

Universal Biosensors Inc

Strong results underpinned by Blood Glucose growth

For the 9 months to 30/9/16, UBI reported a \$4.9m improvement in Operating Profit to a Loss of \$2.25m, driven by:

- A 62% increase in Verio strip sales to 1.05b strips, including 3Q growth of 41% to 348m. This followed an increased marketing push and new and lower priced meters, despite a short term supply disruption at LifeScan in August.
- A 2.4% increase in Revenue to \$13.8m, mostly Quarterly Service Fees (QSFs), although 3Q was impacted by the delivery problems and the tiered QSFs.
- An \$8.5m improvement in Net Cash Inflow to \$7.8m, with \$3.4m in Milestone payments, a \$9.4m R&D Cash Rebate and lower R&D and Corporate costs. Total Cash was \$21.6m (12.3¢ ps) and Available Net Cash of \$2.5m.

Growth in Revenue to continue in CY17

We expect growth to continue in Q4 CY16 and CY17 from:

- Strong growth in LifeScan QSFs, with rising market share, intense marketing, meter replacement and legislative requirements for accuracy.
- An expected lump sum payment of around \$59.5m 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 US in Q1 CY17 and increased marketing in the EU and other key non-USA markets, using Siemens' extensive distribution.

What's UBI worth?

We have taken a conservative approach, assuming exercise of the LifeScan option at the first opportunity, resulting in a DCF Valuation of \$0.67 ps, comprising:

Blood Glucose – DCF Valuation of A\$85.5m (48.5¢ ps), based on Operational Cash Flow for Q4 CY16 to CY17 of around A\$31.3m (US\$23.9m), plus a A\$58.9m (US\$45.1m) Lump Sum payment in CY17 (payable within 60 days of year-end).

Blood Coagulation – A combined DCF of A\$116.2m (66.0¢ ps), covering all Siemens and UBI tests and a US\$1.3m (A\$1.6m) milestone payment in Q4 CY16.

R&D & Corporate Costs – A combined DCF of -\$90.3m (-51.2¢ ps) with R&D up to the launch of the Blood Coagulation tests, plus ongoing corporate costs.

Other – Net Debt/Cash, Working Capital and Current Assets of \$5.4m (3.0¢ ps).

If the LifeScan Option is not exercised in CY17, there would be a substantial increase in the Valuation, with our DCF valuations ranging up to \$1.90 ps.

Forecasts

We now expect an EBIT for CY16 of -\$3.8m. For CY17 with the option exercise, we expect a turnaround to a Profit of \$7.6m, plus a lump sum payment to UBI of around A\$59.5m (33.8¢ ps) relating to the LifeScan option.

For FY18, EBIT will fall to -\$8.3m in the absence of QSFs, before reverting to Profits in CY19 onwards, with escalating Blood Coagulation Revenue.

Recommendation

We maintain a Buy, based on:

Short Term Gain - The possibility of a substantial windfall Profit of \$60m within 18 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.

Valuation – Trading at a substantial discount to our Valuation of \$0.67 ps.

UBI.ASX

BUY

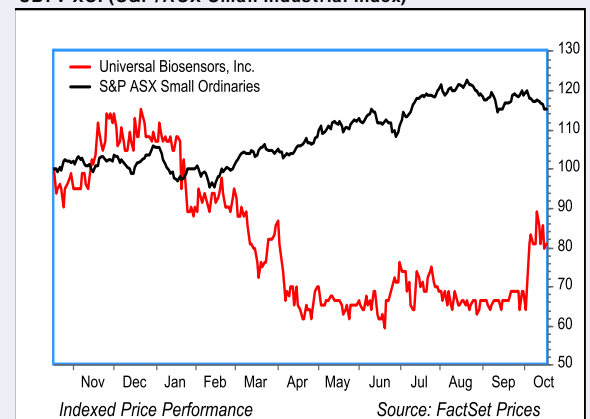
2 November 2016

Price	\$0.33
12 Month Price Target	\$0.67
Valuation	\$0.67
Valuation method	DCF
GICS sector	Financials
12 Mth Price Range	\$0.24 - 0.50
Avg monthly t/o	2.9m
Market Capitalisation	\$58m
Shares on issue	176m
Options on Issue	21m
Enterprise value	\$37m

Previous rating BUY

Year Ended Dec 31	14A	15E	16E	17E	18E	
Revenue	\$m	9.5	16.8	19.4	91.7	16.0
EBIT	\$m	-13.8	-10.4	-3.8	67.1	-8.3
EBIT Growth	%	-21.6	-24.6	-63.5	na	-112.4
EBIT margin	%	-14.5	-62.0	-19.5	73.2	-52.1
NPAT	\$m	-7.2	-5.2	-5.9	64.1	-8.6
Reported Profit	\$m	-9.3	-6.6	-5.9	64.1	-8.6
EPS	¢ ps	-4.1	-2.9	-3.3	36.4	-4.9
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	-9.9	0.9	-6.8
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	4.5	40.9	35.9
EV/EBITDA	x	-2.6	-8.0	-25.7	0.6	-0.8
Gearing (D:E)	%	8.2	42.3	0.0	0.7	0.0
P/OCF	x	-5.5	42.2	16.3	19.5	-8.0
R&D	\$m	-17.1	-19.8	-17.0	-16.0	-13.0
R&D / Revenue	%	179.8	117.8	87.4	49.7	130.9
ROA	%	-27.0	-22.5	-8.7	91.8	-9.2
ROE	%	-28.7	-30.3	-54.1	160.3	-12.7
Interest cover	x	-5.7	-3.4	-1.3	22.4	-35.7

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



Activities

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

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Strong CY2016 growth driven by LifeScan Strip Sales

The 9 Months' Result was substantially ahead of the pcp, despite a mixed Q3 Result.

Profit & Loss				Cash Flow			
9 Mths to Sep (\$m)	CY15	CY16	% Ch	9 Mths to Sep (\$m)	CY15	CY16	% Ch
Strip Sales (m)	648	1058	63.4	Operating Cash Flow	3.87	8.46	118.4
Product Sales - Blood Coagulation	0.97	0.18	-81.1	Capex	-1.08	-0.31	-71.2
Services- Strips	9.88	13.60	37.6	Equity	0.00	0.00	
Services - Development	0.65	0.00		Debt	-1.78	-0.32	
Milestones	1.96	0.00		Other	-2.98	0.00	
Total Revenue	13.46	13.79	2.4	Net Cash Flow	-1.96	7.82	na
Cost of Goods Sold	-1.04	-0.27	-73.8	Currency Adj	1.61	-0.54	
Gross Operating Profit	12.41	13.51		Net Cash Change	-0.35	7.28	
R&D	-14.88	-11.83	-20.5	Balance Sheet	CY15	CY15	% Ch
Expenses	-4.66	-3.94	-15.4	Current Assets	29.83	29.83	
Operating Profit (EBIT)	-7.13	-2.25		Non Current Assets	16.66	16.66	
Interest (Net)	-2.37	-2.04		Total Assets	46.49	46.49	0.00
R&D Refund	6.16	0.16		Current Liabilities	5.24	5.24	
Forex	-0.68	0.77		Non Current Liabilities	25.84	25.84	
Pre-Tax Profit	-4.01	-3.36	-16.3	Total Liabilities	31.08	31.08	0.00
Tax	0.00	0.00		Shareholder Funds	15.41	15.41	0.00
Net Profit	-4.01	-3.36	-16.3	Net Cash (¢ ps)	0.00	1.17	
Gross Margin (%)	92.2	98.0		Net Debt (¢ ps)	3.30	0.00	
Operating Margins (%)	-53.0	-16.3		NTAV (¢ ps)	8.75	4.23	-51.62
R&D/Revenue (%)	110.6	85.8		Net Assets (¢ ps)	8.75	4.80	-45.18
Expenses/Revenue (%)	34.6	28.6		Revenue/Working Capital (x)	1.35	0.90	

Source: UBI

Strip Sales – Sales for the 9 months of CY16 increased by 62% to 1,050m, boosted by strong promotion by LifeScan along with a reduction in non-Verio product offering and an increase in LifeScan’s market share. For the rolling 12 months to 30/9/16, strip sales increased by 69% to 1,338m.

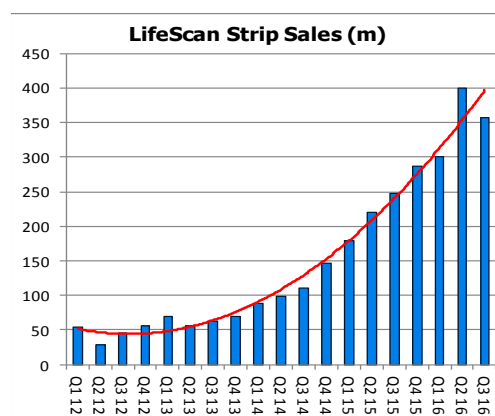
While 3Q sales increased by 41.2% to 348m, they were 10.2% below Q2 CY16, due to a short term supply disruption at LifeScan in August. While there was a partial recovery in September, a full recovery to the normal growth track is expected in Q4.

Revenue - Revenue for the 9 months of CY16 increased by 2.4% to \$13.8m, almost entirely from LifeScan QSFs of \$13.6m, with increased strip sales. This excludes US\$2.5m (A\$3.4m) in Milestone payments, classified as Deferred Revenue. For the rolling 12 months, QSFs increased by 36% to \$16.5m.

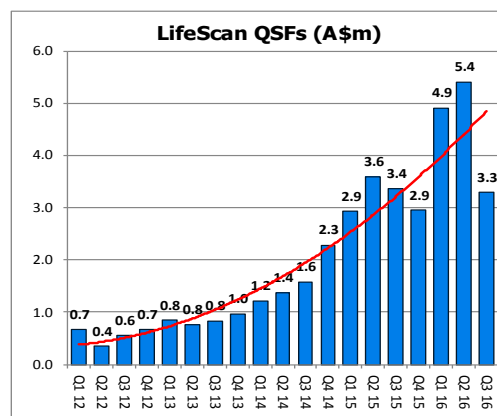
Q3 Revenue fell by 41% to A\$3.3m, due to:

- The lower QSFs due to the LifeScan supply disruption and a lower strip fee rate of US0.75¢ for the full Q3, compared to a mix of US1.25¢ and US0.75¢ per strip in the pcp.
- Lower Revenue of \$0.18m from the sale of strips to Siemens, compared to \$0.65m in the pcp.

Cumulative QSFs increased to US\$31.7m, still well short of the LifeScan option trip level of US\$45m, now expected to be reached in Mid-CY17.



Source:UBI



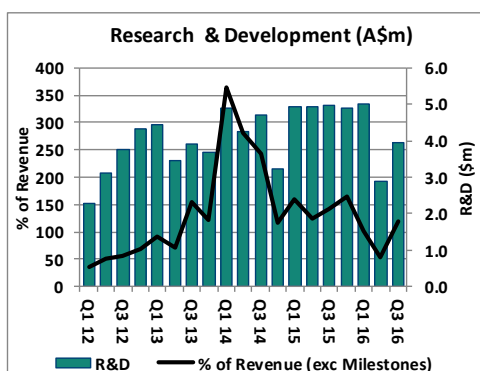
Source:UBI

Operating Profit (EBIT) – Operating Profit for the 9 months of CY16 improved by \$4.9m to a Loss of \$2.3m due to:

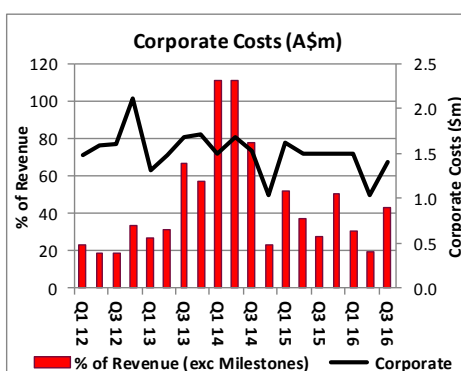
- QSFs - The escalation of strip sales by LifeScan and resultant QSFs, partly offset by a lower contribution from strip sales to Siemens.
- R&D - Reduced R&D payments, down 25.8% to \$11.8m, including 3Q down 26.3% to \$3.9m, from a refocus of the development pipeline with stricter R&D criteria and a focus on ROI.
- Corporate Expenses – Down 18.2% to \$3.9m with 3Q down 8.5% to \$1.4m, reflecting changes in Siemens’ development focus and cost efficiencies.

This excludes a US\$2.5m (A\$3.4m) Milestone payment received from Siemens as part of the changes to the Collaboration Arrangements, classified as Deferred Revenue and to be included as Revenue in CY18.

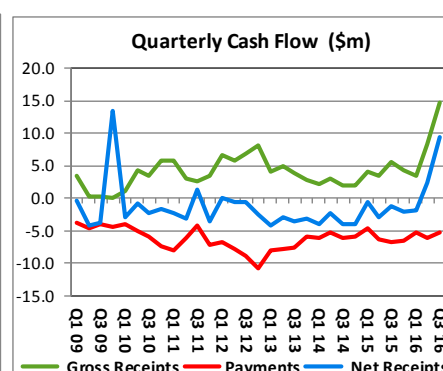
For Q3, the Operating Loss increased by \$1.1m to -\$2.1m with the \$2.7m reduction in Revenue, although partly offset by a reductions in R&D of \$1.0m and Corporate Costs of \$0.1m.



Source: UBI



Source: UBI



Source: UBI

Note: UBI has made no provision for a R&D Cash Refund due to uncertainty around CY16 Revenue exceeding the A\$20m trip level for a R&D Cash Rebate, relating to timing issues on QSFs and Revenue from Siemens. If the potential Cash R&D Rebate (YTD of A\$5.3m, including 3Q of A\$1.8m) is included, Operating Profit for the YTD would have increased to \$3.0m.

Net Profit – The \$0.9m reduction in the Net Loss to -\$3.4m was after:

- A \$0.3m reduction in Net Interest paid, a combination of exchange rates and no additional fees, partly offset by lower Interest Income.
- A \$6.0m reduction in expected R&D Rebates, partly offset by a \$1.0m Forex benefit.

Cash Flow - For the 9 months of CY16, a \$6.2m improvement in Net Cash Inflow to \$7.8m, with:

- Higher strip revenue and lower R&D and Corporate costs.
- A \$9.4m R&D Cash Rebate and A\$3.4m (US\$2.5m) in Milestone payments from Siemens. A further US\$1.25m (A\$1.7m) milestone will be received in 4Q CY16.

Balance Sheet - Key Features were:

- Cash - Gross Cash increased by \$8.4 during Q3 to \$21.6m (12.3¢ ps), with Available Net Cash of \$2.5m. In addition, there is Restricted Cash of \$3.0m (US\$2.0m) required under the Athryrium Agreement and a further \$0.3m of Collateral, classified within Other Non-Current Assets.
- Total Debt of \$19.8m (US\$15m), entirely related to Athryrium, to be repaid with a bullet payment in December CY18.
- Deferred Revenue of \$4.4m, covering the Milestone Payment of \$3.4m received in 2Q, and \$1.1m relating to an allocation of the original Collaboration Agreement in CY11, to be recognised in CY18.
- Other Current and Non-Current Liabilities of \$7.3m, mainly: \$3.0m due to LifeScan for re-imbursement of marketing expenses (\$2.7m) and a part reimbursement of patent fees (A\$0.3m); \$2.6m in Asset Retirement Obligations related to its Melbourne Facility; and \$1.7m in Employee Entitlements.

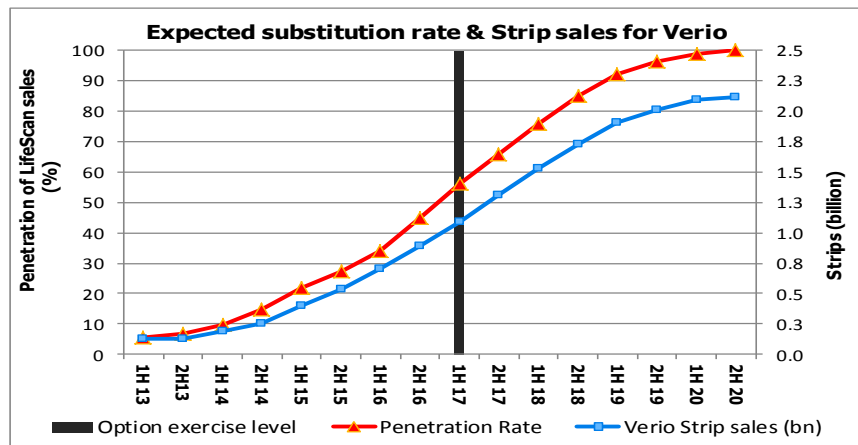
Outlook

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 result will allow the widespread marketing of a generic strip for Ultra 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-2018. 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 exercise at the first opportunity.

On our forecasts, this would result in a one off payment of US\$45.1m (A\$58.9m) in CY17 (to be received within 60 days of Year-end), assuming a A\$:US\$ rate of 0.77¢, as well as a further US\$23.9m (A\$31.3m) in QSFs received for Q4 CY16 and CY17.

Blood Glucose - Forecasts

Option Exercised ²	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 ¹	0.0	18.2	27.0				12.8	18.2	27.0			
Lump Sum									59.5			
Total	0.0	18.2	27.0	0.0	0.0	0.0	12.8	18.2	86.6			

Source : UBI (Act), Veritas (Est)

¹ at A\$:US\$ rate of 0.76

² Option exercised at 1st 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 is outlined in Appendix 2 on Page 10.

Blood Coagulation

PT/INR - While cumulative strip revenue is only \$1.7m, sales are expected to escalate from:

- US FDA Clearance, announced on 5/10/16. UBI will commence strip sales in the USA in either Q4 CY16 or Q1 CY17, ahead of an expected launch in CY17.
- The benefit of 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.

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.

Blood Coagulation - Combined

Calendar Year		2014	2015	2016	2017	2018	2019	2020
Revenue	A\$m	0.2	1.3	1.3	5.1	9.9	21.2	29.7
<i>Increase</i>	%		561.5	-2.9	300	93.1	113.8	39.9
EBIT	A\$m	0.0	0.2	0.4	1.9	4.0	9.7	14.9
<i>Increase</i>	%		na	141	329	106.5	142.5	53.8
Margin	%		14.1	35.0	37.5	40.1	45.5	50.0

Source: Veritas

at A\$:US\$ rate of 0.76

Milestone Payments

As part of 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			0.9		
Total Revenue Recognised	US\$m	1.4	1.4			4.6		
Revenue Recognised	A\$m	1.8	2.0		0.0	6.1		
less Arthyrium Payments	A\$m	-0.4	-0.4					
Net Revenue	A\$m	1.4	1.5	0.0	0.0	6.1		
Cash Flow impact	A\$m	0.9	0.9	4.9	0.0	0.0		

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’ tests and UBI’s Self-Test from CY18.
- R&D up to completion and clearance of the additional Blood Coagulation tests, with no further R&D Cash Rebates.
- 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	18.2	27.0	0.0	0.0	0.0	18.2	27.0	0.0	0.0	0.0
Lump Sum - LifeScan		59.5					59.5			
Strip Sales - Siemens	1.3	5.1	9.9	21.2	29.7	0.4	1.9	4.0	9.7	14.9
Milestones	0.0	0.0	6.1	0.0	0.0	0.0	0.0	6.1	0.0	0.0
R&D						-17.0	-16.0	-13.0	0.0	0.0
Corporate						-5.4	-5.4	-5.4	-5.0	-5.0
Total	19.4	91.7	16.0	21.2	29.7	-3.8	67.1	-8.3	4.7	9.9

Source: Veritas Forecasts

Interest – Annual Interest Payments of US\$1.58m pa (A\$2.1m) for CY16 to CY17, with Debt prepaid 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 CY16, we expect a combined tax credit of around \$18m 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 \$60m in possible Non-Tax Assessable Profit.

Note: We have taken a conservative approach, with no provision for a R&D Cash refund in CY16, due to uncertainty around CY16 Revenue exceeding the A\$20m trip level for a Cash R&D Rebate. This uncertainty relates to the escalating level of QSFs and the timing of strip sales to Siemens ahead of the US launch in CY17.

If the potential Cash R&D Rebate (Forecasts at A\$5.3m) is included, EBIT for the CY16 would increase by \$8.2m to \$3.9m, with a similar increase in Cash on the Balance Sheet in CY17.

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 \$116m (\$0.66ps), 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 (65¢ ps) for Siemens and UBI's Self-Test

Corporate/R&D – A combined DCF of -\$90.3 (51¢ ps) for Ongoing Corporate Costs and R&D expense to CY18. R&D has only been included to CY18, covering completion of the remaining Blood Coagulation products.

Milestones – All milestones and any outgoings related to those milestones, with expectations of a Net \$1.6m (0.9¢ ps) in FY16.

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

Net Cash/Debt – \$5.7m (3.2¢ ps) as at 30/9/16, including Restricted Cash (Athyrium requirement) of A\$3.2m.

VALUATION			
Sum of Parts Segment	Valuation Method	Valuation \$m	Valuation ¢ ps
Blood Glucose	DCF	85.5	48.5
Blood Coagulation	DCF	116.2	66.0
Corporate/R&D	DCF	-90.3	-51.2
Operating Assets		111.5	63.3
Milestones	DCF	1.6	0.9
Other		-0.3	-0.2
Net Cash/Debt (exc Lump Sum)		5.7	3.2
Valuation		118.4	67.3
Current Price (¢ps)			33.0

Source: Veritas

If all Options and Warrants with an Exercise Price below above Valuation are exercised, the Valuation would only fall to \$0.65 ps.

We believe this Valuation is conservative, as:

- If the \$8.2m R&D Cash Rebate for CY16 is applicable, this Valuation would increase by 4.6¢ ps.
- Continuation of the LifeScan arrangement beyond the Option exercise date would boost this valuation (see Appendix 2 on Page 10).
- The valuation assumes continued R&D expenditure to CY18 for completion of all Blood Coagulation products.
- The discount rates are very conservative to reflect the nature of the forecasts, with respect to timing and growth rates.
- The valuation assumes UBI will not receive a Cash R&D Rebate for CY16, which if eligible would boost Cash in CY17 by around \$8.2m.
- This doesn't included any value of IP beyond Blood Coagulation, with over \$100m spent over the last 12 years, or 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). Also, depreciation is a component of Operating Costs and R&D.
- Any further falls in the A\$ or potential corporate action would increase this valuation.

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 ¹	12.8	18.2	27.0	35.5	42.0	44.9	12.8	18.2	27.0	35.5	42.0	44.9
Change (%)		41.5	48.9	31.3	18.2	7.1		41.5	48.9	31.3	18.2	7.1

Source : UBI (Act), Veritas (Est) ¹ 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	18.2	27.0	35.5	42.0	44.9	18.2	27.0	35.5	42.0	44.9
Strip Sales - Siemens	1.3	5.1	9.9	21.2	29.7	0.4	1.9	4.0	9.7	14.9
Milestones	0.0	0.0	6.1	0.0	0.0	0.0	0.0	6.1	0.0	0.0
R&D						-17.0	-16.0	-13.0	0.0	0.0
Corporate						-5.4	-5.4	-5.4	-5.0	-5.0
Total	19.4	32.2	51.5	63.2	74.7	-3.8	7.6	27.2	46.6	54.8

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 \$1.90 ps:

VALUATION			
Sum of Parts Segment	Valuation Method	Valuation \$m	Valuation cps
Blood Glucose	DCF	301	171
Blood Coagulation	DCF	116	66
Corporate/R&D	DCF	-90	-51
Operating Assets		327	186
Milestones	DCF	1.6	1
Other		-0.3	0
Net Debt (exc Lump Sum)		5.7	3
Valuation		334	190
Current Price (cps)			33

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 \$1.75 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 Quarterly Service Fees (QSFs) into a lump sum payment, once the cumulative QSFs reach US\$45m. As at 30/9/16, cumulative QSFs had reached US\$31.7m.

With our forecasts of cumulative QSFs reaching US\$45m in **Mid-CY17** and the option exercised at that time, it will result in total future payments of US\$69.1m (A\$90.1m), comprising:

Calculator	US\$m	A\$m	¢ ps
Received as revenue			
QSFs until US \$45m	13.3	17.5	
Balance for FY17	10.7	14.1	
	24.0	31.6	17.9
Multiplier			
QSFs for CY17	US\$21	2.2x	45.1 59.5 33.8
Total	69.1	91.1	51.7

Source: Veritas

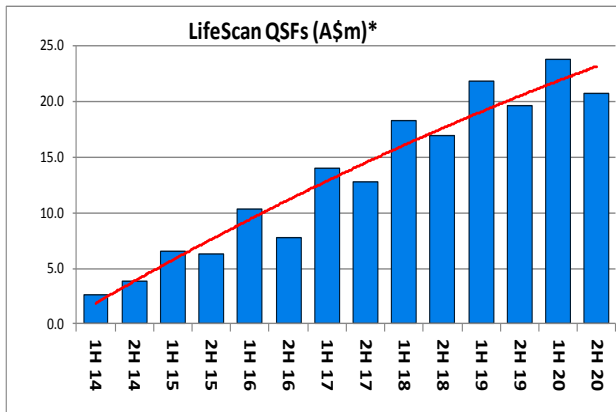
A shorter time in reaching that agreement would result in a higher total, due to the multiplier effect on higher Calendar Year QSFs.

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 a Lump sum payment of A\$88.2m, as well as Cumulative Revenue of A\$109.1m.



Source: Veritas * at A\$:US\$ rate of 0.77

	*2016	2017	2018	2019	2020
Yearly	A\$m	A\$m	A\$m	A\$m	A\$m
Received as Revenue	4.6	27.0	35.5	42.0	44.9
Multiplier (One-Off)		59.5	74.6	88.2	89.9
Total for each Year	4.6	86.6	110.1	130.1	134.8
¢ ps		49.1	62.4	73.7	76.4
Cumulative					
Cumulative Revenue	4.6	31.6	67.1	109.1	154.0
Cumulative Total	4.6	91.1	141.7	197.3	243.9
¢ ps		51.7	80.3	111.8	138.2

Source: Veritas * Q4 Only

Cons – It will initially involve a substantial lump sum payment, possibly over US\$45m. 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.

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BUY – anticipated stock return is greater than 10%
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 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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