



BUY HOLD SELL

ACTION & RECOMMENDATION

UBI has elected to disclose the details of LifeScan's option to "buy out" future Service Fees by paying a Lump Sum Service Fee (LSSF) instead. The option may become available as soon as 2017 and would net UBI a one-off, final payment from LifeScan of US\$50m (WHTMe). The timing and terms of the LSSF were not known, but appear to be crystallised sooner with smaller upside than we would have anticipated. The deletion of future glucose earnings has cut the terminal value in our DCF, and probably diminishes the catalyst potential of near-term glucose Service Fees. The stock is in extreme undervaluation mode now due to the market's dissatisfaction with disclosure. There is value here on paper but the stock has fallen below investment grade. Cut to HOLD.

Greater certainty that glucose is worth less

What's Changed

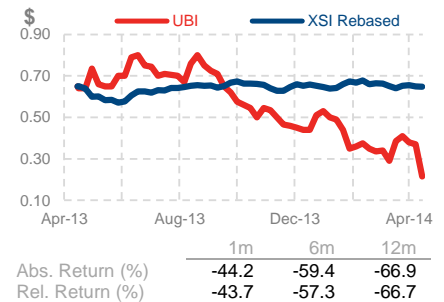
- **LifeScan agreement terms reveal unpleasant surprises** – the precise Service Fee per strip received by UBI is less than we model: US1.25c/strip for the first 500m strips each year and US0.75c thereafter. The average selling price (ASP) for strips is closer to US0.83c/strip in the meaningful sections of the model – compared with the "around one cent per strip" previously advised. Lower ASPs have a 7-9% impact on FY15-16e NPAT forecasts.
- **Buyout terms revealed** – after LifeScan has paid UBI cumulative quarterly service fees (QSFs) of US\$45m, it may, at its option, pay UBI a one-time, final lump sum fee (LSSF). LSSF is calculated by multiplying the QSFs for the relevant year in which LifeScan gives notice by a multiple (varies from 3-2x). Our forecasts imply a LSSF of c.US\$50m payable in FY17. Historically, we had applied a 50% discount to our UBI valuation to account for the uncertainty relating to the LSSF option in the LifeScan agreement. The LSSF looks exercisable in a shorter time frame than we expected and the 2x multiple is also disappointing (WHTMe: c.5x).
- **Valuation and recommendation** – cutting glucose out of the terminal value reduces risked-DCF to 70 cps (previously 104 cps). The market is pricing UBI at the NPV of the LSSF (c.18 cps) + 4 cps for the new coagulation business starting with Siemens in Q3. Clearly, the stock is in extreme under-valuation mode on account of the market's dissatisfaction with disclosure, which will take time and action to repair. Price target cut to 25 cps reflecting a lack of catalysts: glucose QSF catalysts blunted by LSSF overhang and Siemens launch in Q3 still has execution risks (trials, launch, etc).

12m Target Price (AUD)	\$0.25
Share Price @ 12-May-14 (AUD)	\$0.22
Fcst 12m Capital Return	16.3%
Fcst 12m Dividend Yield	0.0%
12m Total S'holder Return	16.3%

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Company Update

12m Share Price Performance



WHTM Return Re-investment Matrix

Return	High	Cash Generator	Champion
	Low	Challenged	Potential
		Low	High
		Re-Investment	

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	-8.2	5.5	14.4
NPAT Norm (\$m)	-9.1	-11.6	-8.2	5.5	14.4
Consensus NPAT (\$m)			-8.2	5.9	15.4
EPS Norm (cps)	-5.5	-6.7	-4.7	3.1	8.2
EPS Growth (%)	39	-23	30	166	164
P/E Norm (x)	-3.9	-3.2	-4.6	6.9	2.6
EV / EBITDA (x)	-7.7	-5.9	-14.0	5.4	2.8
FCF Yield (%)	-5.3	-26.7	-4.8	12.7	24.7
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

Key Changes	24-Apr	After	Var %
NPAT: FY14	-8.2	-8.2	0.0%
Norm FY15	6.0	5.5	-9.0%
(\$m) FY16	15.5	14.4	-7.4%
EPS: FY14	-4.7	-4.7	0.0%
Norm FY15	3.4	3.1	-9.0%
(cps) FY16	8.9	8.2	-7.4%
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:	1.04	0.25	-76.1%
Rec:	BUY	HOLD	

Mkt Cap: \$62m **Enterprise Value:** \$54m **Shares:** 175m **Sold Short:** % **ASX 300 wgt:** n/a **Median T'over/Day:** \$0.0m



PRICE TARGET

	Valuation	Price Target
Discount rate (%)		14.0
Terminal growth (%)		2.5
NPV of FCFs (\$M)		57.6
NPV of perpetuity (\$M)		76.6
Riskd valn (\$M)	134.2	
Risk discount (%)		50
Riskd valn (A\$/share)		0.70
Target price (A\$/share)		0.25

INTERIMS (\$m)

Half Yr (AUD)	Jun 13 1HA	Dec 13 2HA	Jun 14 1HE	Dec 14 2HE
Sales	9.6	5.5	2.4	6.9
EBITDA	-6.7	-2.4	-7.9	4.1
EBIT	-8.0	-3.6	-9.4	2.6
Net Profit	-7.7	-3.9	-10.1	1.8
Norm. EPS	-4.5	-2.3	-5.8	1.1
EBIT/Sales	-83.2	-65.9	-397.0	37.1
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	-8.5	-15.4
Net Debt / Equity (%)	<0	<0	<0
Net Debt / EV (%)	<0	<0	<0
Current Ratio (x)	10.1	2.2	2.5
Interest Cover (x)	<0	<0	5.3
Adj. Cash Int. Cover (x)	<0	<0	7.2
Debt / CashFlow (x)	0.0	<0	2.0
Net Debt (cash) / share	<0	<0	<0
NTA / share (\$)	0.2	0.2	0.2
Book Value / share (\$)	0.2	0.2	0.2
Payout Ratio (%)	0	0	0
Adj. Payout Ratio (%)	0	0	0

EPS RECONCILIATION (\$m)

	FY13A		FY14E	
	Rep.	Norm.	Rep.	Norm.
Sales Revenue	15	15	9	9
EBIT	-11.6	-11.6	-6.9	-6.9
Net Profit	-11.6	-11.6	-8.2	-8.2
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	-8.2	-8.2
Diluted Shrs(m)	173	173	175	175
Diluted EPS (c)	-6.7	-6.7	-4.7	-4.7

RETURNS

	FY13A	FY14E	FY15E	FY16E
ROE (%)	-33.7	-29.6	19.0	37.3
ROIC (%)	-43.3	-24.5	28.2	68.1
Incremental ROE	93.7	-50.5	1,595.9	90.0
Incremental ROIC	-151.1	380.0	-327.9	-861.2

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	-38.7	162.9	57.6
EBIT Growth (%)	17.5	-53.5	93.6	-37.7	21.0	-40.7	-197.9	131.1
NPAT Growth (%)	35.8	-59.4	122.3	-37.8	27.4	-29.1	-166.2	163.7
EPS Growth (%)	35.8	-59.9	119.9	-38.8	23.0	-30.0	-166.2	163.7
EBIT / Sales (%)	12,863.7	-67.5	-104.6	-32.3	-76.8	-74.4	27.7	40.6
Tax Rate (%)	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
ROA (%)	-32.4	-14.6	-32.0	-19.5	-21.2	-12.9	11.6	21.3
ROE (%)	-34.4	-13.5	-36.0	-23.2	-39.2	-31.8	17.4	31.4

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	9.2	24.3	38.3
EBITDA	-14.2	-5.0	-12.1	-6.9	-9.1	-3.8	9.9	18.9
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	-6.9	6.7	15.6
Net Interest Expense	-0.8	-1.2	-0.7	-0.4	0.0	1.4	1.3	1.2
Tax	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
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	-8.2	5.5	14.4
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	-8.2	5.5	14.4

CASHFLOW (\$m)

Year-end December (AUD)	FY09A	FY10A	FY11A	FY12A	FY13A	FY14E	FY15E	FY16E
EBITDA	-14.2	-5.0	-12.1	-6.9	-9.1	-3.8	9.9	18.9
Interest & Tax	0.8	1.2	0.7	0.5	0.0	-1.4	-1.3	-1.2
Working Cap / Other	15.1	-2.7	4.2	3.2	-7.5	2.2	-0.8	-2.4
Operating Cash Flow	1.6	-6.4	-7.2	-3.3	-16.6	-3.0	7.9	15.4
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	-3.0	7.9	15.4
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	-3.9	6.9	14.4
Funded by Equity	0.1	0.7	0.1	13.2	0.0	4.5	0.0	0.0
Funded by Debt	0.0	0.0	0.0	0.0	16.9	0.0	0.0	0.0
Funded by Cash	1.3	8.0	8.2	-8.6	0.4	-0.6	-6.9	-14.4

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	24.3	31.3	45.6
Current Receivables	0.4	3.6	4.9	2.3	2.2	0.1	0.7	1.8
Current Inventories	0.3	3.2	3.6	3.6	0.0	2.0	0.9	2.5
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	13.2	13.6	14.0
Total Assets	56.1	53.8	45.2	49.1	54.6	53.5	58.0	73.1
Current Payables	0.4	1.8	0.6	2.5	1.0	3.0	1.5	1.5
Total Debt	0.0	0.0	0.0	0.0	15.9	15.9	15.9	15.9
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	27.5	26.6	27.3
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	25.9	31.4	45.8
Total Funds Employed	51.3	47.2	35.0	39.4	45.5	41.8	47.3	61.7



RETURN RE-INVESTMENT MATRIX

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

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

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

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

RISK TO VIEW

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

BALANCE SHEET

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

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- Mr Chris Smith (Director)
- Mr Denis Hanley (Director)
- Mr Marshall Heinberg (Director)
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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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