

## Universal Biosensors Inc

### A waiting game as Siemens launch draws near

Although the profitability of the Blood Glucose operations is increasing, the focus has moved to the pending launch of Siemens' blood coagulation testing system. While Siemens' Xprecia Stride was showcased in Europe in May 2013, the launch has been delayed until Q3 CY2014, due to the need for further validation data. The launch and sales ramp up of the initial and 3 other tests will substantially boost revenue and profitability.

### CY2013 Result represents a period of transition

While UBI's blood glucose operations remained profitable, the result was impacted by ongoing development costs for the Siemens product. Key features were:

- Quarterly service fees for CY2013 rose by 52.3% to \$3.4m, including a 46% increase in Q4 to \$1.0m, the highest on record and 16.8% above Q3. This continues recovery from the impact of meter recall in March CY2013.
- Strip sales fell 49% to \$10.2m, as UBI scaled down production for LifeScan.
- The absence of Development Revenue for LifeScan (CY2012 \$3.2m) and Milestone Payments from Siemens (\$4.2m).
- R&D increased by 14.8% to \$15.5m, mainly development work on the Blood Coagulation meter system for Siemens. This cost has been partly offset by recognition of a \$6.3m cash R&D refund, to be received in CY2014.
- Cash Resources within the Balance Sheet were boosted by a new US\$25m Loan Facility, currently drawn to US\$15.0m, maintaining Cash at \$23.7m.

### UBI ceases strip manufacture for LifeScan

With LifeScan assuming total strip production from 31/12/13, UBI will reduce funds employed by \$2.0m, boost product development, facilitate around \$11m in cash R&D refunds and allow a focus on higher margin opportunities.

### Siemens delays launch of the PT/INR test

The launch of Siemens' Xprecia Blood Coagulation test has been delayed until Q3 CY2014, due to the need for further performance testing verification. The development of the 2 additional tests for Siemens is unaffected.

### R&D boost in CY2014

With the support of cash R&D rebates, a continuing R&D program is expected in CY2014 and FY2015, to shorten the time line to the launch of further tests.

### Forecasts amended to reflect the above

Our forecasts now reflect: A return to stronger growth rates for the take-up of Verio strips; continued funding of R&D by R&D refunds and milestone payments; and delays in the launch of the Siemens products to Q3 CY2014.

We now expect losses of \$7.5m for CY2014, falling to \$0.4m in CY2015, with a profit of \$5.7m in CY2016, as: LifeScan service fees escalate; the Blood Coagulation tests gains traction; and milestone payments are received.

### Reasons to BUY

**Growth Markets** – Exposure to large rapid growth Point-of-Care Healthcare sectors, estimated at US\$15b, growing at 10% pa. UBI has proven products, strong partners, and an extensive opportunity pipeline.

**Industry Position** – Leading edge technology and a strong IP position, backed by a strong R&D team and validated by key international healthcare groups.

**Resources** – A modern approved plant capable of supplying UBI's capacity requirements, backed by successful management and Board.

**Strong Financial Position** – Cash Flow positive and rising profit from CY2016.

**Valuation** – Currently trading at a 53% discount to our valuation of \$0.75 ps.

## UBI.ASX

## BUY

20 March 2014

<b>Price</b>	<b>\$0.35</b>
<b>Price Target</b>	<b>\$0.75</b>
Valuation method	Sum of Parts
GICS sector	Healthcare
12 Mth Price Range	\$0.32 - 0.83
Avg monthly t/o	0.7m
Market Capitalisation	\$61m
Shares on issue	175m
Options on Issue	15m
Enterprise value	\$64m
Previous rating	<b>BUY</b>

Year Ended Dec 31		12A	13A	14E	15E	16E
Revenue	\$m	29.6	15.1	12.3	19.6	30.0
EBIT	\$m	-9.3	-18.2	-12.1	-2.2	7.6
EBIT margin	%	-31.3	-120.9	-98.4	-11.2	25.3
NPAT	\$m	<b>-9.1</b>	<b>-11.6</b>	<b>-7.5</b>	<b>-0.4</b>	<b>5.7</b>
EPS	¢ ps	-5.7	-6.7	-4.3	-0.2	3.3
EPS growth	%	-38.4	17.2	-35.7	-95.2	na
Franking	%	0.0	0.0	0.0	0.0	0.0
PER	x	na	-6.9	-8.2	-171.2	10.7
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	22.6	16.9	12.7	12.5	15.7
EV/EBITDA	x	-4.0	-2.9	-5.3	-30.0	6.1
Gearing (D:E)	%	0.0	0.0	13.7	21.8	1.7
P/OCF	x	na	na	-6.2	76.5	8.4
R&D	\$m	-13.5	-15.5	-15.0	-9.0	-8.5
R&D / Revenue	%	45.5	102.6	122.0	45.9	28.3
ROA	%	-19.7	-35.2	-24.4	-5.0	15.8
ROE	%	-25.2	-33.7	-28.9	-1.6	23.1
Interest cover	x	na	na	-8.1	-1.4	4.0

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



Source: IRESS

### 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: \$0.35 ps

Target Price: \$0.75 ps

**FINANCIAL PERFORMANCE**

Year ended 31-Dec	2011A	2012A	2013A	2014E	2015E	2016E
<b>Sales Revenue</b>	\$m 14.7	29.6	15.1	12.3	19.6	30.0
Cost of Goods Sold	\$m -13.0	-18.7	-11.6	-3.0	-6.6	-7.4
<b>Gross Operating Profit</b>	\$m 1.7	11.0	3.4	9.3	13.0	22.6
R&D	\$m -9.8	-13.5	-15.5	-15.0	-9.0	-8.5
Administration Costs	\$m -7.3	-6.8	-6.2	-6.2	-6.2	-6.5
<b>EBIT</b>	\$m -15.4	-9.3	-18.2	-12.1	-2.2	7.6
R&D Refund	\$m 0.0	0.0	6.3	6.1	3.4	0.0
Interest	\$m 0.7	0.2	0.3	-1.5	-1.6	-1.9
<b>Pre Tax Profit</b>	\$m -14.7	-9.1	-11.6	-7.5	-0.4	5.7
Tax	\$m 0.0	0.0	0.0	0.0	0.0	0.0
<b>Reported Profit</b>	\$m -14.7	-9.1	-11.6	-7.5	-0.4	5.7

GROWTH	2011A	2012A	2013A	2014E	2015E	2016E
Revenue	% -19.2	101.7	-49.1	-18.5	59.3	53.1
COGS	% 6.0	43.3	-37.6	-74.2	120.0	12.1
Gross Operating Profit	% -71.6	555.1	-68.6	169.7	39.8	73.8
R&D	% 0.5	37.4	14.8	-3.1	-40.0	-5.6
EBIT	% 97.4	-39.7	96.5	-33.7	-81.8	-445.5
Reported Profit	% 122.3	-37.8	27.4	-35.5	-95.2	-1694.4
EPS	% 120.2	-38.4	17.2	-35.7	-95.2	-1694.2

P&L RATIOS	2011A	2012A	2013A	2014E	2015E	2016E
Gross Operating Profit / Sales	% 11.4	37.1	22.8	75.6	66.3	75.3
EBIT / Sales	% -104.8	-31.3	-120.9	-98.4	-11.2	25.3
Effective Tax Rate	% 0.0	0.0	0.0	0.0	0.0	0.0
Interest Cover	x na	na	na	-8.1	-1.4	4.0
R&D/Revenue	x 66.8	45.5	102.6	122.0	45.9	28.3
Working Cap/Revenue	2.5	21.0	-13.3	8.2	5.6	0.2

Per SHARE	2011A	2012A	2013A	2014E	2015E	2016E
Issued Shares (Year End)	m 159.0	174.0	175.6	174.9	174.9	175.0
Issued Shares (Wt Avg)	m 159.0	160.4	174.4	174.9	174.9	174.9
EPS	¢ps -9.2	-5.7	-6.7	-4.3	-0.2	3.3
Operating Cash Flow ps	¢ps -4.5	-2.1	-9.5	-5.7	0.5	4.2
Free Cash Flow	¢ps -5.2	-2.5	-9.6	-6.3	-1.0	2.5
DPS	¢ps 0.0	0.0	0.0	0.0	0.0	0.0
Franking	% 0.0	0.0	0.0	0.0	0.0	0.0
Dividend Payout Ratio	% 0.0	0.0	0.0	0.0	0.0	0.0

PARAMETERS	2011A	2012A	2013A	2014E	2015E	2016E
PE Ratio	x -8.1	-15.9	-6.9	-8.2	-171.2	10.7
Enterprise Value / EBITDA	x -2.6	-4.0	-2.9	-5.3	-30.0	6.1
Enterprise Value / Profit	x -2.8	-4.1	-4.6	-8.6	-184.5	8.1
Cash Flow ratio	x -16.7	-44.0	-4.8	-6.2	76.5	8.4
Dividend Yield	% 0.0	0.0	0.0	0.0	0.0	0.0
Franking	% 0.0	0.0	0.0	0.0	0.0	0.0

SEGMENTS	2011A	2012A	2013A	2014E	2015E	2016E
<b>Sales Revenue</b>						
Product Sales	\$m 12.1	19.4	10.2	1.3	3.5	6.0
Service	\$m 2.6	6.0	4.9	7.9	13.0	23.0
Milestones	\$m 0.0	4.2	0.0	3.1	3.1	1.0
<b>EBIT</b>						
Product Sales	\$m -0.2	1.4	0.7	-0.7	0.5	2.1
Service	\$m 2.1	4.7	2.9	7.1	12.4	22.5
R&D	\$m -9.8	-13.5	-15.5	-15.0	-9.0	-8.5
Milestones	\$m 0.0	4.2	0.0	3.1	3.1	1.0
Corporate	\$m -7.3	-6.8	-6.2	-5.3	-5.5	-9.5
<b>EBIT Growth</b>						
Product Sales	% na	-660.0	-48.5	-198.3	-171.4	320.0
Service	% -56.7	121.1	-37.8	141.3	74.6	81.5
R&D	% 51.4	37.4	14.8	0.0	-40.0	-5.6
Corporate	% 1.2	-6.6	-8.7	-14.5	3.8	72.7
<b>EBIT Margin</b>						
Product Sales	% 0.0	7.1	7.0	-53.8	14.3	35.0
Service	% 81.2	78.2	59.8	89.9	95.4	97.8

Source: UBI (Act) and Veritas Securities (Est)

**CASH FLOW**

Year ended 31-Dec	2011A	2012A	2013A	2014E	2015E	2016E
<b>Operating EBITDA</b>	\$m 1.9	9.8	1.7	3.1	6.8	16.1
Net Interest Received/Paid	\$m 0.7	0.4	0.5	-1.6	-1.8	-1.9
Tax Paid	\$m 0.0	0.0	0.0	0.0	0.0	0.0
Change Working Capital	\$m -0.8	4.4	-2.5	-2.6	-0.9	-1.9
Other (inc R&D Refund)	\$m 0.8	-4.4	-0.8	6.2	5.7	3.4
<b>Operating Cash Flow</b>	\$m 2.7	10.2	-1.1	5.1	9.8	15.8
R&D	\$m -9.8	-13.5	-15.5	-15.0	-9.0	-8.5
Capex	\$m -1.1	-0.7	-0.2	-1.0	-2.5	-3.0
<b>Free Cash Flow</b>	\$m -8.3	-4.0	-16.8	-10.9	-1.7	4.3
Acquisitions/Asset Sales	\$m 0.0	0.0	0.0	0.0	0.0	0.0
Dividends Paid	\$m 0.0	0.0	0.0	0.0	0.0	0.0
Equity Change	\$m 0.1	12.5	0.4	0.0	0.0	0.0
Debt	\$m 0.0	0.0	16.0	0.1	0.0	0.0
<b>Change in Net Cash</b>	\$m -8.2	8.6	-0.4	-10.8	-1.7	4.3

BALANCE SHEET	2011A	2012A	2013A	2014E	2015E	2016E
Cash	\$m 15.1	23.6	23.7	13.0	11.3	15.5
Receivables	\$m 4.9	2.3	2.2	2.5	3.5	5.4
Inventory	\$m 3.6	3.6	0.0	1.0	3.0	4.6
Other Current Assets	\$m 1.0	0.9	9.9	8.5	5.0	1.5
<b>Current Assets</b>	\$m 24.6	30.5	35.8	25.0	22.8	27.0
Property, Plant & Equipment	\$m 20.3	18.3	15.9	16.8	17.8	20.8
Intangibles	\$m 0.0	0.0	0.0	0.0	0.0	0.0
Other NC Assets	\$m 0.3	0.3	2.9	3.0	3.5	4.5
<b>Non Current Assets</b>	\$m 20.6	18.6	18.8	19.8	21.3	25.3
<b>Total Assets</b>	\$m 45.2	49.1	54.6	44.8	44.1	52.3
Payables	\$m 2.7	4.5	3.3	2.0	3.0	4.6
Current Debt	\$m 0.0	0.0	0.0	0.0	0.0	0.0
Other Current Liabilities	\$m 6.4	1.8	2.1	2.5	3.5	5.5
<b>Current Liabilities</b>	\$m 9.1	6.3	5.4	4.5	6.5	10.1
Non Current Debt	\$m 0.0	0.0	15.9	16.0	16.0	16.0
Other NC Liabilities	\$m 3.2	3.4	3.7	2.1	-0.3	-1.3
<b>Non Current Liabilities</b>	\$m 3.2	3.4	19.5	18.1	15.7	14.7
<b>Total Liabilities</b>	\$m 12.3	9.7	24.9	22.6	22.2	24.8
<b>Shareholder Funds</b>	\$m 33.0	39.4	29.7	22.2	21.8	27.5

BALANCE SHEET RATIOS	2011A	2012A	2013A	2014E	2015E	2016E
Receivables turn	x 3.5	8.3	6.8	5.3	6.5	6.8
Inventory turn	x 3.8	5.2	6.5	6.0	3.3	1.9
Net Debt	\$m 0.0	0.0	0.0	3.0	4.7	0.5
Current Ratio (CA:CL)	x 2.7	4.8	6.6	5.5	3.5	2.7
Net Tangible Assets	¢ps 20.7	22.6	16.9	12.7	12.5	15.7
Cash	¢ps 9.5	13.6	4.5	0.0	0.0	8.6
Return On Assets	% -31.1	-19.7	-35.2	-24.4	-5.0	15.8
Return on Equity	% -36.6	-25.2	-33.7	-28.9	-1.6	23.1

VALUATION	\$	Premium(+)/Discount(-) %
Valuation Method	\$	Premium(+)/Discount(-) %
DCF	0.85	-58.8
Sum of the Parts	0.75	-53.3
Price Target	0.75	-53.3
Current Price	0.35	
<b>Market Capitalisation</b>	<b>\$61.2m</b>	<b>Enterprise Value: \$64.3m</b>

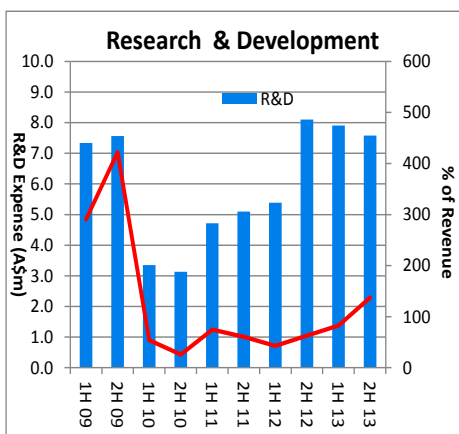
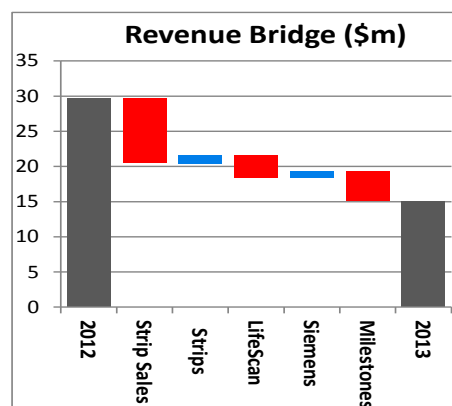
MAJOR SHAREHOLDERS			
Principals Cornerstone	m 25.4	14%	Related to Directors
CM Capital Investments	m 17.8	10%	Healthcare Fund
PFM Cornerstone	m ###	8%	Related to Directors
Australian Executor Trustees	m 10.4	6%	Aust Institution
Australian Ethical	m 8.7	5%	Aust Institution
<b>Top 20 (16/3/2013)</b>	<b>m ###</b>	<b>67%</b>	

DIRECTORS			
Andrew Denver	N-E Chair	Chris Smith	N-E Dir
Paul Wright	MD & CEO	Marshall Heinberg	N-E Dir
Andrew Jane	N-E Dir	Denis Hanley	N-E Dir

Q3 result supported by a recovery in Strip Sales

	CY2011			CY2012						CY2013					
	1H	2H	CY	1H	Ch	2H	Ch	CY	Ch	1H	Ch	2H	Ch	CY	Ch
Profit & Loss	\$m	\$m	\$m	\$m	%	\$m	%	\$m	%	\$m	%	\$m	%	\$m	%
<b>Blood Glucose Products</b>	5.6	6.5	12.1	9.5	69.3	9.9	53.0	19.4	60.6	7.2	-23.9	3.0	-70.0	10.2	-47.5
- Strips	0.2	0.3	0.5	1.0	480.0	1.2	289.0	2.2	357.3	1.6	57.7	1.8	47.8	3.4	52.3
- Development	0.5	1.6	2.1	2.1	278.5	1.0	-35.5	3.1	44.6	0.0	-100.0	0.0	-100.0	0.0	-100.0
<b>Total Revenue - Blood Glucose</b>	<b>6.3</b>	<b>8.4</b>	<b>14.7</b>	<b>12.5</b>	<b>98.8</b>	<b>12.2</b>	<b>45.0</b>	<b>24.7</b>	<b>68.1</b>	<b>8.8</b>	<b>-29.8</b>	<b>4.8</b>	<b>-60.7</b>	<b>13.6</b>	<b>-45.0</b>
Cost of Goods Sold	-6.4	-6.6	-13.0	-9.7	52.5	-8.9	34.4	-18.7	43.3	-6.9	-29.0	-3.5	-60.3	-10.5	-44.0
<b>Blood Glucose - Operating Profit</b>	<b>-0.1</b>	<b>1.8</b>	<b>1.7</b>	<b>2.8</b>	na	<b>3.3</b>	84.7	<b>6.0</b>	260.5	<b>1.9</b>	<b>-32.7</b>	<b>1.2</b>	<b>-61.9</b>	<b>3.2</b>	<b>-46.7</b>
Operating Margin (%)	-1.3	21.0	11.4	22.3		26.7		24.5		21.4		0.3		23.7%	103.8
<b>Add Siemens - Milestone Payments</b>	0.0	0.0	0.0	2.2		2.1		4.2		0.0		0.0		0.0	-100.0
Other Revenue (net of COGS)	0.0	0.0	0.0	0.0		0.7		0.7		0.1		0.2		0.3	-53.5
<b>Total Operating Profit</b>	<b>-0.1</b>	<b>1.8</b>	<b>1.7</b>	<b>5.0</b>		<b>6.0</b>		<b>11.0</b>	554.3	<b>2.03</b>	<b>-59.2</b>	<b>1.6</b>	<b>-73.4</b>	<b>3.6</b>	<b>-67.0</b>
less - Research and Development	-4.7	-5.1	-9.8	-5.4	14.1	-8.1	58.9	-13.5	37.4	-7.9	46.9	-7.6	-6.4	-15.5	14.8
plus - R&D Refund										3.1		3.1		6.2	
less - Corporate Costs	-3.6	-3.7	-7.3	-3.1	-14.8	-3.7	14	-6.8	-6.6	-2.8	-8.9	-3.4	-8.5	-6.2	-8.7
<b>EBIT</b>	<b>-8.4</b>	<b>-7.0</b>	<b>-15.4</b>	<b>-3.5</b>	na	<b>-5.8</b>		<b>-9.3</b>	na	<b>-5.6</b>	59.9	<b>-6.3</b>	7.9	<b>-11.8</b>	27.4
Interest and Other	0.4	0.3	0.7	0.1		0.1		0.2		1.0		-0.7		0.3	
<b>Pre-Tax Profit</b>	<b>-8.0</b>	<b>-6.7</b>	<b>-14.7</b>	<b>-3.4</b>		<b>-5.7</b>		<b>-9.1</b>		<b>-4.6</b>	34.0	<b>-7.0</b>	21.4	<b>-11.6</b>	27.2
R&D:Revenue (%)	74.8	60.8	66.8	42.9		66.6		54.6		89.8				114.0	
Corporate Costs:Revenue (%)	57.1	43.8	49.5	24.5		30.6		27.5		31.8				45.7	
<b>Cash Flow</b>															
Receipts	8.8	9.0	17.8	13.9	57.1	16.4	82.9	30.2	70.1	9.0	-35.1	6.7	-59.4	15.6	-48.3
Payments	-14.3	-11.4	-25.7	-14.5	1.1	-19.5	71.5	-33.9	32.3	-16.0	10.6	-13.4	-31.1	-29.4	-13.3
<b>Net Receipts</b>	<b>-5.5</b>	<b>-2.4</b>	<b>-7.9</b>	<b>-0.6</b>		<b>-3.1</b>	<b>0.0</b>	<b>-3.7</b>		<b>-7.0</b>		<b>-6.78</b>	<b>19.0</b>	<b>-13.8</b>	272.8
<b>Net Cash Flow</b>	<b>-5.8</b>	<b>-8.2</b>	<b>-33.5</b>	<b>-0.4</b>		<b>8.9</b>		<b>8.6</b>		<b>-6.2</b>		<b>-6.2</b>	<b>-169.3</b>	<b>-12.4</b>	-244.7
<b>Net Cash</b>	<b>17.5</b>	<b>15.1</b>	<b>-41.4</b>	<b>14.7</b>		<b>23.6</b>		<b>38.4</b>		<b>18.1</b>		<b>23.7</b>	<b>0.4</b>	<b>23.7</b>	<b>-38.1</b>

Source: UBI & Veritas



Summary

There were positives and negatives in the result:

**Revenue** – The overall Revenue fall of 49.1% was a function of:

- A 47% fall in strip sales to LifeScan to \$10.2m, with LifeScan increasing sourcing from its facility in Scotland. Production for LifeScan ceased as at 31/12/13.
- Growth in service fees on LifeScan strip sales of 52.3% to \$3.4m, including a Q4 increase of 46% to a record \$0.97m, 16.8% above Q3 CY2013. This continues the recovery in LifeScan strip sales following the meter recall in March 2013.
- A partial offset from a \$0.8m increase in cost recovery development work for Siemens to \$1.5m (\$0.3m net of COGS).
- The absence of Development Revenue for LifeScan and Milestone Payments from Siemens (\$3.2m and \$4.2m in CY2012).

**COGS** – Underlying COGS fell with reduced strip production.

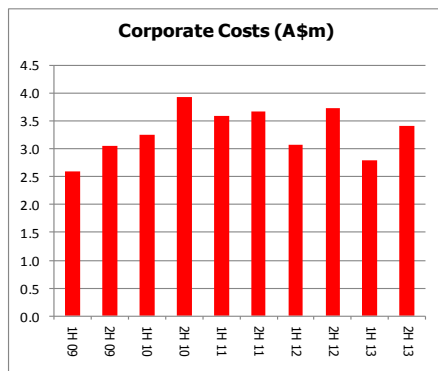
**Blood Glucose Operating Profit** – While GOP for blood glucose fell by 46% to \$3.2m, this comprised a 52% increase in profit on strip service fees from LifeScan to \$3.4m, partly offset by a \$0.3m Loss on strip production.

**Total Operating Profit** – Fell by a similar amount to \$3.6m, with the absence of milestone payments (\$4.2m in CY2012), partly offset by a \$0.3m reimbursement of development work on meters for Siemens.

**R&D** – Increased by 14.8%, with a ramp-up of development costs for the 4 blood coagulation strips (88% of total), especially the PT/INR test, to be released in 1H CY2014.

**R&D Refund** - UBI has provided for the expected receipt of a \$6.2m cash R&D refund, expected to be received in mid-CY2014. This has been included in Other Current Assets on the Balance Sheet.

## EQUITY RESEARCH



**Corporate Costs** – While costs fell by 8.7%, with the streamlining of operations and the scaling down of production, the 2H included \$0.4m of additional costs from the cessation of strip manufacture for LifeScan.

**Interest and Other** – Comprises Interest Received of \$0.5m and a Currency Gain of \$0.6m, offset by \$0.8m in Interest Paid and Establishment Charges on the US\$25m financing facility (see below). Additional charges of \$0.8m will be amortised over the loan term.

**Cash Flow** - Net Cash outflow of \$0.3m comprises an Operating Cash Outflow of \$16.2m, mostly offset by a \$16.0m increase in Borrowings, mostly related to the facility. Adjusting for R&D, Operating Cash Outflow was only -\$0.7m.

**Balance Sheet** – With the cash outflow offset by the finance facility, cash levels were steady at \$23.6m. However, this excludes \$2.6m in held in 'Other Assets' to support the Loan Facility, which includes cash to \$26.2m (15¢ ps), although adjusted Net Cash fell to \$10.5m (6.0¢ ps).

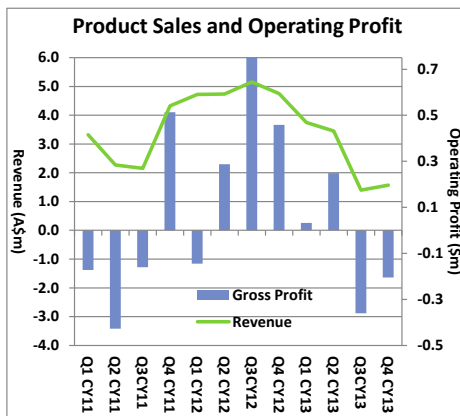
### The Athyrium Loan Facility, a boost to cash resources

#### Agrees a US\$25m Loan Facility

UBI has secured a US\$25m interest-only 5 year Loan Facility with funds managed by Athyrium Capital Management, a US based investment advisor. The facility has a coupon of 10.5% and attracts additional fees. UBI has also issued a 7 year warrant over 4.5m shares at an exercise price of \$1.00 ps, and has agreed an entitlement of \$0.6m from Siemens milestone payments.

While we believe the effective interest rate is around 13%, UBI believe this rate is at the lower end of rates for an unsecured facility. UBI has drawn US\$15m, with the fund to be used to develop the 3 Blood Coagulation testing products for Siemens and UBI's patient self-test.

### UBI to cease products sales to Lifescan



Source: UBI

LifeScan ceased sourcing Verio strips from UBI as at 31/12/13. This will enable LifeScan to achieve economies of scale and higher overhead recovery from its own facility, where it recently doubled capacity to 1.5bn strips pa. While it may be looked upon by some as disappointing, the following advantages for UBI substantially outweigh any negatives:

- It eliminates over \$2m pa in Funds Employed by UBI across overheads, working capital and management, especially as sales were declining, resulting in operating losses.
- The reduced revenue will allow UBI to claim R&D cash rebates in CY2013 and CY2014, as Revenue will remain below \$20m. This will allow UBI to continue R&D at similar levels, on future products, reducing the time to market on future products, part funded by a similar refund. As UBI's revenue is likely to exceed \$20m in CY2015, the existence of tax losses will defer the benefit of tax credits to future years.
- It will allow UBI to focus its attention on manufacture of strips for PT/INR and subsequent products, where it achieves a full manufacturing margin.

However, UBI has demonstrated that it can successfully produce strips in volume to a quality standard.

### Siemens delays launch of PT/INR Test

#### Launch of initial PT-INR test delayed until Q3 CY2014

#### To be initially launched in Europe

Siemens showcased the Xprecia Stride prothrombin time test system (PT/INR) at a European Conference in May 2013, with expectations of a release in CY2013. On 7/11/13, UBI advised that the launch of Siemens Xprecia Stride had been delayed until 1H CY2014.

We now expect the PT/INR test to be launched in Europe under self-regulation provisions in Q3 CY2014, with the milestone payments of US\$3.1m previously expected in 2H CY2013 now expected in 2H CY2014, with the balance of \$5.1m in CY2015. However, strip sales to Siemens will be in advance of a launch, as Siemens fills its supply pipeline.

The blood coagulation market remains an attractive market with over 7m warfarin users globally and estimated revenue of over US\$500m, growing at 10% pa. It is also an indication for the treatment of deep vein thrombosis, pulmonary embolism and to prevent blood clots in patients with a surgical implant, such as an artificial heart valve.

UBI expect the 2 other tests for to be launched in CY2015. While PT/INR represents 70% of the blood coagulation market, there is potential in the other tests.

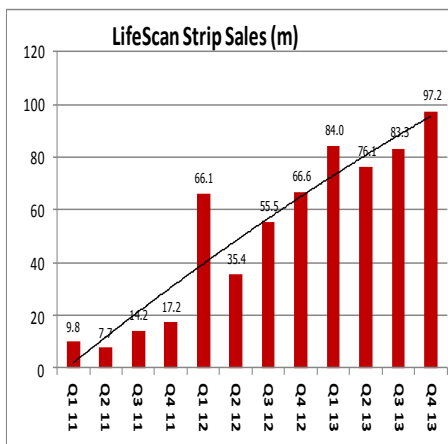
#### Blood coagulation is the second largest POC market

**UBI progresses Patient Self-test**

UBI has continued to progress the development of its patient self-testing system, with further development of the meter system and negotiating MOUs with specialist distribution partners in some regions. UBI is in discussion with at least one partner in key regions, as there is no global distributor.

The strips in this market will sell at a premium to the professional market, in a potential market of \$200m - \$300m. While this will be highly profitable, it also establishes a potential distribution channel for future products

**Blood Glucose strip sales return to growth**



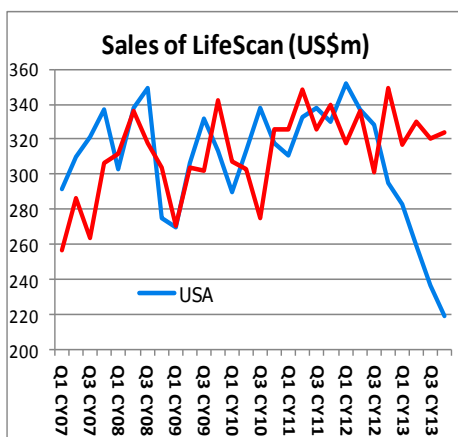
Source: UBI

Quarterly service fees for CY2013 increased by 52.3% to \$3.4m (340.6m strips). This included a 50.1% increase in Q4 CY2013 to \$0.97m (97.2m strips), the highest on record, 46.0% above the pcp and 16.8% above Q3 CY2013.

However, this growth was substantially lower than the 311% achieved in CY2012, due to the meter recall in March CY2013, which curtailed sales growth in Q1 CY2013 to 27.1%, reduced Sales in Q2 below Q1 (although still 115% above the pcp), and limited growth in Q3 and Q4.

There are now indications that the recall has run its full course, with expectations of strong Quarter on Quarter strip sales growth in CY2014. This is supported by the release of new Verio meters, including the recently launched OneTouch VerioSync Meter, which automatically links with an iPhone, and the integration of the diabetes medication and meter systems marketing. UBI has commented:

*"Given that the Quarterly Service Fees are a key driver of value for UBI and a direct reflection of the success of the product in the marketplace, it's exciting to see a return to a growth trajectory"*



Source: Johnson & Johnson

LifeScan has been under pricing and margin pressure, mostly within the USA, due to:

- Changes in the re-imbursement regime, including a 60% reduction in Medicare reimbursements from July 2013 and competitive bidding. The Q4 CY2013 fall of 25.8% was similarly felt by US Roche (-17%) and Abbott (-14%).
- The advent of private label and low-price players and a shift in distribution to low cost forms, such as mail order.

We believe this is an overall positive for UBI, as:

- The lower price should increase the volume of strips sold in the US. As UBI is paid on a volume basis at a flat rate of US1.0 ¢ per strip, it should increase strip service revenue.
- We believe LifeScan will aggressively push the substitution of Verio to existing and new users within the US. Also, with higher margins outside the US, LifeScan will look to increase market share in those regions. Verio is now sold in 90% of markets.

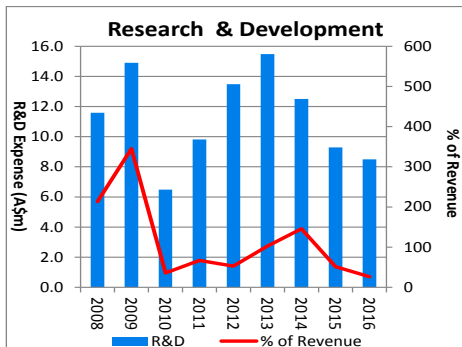
There is a significant level of restructuring activity in the sector, as a result of structural changes, which may work in favour of LifeScan. These are a deterrent for further or new investment, or may lead to the withdrawal from the sector by competitors. This is a result of:

- The substantial fall in revenue per strip has forced an increased focus on production costs. The direct production costs of the patented Verio strips have the potential to be lower than competing potential new strips.
- There are requirements for improved accuracy and performance, with a new ISO standard introduced in June 2013, new FDA draft guidance released for discussion in January 2014 and additional focus expected on post market surveillance. These will provide entry barriers for low cost competitors, as well as making the upgrade and development of new strip systems more difficult.

While we still expect a strong take-up of strip sales, we have adjusted our diffusion curve and sales forecasts, effectively deferring the major ramp-up in penetration by 6 months.

**Structural changes on profitability and accuracy, work in favour of Verio**

R&D to continue at high levels



Source: UBI (Actual) Veritas (Forecasts)

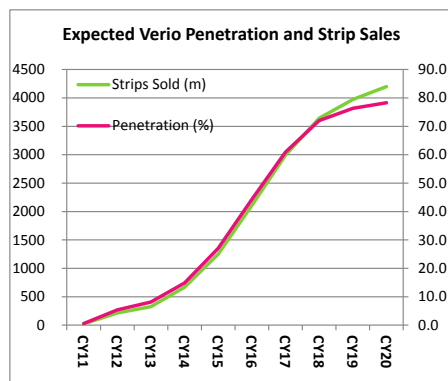
R&D to be part funded by milestone payments and R&D rebates

We expect R&D to continue at high levels in CY2014, with the extra trials for the PT/INR meter and to advance the development of the other 2 blood coagulation test strips for Siemens and UBI's home test for Blood Coagulation.

- UBI see the importance of the timely release of the other blood coagulation products, given the potential value to be generated.
- The development of a patient self-test and decentralizing processing is progressing. With a substantially de-risked PT-INR testing technology, process technology already in place and a prototype system now available and demonstrated to potential distributors, UBI is accelerating discussion with potential distributors.
- The potential in immunoassay (CRP, D-Dimer) and enzymatic tests, as well as its Molecular Diagnostic Platforms, although still some time ahead.
- The ability to claim a cash R&D rebate in CY2014 on 45% of R&D expenditure.

Beyond CY2014, the increasing revenue from strip service fees and the launch of the Blood Coagulation test systems will increase revenue above \$20m, resulting in a rebate at a reduced rate of 40% taken as tax credits, rather than a cash refund. With substantial accumulated tax losses, the economic benefit of these will be delayed until these losses are used up.

Forecasts



Source: UBI actual, Veritas Forecasts

Strong service fee growth expected

Blood coagulation strip sales to escalate in CY15 and CY16

The forecasts have been adjusted as follows:

Blood Glucose

- **Product Sales** – Sales to Lifescan beyond CY2013 eliminated, with all inventory cleared, although some costs will remain.
- **Strip Service fees** – An increase in CY2014 of around 102% to \$6.9m, with an increase of 88% for CY2015 to \$13.0m and 69% for CY2016 to \$22m.
- **Contract Development work for LifeScan** – While we expect further development work over the next 2 years, we won't build this into our forecasts until announced.

Blood Coagulation

- **Product Sales (Siemens)** – Initial sales in Europe Q3 CY2014 and the USA in Q4 CY2014, with expectations of strip sales to Siemens 2 months ahead of launch, giving it the opportunity to fill its pipeline. This should result in sales of \$1.3m in CY2014, increasing to \$3.5m and \$6m in CY2015 and CY2016.
- **Milestone Payments** - We have delayed inclusion of the further milestone payments of US\$1.5m each, as well as the recognition as revenue of the remaining US\$1.7m from the \$3.0m initial technology access fee received in September 2011. We now expect A\$3.1m in CY2014 and A\$3.1m in CY2015.
- **Meter Development Reimbursement** – We expect a further \$0.5m CY2014.
- **PT/INR meter for home use (UBI)** – No impact until Q1 CY2015, although UBI is accelerating potential distribution arrangement.

**R&D** – Forecast at \$15m in CY2014 with the extra trials, before declining to \$9.0m in CY2015. A cash tax rebate of \$5.7m for CY2014 is expected (to be received in CY2015) and \$3.4m in FY2015, equivalent of 45% of eligible R&D (assumed 85% of R&D). We are treating these payments as adjustments above the Pre-tax Profit line.

**Corporate Costs** – A reduction in corporate costs with cessation of Blood Glucose strip manufacture and the absence of the restructure costs in Q4 CY2013.

Valuation

**Valuation maintained at \$0.75 ps**

We have reduced our Valuation and Price Target to \$0.75 ps, based on a revised Sum of the Parts valuation, although this is below our Discounted Cash Flow valuation of \$0.81 ps.

The Sum of the Parts valuation attributes:

- \$80m (\$0.45 ps) to Blood Glucose, based on CY2015 EBIT multiple of 6.0x.
- \$45m (\$0.28 ps) to Blood Coagulation (to increase with launch and progress on home-test), based on a DCF, assuming launch in 2Q CY2014 and receipt of milestone payments.
- \$15m (\$0.05 ps) to the Immunoassay and Molecular Diagnostics (to increase with acceleration in development), based on estimated expenditure to date.
- Net Debt of \$3m (-\$0.02 ps) in Cash at December 2014.

We believe this is conservative, with potential for a substantial increase post the Siemens and UBI self-testing launches.

Sales

Robert Scappatura +61 2 8252 3240  
 Willem Ter Avest +61 2 8252 3270  
 Andrew McCauley +61 2 8252 3260  
 Patrick Ford +61 2 8252 3211  
 Clay Melbourn +61 2 8252 3220  
 Bryce Reynolds +61 2 8252 3210  
 Stephen Murphy +61 8 9284 7444

Research

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

Resources  
 Piers Reynolds +61 3 8601 1196

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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](http://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

Perth  
 Suite 6b, 431 Roberts Road,  
 Subiaco, 6008  
 Tel: (08) 9284 7444