

ASX Announcement :

Managing Director, Andrew McLellan on Bluechiip deliveries, operations and developments in the September quarter



Bluechiip Limited
1 Dalmore Drive
Caribbean Business Park
Scoresby VIC 3179 AUSTRALIA

Open Briefing interview with MD Andrew McLellan

In this Open Briefing®, Andrew discusses:

- Significant increase in cash receipts for the quarter ended 30 September 2019
- Outlook for further growth in chip volumes and sales over the coming quarters
- Production of prototype consumables for potential new OEM partner
- Expanding production and supply chain capacity to allow for tens of millions of chips per annum

Record of interview:

1. Bluechiip today announced record cash receipts for the September quarter of \$441k, up 8.5x from the June quarter. Revenues for the quarter though were \$103k, down 80% from the June quarter. You have said previously that growth in cash receipts and accounting revenues will take several quarters to smooth out. What should we expect for the next several quarters?

Thank you. It's exciting to be receiving record cash flows from our customers with cash receipts from our deliveries in the 2nd half of FY19.

While cash receipts were up, our revenues and deliveries for the quarter were down. Overall, we expect a trend of rising cash, revenues and deliveries, however on a quarterly basis there has and will be fluctuations, but these will smooth out as we scale. Some of the variation you have seen is seasonal, for example we pushed very hard in the last quarter of financial 2019 to deliver readers and we are now seeing the cash flow from those deliveries in this quarter.

The lead-lag between cash, sales and deliveries is expected to smooth over the next 6 to 12 months.

Over the next two to five years we expect to show considerable growth and that is what our business planning is predicated on: existing orders and agreements and also the activity level within our pipeline of potential OEM partnerships.

We have orders in hand from our leading OEM partner Labcon, which is rolling the Coldpoint Bluechiip enabled range into the market. Its sales team has been trained throughout 2019 and their team members are gaining increasing interest and confidence with the end customer base. Some of the feedback has been extremely positive with end users highlighting significant productivity improvement opportunities with the Bluechiip enabled range.

2. With rapidly rising volumes of chips sales, can you tell us how you are scaling production, the impact on unit costs and how you are ensuring security of production?

We have been working hard during this quarter on increasing and securing supply of our chips to see us move through several of those quite significant volume increases to both meet our existing contracted orders and also anticipated growth from other potential OEM customers in our pipeline.

As highlighted in the 4C, we have now, subsequent to the end of the quarter, put in place a forward order over the next 18-24 months and beyond. This order is expected to see us moving through 3 million units a year, then 5 million units and eventually provides the base for over 10 million units a year.

We have worked with our suppliers to put the commitment in place and there are a number of factors that influence how that will operate including additional R&D on the chips and production technology and a forward down payment

3. Shipping tens of millions of chips a year to multiple customers sounds like quite a meaningful logistics exercise. How will Bluechiip manage this process?

Yes, it is a very large number of chips, but in volume terms each chip is relatively small, about one cubic millimetre. The chips are a high value by both by weight and volume, so we can ship significant numbers in relatively small shipments.

We are also making some significant investments in terms of the supply chain. Firstly, with additional R&D, which is forecast to increase to \$1,285k up from \$427 in the September quarter, to optimise performance and efficiency of our core Bluechiip chips. Secondly, with additional working capital to secure our volumes which also includes some partial upfront payments and stepped pricing at different volumes. By that I mean, lower unit production costs as we increase volumes.

4. You have converted a proposal to develop prototype consumables for a potential OEM partner and delivered them a developer kit. Does this imply a shortening of the normal process from NDA through developer kit to OEM partnership?

Yes. The dynamic has changed and we anticipate that this could see us with an accelerated path to OEM licence and supply agreements.

We are seeing a significant amount of activity from potential partners that already have developer kits and from new parties that have proposals to incorporate Bluechiip technology into their products.

A year or two ago potential OEM partners needed to evaluate our core technology and test to see if it works. Now we are in a position where when we put developer kit proposals into the market, they include us customising and producing often hundreds of consumables.

By delivering customised consumables with the developer kit it allows our potential OEM partners to test their consumables with our technology with their end customers sooner than they would have say a year ago.

We do have a number of proposals on the table as we speak.

Predicting exact timing is always difficult but we anticipate that we will convert a number of OEM proposals into licence and supply agreements in the medium term.

5. What is the significance of achieving CE Mark compliance and testing to Federal Communications Commission (FCC) requirements for the Hand-Held, Multi-Vial and Matchbox readers that are now in full production? Also, how long will it take to achieve ISO 9001 compliance and what is the importance of that?

These certifications are an important part of our ability to scale and deliver capacity.

The CE Marking allows Bluechiip and our OEM partners to sell product into Europe as compliant to European standards. The FCC mark allows sale of Bluechiip products into the USA.

What this means is that as we've gone into full scale production of readers over the last couple of quarters, we are able to deliver certified product not just into the hands of our OEM customers but also their downstream customers.

We are putting in place processes that meet both ISO9001 and also ISO13485 which is a quality management system required for medical devices. We also intend to be audited to the ISO9001 standard.

We are targeting to put these systems and processes in place over the next six months.

It is significant as a basis for our scaling and as a clear indication that Bluechiip is putting in place all of the systems and processes to meet our customers' needs at significant volumes and under some quite rigorous quality process requirements.

6. As you step up your R & D expenditure, what level of cash in-flow should we expect from R&D Tax Incentives over the coming two to three quarters?

In the forthcoming December or March quarter we expect to receive over \$1 million in cash from the R&D Tax Incentive refund from Ausindustry for the approved R&D spend incurred in FY'19. As highlighted above we expect to see a significant step up in R & D spend and as a result a similar step up in R & D Tax incentives over the coming year.

7. You now have 34 developer kits with a multitude of potential OEM partners. Can you tell us which markets these are focussed on and what stage the negotiations are at?

We are defining road maps as to how we can proceed with various partners and have OEM proposals on the table. The key focus markets remain in our traditional life science and the 300 million a year bio-sample preservation and storage markets. On top of this we are

seeing significant interest from both the cell therapy, IVF markets with both existing and potential partners.

Additionally, we are seeing strong interest from the blood bag and pharmaceutical consumables space.

8. With accelerating customer receipts, increasing R & D tax credits but also increasing investment in R & D and working capital, can you summarise what you expect the net impact to be on your cash demands over the coming quarters?

We currently have a cash balance of just under \$3m and expect to receive over \$1m from the R&D tax incentive in the current quarter or early in the March quarter, along with customer receipts including from sales of chips and readers

In terms of cash outflow, we have noted there is a significant step up in R & D spend on chips and production. This will see us gain significant efficiencies and will give us further confidence in scaling our production.

The growth of the business does require us to invest in working capital, but this is a very positive reflection of where current demand is and where we can see demand going based both on existing orders and on progress with a number of potential OEM customers. On this basis, the board is assessing how we can optimise funding for working capital as we move forward and execute on our growth strategy.

openbriefing.com

Thank you.

DISCLAIMER: Ramsgate Advisors Ltd and Orient Capital Pty Ltd have taken all reasonable care in publishing the information contained in this Open Briefing®; furthermore, the entirety of this Open Briefing® has been approved for release to the market by the participating company. It is information given in a summary form and does not purport to be complete. The information contained is not intended to be used as the basis for making any investment decision and you are solely responsible for any use you choose to make of the information. We strongly advise that you seek independent professional advice before making any investment decisions. Ramsgate Advisors Ltd and Orient Capital Pty Ltd are not