Zacks Small-Cap Research

July 25, 2016

Brian Marckx, CFA
bmarckx@zacks.com
Ph (312) 265-9474

scr.zacks.com

10 S. Riverside Plaza, Chicago, IL 60606

Chembio Diagnostics Inc. (CEMI-NASDAQ)

CEMI: **Big Downward Revisions to Revenue**

We look for 2017 revenue of $24.6M. We use OSUR as a comp for valuation purposes. OSUR trades at approximately 3x 2017 estimated sales which values CEMI at ~$7.75/share.

Current Price (07/25/16)	$6.50
Valuation	**$7.75**

OUTLOOK

CLIA Waiver granted for DPP HIV assay. CEMI signed distribution agreements and also direct sales force to sell direct in the U.S. Int'l lateral flow sales helped buoy 2015 revenue. HIV self-testing kit launched in Europe with early successes. DPP international sales had been growth driver for last few years but waned in 2015 with slump to FIOCRUZ. We think FIOCRUZ STD sales could continue to decline. Mexico also down in 2015 but could return to growth in 2016.

DPP HIV/Syph in U.S. trials - could launch and contribute in 2017. Meanwhile, new fever portfolio looks like it could be a needle-mover – off to a strong start and most recently added Zika. Zika assays delayed but could come to market by early 2017.

While we continue to think fever represents the next wave of growth, declining DPP sales to FIOCRUZ and US lateral flow sales will result in total revenue contraction in 2016.

CEMI also focused on complementary revenue opportunities including add'l R&D contracts/grants, expansion of international commercialization footprint, and potentially in-licensing products.

SUMMARY DATA

52-Week High	**$9.40**
52-Week Low	**$3.33**
One-Year Return (%)	**62.81**
Beta	**1.04**
Average Daily Volume (sh)	**41,622**
Shares Outstanding (mil)	**10**
Market Capitalization ($mil)	**$74**
Short Interest Ratio (days)	**N/A**
Institutional Ownership (%)	**16**
Insider Ownership (%)	**7**
Annual Cash Dividend	**$0.00**
Dividend Yield (%)	**0.00**
5-Yr. Historical Growth Rates	
Sales (%)	**7.4**
Earnings Per Share (%)	**-55.9**
Dividend (%)	**N/A**
P/E using TTM EPS	**N/A**
P/E using 2016 Estimate	**N/A**
P/E using 2017 Estimate	**N/A**
Zacks Rank	**N/A**

Risk Level	**Average,**
Type of Stock	**Small-Blend**
Industry	**Med Products**

ZACKS ESTIMATES

Revenue
(millions)

	Q1 (Mar)	Q2 (Jun)	Q3 (Sep)	Q4 (Dec)	Year (Dec)
2015	$6.23 A	$6.72 A	$6.89 A	$4.42 A	$24.26 A
2016	$6.60 A	$3.25 E	$3.92 E	$4.59 E	$18.36 E
2017					$24.60 E
2018					$30.08 E

Adjusted Earnings per Share

	Q1 (Mar)	Q2 (Jun)	Q3 (Sep)	Q4 (Dec)	Year (Dec)
2015	-$0.09 A	-$0.09 A	-$0.06 A	-$0.16 A	-$0.40 A
2016	-$0.05 A	-$0.87 E	-$0.20 E	-$0.18 E	-$1.25 E
2017					-$0.36 E
2018					-$0.14 E

Zacks Projected EPS Growth Rate - Next 5 Years % **25**

© Copyright 2016, Zacks Investment Research. All Rights Reserved.

WHAT'S NEW

Big Downward Revisions to Revenue Related to Lower Sales of U.S. Lateral Flow and DPP FIOCRUZ...

Chembio announced Q2 expected revenue, operating loss and net loss for Q2 and also provided general guidance for 2H 2016 - all of which are significantly lower than what we were modeling. The guidance vs. estimates are;

> Q2 Revenue $3.2M - $3.3M vs. our $5.0M estimate and $4.94M Street consensus
> Q2 Operating loss $2.3M - $2.5M vs. our $1.2M (loss)
> Q2 Net income which will be impacted $6M (non-cash) reversal of the deferred tax asset: $8.3M - $8.5M vs our $868k (loss)
> 2H 2016 Revenue $8.0M - $10.0M vs our $12.0M estimate and $14.1M Street consensus

The Q2 and 2H revenue guidance implies yoy contraction (using guidance mid-points) of approximately 50% and 20% respectively. CEMI cites lower U.S. lateral flow sales and DPP sales to FIOCRUZ as the major factors contributing to the expected slide in the top-line. Reversal of the deferred tax asset relates to CEMI's belief that it is more likely than not that it will not be realized (i.e. do not expect taxable income in the foreseeable future) due to longer than expected delays related to development and launch of the DPP Zika assays.

We note that both U.S. lateral flow and DPP FIOCRUZ sales were big question marks in terms of how they would hold up. CEMI began detailing SURE CHECK HIV 1/2 on June 1st, following the roll-off of Alere's marketing rights to the product. This follows a similar situation with STAT-PAK in 2014. While we had anticipated CEMI's much smaller (relative to Alere) sales force and distribution reach would likely result in a meaningful decrease in U.S. lateral flow sales, we think it is likely we underestimated, at least, the near-term impact. As far as DPP FIOCRUZ - CEMI noted on the Q1 call that they expected sales to fall in 2016 relative to the prior year. And while we had modeled as much, again we likely underestimated. DPP FIOCRUZ is inherently difficult to model given the fact that most of the minimum purchases under the technology transfer agreement had been met.

We have made significant downward revisions to our modeled revenue for the remainder of 2016 as well as the out years, which reflects across the board cuts to U.S. lateral flow and DPP FIOCRUZ. We note, however, that we continue to expect both DPP FIOCRUZ and U.S. lateral flow to be significant contributors to revenue. Most of the growth in our model continues to come from the Fever portfolio which we now think makes an initial meaningful contribution in late 2016/early 2017.

CEMI expects to show $1.44M of cash as of the end of Q2. CEMI also announced today a proposed public offering under an existing shelf of $10M of common stock led by Craig-Hallum and co-managed by The Benchmark Company. We think a $10M raise should be sufficient to get the company to a point of cash flow positive.

VALUATION

We continue to use OSUR as a comp for valuation purposes. OSUR trades at approximately 3x 2017 estimated sales which values CEMI at ~$7.75/share, revised from $9/share.

FINANCIAL STATEMENTS

INCOME STATEMENT

Chembio Diagnostics, Inc.

	2015 A	Q1A	Q2E	Q3E	Q4E	2016 E	2017 E	2018 E	2019 E
Product sales	**$21,887**	**$5,917**	**$2,572**	**$3,065**	**$3,730**	**$15,284**	**$21,186**	**$26,555**	**$33,166**
% of total revenue	*90.2%*	*89.6%*	*79.2%*	*78.2%*	*81.2%*	*83.3%*	*86.1%*	*88.3%*	*93.5%*
YOY Growth	*-15.7%*	*5.4%*	*-59.3%*	*-50.6%*	*-0.3%*	*-30.2%*	*38.6%*	*25.3%*	*24.9%*
License & royalty income	**$53**	**$22**	**$27**	**$22**	**$26**	**$97**	**$411**	**$526**	**$310**
% of total revenue	*0.2%*	*0.3%*	*0.8%*	*0.6%*	*0.6%*	*0.5%*	*1.7%*	*1.7%*	*0.9%*
R&D contracts, grants, milestones	**$2,316**	**$662**	**$650**	**$830**	**$835**	**$2,977**	**$3,000**	**$3,000**	**$2,000**
% of total revenue	*9.5%*	*10.0%*	*20.0%*	*21.2%*	*18.2%*	*16.2%*	*12.2%*	*10.0%*	*5.6%*
Total Revenues	$24,255.5	$6,601.6	$3,249.0	$3,917.0	$4,591.0	$18,358.6	$24,596.8	$30,080.2	$35,475.2
YOY Growth	*-12.3%*	*5.9%*	*-51.6%*	*-43.1%*	*3.9%*	*-24.3%*	*34.0%*	*22.3%*	*17.9%*
Cost of Revenues	$13,769	$3,436	$1,872	$2,170	$2,611	$10,089	$13,263	$15,720	$18,971
Gross Income	$10,486	$3,166	$1,377	$1,747	$1,980	$8,270	$11,334	$14,360	$16,504
Gross Margin	*43.2%*	*48.0%*	*42.4%*	*44.6%*	*43.1%*	*45.0%*	*46.1%*	*47.7%*	*46.5%*
Product Margin	*37.1%*	*41.9%*	*27.2%*	*29.2%*	*30.0%*	*34.0%*	*37.4%*	*40.8%*	*42.8%*
Research & Development	$6,377	$1,634	$1,951	$1,994	$2,038	$7,617	$6,944	$6,501	$6,684
% R&D	*26.3%*	*24.8%*	*60.0%*	*50.9%*	*44.4%*	*41.5%*	*28.2%*	*21.6%*	*18.8%*
Selling General & Admin	$7,663	$1,999	$1,787	$1,841	$1,974	$7,601	$8,535	$9,445	$10,465
% SG&A	*31.6%*	*30.3%*	*55.0%*	*47.0%*	*43.0%*	*41.4%*	*34.7%*	*31.4%*	*29.5%*
Operating Income	($3,554)	($468)	($2,361)	($2,088)	($2,032)	($6,949)	($4,145)	($1,586)	($645)
Operating Margin	*-14.7%*	*-7.1%*	*-72.7%*	*-53.3%*	*-44.3%*	*-37.9%*	*-16.9%*	*-5.3%*	*-1.8%*
Other income (expense)	($5)	$0	($6,000)	$0	$0	($6,000)	$0	$0	$0
Interest income, net	$1	$3	$0	$0	$0	$4	($50)	($35)	($10)
Pre-Tax Income	($3,558)	($465)	($8,361)	($2,088)	($2,032)	($12,945)	($4,195)	($1,621)	($655)
Taxes	($1,161)	($162)	$0	$0	$0	($162)	$0	$0	$0
Tax Rate	*32.6%*	*34.7%*	*0.0%*	*0.0%*	*0.0%*	*1.2%*	*0.0%*	*0.0%*	*0.0%*
Net Income	($2,397)	($304)	($8,361)	($2,088)	($2,032)	($12,784)	($4,195)	($1,621)	($655)
YOY Growth	*110.8%*	*-53.1%*	*1159.0%*	*377.5%*	*212.9%*	*433.3%*	*-67.2%*	*-61.3%*	*-59.6%*
Net Margin	*-9.9%*	*-4.6%*	*-257.3%*	*-53.3%*	*-44.3%*	*-69.6%*	*-17.1%*	*-5.4%*	*-1.8%*
EPS	($0.25)	($0.03)	($0.87)	($0.20)	($0.18)	($1.25)	($0.36)	($0.14)	($0.05)
YOY Growth	-	-	-	-	-	-	-	-	-
Weighted Avg. Shares O/S	9,626	9,632	9,660	10,400	11,100	10,198	11,500	11,800	12,000

Brian Marckx, CFA

HISTORICAL ZACKS RECOMMENDATIONS



© Copyright 2016, Zacks Investment Research. All Rights Reserved.

DISCLOSURES

The following disclosures relate to relationships between Zacks Small-Cap Research ("Zacks SCR"), a division of Zacks Investment Research ("ZIR"), and the issuers covered by the Zacks SCR Analysts in the Small-Cap Universe.

ANALYST DISCLOSURES

I, Brian Marckx, CFA, hereby certify that the view expressed in this research report accurately reflect my personal views about the subject securities and issuers. I also certify that no part of my compensation was, is, or will be, directly or indirectly, related to the recommendations or views expressed in this research report. I believe the information used for the creation of this report has been obtained from sources I considered to be reliable, but I can neither guarantee nor represent the completeness or accuracy of the information herewith. Such information and the opinions expressed are subject to change without notice.

INVESTMENT BANKING AND FEES FOR SERVICES

Zacks SCR does not provide investment banking services nor has it received compensation for investment banking services from the issuers of the securities covered in this report or article.
Zacks SCR has received compensation from the issuer directly or from an investor relations consulting firm engaged by the issuer for providing non-investment banking services to this issuer and expects to receive additional compensation for such non-investment banking services provided to this issuer. The non-investment banking services provided to the issuer includes the preparation of this report, investor relations services, investment software, financial database analysis, organization of non-deal road shows, and attendance fees for conferences sponsored or co-sponsored by Zacks SCR. The fees for these services vary on a per-client basis and are subject to the number and types of services contracted. Fees typically range between ten thousand and fifty thousand dollars per annum. Details of fees paid by this issuer are available upon request.

POLICY DISCLOSURES

This report provides an objective valuation of the issuer today and expected valuations of the issuer at various future dates based on applying standard investment valuation methodologies to the revenue and EPS forecasts made by the SCR Analyst of the issuer's business.
SCR Analysts are restricted from holding or trading securities in the issuers that they cover. ZIR and Zacks SCR do not make a market in any security followed by SCR nor do they act as dealers in these securities. Each Zacks SCR Analyst has full discretion over the valuation of the issuer included in this report based on his or her own due diligence. SCR Analysts are paid based on the number of companies they cover. SCR Analyst compensation is not, was not, nor will be, directly or indirectly, related to the specific valuations or views expressed in any report or article.

ADDITIONAL INFORMATION

Additional information is available upon request. Zacks SCR reports and articles are based on data obtained from sources that it believes to be reliable, but are not guaranteed to be accurate nor do they purport to be complete. Because of individual financial or investment objectives and/or financial circumstances, this report or article should not be construed as advice designed to meet the particular investment needs of any investor. Investing involves risk. Any opinions expressed by Zacks SCR Analysts are subject to change without notice. Reports or articles or tweets are not to be construed as an offer or solicitation of an offer to buy or sell the securities herein mentioned.