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Zacks Small-Cap Research

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Chembio Diagnostics Inc. (CEMI-NASDAQ)

CEMI: **Moving PT to $15.5/Share On Upward Revenue Revisions, Comp Multiple Expansion**

OSUR trades at 6x consensus 2018 sales. We model CEMI 2018 revenue of $32.1M, which at a 6x multiple, values the company approximately $15.50/share.

Current Price (12/06/17)	$7.30
Valuation	**$15.50**

OUTLOOK

As we noted in our Q3 update (Nov 17th), the recent additional activity from FIOCRUZ bolstered our confidence that future incremental business would materialize for the DPP HIV ½ products from Brazil (and prompted an increase in anticipated related sales). We, however, did not anticipate such a significant commitment (i.e. the $8.5M agreement) would materialize this soon. We have since further upwardly revised our estimated FIOCRUZ-related revenue for 2018.

We have also made upward revenue adjustments to our model (for years 2018 and 2019) related to CEMI's announcement in late December that they were awarded a "Long Term Arrangement" from UNICEF related to that organizations' RFP for the supply of POC Zika diagnostics.

OSUR trades at approximately 6x (up from 5x since our last update in November) consensus 2018 sales. The updates to our estimated revenue, combined with expansion of the comp P/S multiple, results in our price target for CEMI moving from $12.5/share to $15.5/share.

SUMMARY DATA

52-Week High	**$7.60**
52-Week Low	**$5.05**
One-Year Return (%)	**4.44**
Beta	**1.25**
Average Daily Volume (sh)	**15,630**
Shares Outstanding (mil)	**12**
Market Capitalization ($mil)	**$90**
Short Interest Ratio (days)	**N/A**
Institutional Ownership (%)	**35**
Insider Ownership (%)	**14**
Annual Cash Dividend	**$0.00**
Dividend Yield (%)	**0.00**
5-Yr. Historical Growth Rates	
Sales (%)	**-9.2**
Earnings Per Share (%)	**N/A**
Dividend (%)	**N/A**
P/E using TTM EPS	**N/A**
P/E using 2017 Estimate	**N/A**
P/E using 2018 Estimate	**N/A**
Zacks Rank	**N/A**

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

ZACKS ESTIMATES

Revenue
(millions)

	Q1 (Mar)	Q2 (Jun)	Q3 (Sep)	Q4 (Dec)	Year (Dec)
2016	$6.60 A	$3.27 A	$3.75 A	$4.25 A	$17.87 A
2017	$6.33 A	$4.11 A	$7.59 A	$5.61 E	$23.64 E
2018					$32.13 E
2019					$37.63 E

Adjusted Earnings per Share

	Q1 (Mar)	Q2 (Jun)	Q3 (Sep)	Q4 (Dec)	Year (Dec)
2016	-$0.03 A	-$0.25 A	-$0.19 A	-$0.21 A	-$0.71 A
2017	-$0.13 A	-$0.18 A	-$0.05 A	-$0.12 E	-$0.48 E
2018					-$0.23 E
2019					-$0.11 E

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

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WHAT'S NEW

MODEL ADJUSTMENTS FOR $8.5M FIOCRUZ ORDER, UNICEF RFP AWARD (UP TO $4.9M)

New $8.5M DPP HIV, Leishmania Order From Brazil Prompts Upward Revision to Estimated 2018 Revenue…

Yesterday (Dec 5th) Chembio (CEMI) announced that they received a commitment from Bio-Manguinhos (i.e. FIOCRUZ) to purchase $8.5M worth of DPP HIV ½ and DPP Leishmania intermediate product and test components and for the related sales to occur in 2018. This is in addition to the May 2017 announcement that FIOCRUZ would purchase $5.8M worth DPP HIV ½ test components during 2017 ($4.2M of which was fulfilled through Q3, with the remaining $1.6M expected to be shipped by year-end).

These recent orders, in our opinion, are important for not only the near-term revenue contribution but also because of what they suggest in terms of the competitive quality of the DPP technology and the strength of the relationship between CEMI and FIOCRUZ. This is also why we are optimistic about the likelihood of Brazil continuing to be a significant and important customer of CEMI's for the foreseeable future (for not only CEMI's sexually transmitted disease assays, but also for its burgeoning DPP fever portfolio).

We think it is worth a look back to provide some context about how important a partner FIOCRUZ has been. As a refresher, CEMI's relationship with FIOCRUZ blossomed with a technology transfer agreement in 2004 related to the company's lateral flow HIV assays and technology (for context, this agreement even pre-dated the U.S. distribution relationship with Inverness / Alere which was initiated in 2006).

In 2008 the duo entered into a new technology transfer agreement – which covered the DPP technology and certain DPP assays (leptospirosis, canine leishmaniasis, HIV 1/2 and 5-band multiplex HIV 1/2 confirmation test). The DPP agreement required FIOCRUZ to purchase (in aggregate) at least $12M worth of assays before the technology would be transferred and allow CEMI's Brazilian partner to manufacture the products themselves. That agreement ended up being wildly successful for CEMI, helping to drive DPP sales from about $4.3M in 2011 to $10M in 2012. FIOCRUZ purchased well beyond the minimum required and DPP sales increased to $15.7M (60% of product revenue) in 2014. While CEMI has not disclosed the amount of DPP assays that FIOCRUZ has purchased since the 2008 technology transfer agreement was signed, we estimate that through the end of 2016, it could be more than $50M worth of related revenue.

While FIOCRUZ-related sales fell by $5.3M from 2015 to 2016, that slump largely related to a competitor under-pricing where it was not economically feasible for CEMI to compete. The decreased sales to FIOCRUZ was the major reason for CEMI's total product sales falling $8.2M (38%) over that same period (the other contributor was roll-off of Alere's U.S. distribution for CEMI's lateral flow products). But, FIOCRUZ quickly came back to CEMI and their DPP products – committing in May to buy $5.8M worth of DPP HIV ½ test components during 2017 – then just 7 months later committing to purchase another $8.5M worth of DPP product during 2018.

CEMI has not disclosed pricing, but we think it is likely that FIOCRUZ is paying some premium for Chembio's products versus competitors' (such as Trinity's UniGold HIV assay) – which certainly suggests quality and accuracy associated with the DPP technology can trump pricing. We also think the long-standing and mutually-beneficial relationship that CEMI and FIOCRUZ have built may also provide some competitive benefit.

As we noted in our Q3 update (Nov 17th), the recent additional activity from FIOCRUZ bolstered our confidence that future incremental business would materialize for the DPP HIV ½ products from Brazil (and prompted an increase in anticipated related sales). We, however, did not anticipate such a significant commitment (i.e. the $8.5M agreement) would materialize this soon. We have since further upwardly revised our estimated FIOCRUZ-related revenue for 2018. And while we have not made adjustments to (FIOCRUZ-related) revenue in the out years in our model, we think these two very significantly-sized orders, along with the recent approval of DPP Zika (including the micro-reader) in Brazil, could be harbingers for additional upside surprises.

UNICEF RFP Award: At least $1.5M, up to $4.9M…

We have also made upward revenue adjustments to our model (for years 2018 and 2019) related to CEMI's announcement in late November that they were awarded a "Long Term Arrangement" from UNICEF related to that organizations' RFP for the supply of POC Zika diagnostics. The RFP was initially announced in February but award grants had been drawn out longer than anticipated – so while we had a potential award on our radar, we had yet to model an assumed contribution. CEMI has a firm commitment for sales of $1.5M of their DPP Zika test (and micro-

reader) with a potential of up to $4.9M. Sales are conditioned upon CEMI first receiving WHO Emergency Use Assessment, clinical and analytical evaluation and quality management system inspection. We had little concern about the ability to meet these prerequisites. As a reminder, in addition to Brazilian regulatory approval and CE Mark, DPP Zika has been granted Emergency Use Authorization by the FDA (the only such rapid Zika test to receive such).

Model Updates
With upward revisions to revenue as a result of the new FIOCRUZ order and this UNICEF award (we currently model just the initial $1.5M – which will be updated if and when appropriate), we now have 2018 and 2019 estimated total revenue of $32.1M and $37.6M, respectively – which is revised from $30.2M and $37.1M.

VALUATION

OSUR trades at approximately 6x (up from 5x since our last update in November) consensus 2018 sales. The updates to our estimated revenue, combined with expansion of the comp P/S multiple, results in our price target for CEMI moving from $12.5/share to $15.5/share.

FINANCIAL STATEMENTS

INCOME STATEMENT

Chembio Diagnostics, Inc.

	2016 A	Q1A	Q2A	Q3A	Q4E	2017 E	2018 E	2019 E
Product sales	$13,679	$5,427	$2,893	$6,133	$4,438	$18,889	$28,383	$35,127
% of total revenue	76.6%	85.8%	70.3%	80.8%	79.1%	79.9%	88.3%	93.3%
YOY Growth	-37.5%	-8.3%	42.2%	145.1%	37.5%	38.1%	50.3%	23.8%
License & royalty income	$450	$100	$228	$150	$132	$610	$526	$310
% of total revenue	2.5%	1.6%	5.5%	2.0%	2.4%	2.6%	1.6%	0.8%
R&D contracts, grants, milestones	$3,739	$798	$994	$1,305	$1,043	$4,140	$3,230	$2,193
% of total revenue	20.9%	12.6%	24.2%	17.2%	18.6%	17.5%	10.1%	5.8%
Total Revenues	**$17,868.8**	**$6,325.2**	**$4,114.8**	**$7,587.4**	**$5,613.0**	**$23,640.4**	**$32,138.1**	**$37,629.4**
YOY Growth	-26.3%	-4.2%	26.0%	102.5%	31.9%	32.3%	35.9%	17.1%
Cost of Revenues	$9,418	$3,219	$2,204	$4,065	$2,752	$12,239	$16,434	$19,847
Gross Income	**$8,451**	**$3,106**	**$1,911**	**$3,523**	**$2,861**	**$11,401**	**$15,705**	**$17,783**
Gross Margin	47.3%	49.1%	46.4%	46.4%	51.0%	48.2%	48.9%	47.3%
Product Margin	31.2%	40.7%	23.8%	33.7%	38.0%	35.2%	42.1%	43.5%
Research & Development	$8,428	$2,247	$1,982	$1,806	$1,888	$7,923	$7,612	$7,244
% R&D	47.2%	35.5%	48.2%	23.8%	33.6%	33.5%	23.7%	19.3%
Selling General & Admin	$7,596	$2,488	$2,109	$2,305	$2,498	$9,401	$11,280	$12,117
% SG&A	42.5%	39.3%	51.3%	30.4%	44.5%	39.8%	35.1%	32.2%
Operating Income	**($7,572)**	**($1,629)**	**($2,181)**	**($589)**	**($1,524)**	**($5,923)**	**($3,188)**	**($1,578)**
Operating Margin	-42.4%	-25.8%	-53.0%	-7.8%	-27.2%	-25.1%	-9.9%	-4.2%
Other income (expense)	$0	$0	$0	$0	$0	$0	$0	$0
Interest income, net	$26	$13	$8	$4	$1	$26	($24)	($14)
Pre-Tax Income	**($7,546)**	**($1,616)**	**($2,173)**	**($585)**	**($1,523)**	**($5,897)**	**($3,212)**	**($1,592)**
Taxes	$5,801	$0	$0	$0	$0	$0	$0	$0
Tax Rate	-76.9%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%
Net Income	**($13,347)**	**($1,616)**	**($2,173)**	**($585)**	**($1,523)**	**($5,897)**	**($3,212)**	**($1,592)**
YOY Growth	456.8%	431.3%	-74.0%	-72.7%	-40.4%	-55.8%	-45.5%	-50.4%
Net Margin	-74.7%	-25.5%	-52.8%	-7.7%	-27.1%	-24.9%	-10.0%	-4.2%
EPS	**($1.26)**	**($0.13)**	**($0.18)**	**($0.05)**	**($0.12)**	**($0.48)**	**($0.23)**	**($0.11)**
YOY Growth	-	-	-	-	-	-	-	-
Weighted Avg. Shares O/S	10,622	12,271	12,299	12,311	12,315	12,299	13,800	14,000

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