services, U.S.	roger.read@blr.natixis.com	1-713-751-1632
Sunil Sibal	Coal, U.S.	sunil.sibal@blr.natixis.com	1-212-698-3179
Jeffrey Spittel	Oil Services, U.S.	jeffrey.spittel@blr.natixis.com	1-713-751-1652
Jeremy Sussman	Coal, U.S.	jeremy.sussman@blr.natixis.com	1-212-698-3295
Curtis Trimble	Exploration and Production, U.S.	curtis.trimble@blr.natixis.com	1-713-751-1638

Electrical Equipment

Ludovic Debailleux	Electrical Equipment, Europe	ludovic.debailleux@sec.natixis.com	33-1-58-55-0685
Arnaud Schmit	Electrical Equipment, Europe	arnaud.schmit@sec.natixis.com	33-1-58-55-9685

Food and Beverage, Tobacco

Joséphine Chevallier	Beverages, Other Consumer Goods, Europe	josephine.chevallier@sec.natixis.com	33-1-58-55-9655
François Digard	Food, Europe	francois.digard@sec.natixis.com	33-1-58-55-0340
Alison Donohoe	Beverages, Europe	alison.donohoe@sec.natixis.com	33-1-58-55-0447
Virginia Heeribout	Tobacco, Other Consumer Goods, Europe	virginia.heeribout@sec.natixis.com	33-1-58-55-0499
Orianne Segaud	Tobacco, Other Consumer Goods, Europe	orianne.segaut@sec.natixis.com	33-1-58-55-0095

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