

Universal Biosensors

Strengthening the relationship



Wilson HTM
INVESTMENT GROUP

18 May 2009

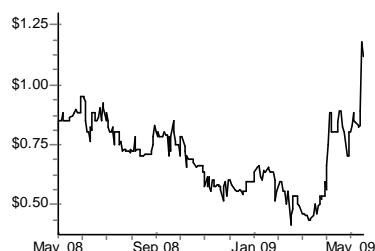
\$1.12

BUY

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Price Performance



Security/Capital Details

ASX Code	UBI
Market Cap	\$181 M
Issued Shares	161.4 M
Avg Mth T'over	1.03 M
12 Mth High – Low	\$0.95 - \$0.41

Key Data/Ratios – FY 2009

Cash	\$28M
Cash burn	\$13M
EV	\$153M
Interest Cover	x
ROE	-17.9%
EPS Growth	9.0%
PEG Ratio	x
NTA / Share	\$ 0.26
DCF	\$ 2.42
12 Mth Price Target	\$ 2.83

BUY: Total return +10% or more over a 12 month period

HOLD: Total return expected to be between +10% to -10% over a 12-month period

SELL: Total return expected to be -10% or more over a 12 month period

TOTAL RETURN OR TSR = capital growth in share price + expected dividend yield in that period

Year to Dec	NPAT (Rep) \$M	EPS (Norm) c	EPS Growth %	PER x	P/CF x	EV/EBITDA x	DPS c	Div Yld %	Franking %
2008a	-8.8	-5.5	4.2	-16.4	-17.1	-13.2	0.0	0.0	0
2009e	-8.0	-5.0	9.0	-15.8	-13.9	-16.7	0.0	0.0	0
2010e	16.8	10.4	309.9	7.5	9.0	3.9	0.0	0.0	0
2011e	32.2	20.0	91.6	5.6	3.8	2.3	0.0	0.0	0

Equities Research – Universal Biosensors

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Recommendation

We maintain our BUY recommendation as UBI has announced that the Master Services and Supply agreement with LifeScan for the glucose test strip system has been successfully renegotiated. While management have been coy about the details, they have stated that UBI will receive a service fee of approximately 1 cent per strip sold by UBI regardless of where it is manufactured. This implies revenue of \$40M p.a. if 4B strips are sold. Moreover this flows straight to the bottom line after tax as there are no costs associated with this revenue stream. The company still receives normal manufacturing revenues for R&D and milestone revenues.

Key Points

- UBI has announced that it has entered into an amended Master Services and Supply Agreement (MSS agreement) with LifeScan.

While UBI management has been coy about releasing details about the terms of the new MSS agreement, it would be reasonable to expect that there has been agreement to increase the value of the milestone payments, as UBI needs to be rewarded for being capable of developing an enhanced product well ahead of schedule.

In terms of additional payments, UBI makes it clear that LifeScan will provide an increased level of R&D funding from 2010, although how much is not divulged (or even what it was).

- UBI has also given guidance regarding revenues that could be expected from the glucose strip in the first 12 months post regulatory approval of \$20M-\$30M, and that UBI will receive a service fee amounting to approx 1 cent per strip regardless of who manufactures the strip.
- This statement needs to be seen in the context of a previous announcement that LifeScan will establish its own manufacturing facility (with assistance from UBI). It is not unreasonable to assume that such a facility will have a capacity of at least 3B strips p.a. (bringing total manufacturing capacity up to 4.5B p.a.)
- Thus at some point in time, it is likely that UBI will be earning revenues of \$40M p.a. (from 4B strips) solely from the service fee, which would drop straight to the bottom line as there would be no costs associated with this revenue. A best case scenario is that LifeScan ramps production up rapidly to 4B strips p.a., resulting in after tax revenue to UBI of \$28M p.a. Applying a 20x multiple to this, one obtains a valuation of \$560M, or \$3.56 per share. However this valuation excludes time value of money, but gives one an indication of what can be achieved in the future.
- The company's other products under development are expected to be commercialised over the next 18-30 months. The company expects to sign commercialisation agreements with a range of other players to enable these products to reach the market.
- We therefore maintain our BUY recommendation.



New Agreement

Master Services and Supply Agreement

UBI has announced that it has entered into an amended master Services and Supply Agreement (MSS agreement) with LifeScan. This had been foreshadowed in light of LifeScan's decision to leapfrog over the launch of the first generation glucose test strip system to the second generation product.

The effect of the decision to move directly to the second generation product has the following effects on UBI:

- Delays the onset of revenues (and profits) from manufacture of strips
- Delays the onset of milestone payments (in all likelihood payable upon successful regulatory clearance)
- Delays the payment of a service fee

While UBI management has been coy about releasing details about the terms of the new MSS agreement, it would be reasonable to expect that there has been agreement to increase the value of the milestone payments, as UBI needs to be rewarded for being capable of developing an enhanced product well ahead of schedule.

In terms of additional payments, UBI makes it clear that LifeScan will provide an increased level of R&D funding from 2010, although how much is not divulged (or even what it was).

Guidance and Revenue Streams

UBI has also given guidance regarding revenues that could be expected from the glucose strip in the first 12 months post regulatory approval of \$20M-\$30M, and that UBI will receive a service fee amounting to approx 1 cent per strip regardless of who manufactures the strip.

Revenue Streams

It is important to note that UBI has four revenue streams with regard to the glucose strips:

1. milestone payments from LifeScan on successful regulatory outcomes
2. payment on supply of strips to LifeScan
3. payment for ongoing R&D
4. a service fee of approximately 1 cent per strip based on the sale of strips regardless of the manufacturing site.

Milestone and R&D Payments for Glucose Strip

These have not been disclosed by UBI or LifeScan, but we note that in Q109, the company received approximately \$1.5M from customers (which we can only but assume to be from LifeScan). We have assumed that these payments amount to a total of US\$4M for FY09 (note the company has a December year end). This drops to US\$2M in FY10, and zero thereafter in our model.



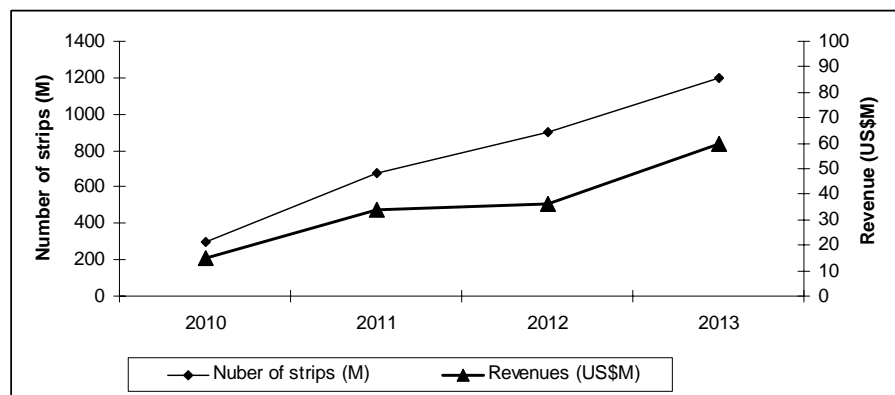
Payment on Supply of Strips

While UBI management has not stated when sales of the glucose strip are expected to begin, it is not unreasonable to assume they begin in FY10. Our model assumes sales begin in January 2010. It must be noted that regulatory approval is LifeScan's responsibility. The first indication we would receive of sales being imminent (as well as the territory) is when LifeScan announces that regulatory approval has been received.

We believe UBI currently has installed capacity able to product 750M strips p.a., and that by the end of 2009, expect this to double to 1.5B strips. Our model assumes a sales price to LifeScan of US\$4 per strip with a gross profit margin of 50%.

Our unit sales and manufacturing revenue forecasts for the glucose strip are shown in Chart1 (assumes sales begin 1 January 2010).

Chart1: Unit sales and manufacturing revenue forecasts for glucose strip



Source: WHTM

Service Fee

The major disclosure in this announcement is that UBI will receive a service fee amounting to approximately 1 cent per strip regardless of where the strip is manufactured. This statement needs to be seen in the context of a previous announcement that LifeScan will establish its own manufacturing facility (with assistance from UBI). It is not unreasonable to assume that such a facility will have a capacity of at least 3B strips p.a. (bringing total manufacturing capacity up to 4.5B p.a.), particularly in light of :

- current global demand for glucose test strips is around 16B strips p.a.
- LifeScan currently supplying the market with approximately 4B strips p.a. from its plant in Scotland. (this ties up with our estimate that LifeScan has a 20%-25% share of the global test strip market).

Thus at some point in time, it is likely that UBI will be earning revenues of \$40M p.a. (from 4B strips) solely from the service fee, which would drop straight to the bottom line as there would be no costs associated with this revenue. The unit sales volume assumes only that LifeScan maintains its global share at 4M strips p.a. This is naïve as we believe the new strip will allow LifeScan to increase its market share, and of course this valuation takes no account of market growth itself. However, no matter how big the market is, the rate limiting step is the capacity that LifeScan would have.

A best case scenario is that LifeScan ramps production up rapidly to 4B strips p.a., resulting in after tax revenue to UBI of \$28M p.a. Applying a 20x multiple to this, one obtains a valuation of \$560M, or \$3.56 per share. However this valuation excludes time value of money, but gives one an indication of what can be achieved in the future. NOTE THAT THIS IS PURELY THE SERVICE FEE COMPONENT.



We attribute a value to the service revenue of approximately \$49M (31 cps) based on a DCF valuation using a discount rate of 17%. The sensitivity of this valuation to the discount rate is shown in Table 1.

Table1: Service Fee Valuation Sensitivity

Discount rate	Value	Value per share
11%	\$70.11	\$0.45
12%	\$65.87	\$0.42
13%	\$61.97	\$0.39
14%	\$58.36	\$0.37
15%	\$55.02	\$0.35
16%	\$51.94	\$0.33
17%	\$49.08	\$0.31

Source: WHTM

If one assumes the UBI plant reaches full capacity at the end of FY10, the service revenue profit would amount to \$10.5M post tax. Placing this on a 20x PE results in a valuation of \$1.44 per share. THIS IS FOR THE SERVICE FEE ALONE.

Product Development Pipeline

The company has three other test strip systems for the Point of Care (PoC) market under development. These are:

- **Prothrombin time test**
 - Used to maintain the correct level of warfarin (blood thinner) to prevent development of blood clots. Too much warfarin and a patient can develop serious internal bleeding, while too little may allow the development of a clot leading to a stroke and/or death.
 - According to management, they expect to commercialise this system in FY10.
 - This implies that the company will sign a commercialisation and marketing agreement with a partner within the next 18 months, and that the product will be approved for use in FY10.

C-Reactive Protein (CRP) Test

- The company has developed a sensitive CRP test that is able to determine the level of this protein and use it as a method of diagnosing and monitoring cardiac disease (Think of statins which are drugs to treat cardiac disease. The market for these drugs is worth billions of dollars p.a.).
 - The ability of a sensitive CRP test to be used in the above manner is receiving significant interest in clinical circles, and it appears that the only hurdles clinicians are waiting to be overcome is final clinical proof of its effectiveness as a diagnostic and management tool, and a cheap easy to use point of care system.
 - In terms of effectiveness the JUPITER trial to determine the effectiveness of CRP in this regard was halted recently as initial analysis showed a clear cut link between CRP and cardiac disease.
- According to management, they expect to commercialise this system in FY10.
- This implies that the company will sign a commercialisation and marketing agreement with a partner within the next 18 months, and that the product will be approved for use in FY10.



D-Dimer

- D-dimer is a ubiquitous marker for deep vein thrombosis and development of other blood clots. The D-dimer market is well established with a number of test systems on market, but in essence they all suffer from one or a number of the following problems:
 - Difficult to use
 - Require large systems
 - High proportion of false positives
 - Low specificity
- It appears that UBI's technology overcomes all of the above hurdles in a cost effective manner
- It is interesting to note that UBI CEO Mark Morrisson has extensive experience in this market.
 - According to management, they expect to commercialise this product in FY11.
- This implies that the company will sign a commercialisation and marketing agreement with a partner within the next 18 months, and that the product will be approved for use in FY10.

Valuation and Recommendation

We have adjusted our valuation to take the new MSA into account, but emphasise that there is significant probability that our forecasts are incorrect due to non-disclosure of timing of numerous value creation events, such as when regulatory approval applications will be submitted by LifeScan, in which jurisdictions, and when sales are expected to begin. We have also adjusted the timing for revenues to flow from PT test and CRP to end of FY10 as opposed to earlier in the year.

Our DCF amounts to \$2.42 per share using a 17% discount rate. While we use a 100% probability of the glucose system being approved for marketing, we still discount the probabilities for the rest of the pipeline as shown in Table 2.

Table 2: Assumed product probabilities used in valuation

	Probability adjustments
Glucose	100%
PT	80%
CRP	60%
D-Dimer	40%

Source: WHTM

The valuation at 100% probability amounts to \$3.60 per share. Before we increase our probabilities we would need to see significant movement towards commercialisation.

We therefore retain our BUY recommendation with a valuation of \$2.42, and a 12-month price target of \$2.83. The company currently has approximately \$28M in cash, and therefore has no need to raise capital. Unfortunately there is substantial risk in our valuation both on the upside and downside. We do not know when LifeScan will launch the glucose system, and we do not know where it will launch the system. In addition, the rate at which LifeScan/UBI decide to increase production is also unknown. All these issues have both upside and downside risks.

Universal Biosensors (UBI : \$1.12)

INVESTMENT FUNDAMENTALS (US\$)

Yr Ending Dec	2007A	2008A	2009E	2010E	2011E
EPS Reported (c)	-5.7	-5.5	-5.0	10.4	20.0
EPS Normalised (c)	-5.7	-5.5	-5.0	10.4	20.0
EPS Growth (%)	N/A	4.2%	9.0%	309.9%	91.6%
PER Normalised (x)	-16.2	-16.4	-15.8	7.5	5.6
DPS (c)	0.0	0.0	0.0	0.0	0.0
Payout (%)	0.0%	0.0%	0.0%	0.0%	0.0%
Yield (%)	0.0%	0.0%	0.0%	0.0%	0.0%
Franking (%)	0%	0%	0%	0%	0%

VALUATION DATA

Yr Ending Dec	2007A	2008A	2009E	2010E	2011E
EV / EBITA (x)	-13.7	-13.8	-20.5	5.8	2.4
EV / EBITDA (x)	-12.3	-13.2	-16.7	3.9	2.3
CFPS (c)	-4.5	-6.6	-8.1	12.4	29.1
Price / CF	-25.1	-17.1	-13.9	9.0	3.8
Book Value / Share (\$)	0.3	0.3	0.3	0.4	0.5
Price / Book (x)	3.3	3.6	4.3	3.0	2.1

PROFIT & LOSS (US\$M)

Yr Ending Dec	2007A	2008A	2009E	2010E	2011E
Sales Revenue	0.0	0.0	4.4	20.0	61.6
EBITDA	-9.1	-8.5	-6.9	25.1	47.1
Depreciation	0.8	1.7	1.1	1.1	1.1
EBITA	-9.9	-10.1	-8.0	24.0	46.0
Amortisation	0.0	0.0	0.0	0.0	0.0
EBIT	-9.9	-10.1	-8.0	24.0	46.0
Net Interest Expense	-1.4	-1.4	0.0	0.0	0.0
Pre-tax Profit	-8.5	-8.8	-8.0	24.0	46.0
Tax	-0.1	0.0	0.0	7.2	13.8
Tax rate (%)	1.6%	-0.2%	0.0%	30.0%	30.0%
Minorities / pref divs	0.0	0.0	0.0	0.0	0.0
Equity accounted NPAT	0.0	0.0	0.0	0.0	0.0
Net Profit	-8.4	-8.8	-8.0	16.8	32.2
Abn's / Extraord's	0.0	0.0	0.0	0.0	0.0
Reported Net Profit	-8.4	-8.8	-8.0	16.8	32.2
Revenue Growth (%)	N/A	N/A	N/A	354.6%	207.8%
EBIT Growth (%)	N/A	-2.7%	21.1%	400.0%	91.7%
NPAT Growth (%)	N/A	-5.3%	9.1%	310.0%	91.7%

PROFITABILITY RATIOS

Yr Ending Dec	2007A	2008A	2009E	2010E	2011E
EBIT / Sales (%)			-181.8%	120.0%	74.7%
ROA (%)	N/A	-48.8%	-26.6%	67.0%	136.1%
ROE (%)	N/A	-17.3%	-17.9%	34.0%	45.8%
ROFE (%)	N/A	-59.5%	-32.0%	82.5%	235.3%

INTERIMS (US\$m)

Half Yr	Jun 08	Dec 08	Jun 09	Dec 09	Jun 10
Yr Ending Dec	1H A	2H A	1H E	2H E	1H E
Sales Revenue	0.0	0.0	1.4	3.0	10.0
EBIT	-4.9	-5.3	-4.0	-4.0	8.0
Net Profit	-3.5	-5.3	-4.0	-4.0	5.6
EBIT / Sales (%)			-285.7%	-133.3%	80.0%

BALANCE SHEET (US\$m)

Yr Ending Dec	2007A	2008A	2009E	2010E	2011E
Cash	39.7	27.8	11.8	28.8	72.8
Receivables	0.0	2.0	1.5	5.7	3.1
Inventories	0.4	3.0	3.0	11.3	6.2
Other	6.9	0.6	12.7	0.0	0.0
Current Assets	41.5	33.4	29.0	45.7	82.0
Net PPE	14.4	19.5	17.8	19.7	21.7
Investments	0.0	0.0	0.0	0.0	0.0
Intangibles	0.0	0.0	0.0	0.0	0.0
Other	0.0	0.0	0.0	0.0	0.0
Non-current Assets	14.5	19.5	17.8	19.7	21.7
Total Assets	56.0	52.9	46.8	65.5	103.7
Current Payables	0.8	1.0	2.4	4.5	10.7
Current Debt	0.0	0.0	0.0	0.0	0.0
Non-Current Debt	0.0	0.0	0.0	0.0	0.0
Provisions	2.5	3.1	3.6	3.1	10.2
Other	0.0	0.0	0.0	0.0	0.0
Total Liabilities	3.3	4.1	6.0	7.6	20.9
Equity	58.9	59.4	59.4	57.3	57.3
Reserves	3.5	8.0	8.0	8.0	0.7
Retained Profits	-9.8	-18.6	-26.6	-7.4	24.8
Minorities	0.0	0.0	0.0	0.0	0.0
Total Equity	52.7	48.8	40.8	57.9	82.8
Total Funds Employed	12.9	21.0	29.0	29.1	10.0

LIQUIDITY & LEVERAGE RATIOS (US\$m)

Yr Ending Dec	2007A	2008A	2009E	2010E	2011E
Net Debt (Cash) (\$m)	-39.7	-27.8	-11.8	-28.8	-72.8
Net Debt / Equity (%)	-75.4%	-56.9%	-28.9%	-49.7%	-87.9%
Interest Cover (x)	7.2	7.5			
Debt / CashFlow (x)	0.0	0.0	0.0	0.0	0.0

CASHFLOW (US\$m)

Yr Ending Dec	2007A	2008A	2009E	2010E	2011E
EBIT	-9.9	-10.1	-8.0	24.0	46.0
Dep'n and Amort'n	0.8	1.7	1.1	1.1	1.1
Net Int Rec'd (Paid)	1.4	1.4	0.0	0.0	0.0
Tax Paid	0.2	0.0	0.0	0.0	0.0
Dec / (Inc) W'kg Cap	0.0	-2.3	-8.0	-5.0	0.0
Other	1.0	-1.2	1.9	-0.1	-0.1
Operating Cash Flow	-6.6	-10.6	-13.0	20.0	47.0
Capital Expenditure	-7.7	-4.8	-3.0	-3.0	-3.0
Asset Sales	0.0	0.0	0.0	0.0	0.0
Investments	0.0	0.0	0.0	0.0	0.0
Other Inv. Flows	-2.8	0.0	0.0	0.0	0.0
Investing Cash Flow	-10.5	-4.8	-3.0	-3.0	-3.0
Equity Raised	28.3	2.9	0.0	0.0	0.0
Inc / (Dec) in Loans	0.0	0.0	0.0	0.0	0.0
Dividends Paid	0.0	0.0	0.0	0.0	0.0
Other Fin. Flows	0.0	0.0	0.0	0.0	0.0
Financing Cash Flow	28.3	2.9	0.0	0.0	0.0
Net Cash Flow	11.2	-12.4	-16.0	17.0	44.0

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