

## Universal Biosensors Inc

### Strong results underpinned by Blood Glucose growth

For CY16, Operating Profit increased by 14.8% (\$2.3m) to \$17.7m and \$5.0m in EBIT to \$3.8m, on a 27.1% increase in Revenue to \$18.8m, driven by:

- A 56% increase in Verio strip sales to 4.46b strips, with a 39.2% increase in QSFs to \$17.9m. This followed an increased marketing push and new meters, despite a short term supply disruption at LifeScan in Q3 CY16. This was partly offset by a \$0.7m fall in strip sales to Siemens to \$0.6m.
- A \$3.9.0m (19.7%) reduction in R&D to \$15.9m and a \$0.5m fall in Corporate Costs to \$5.5m, partly funded an expected R&D Cash Rebate of \$7.6m.
- A \$1.3m improvement in Operating Cash Flow to \$22.9m, boosted by a Cash R&D Rebate of \$9.4m (relating to CY15) and Siemens Pre-paid Milestones of \$5.1m (US\$3.8m). Net Cash Flow increased by \$9.0m to \$6.0m.
- A strong Balance Sheet, with Gross Cash of \$20.4m and Net Debt of \$0.3m.

### Strong growth to continue in CY17

- Strong growth in LifeScan QSFs is expected to around \$27.9m, with rising market share, intense marketing, meter replacement and competitive advantage with legislative requirements for accuracy.
- An expected lump sum payment of around \$61.3m from LifeScan with the exercise of its QSF buyback option in Mid-CY17.
- Increasing sales of blood coagulation strips in CY17, with the launch of the Xprecia Stride in the USA in Q1 CY17 and increased marketing in the EU and other key non-USA markets, using Siemens' extensive distribution.
- Strong Cash Flow, with improving Revenue, control of costs and a further Cash R&D Rebate of around \$7.6m.

### What's UBI worth?

We take a conservative approach, assuming exercise of the LifeScan option at the first opportunity (Q2 CY17), resulting in a DCF Valuation of \$0.69 ps, comprising:

**Blood Glucose** – DCF Valuation of A\$84.9m (48¢ ps), based on Operational Cash Flow for CY17 of around A\$27.9m (US\$21.0m), plus at least a CY17 A\$61.3m (US\$46.3m) Lump Sum payment (payable within 60 days of year-end).

**Blood Coagulation** – A combined DCF of A\$98.8m (56¢ ps), covering all Siemens and UBI tests.

**R&D & Corporate Costs** – A combined DCF of -\$64.3m (-37¢ ps) with R&D to the launch of the Blood Coagulation tests in CY18, plus ongoing corporate costs.

**Other** – Net Debt/Cash, Working Capital and Current Assets of \$3.7m (2¢ ps).

If the LifeScan QSF's Option is not exercised in CY17, there would be a substantial increase in the Valuation, with our DCF valuations ranging up to \$2.05 ps.

### Forecasts

We now expect an EBIT for CY17 of \$7.6m, plus a lump sum payment to UBI of around A\$61.3m (34.8¢ ps) relating to the exercise of the LifeScan option. For FY18, EBIT will fall to -\$3.3m in the absence of QSFs, before reverting to Profits in CY19 onwards, with escalating Blood Coagulation Revenue.

### Recommendation

Buy, based on a substantial discount to our Valuation of \$0.69 ps, and:

**Short Term Gain** - The possibility of a substantial windfall Profit of \$61m within 15 Months, with an even stronger fall-back position.

**Growth Markets** – Leading edge technology, a strong IP position in large rapid-growth Healthcare sectors and key relationship with global healthcare groups.

**Resources** – A modern approved plant meeting future capacity requirements.

## UBI.ASX BUY

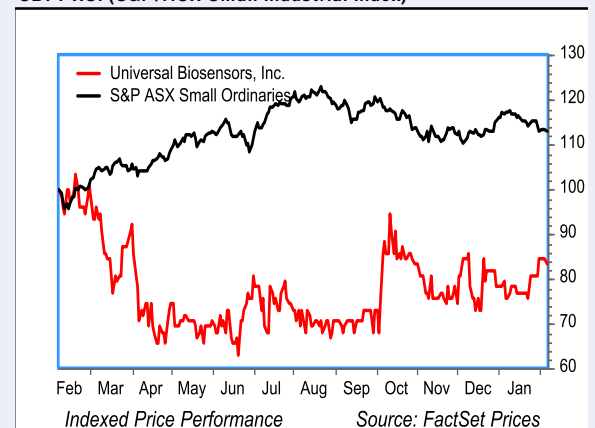
13 February 2017

<b>Price</b>	<b>\$0.32</b>
<b>12 Month Price Target</b>	<b>\$0.68</b>
<b>Valuation</b>	<b>\$0.68</b>
Valuation method	DCF
GICS sector	Financials
12 Mth Price Range	\$0.24 - 0.42
Avg monthly t/o	2.5m
Market Capitalisation	\$56m
Shares on issue	176m
Options on Issue	20m
Enterprise value	\$50m

**Previous rating BUY**

Year Ended Dec 31	14A	15E	16E	17E	18E
Revenue	\$m 9.5	16.8	18.8	92.6	13.6
EBIT	\$m -3.9	-1.2	3.8	69.0	-3.3
EBIT Growth	% -66.0	-69.6	-427.4	na	-104.8
EBIT margin	% -40	-7.0	20.4	74.6	-24.2
NPAT	\$m -7.2	-5.2	1.3	66.0	2.4
Reported Profit	\$m -9.3	-6.6	1.3	66.0	2.4
EPS	¢ ps -4.1	-2.9	0.7	37.5	1.4
DPS	¢ ps 0.0	0.0	0.0	0.0	0.0
Franking	% 0.0	0.0	0.0	0.0	0.0
PER	x -4.2	-14.9	43.7	0.9	23.1
DPS	¢ ps 0.0	0.0	0.0	0.0	0.0
Dividend yield	% 0.0	0.0	0.0	0.0	1.0
NTA/share	¢ ps 11.6	7.8	8.6	46.0	47.4
EV/EBITDA	x -15.3	50.2	9.2	0.7	11.4
Gearing (D:E)	% 8.2	42.3	1.7	0.0	0.0
P/OCF	x -5.5	42.2	7.7	4.8	-25.8
R&D	\$m -17.1	-19.8	-15.9	-16.0	-13.0
R&D / Revenue	% 220.3	133.4	84.3	51.1	172.7
ROA	% -7.5	-2.5	8.1	84.8	-3.2
ROE	% -28.7	-30.3	8.7	137.3	3.0
Interest cover	x -1.6	-0.4	1.4	23.0	-14.1

UBI v XSI (S&P/ASX Small Industrial Index)



### Activities

Development & commercialisation of medical diagnostic devices, especially for point of care in vitro tests.

[www.universalbiosensors.com](http://www.universalbiosensors.com)

**Brent Mitchell (03) 86054830**

[bmitchell@veritassecurities.com.au](mailto:bmitchell@veritassecurities.com.au)



**Universal Biosensors (UBI)**

**Current Price: \$0.32 ps Target Price: \$0.68 ps**

Universal Biosensors

FINANCIAL PERFORMANCE							
Year ended 31-Dec		13A	14A	15A	16A	17E	18E
<b>Sales Revenue</b>	\$ m	15.1	7.8	14.8	18.8	31.3	7.5
Milestones, Lump Sum*	\$ m	0.0	18	2.0	0.0	61.3	6.1
<b>Total Revenue</b>	\$ m	15.1	9.5	16.8	18.8	92.6	13.6
Cost of Goods Sold	\$ m	-11.6	-0.6	-1.4	-12	-2.2	-4.5
<b>Gross Operating Profit</b>	\$ m	3.4	9.0	15.4	17.7	90.4	9.1
R&D	\$ m	-15.5	-17.1	-19.8	-15.9	-16.0	-13.0
R&D Refund	\$ m	6.9	9.9	9.2	7.6	0.0	6.0
Corporate Costs	\$ m	-6.2	-5.6	-6.0	-5.5	-5.4	-5.4
<b>EBIT</b>	\$ m	-11.3	-3.9	-1.2	3.8	69.0	-3.3
Interest	\$ m	-0.3	-2.4	-3.1	-2.7	-3.0	-0.2
Forex Adjustment	\$ m	0.0	-0.9	-1.0	0.1	0.0	0.0
<b>Pre Tax Profit</b>	\$ m	-11.6	-7.2	-5.2	1.3	66.0	2.4
Tax	\$ m	0.0	0.0	0.0	0.0	0.0	0.0
<b>Normalised Profit</b>	\$ m	-11.6	-7.2	-5.2	1.3	66.0	2.4
Significant Items (Net of tax)	\$ m	0.0	-2.1	-1.4	0.0	0.0	0.0
<b>Reported Profit</b>	\$ m	-11.6	-9.3	-6.6	1.3	66.0	2.4

GROWTH							
		13A	14A	15A	16A	17E	18E
Revenue	%	-49.1	-48.4	90.5	27.1	66.2	-75.9
COGS	%	-37.6	-95.2	148.3	-16.6	87	109.5
Gross Operating Profit	%	-68.6	160.3	71.6	14.8	411.6	-89.9
R&D	%	14.8	10.7	15.3	-19.7	0.8	-18.8
EBIT	%	21.9	-66.0	-69.6	-427.4	na	-104.8
Reported Profit	%	31.1	-38.3	-27.9	-124.2	na	na
EPS	%	20.6	-38.7	-27.9	-124.1	na	na

P&L RATIOS							
		13A	14A	15A	16A	17E	18E
Gross Operating Profit / Sales	%	22.8	94.2	91.8	93.9	97.7	66.9
EBIT / Sales	%	-75.0	-40.4	-7.0	20.4	74.6	-24.2
Effective Tax Rate	%	0.0	0.0	0.0	0.0	0.0	0.0
Interest Cover	x	-35.4	-1.6	-0.4	14	23.0	-14.1
R&D/Tot Revenue	x	102.6	220.3	133.4	84.3	51.1	172.7
Expenses/Revenue		4.11	72.3	40.7	29.4	17.3	71.7
Working Cap/Revenue		-13.3	3.7	20.9	5.6	8.9	1.7

Per SHARE							
		13A	14A	15A	16A	17E	18E
Issued Shares (Year End)	m	175.6	175.6	176.1	176.2	176.2	176.3
Issued Shares (Wt Avg)	m	174.4	175.6	175.6	176.1	176.2	176.2
EPS	¢ps	-6.7	-4.1	-2.9	0.7	37.5	14
Operating Cash Flow ps	¢ps	-9.5	-3.1	1.0	4.0	6.7	-12
DPS	¢ps	0.0	0.0	0.0	0.0	0.0	0.0

PARAMETERS							
		13A	14A	15A	16A	17E	18E
<b>Year-End Share price</b>	¢ps	46	17	44	31	32	32
PE Ratio	x	-6.9	-4.2	-14.9	43.7	0.9	23.1
Enterprise Value / EBITDA	x	-6.9	-15.3	50.2	9.2	0.7	11.4
Enterprise Value / Profit	x	-6.3	-4.4	-12.0	45.3	0.8	-4.4
Cash Flow ratio	x	-4.8	-5.5	42.2	7.7	4.8	-25.8
Dividend Yield	%	0.0	0.0	0.0	0.0	0.0	0.0

SEGMENTS							
		13A	14A	15A	16A	17E	18E
<b>Sales Revenue</b>							
Strip Sales	\$ m	10.2	0.2	1.3	0.6	3.4	7.5
QSFs (Lifescan)	\$ m	3.4	6.4	12.8	17.9	27.9	0.0
Other	\$ m	1.5	1.1	0.7	0.4	0.0	0.0
Milestones	\$ m	0.0	18	2.0	0.0	61.3	6.1
<b>EBIT</b>							
Strip Sales	\$ m	-0.3	-0.1	0.2	-0.4	1.3	3.0
QSFs (Lifescan)	\$ m	3.4	6.4	12.8	17.9	27.9	0.0
Other	\$ m	0.3	0.9	0.4	0.2	0.0	0.0
Milestones	\$ m	0.0	18	2.0	0.0	61.3	6.1
R&D	\$ m	-15.5	-17.1	-19.8	-15.9	-16.0	-13.0
Admin Fees	\$ m	-6.2	-5.6	-6.0	-5.5	-5.4	-5.4
<b>EBIT Growth</b>							
Strip Sales	%	-120.6	na	na	-320.0	-413	134.2
QSFs (Lifescan)	%	52.3	89.3	99.0	39.1	56.1	na
R&D	%	14.8	10.7	15.3	-19.7	0.8	-18.8
Admin Fees	%	-8.7	-9.3	7.2	-8.2	-2.4	0.0
<b>EBIT Margin</b>							
Strip Sales	%	-2.8	-45.4	14.2	-70.5	37.5	40.1
QSFs (Lifescan)	%	100.0	100.0	100.0	100.0	100.0	0.0

CASH FLOW							
Year ended 31-Dec		13A	14A	15A	16A	17E	18E
<b>Operating Profit</b>	\$ m	4.9	15.7	13.1	18.3	23.7	12.0
Net Interest Received/Paid	\$ m	0.5	-2.4	-0.2	-2.2	-3.0	-0.2
Tax Paid	\$ m	0.0	0.0	0.0	0.0	0.0	0.0
Change Working Capital	\$ m	-2.5	-3.2	4.6	-2.6	-0.1	-1.0
Other (inc R&D Refund)	\$ m	-4.0	1.6	4.1	9.4	7.2	0.0
<b>Operating Cash Flow</b>	\$ m	-1.1	11.7	21.6	22.9	27.8	10.8
R&D	\$ m	-15.5	-17.1	-19.8	-15.9	-16.0	-13.0
Capex	\$ m	-0.2	-1.0	-1.3	-1.2	-1.6	-1.6
<b>Free Cash Flow</b>	\$ m	-16.8	-6.4	0.6	5.8	10.2	-3.8
Acquisitions/Asset Sales	\$ m	0.0	0.0	0.0	-0.1	0.0	0.0
Dividends Paid	\$ m	0.0	0.0	0.0	0.0	0.0	0.0
Equity Change	\$ m	0.4	0.0	0.0	0.0	0.0	0.0
Debt	\$ m	16.0	0.5	-0.2	0.0	-0.8	-19.9
Other	\$ m	0.0	-2.3	-3.6	0.0	-3.2	64.3
<b>Net Cash Flow</b>	\$ m	-0.4	-8.2	-3.2	5.8	6.2	40.6
Currency Adjustment	\$ m	0.5	0.7	1.2	0.2	0.0	0.0
<b>Net Change in Cash</b>	\$ m	0.1	-7.4	-2.0	6.1	6.2	40.6

BALANCE SHEET							
		13A	14A	15A	16A	17E	18E
Cash	\$ m	23.7	16.3	14.4	20.4	26.6	67.3
Receivables	\$ m	2.2	3.8	3.2	4.8	5.0	6.0
Inventory	\$ m	0.0	0.4	0.4	0.8	2.5	3.5
Other Current Assets	\$ m	9.9	9.7	11.0	9.2	63.8	3.0
<b>Current Assets</b>	\$ m	35.8	30.3	28.8	35.2	97.9	79.8
Property, Plant & Equipment	\$ m	15.9	14.3	12.9	11.5	11.5	10.8
Intangibles	\$ m	0.0	0.0	0.0	0.0	0.0	0.0
Other NC Assets	\$ m	2.9	2.9	3.2	3.2	3.5	0.5
<b>Non Current Assets</b>	\$ m	18.8	17.3	16.1	14.7	15.0	11.3
<b>Total Assets</b>	\$ m	54.6	47.5	45.0	50.0	112.9	91.0
Payables	\$ m	3.3	2.1	2.8	2.3	4.0	5.0
Current Debt	\$ m	0.0	0.5	0.3	0.4	19.9	0.0
Other Current Liabilities	\$ m	2.1	3.9	1.7	3.2	2.5	2.5
<b>Current Liabilities</b>	\$ m	5.4	6.5	4.8	5.9	26.4	7.5
Non Current Debt	\$ m	15.9	17.5	19.9	20.3	0.0	0.0
Other NC Liabilities	\$ m	3.7	3.8	7.0	10.5	5.4	0.0
<b>Non Current Liabilities</b>	\$ m	19.5	21.3	26.9	30.8	5.4	0.0
<b>Total Liabilities</b>	\$ m	24.9	27.8	31.7	36.7	31.8	7.5
<b>Shareholder Funds</b>	\$ m	29.7	20.4	13.8	15.1	81.1	83.6

BALANCE SHEET RATIOS							
		13A	14A	15A	16A	17E	18E
Receivables turn	x	6.8	2.6	4.3	4.7	6.4	14
Inventory turn	x	6.5	2.8	3.7	1.9	1.3	1.5
Net Debt	\$ m	0.0	1.7	5.8	0.3	0.0	0.0
Gearing (D:D+E)	%	0.0	7.6	29.7	1.7	0.0	0.0
Current Ratio (CA:CL)	x	6.6	4.7	6.0	5.9	3.7	10.6
Net Tangible Assets	¢ps	16.9	11.6	7.8	8.6	46.0	47.4
Cash	¢ps	4.5	0.0	0.0	0.0	3.8	38.1
Return On Assets	%	-21.8	-7.5	-2.5	8.1	84.8	-3.2
Return on Equity	%	-33.7	-28.7	-30.3	8.7	137.3	3.0

VALUATION			
Valuation Method	\$	Premium(+)/Discount(-) %	
DCF	0.68	-53.3	
Price Target	0.68	-53.3	
Current Price	0.32		
<b>Market Capitalisation</b>	<b>\$56.4m</b>	<b>Enterprise Value: \$49.6m</b>	

MAJOR SHAREHOLDERS			
Viburnum	m	23.9	13.5% Fund Manager
KFT Investments	m	18.0	10.2% George Kepper
<b>Top 20 (19/4/2016)</b>	<b>m</b>	<b>106.6</b>	<b>60%</b>

DIRECTORS	
Andrew Denver	Executive Chairman
Judith Smith	N-E Dir
Denis Hanley	N-E Dir
Marshall Heinberg	N-E Dir
David Hoey	N-E Dir
Craig Coleman	N-E Dir

\* Mostly Siemens' Milestones and LifeScan Option Payment

### Strong CY2016 growth driven by LifeScan Strip Sales

This is the first Net Profit since CY09 (when UBI received a \$17.7m milestone from LifeScan), with escalating Quarterly Service Fees. Cash Flow and the Balance Sheet were buoyed by the \$9.4m R&D Cash Rebate for R&D Incurred in CY16 and \$5.1m in pre-paid Milestones from Siemens.

Profit & Loss				Cash Flow			
Year ended 31-Dec (\$m)	2015	2016	% Ch	Year ended 31-Dec (\$m)	2015	2016	% Ch
<b>Strip Sales (m)</b>	<b>935</b>	<b>1,460</b>	56.2	<b>Net cash from Operating</b>	<b>-7.4</b>	<b>-7.3</b>	<b>-1.9</b>
Service Fees (LifeScan)	12.8	17.9	39.1	R&D Cash Rebate & Milestones	9.2	14.3	
Product Sales - Siemens	1.3	0.6	-55.8	<b>Operating Cash Flow</b>	<b>1.8</b>	<b>7.0</b>	<b>285.3</b>
Milestones	2.0	0.0		Capex	-1.3	-1.2	-4.5
Other (mainly Siemens)	0.7	0.0	-100.0	Equity	0.0	0.0	
<b>Total Revenue</b>	<b>16.8</b>	<b>18.8</b>	<b>12.3</b>	Debt	-0.2	0.0	
Cost of Goods Sold	-1.4	-1.2	-16.6	Other	-3.6	0.0	
<b>Operating Profit</b>	<b>15.4</b>	<b>17.7</b>	<b>14.8</b>	<b>Net Cash Flow</b>	<b>-3.2</b>	<b>5.8</b>	<b>-283.3</b>
R&D	-19.8	-15.9	-19.7	Currency Adj	1.2	0.2	
Corporate	-6.0	-5.5	-8.2	<b>Net Cash Flow Change</b>	<b>-2.0</b>	<b>6.1</b>	
R&D Rebate	9.2	7.6	-18.0	<b>Balance Sheet</b>	<b>2015</b>	<b>2016</b>	<b>% Ch</b>
<b>EBIT</b>	<b>-1.2</b>	<b>3.8</b>	<b>na</b>	Current Assets	28.8	35.2	
Interest (Net)	-3.1	-2.7	-12.6	Non Current Assets	16.1	14.7	
Currency Adjustment	-1.0	-0.2		Total Assets	45.0	50.0	11.2
<b>Pre-Tax profit</b>	<b>-5.2</b>	<b>0.9</b>	<b>na</b>	Current Liabilities	4.8	5.9	
Tax	0.0	0.0		Non Current Liabilities	26.9	30.8	
<b>Net Profit</b>	<b>-5.2</b>	<b>0.9</b>	<b>na</b>	Total Liabilities	31.7	36.7	15.9
Significant Items (Net)	-1.4	0.0		<b>Shareholder Funds</b>	<b>13.8</b>	<b>14.8</b>	<b>6.8</b>
<b>Reported Profit</b>	<b>-6.6</b>	<b>0.9</b>	<b>-114.4</b>	<b>Market Capitalisation</b>	<b>56.4</b>	<b>56.4</b>	<b>0.1</b>
Operating Margin (%)	91.8	93.9		<b>Enterprise Value</b>	<b>62.2</b>	<b>56.6</b>	<b>-8.9</b>
EBIT Margin (%)	-7.0	20.4		Cash (Gross)	14.4	20.4	42.2
R&D/Revenue (%)	133.4	84.3		Net Cash (¢ ps)	0.0	0.0	
Corporate/Revenue (%)	47.0	31.0		Net Debt (\$m)	5.8	0.3	
EPS (¢ ps)	-2.9	0.5	-118.2	Gearing D:D+E (%)	29.7	1.7	
Cash Flow (¢ ps)	1.0	4.0	284.1	NTAV (¢ ps)	7.8	8.4	6.8
DPS (¢ ps)	0.0	0.0		Revenue/Working Capital (x)	20.9	5.6	

Source: UBI

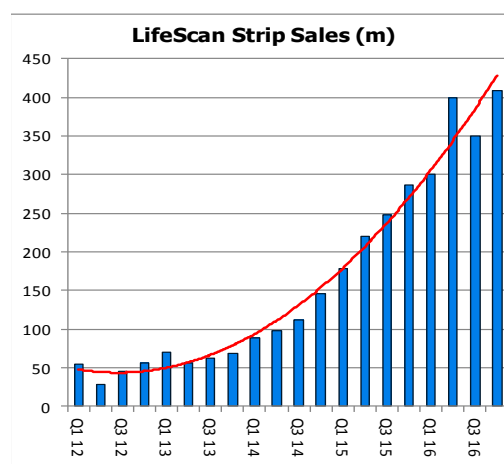
### Revenue

**LifeScan Strip Sales** – Q4 Strip sales increased by 42.5% to 409m, resulting in a CY16 increase in strip sales of 56% to 1.46b.

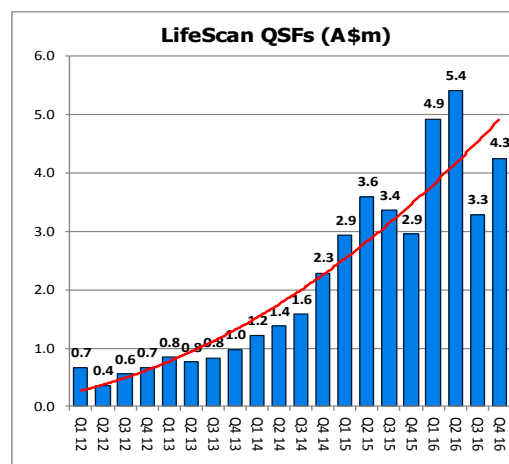
Quarterly data in Q2 and Q3 was not indicative on a comparable basis, due to a major change in logistics within LifeScan in Q3, with the Q2 increase above and Q3 fall below the normal trend.

**QSFs** – QSFs from LifeScan strip sales for Q4 CY16 increased by 44% to \$4.3m, resulting in a CY16 increase of 39.2% to \$17.9m.

Cumulative QSFs increased to US\$34.8m, still well short of the LifeScan option trip level of US\$45m, now expected to be reached in Mid-CY17.



Source:UBI



Source:UBI

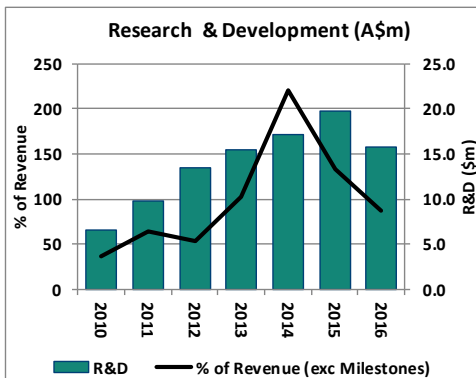
**Siemens** – Revenue of \$0.6m from strip sales to Siemens, comprising 300,000 strips at US\$1.30¢ per strip. While sales were deferred to CY17 to support a US launch, UBI already has an order for delivery of 800,000 strips worth \$1.4m in Q1 CY17. UBI also undertook \$0.4m in Development work for Siemens. This excludes Pre-paid Milestone of US\$3.5m (A\$4.9m) from Siemens, classified as Deferred Revenue.

### Operating Profit (EBIT)

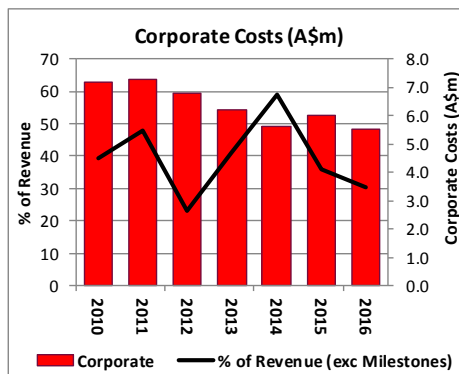
Operating Profit for CY16 improved by \$5.3m to \$4.0m, due to:

- QSFs - The escalation of strip sales by LifeScan and resultant QSFs, partly offset by a loss of \$0.2m from strip sales and service fees to Siemens.
- R&D - Reduced R&D payments, down 25.1% to \$15.9m from a refocus of the development pipeline, with stricter R&D criteria and a focus on ROI.
- Corporate Expenses – Down 8.8% to \$5.5m, with changes in the development focus and cost efficiencies.
- Recognition of an expected \$7.6m in a Cash R&D Rebate relating to CY16 R&D, applicable with CY16 Revenue below the \$20m threshold. This cash will be received in CY17.

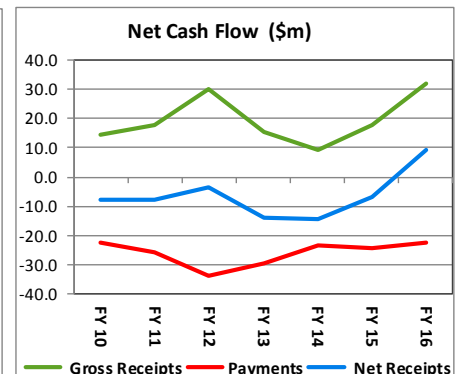
This excludes a US\$3.75m (A\$4.9m) Milestone payment received from Siemens as part of the changes to the Collaboration Arrangements, classified as Deferred Revenue. This and related Collaboration Revenue of US\$0.9m (A\$1.1m) will most likely be included as Revenue in CY18, with the milestones reached.



Source: UBI



Source: UBI



Source: UBI

**Net Profit** – The \$6.2m improvement in Net Profit to \$1.0m was after:

- A \$0.4m reduction in Net Interest paid to \$2.9m, a combination of exchange rates and the absence of debt restructuring fees, partly offset by lower Interest Income.
- A \$0.8m Forex benefit.

**Cash Flow** - Operating Cash Flow improved by \$5.2m improvement to \$7.0m, boosted by a Cash R&D Rebate of \$9.4m (relating to CY15) and Siemens Pre-paid Milestones of \$4.9m (US\$3.75m).

Net Cash Flow increased by \$8.1m to \$6.1m, after Capex of \$1.2m and a \$0.2m positive forex adjustment.

**Balance Sheet** - Key Features were:

- Cash - Gross Cash of \$20.4m (11.6¢ ps), with Net Debt of \$0.3m. In addition, there is Restricted Cash of \$3.0m (US\$2.0m) required under the Athyrium Agreement and a further \$0.3m of Collateral, classified within Other Non-Current Assets.
- Total Debt of \$20.7m (US\$15m), related to Athyrium, to be repaid with a bullet payment in December CY18 or on exercise of the LifeScan option.
- Deferred Revenue of \$6.1m, covering the pre-paid Milestone Payment of \$4.9m (US\$3.75m) received in CY16, and US\$0.9m (A\$1.1m) relating to an allocation of the original Collaboration Agreement paid in CY11, both expected to be recognised in CY18.

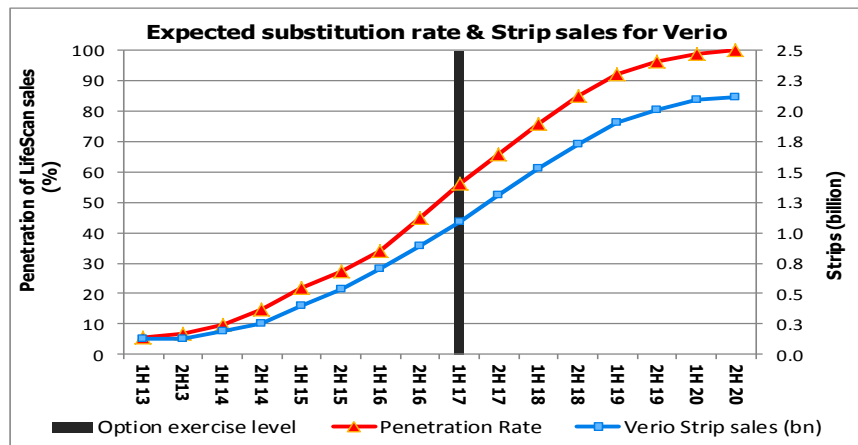
Outlook

**Blood Glucose**

Continued growth in Quarterly Service Fees is expected with strong increase in strip sales, from:

- The continued growth in diabetes sufferers globally, with an estimated 20b blood glucose tests annually.
- The continued substitution by LifeScan of Verio for its existing Ultra range, accelerated by:
  - Identification of Verio as the market leader and LifeScan’s most competitive product platforms. This has been boosted by the introduction of new Verio meters with added functionality, making it easier for users to monitor blood glucose levels on a continual basis, including the recent release of the OneTouch Verio Flex into Canada and Europe, which incorporates wireless integration to a mobile phone via a mobile app.
  - A recent court case allowing the widespread marketing of a generic strip for LifeScan’s Ultra brand within the US, which impacts the viability of that product range and will increase the substitution of Verio for Ultra.
  - The pending introduction in Europe of ISO accuracy standards, although delayed until mid-CY2018. LifeScan has a program of free replacement of its ‘Ultra’ range of meters with Verio meters in some jurisdictions.

With the strong take up of Verio meters and resultant strip sales, we have adjusted our Diffusion Curve covering the substitution of Verio for Ultra strips within LifeScan and expected half yearly strip sales. We now expect the US\$45m in cumulative strip sales required for the LifeScan option to be reached in Mid-CY17.



Source: UBI (Act), Veritas (Est)

With continued strong growth in strip sales, the LifeScan Option Agreement becomes an important consideration. While we are uncertain whether or when LifeScan will exercise the Option, we have taken a conservative approach and assumed cumulative QSF’s incurred by LifeScan reach US\$45m in Q2 CY17 and received by UBI in Q3 CY17, and the option is exercised at the first opportunity.

On our forecasts, this would result in a one off payment of US\$46.3m (A\$61.3m or 34.8¢ ps) in CY17 (to be received within 60 days of Year-end), assuming a A\$:US\$ rate of 0.76¢, as well as a further US\$21.0m (A\$27.9m) in QSFs to be received for CY17.

**Blood Glucose - Forecasts**

Option Exercised <sup>2</sup>	Revenue (A\$m)						EBIT (A\$m)					
	CY 15	CY 16	CY 17	CY 18	CY 19	CY 20	CY 15	CY 16	CY 17	CY 18	CY 19	CY 20
Service Revenue - Strips <sup>1</sup>	0.0	17.9	27.9				12.8	17.9	27.9			
Lump Sum									61.3			
<b>Total</b>	<b>0.0</b>	<b>17.9</b>	<b>27.9</b>	<b>0.0</b>	<b>0.0</b>	<b>0.0</b>	<b>12.8</b>	<b>17.9</b>	<b>89.1</b>			

Source : UBI (Act), Veritas (Est)

<sup>1</sup> at A\$:US\$ rate of 0.76

<sup>2</sup> Option exercised at 1<sup>st</sup> Opportunity

**UBI Forecasts for Non-Exercise of the LifeScan Option are outlined in Appendix 1 on Page 9.**

**An explanation of the option and the likelihood of exercise are outlined in Appendix 2 on Page 10.**

**Blood Coagulation**

**PT/INR** - While cumulative strip revenue was only \$0.6m in CY16, sales are expected to escalate in CY17 from:

- Improvements in the accuracy of the strip, at least to the standard of the competing Roche strip.
- US FDA Clearance, announced on 5/10/16. UBI will commence strip sales in the USA Q1 CY17, ahead of an expected launch in CY17, with an initial order of 800,000 already received, worth around A\$1.4m.
- The recent commercial launch across the majority of the 31 countries in Europe covered by CE Mark and other countries that rely on PDA clearance or CE Mark approval, marketed through Siemens’ distribution network.
- The recent withdrawal from the market of Alere (the No.2 player) which had an 18% market share.
- A minor contribution from the recent acquired Hemostasis Reference Laboratory, with UBI its major customer.

The Worldwide Point-of Care market for Blood Coagulation testing was estimated at \$1b in CY14 with growth Forecasts of 9% pa to about US\$1.4b by 2018. PT/INR at around 65% of this market is expected to be worth \$0.91b in CY18.

**Other Blood Coagulation** - Following changes to the focus of the joint product development activities, the two additional Blood Coagulation testing systems for Siemens underway are not expected to be launched in the EU until CY2018, although Siemens have some advanced prototypes in clinical and reliability testing. Clinical trials are expected to commence in CY17, with regulatory approval sought after completion of these trials. While the markets for these tests are smaller, they are expected to be higher growth markets, with lesser competition and higher margins. We also would not rule out further testing systems for Siemens.

**UBI’s Home PT/INR test system** – Due to flagged changes in the FDA regulatory requirements, the development of UBI’s PT-INR self-testing device has been delayed as UBI seeks to enhance the product to meet these changes.

Accordingly we haven’t included sales from the new Siemens’ test and UBI’s Home test in our forecasts before CY18. With the later launch time and lower penetration rates for Europe, we have moderated our forecasts, now expecting:

Calendar Year		2014	2015	2016	2017	2018	2019	2020
Revenue	A\$m	0.2	1.3	0.6	3.4	7.5	17.8	26.0
<i>Increase</i>	%		561.5	-57.0	506	118.8	136.7	46.1
EBIT	A\$m	0.0	0.2	-0.4	1.3	3.0	8.1	13.0
<i>Increase</i>	%		na	-323	-410	134.2	168.0	60.8
Margin	%		14.1	-73.3	37.5	40.1	45.4	50.0

Source: Veritas

at A\$:US\$ rate of 0.76

**Milestone Payments**

With changes to the Siemens’ Collaboration Agreement, UBI received US\$2.5m (A\$3.4) in Milestone payments in 1H CY16 and will receive a further US\$1.25 (A\$1.7m) in Q4 CY16. These payments will not be recognised as Revenue until approval/launch milestones are reached in CY18. According we have included US\$4.6m (A\$6.0m) in Revenue in CY18, comprising actual milestones and an allocation of a payment under the original Collaboration Agreement.

**Milestones - Revenue Recognition**

Calendar Year		2014	2015	2016	2017	2018	2019	2020
Siemens Milestones	US\$m	1.0	1.0			3.8		
Collaboration Revenue	US\$m	0.4	0.4			<b>0.9</b>		
<b>Total Revenue Recognised</b>	<b>US\$m</b>	<b>1.4</b>	<b>1.4</b>			<b>4.6</b>		
<b>Revenue Recognised</b>	<b>A\$m</b>	<b>1.8</b>	<b>2.0</b>			<b>6.1</b>		
less Arthyrium Payments	A\$m	-0.4	-0.4					
<b>Net Revenue</b>	<b>A\$m</b>	<b>1.4</b>	<b>1.5</b>	<b>0.0</b>	<b>0.0</b>	<b>6.1</b>		
<b>Cash Flow impact</b>	<b>A\$m</b>	<b>0.9</b>	<b>0.9</b>	<b>5.0</b>	<b>0.0</b>	<b>0.0</b>		

Source:UBI (Act), Veritas (Est)

at A\$:US\$ rate of 0.76

**Other products**

**Immunoassay** - UBI is continuing with the development of a Point of Care immunoassay platform, with feasibility expected to be demonstrated within 12 months.



## Forecasts

### LifeScan Option Exercised

Forecasts are based on exercise of LifeScan’s Option at the first opportunity, including:

- Forecast LifeScan QSFs based on our Diffusion Curve, assuming exercise of the Option during CY17.
- Forecasts for Siemens’ PT/INR and inclusion of additional Siemens’ and UBI’s Self-Test from CY18.
- R&D up to completion and clearance of the additional Blood Coagulation tests, with no R&D Cash Rebates in CY17, with Revenue expected to be above the A\$20m limit.

However, we expect UBI to receive an R&D Tax Credit of around \$6.4m in CY17, which can be offset against the profit from the Option exercise. We have also included an expected R&D Cash Rebate for CY18 of around \$6.0m, with Revenue fall below \$20m in the absence of QSFs.

- On-going Corporate Costs, mainly lease obligations and staff costs.

### Assuming Exercise of Option

Division	Revenue (\$m)					EBIT (\$m)				
	CY16	CY17	CY18	CY19	CY20	CY16	CY17	CY18	CY19	CY20
QSFs - LifeScan	17.9	27.9	0.0	0.0	0.0	17.9	27.9	0.0	0.0	0.0
Lump Sum - LifeScan		61.3					61.3			
Siemens	1.0	3.4	7.5	17.8	26.0	-0.2	1.3	3.0	8.1	13.0
Milestones	0.0	0.0	6.1	0.0	0.0	0.0	0.0	6.1	0.0	0.0
R&D						-15.9	-16.0	-13.0	0.0	0.0
R&D Cash Rebate						7.6	0.0	6.0	0.0	0.0
Corporate						-5.5	-5.4	-5.4	-4.0	-4.0
<b>Total</b>	<b>18.8</b>	<b>92.6</b>	<b>13.6</b>	<b>17.8</b>	<b>26.0</b>	<b>3.8</b>	<b>69.0</b>	<b>-3.3</b>	<b>4.1</b>	<b>9.0</b>

Source: Veritas Forecasts

**Interest** – Annual Interest Payments of US\$1.58m pa (A\$2.1m) for CY17, with Debt to be repaid upon receipt of the Lump-Sum payment within 60 days of CY17 Year-end, as per the Athryium Agreement.

**Tax** - With Revenue exceeding \$20m in CY17, we expect a combined tax credit of around \$6.4m related to 40% of applicable R&D for CY16 to CY18. This along with current combined Tax Losses, R&D Tax Offsets and US Tax Losses, and Expected Losses in CY16, will result in UBI having in excess of \$50m in possible Non-Tax Assessable Profit.

**UBI Forecasts for Non-Exercise of the LifeScan Option are outlined in Appendix 1 on Page 9**

**An explanation of the option and the likelihood of exercise is outlined in Appendix 2 on Page 10.**

**Valuation**

We now have a valuation of \$121m (\$0.69ps), based on Blood Glucose (assuming exercise of the Options), Blood Coagulation (both Siemens and UBI’s Self-Test) and Liquid Assets across:

**Blood Glucose** – A DCF Valuation of \$4.6m (48.0¢ps), comprising Operational Cash Flow for Q4 CY16 to CY17 of around A\$31.3m (US\$23.9m), plus the A\$58.9m (US\$45.1m) Lump Sum payment in CY17 (payable within 60 days of year-end).

**Blood Coagulation** – A combined DCF valuation of \$114.7m (56¢ ps) for Siemens and UBI’s Self-Test

**Corporate/R&D** – A combined DCF of -\$64.2m (-36¢ ps) for Ongoing Corporate Costs and R&D expense to CY18 and expected Cash R&D Rebates. R&D has only been included to CY18, covering completion of the remaining Blood Coagulation products.

We have added an expected Cash R&D Rebates for CY19 of \$5.9m (relating to R&D in CY18), with our forecasts of Revenue for FY18 remaining below \$20m. However, should the option not be exercised, this will not be applicable, with Revenue exceeding \$20m.

**Milestones** – No further Milestones currency expected

**Other** – Comprising Working Capital and Current Liabilities, including amounts owed to LifeScan.

**Net Cash/Debt** – \$3.7m as at 31/12/16, including Restricted Cash (Athyrium requirement) of A\$3.2m.

VALUATION			
Sum of Parts Segment	Valuation Method	Valuation \$m	Valuation ¢ ps
Blood Glucose	DCF	84.9	48.2
Blood Coagulation	DCF	98.8	56.1
Corporate/R&D	DCF	-64.2	-36.4
<b>Operating Assets</b>		<b>119.5</b>	67.8
Other		-2.2	-1.3
Net Cash/Debt (exc Lump Sum)		3.7	2.1
<b>Valuation</b>		<b>121.0</b>	<b>68.7</b>
<b>Current Price (¢ps)</b>			<b>32.0</b>

Source: Veritas

If all Options and Warrants with an Exercise Price below above Valuation are exercised, the Valuation would only fall to \$0.66 ps.

We believe this Valuation is conservative, as:

- Continuation of the LifeScan arrangement beyond the Option exercise date would boost this valuation (see Appendix 2 on Page 10).
- The discount rates are very conservative to reflect the nature of the forecasts, with respect to timing and growth rates and exclude any of the profit sharing arrangements with Siemens. Any further falls in the A\$ would increase this valuation.
- This doesn’t include: any value of IP beyond Blood Coagulation, with over \$115m spent over the last 13 years; the value of its R&D/manufacturing facility which has been developed at a cost of over \$30m (in the Balance Sheet as \$8.9m Net of Asset Retirement Obligations).
- Any potential corporate action. While Siemens has the option to obtain the right to manufacture or have a Third Party manufacture strips upon 12 months’ notice or competitors acquiring control of UBI, it would have to reimburse UBI for the gross margin it would otherwise have received until expiry of the supply agreement in 2022 (or 2027 if rolled for a further 5 years).

However, the valuation only assumes continued R&D expenditure to CY18 for completion of all Blood Coagulation products. R&D beyond CY18 has not been included as we are unable to model the revenue from the development of additional products and we are not aware of UBI’s ongoing R&D strategy beyond CY18.



## Appendix 1 – Option Not Exercised

### Forecasts

#### Blood Glucose

For information purposes, we have included Forecasts for the continuation of the present arrangements.

Accordingly, the QSF Revenue will escalate with an increase in substitution rate within LifeScan and continued underlining market growth.

#### Blood Glucose - Forecasts

Option Not Exercised	Revenue (A\$m)						EBIT (A\$m)					
	CY 15	CY 16	CY 17	CY 18	CY 19	CY 20	CY 15	CY 16	CY 17	CY 18	CY 19	CY 20
Service Revenue - Strips <sup>1</sup>	12.8	17.9	27.9	36.9	44.1	47.6	12.8	17.9	27.9	36.9	44.1	47.6
Change (%)		39.2	56.0	32.6	19.3	8.1		39.2	56.0	32.6	19.3	8.1

Source : UBI (Act), Veritas (Est) <sup>1</sup> at A\$:US\$ rate of 0.76

#### UBI

The only difference relates to inclusion of ongoing Forecast LifeScan QSFs based on our Diffusion Curve.

#### Assuming Continuation of LifeScan QSFs

Division	Revenue (\$m)					EBIT (\$m)				
	CY16	CY17	CY18	CY19	CY20	CY16	CY17	CY18	CY19	CY20
QSFs - LifeScan	17.9	27.9	36.9	44.1	47.6	17.9	27.9	36.9	44.1	47.6
Siemens	1.0	3.4	7.5	17.8	26.0	-0.2	1.3	3.0	8.1	13.0
Milestones	0.0	0.0	6.1	0.0	0.0	0.0	0.0	6.1	0.0	0.0
R&D						-15.9	-16.0	-13.0	0.0	0.0
R&D Cash Rebate						7.6	0.0	0.0	0.0	0.0
Corporate						-5.5	-5.4	-5.4	-4.0	-4.0
<b>Total</b>	<b>18.8</b>	<b>31.3</b>	<b>50.6</b>	<b>61.9</b>	<b>73.7</b>	<b>3.8</b>	<b>7.7</b>	<b>27.7</b>	<b>48.2</b>	<b>56.7</b>

Source: Veritas Forecasts

**Interest** - Annual Interest Payments of US\$1.58m pa (A\$2.1m) for CY16, CY17 and CY18 with a Bullet repayment in December 2018. We would expect this to be met by increasing Cash Flow.

**Tax** - We would expect UBI to provide for tax in CY17 onwards and offset tax payable against Deferred Tax Assets and any Carried Forward R&D tax credits.

## Valuation

Should the Option not be exercised at all, the valuation increases sharply to a Maximum of \$362m (\$2.05 ps):

VALUATION			
Sum of Parts Segment	Valuation Method	Valuation \$m	Valuation ¢ ps
Blood Glucose	DCF	323.4	184
Blood Coagulation	DCF	98.8	56
Corporate/R&D	DCF	-64.2	-36
<b>Operating Assets</b>		<b>358.1</b>	<b>203</b>
Other		-2.2	-1
Net Debt (exc Lump Sum)		5.7	3
<b>Valuation</b>		<b>361.5</b>	<b>205</b>
<b>Current Price (cps)</b>			<b>32</b>

Source: Veritas Securities

If all Options and Warrants with a lower Exercise Price to the above Valuation are exercised, the Valuation would only fall to \$1.91 ps.

However, if the option is not immediately exercised, it is likely to be exercised at a later date, on the proviso that the QSF flow meets our forecasts. An indication of the Lump Sum and QSFs applicable to that year are outlined in Appendix 2 on Page 10.

## Appendix 2 - LifeScan Option Agreement

LifeScan has an option to terminate the Master Services Agreement by converting the QSFs into a lump sum payment, once the cumulative QSFs **received** by UBI reach US\$45m. As at 31/12/16, cumulative QSFs incurred by LifeScan had reached US\$34.8m, with QSFs received by UBI reaching \$31.7m (ie paid 1 month in arrears).

With our forecasts of cumulative QSFs received by UBI reaching US\$45m in **Mid-CY17** and the option exercised in the following quarter, it will result in total future payments of around US\$67.3m (A\$89.1m), comprising:

Calculator	US\$m	A\$m	¢ ps
<b>Received as revenue</b>			
QSFs until US \$45m	10.2	13.5	
Balance for FY17	10.9	14.4	
	<b>21.0</b>	<b>27.9</b>	<b>15.8</b>
<b>Multiplier</b>			
QSFs for CY17	US\$21	2.2x	
	46.3	61.3	34.8
<b>Total</b>	<b>67.3</b>	<b>89.1</b>	<b>50.6</b>

Source: Veritas

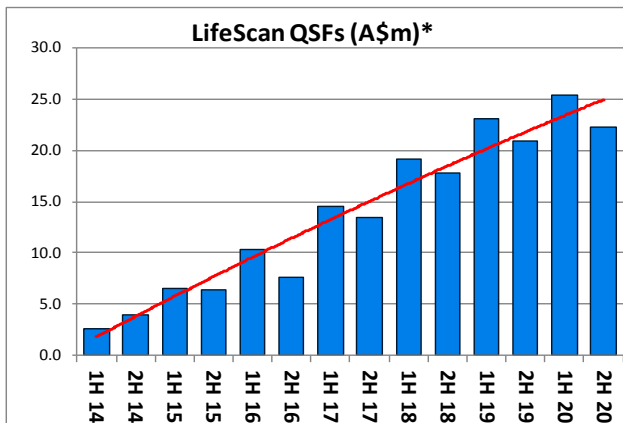
**Note:** As UBI receives in QSFs in the following quarter and LifeScan can only exercise its option in the subsequent quarter, should QSFs reach \$45m in Q3 or Q4 CY17, UBI would receive QSFs for both CY17 and CY18, and a multiple of CY18 QSFs.

However, we make the following points around alternatives at option exercise date:

**Continuation** - It's a possibility that the option won't be exercised or exercised by LifeScan at the first opportunity.

The Pros and Cons on the exercise are:

**Pros** – It will increase LifeScan's margins and Cash Flow and eliminate the requirement to provide strip sales data. The size of the payment increases significantly over time. As an example, exercise of the Option in CY19 would result in receipt of Revenue in that year of A\$136.7m (77.3¢ ps), comprising Revenue for that year of A\$44.1m and a Lump sum payment of A\$92.6m. Total Revenue received to that point would be around A\$201.5m (113.9¢ ps).



Source: Veritas

at A\$:US\$ rate of 0.76

Revenue Forecasts	2017	2018	2019	2020
<b>Yearly</b>	<b>A\$m</b>	<b>A\$m</b>	<b>A\$m</b>	<b>A\$m</b>
Received as Revenue	27.9	36.9	44.1	47.6
Multiplier (One-Off)*	61.3	77.6	92.6	95.3
<b>Total for Year of Exercise</b>	<b>89.1</b>	<b>114.5</b>	<b>136.7</b>	<b>142.9</b>
<i>Increase</i>		28.5%	19.3%	4.6%
¢ ps	50.6	65.0	77.3	80.7
<b>Cumulative until Year of Exercise</b>				
Cumulative Revenue	27.9	64.8	108.9	156.5
<b>Cumulative Total</b>	<b>89.1</b>	<b>142.4</b>	<b>201.5</b>	<b>251.8</b>
¢ ps	50.6	80.8	113.9	142.3

Source: Veritas

\*Multiplier falls from 2.2x to 2.0x

**Cons** – It will initially involve a substantial lump sum payment, initially over US\$46m. This may not be palatable for LifeScan, given the substantial impact on LifeScan's Balance Sheet and Profit & Loss, especially with the current market pressures within the key US market, or given LifeScan's outlook on the market around forecasts of Verio strip sales.

It will also sever all ties with UBI, severely restricting further Blood Glucose product research and development, essential for a global leader in a sector highlighted by continued innovation. For example, a recently completed UBI feasibility project for a testing system for a normal glucose sensor would not be progressed.

**Renegotiate** – LifeScan may seek to renegotiate the QSFs to a lower level, or introduce a further tier, continuing a development relationship with UBI.

**Early Payment** – LifeScan may seek an agreement with UBI for early termination on a "to be determined" basis.

**Sales**

Robert Scappatura +61 2 8252 3240  
 Andrew McCauley +61 2 8252 3260  
 Patrick Ford +61 2 8252 3211  
 Clay Melbourn +61 2 8252 3220  
 Bryce Reynolds +61 2 8252 3210

**Research**

**Industrials**  
 Brent Mitchell +61 3 8605 4830  
 Levi Hawker +61 3 8676 0689

**Resources**  
 Piers Reynolds +61 3 8601 1196  
 Nick Raffan +61 2 8252 3250

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**RATING**

**BUY** – anticipated stock return is greater than 10%  
**SELL** – anticipated stock return is less than -10%  
**HOLD** – anticipated stock return is between -10% and +10%  
**SPECULATIVE** – High risk with stock price likely to fluctuate by 50% or more

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Veritas Securities Limited  
 A.B.N. 94 117 124 535  
 AFSL No. 297 043  
 GPO Box 4877, Sydney, NSW, 2001  
 www.veritassecurities.com.au

Sydney  
 Level 4, 175 Macquarie Street  
 Sydney, NSW, 2000  
 Tel: (02) 8252 3200  
 Fax: (02) 8252 3299

Melbourne  
 Level 8, 350 Collins Street  
 Melbourne, VIC, 3000  
 Tel: (03) 8601 1196  
 Fax: (03) 8601 1180