30 June 2014

# UNIVERSAL BIOSENSORS INC (UBI)

Wilson HTM INVESTMENT GROUP | *A Leading Wealth Manager and Adviser to Emerging Companies*

BUY **HOLD** SELL

## ACTION & RECOMMENDATION

**UBI's coagulation business advanced last week, with Siemens placing its first order for PT-INR strips, ahead of a potential Q3 launch. It will take a number of years before PT-INR strip sales can support UBI's current cost structure and generate enough free cash to pay back debt. We assess 44 cps of potential value in UBI, split more or less equally between glucose and coagulation. The operating business (cutting out research, only doing development, funded by partners' money) would be worth 50% more. Our inclination is to exit the investment as we doubt the group's commitment to shareholder value. There are conditions under which the stock could be worth 2-3x current market value. Our 25 cps PT and HOLD rating remain.**

| | |
|---|---|
| **12m Target Price** (AUD) | **$0.25** |
| Share Price @ 26-Jun-14 (AUD) | $0.20 |
| Fcst 12m Capital Return | 25.0% |
| Fcst 12m Dividend Yield | 0.0% |
| **12m Total S'holder Return** | **25.0%** |


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## Bleeding out

Company Update

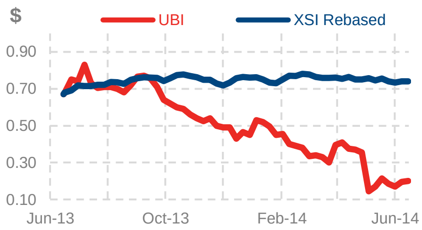
### What's Changed

- **UBI shipping PT/INR product to Siemens** – UBI has received its first commercial order from Siemens for the production and supply of PT-INR test strips. These strips are the major consumable associated with Siemens' xPrecia Stride product for point-of-care blood coagulation testing. Clinical work needs to be completed before approval and anticipated launch in Q3. The product can be "self-certified" in Europe but requires a 510(k) clearance by the FDA.
- **Forecasts** – we have marked down our quarterly service fee (QSF) expectations from UBI's glucose business to amplify the importance of the coagulation earnings, which have greater longevity. The group's medium-term financial viability depends on QSFs and debt.
- **Valuation** – we assess 44 cps of potential value in UBI of which 24.5 cps represents glucose. Coagulation value is 19.5 cps by difference. That valuation includes PT-INR, the second and third products under the Siemens agreement and the patient self-testing applications for coagulation monitoring, for which UBI must find distributors. Eliminating R&D expenses would increase coagulation portfolio valuation to 43 cps.

### Risks & Catalysts

- **Catalysts**: a) quarterly service fees; b) progress with Siemens product approvals and launch; c) partnering outcomes on patient self-testing (coagulation); d) changes to board and management.
- **Risks**: a) poor execution; b) governance record; c) lower than forecast product demand; d) product recalls; e) expense control.

**12m Share Price Performance**




| | 1m | 6m | 12m |
|---|---|---|---|
| Abs. Return (%) | 11.1 | -53.5 | -70.1 |
| Rel. Return (%) | 12.8 | -51.3 | -80.5 |

WHTM Return Re-investment Matrix

| Return | Re-Investment: Low | Re-Investment: High |
|---|---|---|
| High | Cash Generator | Champion |
| Low | Challenged | **Potential** |

WHTM Risk Assessment

| | Low | Med | High | Spec |
|---|---|---|---|---|
| Share Price Risk | | | | ■ |
| Business Risk | | | | ■ |

| Year-end December (AUD) | FY12A | FY13A | FY14E | FY15E | FY16E |
|---|---|---|---|---|---|
| NPAT Rep ($m) | -9.1 | -11.6 | -9.6 | -7.8 | -1.9 |
| NPAT Norm ($m) | -9.1 | -11.6 | -9.6 | -7.8 | -1.9 |
| Consensus NPAT ($m) | | | -8.3 | 5.5 | 14.4 |
| EPS Norm (cps) | -5.5 | -6.7 | -5.5 | -4.5 | -1.1 |
| EPS Growth (%) | 39 | -23 | 18 | 19 | 75 |
| P/E Norm (x) | -3.7 | -3.0 | -3.6 | -4.5 | -18.0 |
| EV / EBITDA (x) | -4.1 | -3.1 | -2.6 | -4.6 | 23.5 |
| FCF Yield (%) | -9.4 | -47.4 | -0.8 | -25.7 | -4.4 |
| DPS (cps) | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 |
| Dividend Yield (%) | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 |
| Franking (%) | 0 | 0 | 0 | 0 | 0 |

**Mkt Cap:** $35m **Enterprise Value:** $28m **Shares:** 175m **Sold Short:** %

| Key Changes | | 13-May | After | Var % |
|---|---|---|---|---|
| **NPAT:** | **FY14** | -8.2 | -9.6 | N/A |
| **Norm** | **FY15** | 5.5 | -7.8 | <-99% |
| ($m) | **FY16** | 14.4 | -1.9 | <-99% |
| **EPS:** | **FY14** | -4.7 | -5.5 | N/A |
| **Norm** | **FY15** | 3.1 | -4.5 | <-99% |
| (cps) | **FY16** | 8.2 | -1.1 | <-99% |
| **DPS:** | **FY14** | 0.0 | 0.0 | 0.0% |
| (cps) | **FY15** | 0.0 | 0.0 | 0.0% |
| | **FY16** | 0.0 | 0.0 | 0.0% |
| **Price Target:** | | **0.25** | **0.25** | **0.0%** |
| **Rec:** | | **HOLD** | **HOLD** | |

**ASX 300 wgt:** n/a **Median T'over/Day:** $0.0m

## PRICE TARGET

| | Valuation | Price Target |
|---|---|---|
| Discount rate (%) | 14.0 | |
| Terminal growth (%) | 0.0 | |
| NPV of FCFs ($M) | 32.1 | |
| NPV of perpetuity ($M) | 52.9 | |
| Valuation ($M) | 85.0 | |
| **Valuation (A$/share)** | | **0.44** |
| **Target price (A$/share)** | | **0.25** |

## INTERIMS ($m)

| Half Yr (AUD) | Jun 13 | Dec 13 | Jun 14 | Dec 14 |
|---|---|---|---|---|
| | 1HA | 2HA | 1HE | 2HE |
| Sales | 9.6 | 5.5 | 2.4 | 5.3 |
| EBITDA | -6.7 | -2.4 | -7.6 | -3.3 |
| EBIT | -8.0 | -3.6 | -9.1 | -4.8 |
| **Net Profit** | **-7.7** | **-3.9** | **-10.0** | **0.3** |
| **Norm. EPS** | **-4.5** | **-2.3** | **-5.7** | **0.2** |
| EBIT/Sales | -83.2 | -65.9 | -384.4 | -90.8 |
| Dividend (c) | 0.0 | 0.0 | 0.0 | 0.0 |
| Franking (%) | 0.0 | 0.0 | 0.0 | 0.0 |

## FINANCIAL STABILITY

| Year-end December | FY13A | FY14E | FY15E |
|---|---|---|---|
| Net Debt | -7.9 | -6.7 | 3.3 |
| Net Debt / Equity (%) | <0 | <0 | 26.8 |
| **Net Debt / EV (%)** | **<0** | **<0** | **11.5** |
| Current Ratio (x) | 10.1 | 1.9 | 1.5 |
| Interest Cover (x) | <0 | <0 | <0 |
| **Adj. Cash Int. Cover (x)** | **<0** | **<0** | **<0** |
| Debt / CashFlow (x) | 0.0 | <0 | <0 |
| Net Debt (cash) / share | <0 | <0 | 0.0 |
| NTA / share ($) | 0.2 | 0.1 | 0.1 |
| Book Value / share ($) | 0.2 | 0.1 | 0.1 |
| Payout Ratio (%) | 0 | 0 | 0 |
| Adj. Payout Ratio (%) | 0 | 0 | 0 |

## EPS RECONCILIATION ($m)

| | FY13A | | FY14E | |
|---|---|---|---|---|
| | Rep. | Norm. | Rep. | Norm. |
| Sales Revenue | 15 | 15 | 8 | 8 |
| EBIT | -11.6 | -11.6 | -14.0 | -14.0 |
| **Net Profit** | **-11.6** | **-11.6** | **-9.6** | **-9.6** |
| Notional Earn. | 0.0 | 0.0 | 0.0 | 0.0 |
| Pref./Conv. Div. | 0.0 | 0.0 | 0.0 | 0.0 |
| **Profit for EPS** | **-11.6** | **-11.6** | **-9.6** | **-9.6** |
| Diluted Shrs(m) | 173 | 173 | 175 | 175 |
| **Diluted EPS (c)** | **-6.7** | **-6.7** | **-5.5** | **-5.5** |

## RETURNS

| | FY13A | FY14E | FY15E | FY16E |
|---|---|---|---|---|
| ROE (%) | -33.7 | -38.8 | -48.6 | -17.3 |
| ROIC (%) | -43.3 | -55.7 | -45.3 | -9.6 |
| Incremental ROE | 93.7 | -20.6 | -20.5 | -120.4 |
| Incremental ROIC | -151.1 | 140.1 | -102.8 | 368.4 |

## KEY ASSUMPTIONS

| Year-end December (AUD) | FY09A | FY10A | FY11A | FY12A | FY13A | FY14E | FY15E | FY16E |
|---|---|---|---|---|---|---|---|---|
| Revenue Growth (%) | | 8,759.9 | 25.0 | 101.7 | -49.1 | -48.9 | 65.2 | 75.3 |
| EBIT Growth (%) | 17.5 | -53.5 | 93.6 | -37.7 | 21.0 | 20.5 | -33.2 | -76.9 |
| NPAT Growth (%) | 35.8 | -59.4 | 122.3 | -37.8 | 27.4 | -17.1 | -18.6 | -75.2 |
| **EPS Growth (%)** | **35.8** | **-59.9** | **119.9** | **-38.8** | **23.0** | **-18.1** | **-18.6** | **-75.2** |
| EBIT / Sales (%) | -12,863.7 | -67.5 | -104.6 | -32.3 | -76.8 | -181.3 | -73.3 | -9.7 |
| Tax Rate (%) | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 38.4 | 33.8 | 60.6 |
| **ROA (%)** | **-32.4** | **-14.6** | **-32.0** | **-19.5** | **-21.2** | **-27.1** | **-18.3** | **-4.3** |
| **ROE (%)** | **-34.4** | **-13.5** | **-36.0** | **-23.2** | **-39.2** | **-48.1** | **-64.3** | **-19.0** |

## PROFIT & LOSS ($m)

| Year-end December (AUD) | FY09A | FY10A | FY11A | FY12A | FY13A | FY14E | FY15E | FY16E |
|---|---|---|---|---|---|---|---|---|
| Sales Revenue | 0.1 | 11.8 | 14.7 | 29.6 | 15.1 | 7.7 | 12.7 | 22.3 |
| EBITDA | -14.2 | -5.0 | -12.1 | -6.9 | -9.1 | -10.9 | -6.1 | 1.2 |
| Depn & Amort | 2.9 | 3.0 | 3.3 | 2.6 | 2.5 | 3.0 | 3.2 | 3.4 |
| **EBIT** | **-17.1** | **-7.9** | **-15.4** | **-9.6** | **-11.6** | **-14.0** | **-9.3** | **-2.2** |
| Net Interest Expense | -0.8 | -1.2 | -0.7 | -0.4 | 0.0 | 1.7 | 2.5 | 2.8 |
| Tax | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | -6.0 | -4.0 | -3.0 |
| Minorities / pref divs | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 |
| Equity accounted NPAT | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 |
| **Net Profit pre Sig. Items** | **-16.3** | **-6.6** | **-14.7** | **-9.1** | **-11.6** | **-9.6** | **-7.8** | **-1.9** |
| Abn's / Ext's / Signif. | 17.7 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 |
| **Reported Net Profit** | **1.4** | **-6.6** | **-14.7** | **-9.1** | **-11.6** | **-9.6** | **-7.8** | **-1.9** |

## CASH FLOW ($m)

| Year-end December (AUD) | FY09A | FY10A | FY11A | FY12A | FY13A | FY14E | FY15E | FY16E |
|---|---|---|---|---|---|---|---|---|
| EBITDA | -14.2 | -5.0 | -12.1 | -6.9 | -9.1 | -10.9 | -6.1 | 1.2 |
| Interest & Tax | 0.8 | 1.2 | 0.7 | 0.5 | 0.0 | -1.7 | -2.5 | -2.8 |
| Working Cap / Other | 15.1 | -2.7 | 4.2 | 3.2 | -7.5 | 12.3 | -0.4 | 0.0 |
| **Operating Cash Flow** | **1.6** | **-6.4** | **-7.2** | **-3.3** | **-16.6** | **-0.3** | **-9.0** | **-1.6** |
| Maintenance Capex | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 |
| **Free Cash Flow** | **1.6** | **-6.4** | **-7.2** | **-3.3** | **-16.6** | **-0.3** | **-9.0** | **-1.6** |
| Dividends Paid | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 |
| Growth Capex | -3.0 | -2.3 | -1.1 | -0.7 | -0.2 | -0.9 | -1.0 | -1.0 |
| Invest. / Disposals | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 |
| Other Inv. Flows | 0.0 | 0.0 | 0.0 | -0.6 | -0.6 | 0.0 | 0.0 | 0.0 |
| **Cash Flow Pre Financing** | **-1.3** | **-8.7** | **-8.3** | **-4.6** | **-17.4** | **-1.2** | **-10.0** | **-2.5** |
| Funded by Equity | 0.1 | 0.7 | 0.1 | 13.2 | 0.0 | 0.0 | 0.0 | 0.0 |
| Funded by Debt | 0.0 | 0.0 | 0.0 | 0.0 | 16.9 | 0.0 | 10.8 | 0.0 |
| Funded by Cash | 1.3 | 8.0 | 8.2 | -8.6 | 0.4 | 1.2 | -0.8 | 2.5 |

## BALANCE SHEET SUMMARY ($m)

| Year-end December (AUD) | FY09A | FY10A | FY11A | FY12A | FY13A | FY14E | FY15E | FY16E |
|---|---|---|---|---|---|---|---|---|
| Cash | 31.3 | 23.3 | 15.1 | 23.6 | 23.7 | 22.6 | 23.3 | 20.8 |
| Current Receivables | 0.4 | 3.6 | 4.9 | 2.3 | 2.2 | 0.1 | 0.6 | 1.8 |
| Current Inventories | 0.3 | 3.2 | 3.6 | 3.6 | 0.0 | 3.0 | 3.0 | 6.0 |
| Net PPE | 21.3 | 23.1 | 20.3 | 18.3 | 15.9 | 13.8 | 11.5 | 9.2 |
| Investments | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 |
| Intangibles / Capitalised | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 |
| Other | 2.8 | 0.7 | 1.3 | 1.3 | 12.8 | 12.1 | 12.5 | 12.9 |
| **Total Assets** | **56.1** | **53.8** | **45.2** | **49.1** | **54.6** | **51.6** | **51.0** | **50.6** |
| Current Payables | 0.4 | 1.8 | 0.6 | 2.5 | 1.0 | 7.0 | 2.9 | 3.8 |
| Total Debt | 0.0 | 0.0 | 0.0 | 0.0 | 15.9 | 15.9 | 26.6 | 26.6 |
| Other Liabilities | 4.3 | 4.9 | 9.6 | 7.2 | 8.1 | 8.7 | 9.3 | 10.0 |
| **Total Liabilities** | **4.8** | **6.6** | **10.2** | **9.7** | **24.9** | **31.5** | **38.8** | **40.4** |
| Minorities / Convertibles | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 |
| **Shareholder Equity** | **51.3** | **47.2** | **35.0** | **39.4** | **29.7** | **20.0** | **12.2** | **10.3** |
| **Total Funds Employed** | **51.3** | **47.2** | **35.0** | **39.4** | **45.5** | **35.9** | **38.8** | **36.9** |

# Coagulation progress and valuation update

## MOVEMENT ON COAGULATION BUSINESS

**Shipping PT-INR product to Siemens** – UBI has received its first commercial order from Siemens for the production and supply of PT-INR test strips. These strips are the major consumable associated with Siemens' xPrecia Stride product for point-of-care coagulation testing. Essentially, Siemens' has placed a first stocking order, ahead of anticipated launch in Q3.

*Siemens' stocking order signals progress towards commercialising UBI's PT-INR product*

**Clinical work needs to be completed before approval** – we understand that the clinical testing phase for the product is continuing, collecting clinical data that will ultimately be filed with regulators. The product can be "self-certified" in Europe, which makes this the most likely region for launch. The regulatory process in USA requires a 510(k) application to the US Food and Drug Administration, which can take 3-6 months to approve, post filing.

**Recapping on the Siemens deal** – the deal between Siemens and UBI is in relation to this PT-INR product and two further diagnostic strips in development, which have not been disclosed. UBI will manufacture the product from its facility in Rowville and sell strips exclusively to Siemens for a "per strip" transfer price. Siemens has global rights to sell UBI's product, but only in "professional" healthcare settings, such as hospitals and clinics. UBI has retained the rights to sell a less complicated, cheaper product to the homecare setting, in which Siemens does not participate. We estimate global demand of c.110m PT-INR strips in professional settings.

*UBI is the manufacturer of PT-INR blood testing strips, which it supplies exclusively to Siemens for sale in "professional" settings*

UBI has invested R&D expense in developing these products and is part-compensated for that financial risk by milestone payments based on achieving development milestones. We anticipate the next milestone is payable on an approval of PT-INR. The quantum of the outstanding milestones are not disclosed – but we assume a further c.$7m in milestone payments are receivable over FY14-16 as PT-INR and other products reach major market approvals.

### TABLE 1: ESTIMATED REVENUE OPPORTUNITY FOR PT-INR STRIP PRODUCTS

| | FY13 | FY14 | FY15 | FY16 | FY17 | FY18 | FY19 | FY20 | FY21 |
|---|---|---|---|---|---|---|---|---|---|
| Hospital Market (US$M) | 200 | 220 | 233 | 249 | 266 | 282 | 299 | 315 | 331 |
| Clinics Markets (US$M) | 380 | 415 | 439 | 468 | 497 | 526 | 556 | 585 | 614 |
| Strip market (90%) | 522 | 572 | 604 | 645 | 687 | 728 | 769 | 810 | 851 |
| **Global Strip volumes (M)*** | **100** | **110** | **116** | **124** | **132** | **140** | 148 | 156 | 164 |
| Siemens market share | - | 0.2% | 1.7% | 3.7% | 5.8% | 8.5% | 13.3% | 19.3% | 20.0% |
| UBI PT-INR strips (M) | - | 0.3 | 2.0 | 4.6 | 7.6 | 12.0 | 19.8 | 30.1 | 32.7 |
| **UBI PT-INR product sales (A$m)** | **-** | **0.3** | **1.8** | **4.4** | **7.6** | **12.0** | **19.8** | **30.1** | **32.7** |

*Source: WHTM Research*

**No buy-out clause here** – there is no provision in the UBI-Siemens agreement for Siemens paying a lump sum amount to extinguish future payments. Siemens does have future rights to assume manufacturing responsibilities, but must pay UBI an ongoing per strip fee, which is understood as similar to UBI's gross profit as a strip manufacturer. The agreement is for ten years initially, and is renewable in three-year increments, thereafter, at Siemens' option. Siemens' obligations to pay UBI also depend on UBI maintaining valid patent rights and other forms of intellectual property rights over the life of the agreement. All intellectual property rights revert to UBI in the event of termination.

*Siemens has rights to assume manufacturing but must continue to pay "per strip" fees to UBI*

**Revenue profile and valuation dominated now by coagulation** – having assumed that LifeScan will seek to terminate its relationship with UBI via a lump sum payment in 2018/9, the coagulation products form the basis for UBI's valuation and longer-term outlook. Important assumptions include:

*We have cut glucose forecasts, principally to "stress test" the model for medium-term financial viability*

- continuing growth in service fees received from LifeScan, with cumulative receipts reaching US$45m in 2018 triggering a lump sum payment of US$29m (A$37m) in the same year.
- Siemens products 2 and 3 (in aggregate) are modelled at half the revenue of PT-INR (launching in 2015 and 2016);
- gross margin on Siemens products 50-55%; and
- patient self-test (PST) revenue opportunity modelled at half the PT-INR market and ignores the potential meter sales. Launching towards end of 2015.

*We have delayed the lump sum payment trigger into FY18, to coincide with UBI's debt repayment to Athyrium*

## TABLE 2: EARNINGS PROFILE FY14-22E

| A$m | FY14 | FY15 | FY16 | FY17 | FY18 | FY19 | FY20 | FY21 | FY22 |
|---|---|---|---|---|---|---|---|---|---|
| **SMBG business (LifeScan)** | | | | | | | | | |
| Service Fees on strips | 5.4 | 8.2 | 12.4 | 15.1 | 18.6 | - | - | - | - |
| Lump Sum Service Fee | - | - | - | - | 37.1 | - | - | | |
| R&D Revenue (AUDm) | - | - | - | - | - | - | - | - | - |
| **Coagulation (Siemens)** | | | | | | | | | |
| Siemens Milestone Payments | 2.0 | 2.0 | 3.3 | - | - | - | - | - | - |
| PT/INR Revenue | 0.3 | 1.8 | 4.4 | 7.6 | 12.0 | 19.8 | 30.1 | 32.7 | 37.6 |
| #2 and #3 | - | 0.4 | 2.0 | 4.9 | 8.1 | 11.5 | 15.5 | 19.5 | 22.4 |
| **Coagulation (PST)** | 0.0 | 0.4 | 1.5 | 4.2 | 7.9 | 11.9 | 16.6 | 19.5 | 24.3 |
| **REVENUE** | **7.7** | **12.7** | **23.6** | **31.9** | **83.6** | **43.2** | **62.1** | **71.7** | **84.4** |
| Product COGS | 0.2 | 1.2 | 3.7 | 7.7 | 12.7 | 19.6 | 28.3 | 32.6 | 38.1 |
| **GROSS PROFIT** | **7.5** | **11.5** | **19.9** | **24.2** | **70.9** | **23.6** | **33.8** | **39.1** | **46.2** |
| *gross margin* | *97.9%* | *90.4%* | *84.3%* | *76.0%* | *84.8%* | *54.6%* | *54.4%* | *54.5%* | *54.8%* |
| R&D Expense | 10.5 | 9.5 | 9.1 | 8.4 | 8.0 | 8.0 | 8.0 | 8.0 | 8.0 |
| SG&A | 8.0 | 8.1 | 8.3 | 8.5 | 8.6 | 8.8 | 9.0 | 9.2 | 9.3 |
| **EBITDA** | **(10.9)** | **(6.1)** | **2.5** | **7.4** | **54.3** | **6.8** | **16.8** | **21.9** | **28.9** |
| *EBITDA margin* | | | *10.4%* | *23.1%* | *65.0%* | *15.7%* | *27.1%* | *30.6%* | *34.2%* |
| EBIT | (14.0) | (9.3) | (2.2) | 3.8 | 50.6 | 2.9 | 12.7 | 17.6 | 24.4 |
| Net interest | (1.7) | (2.5) | (2.8) | (2.8) | (1.4) | 0.0 | 0.0 | 0.0 | 0.0 |
| PBT | (15.6) | (11.8) | (4.9) | 1.0 | 49.2 | 2.9 | 12.7 | 17.6 | 24.4 |
| Tax expense/rebates | 6.0 | 4.0 | 3.0 | - | - | - | - | - | (6.1) |
| **NPAT (A$m)** | **(9.6)** | **(7.8)** | **(1.9)** | **1.0** | **49.2** | **2.9** | **12.7** | **17.6** | **18.2** |
| **EPS (cps)** | | | | **0.6** | **28.1** | **1.6** | **7.3** | **10.1** | **10.4** |

*Source: WHTM Research*

**Glucose business underpins short-term business viability**. The coagulation business would need to develop for several years before it could support UBI's current cost structure. Continuing growth in the glucose business therefore remains the key to UBI remaining solvent over the next five years, even having assumed a further US$10m drawdown from its debt facility in 2015.

*We think UBI will draw down US$10m in debt next year, increasing net interest expense*

## TABLE 3: CASH FLOW AND VALUATION FRAMEWORK FY14-22E

| **Cash flow** | FY14 | FY15 | FY16 | FY17 | FY18 | FY19 | FY20 | FY21 | FY22 |
|---|---|---|---|---|---|---|---|---|---|
| EBIT | (14.0) | (9.3) | (2.2) | 3.8 | 50.6 | 2.9 | 12.7 | 17.6 | 24.4 |
| D&A | 3.0 | 3.2 | 4.6 | 3.5 | 3.7 | 3.9 | 4.1 | 4.3 | 4.5 |
| Interest, tax, other | 10.7 | (2.9) | (4.0) | (9.1) | (3.7) | (3.2) | (3.5) | (1.5) | (9.5) |
| **Operating cash flow** | **(0.3)** | **(9.0)** | **(1.6)** | **(1.8)** | **50.6** | **3.6** | **13.3** | **20.4** | **19.4** |
| | | | | | | | | | |
| **Capex** | **(0.9)** | **(1.0)** | **(1.0)** | **(1.0)** | **(1.1)** | **(1.1)** | **(1.2)** | **(1.2)** | **(1.2)** |
| **Financings** | **-** | **10.8** | **-** | **-** | **(30.1)** | **-** | **-** | **-** | **-** |
| Aggregate cash flow | (1.2) | 0.8 | (2.5) | (2.8) | 19.4 | 2.5 | 12.2 | 19.2 | 18.2 |
| **Closing cash** | **22.6** | **23.3** | **20.8** | **18.0** | **37.4** | **39.9** | **52.1** | **71.3** | **89.4** |

| **DCF** | FY14 | FY15 | FY16 | FY17 | FY18 | FY19 | FY20 | FY21 | FY22 |
|---|---|---|---|---|---|---|---|---|---|
| Post-tax EBIT | (8.0) | (5.3) | 0.8 | 3.8 | 50.6 | 2.9 | 12.7 | 17.6 | 18.2 |
| D&A | 3.0 | 3.2 | 3.4 | 3.5 | 3.7 | 3.9 | 4.1 | 4.3 | 4.5 |
| Chg W/C | (0.2) | (4.4) | (3.0) | (3.2) | (2.5) | (1.2) | (1.2) | (1.2) | (0.4) |
| Capex | (0.9) | (1.0) | (1.0) | (1.0) | (1.1) | (1.1) | (1.2) | (1.2) | (1.2) |
| **FCFF** | **(6.0)** | **(7.5)** | **0.2** | **3.1** | **50.8** | **4.5** | **14.5** | **19.5** | **21.1** |
| **Terminal value (TV)** | | | | | | | | | **151.0** |

| | |
|---|---|
| Discount rate | 14.0% |
| Terminal growth | 0.0% |
| | |
| NPV FFCFs | 32.1 |
| NPV TV | 52.9 |
| Asset value | 85.0 |
| **Valuation (/sh)** | **0.44** |

*Source: WHTM Research*

**Valuation more equally distributed between glucose and coagulation**. We assess 44 cps value in the stock by DCF, having pared back our glucose forecasts to extend the lump sum trigger into 2018. Although the NPV of coagulation revenues is more than twice that of glucose, glucose remains the more valuable asset because its cash flows are nearer term and they are shareholders' near-term protection from losing the value of the investment through dilution or worse.

It is difficult to arrive at a sensible stand-alone valuation for coagulation because the business would need new equity capital, if denied the glucose quarterly service fees. Coagulation is unlikely to generate enough free cash in time to pay back the US$15m debt held by Athyrium Capital Management, which falls due by the end of 2018. The NPV of glucose (cost-free cash flows for UBI) is c.24.5 cps. Coagulation is perhaps worth 19.5 cps by difference, although we recognise the shortcomings of that approach. Stripping out R&D (modelled at c.$8m per year) would increase the group valuation to 68 cps – implying 43 cps for coagulation.

We have maintained our price target at 25 cps which reflects a c.40% discount to valuation.

## WHAT TO DO WITH THE STOCK AND WHAT TO WATCH OUT FOR

We maintain a HOLD rating on the stock notwithstanding a 25% total shareholder return. Credibility and execution risks for this company remain high, so that we would need to see the stock become a) cheaper or b) substantially de-risked before recommending buying it, however speculatively. Our inclination is to exit the stock, but there are conditions under which the stock could be worth 2-3x current market value; so we remain disinclined to sell out at these levels. The following catalysts could push the share price above our target price and closer to the 44 cps fair value:

- **Quarterly service fees** – the trajectory of this revenue stream remains important if UBI expects to maintain decent cash levels in FY16 and FY17. Our forecasts have working capital requirements intensifying in FY15-17 as UBI extends to producing three products from the Rowville plant. Anything that upsets the momentum of OneTouch Verio service fees (such as another recall) could impact UBI's ability to stably finance the coagulation roll-out.
- **Must take the money in 2015** – UBI is almost certain to draw down the remaining US$10m under the Athyrium facility. This is five-year money bearing 10.5% interest.
- **See downwards pressure on R&D expense** – the development of other applications of UBI's technology (immunoassay, molecular diagnostics) has been disappointing. Further controls on R&D spending (outside specific, partner-subsidised projects as per the Siemens deal) remain necessary. Eliminating R&D expense more than doubles the valuation of coagulation.
- **Patient self-testing needs a progress report** – this aspect of the coagulation opportunity remains relevant. The announcement of distribution agreements for this product would be well received.
- **Board and management change** – this remains a necessity if these assets are to be properly recognised and valued by the market.

## RETURN RE-INVESTMENT MATRIX

| Return | Low Re-investment | High Re-investment |
|---|---|---|
| High | Cash Generator | Champion |
| Low | Challenged | Potential |

We rate UBI technology highly, noting multiple high-value diagnostic opportunities which can be accessed on modest R&D investment.

## RISK MEASURES

| | Low | Med | High | Spec |
|---|---|---|---|---|
| Share Price Risk | | | | ■ |
| Business Risk | | | | ■ |

UBI stock is relatively illiquid. Business risks mitigated by involvement of multinational partners with established presence in UBI's product areas.

## BUSINESS DESCRIPTION

Universal Biosensors Inc (UBI) is a developer and manufacturer of molecular diagnostics equipment for point-of-care (PoC) medical settings. It has developed electrochemical cell and manufacturing technologies to produce "strip and meter" diagnostic tools for diabetes care (partnered with JNJ subsidiary LifeScan) and blood coagulation monitoring (partnered with Siemens). It is also growing into new, high value PoC applications such as genetic typing and immunoassay.

## INVESTMENT THESIS

Our thesis on UBI is that we see the company becoming a multiple royalty house, continuing to partner new diagnostic products with groups that are ranked either 1 or 2 in their fields. In our view, its partnering success to date has been a function of delivering new product features at low cost of goods, thanks to its proprietary, high yielding "reel-to-reel" manufacturing capabilities.

## REVENUE DRIVERS

- LifeScan conducting global launch of UBI's OneTouch Verio glucose monitoring strip for diabetes care – could grow to 4.5bn strips/year
- Siemens to launch UBI coagulation monitoring product in 2013
- Prospect of further partnering deals based on product pipeline

## BALANCE SHEET

- UBI had $19.4m cash as at end-Q1

## MARGIN DRIVERS

- Make a modest (c.15%) gross margin on OneTouch Verio strips supplied to LifeScan
- Make a zero cost US1c/strip "service fee" on all OneTouch Verio strips sold globally
- We estimate 70% gross margin on coagulation strips sold to Siemens

## BOARD

- Mr Andrew Denver (Chairman, Director)
- Mr Paul Wright (Managing Director, CEO)
- Mr Chris Smith (Director)
- Mr Denis Hanley (Director)
- Mr Marshall Heinberg (Director)
- Mr Andrew Jane (Director)

## KEY ISSUES/CATALYSTS

- Upside risks:
  - Quarterly cash-flow and SEC filings indicate LifeScan's progress on OneTouch Verio strip sales
  - Product launches by Siemens
  - New partnering transactions on other products
  - New technology innovation, pipeline development

## MANAGEMENT

- Mr Paul Wright (Managing Director, CEO)
- Mr Salesh Balak (CFO)

## RISK TO VIEW

- Downside risks:
  - Large partners like LifeScan are slow to move – provide low visibility
  - Medical device risks – difficulties with competitors, product recalls

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**Return Reinvestment Matrix and Risk Measures**

Definitions at http://www.wilsonhtm.com.au/Disclosures

**Recommendation Structure and Other Definitions**

Definitions at http://www.wilsonhtm.com.au/Disclosures

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