

January 17, 2011

## Microfluidics (NasdaqOTCBB/MFLU)

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**Neutral                      Lowering to Neutral on Buy-out**

*Microfluidics manufactures fluid processing systems*

### Investment Highlights

1) Microfluidics has agreed to be acquired by Chicago-based IDEX Corporation (NYSE/IEX/Not Rated) for \$1.35 per share in cash. The transaction, which has been approved by the board of Microfluidics as well as its founders and executive officers, is expected to close by the end of Q1/2011. In addition, Global Strategic Partners, a wholly-owned subsidiary of Celgene (Nasdaq/CELG/Not Rated) acquired as part of the Abraxis Biosciences acquisition last year, has agreed to sell to IDEX the \$5 million convertible debenture issued to GSP several years ago. IDEX is an acquisition-oriented manufacturer of fluid and metering technologies sold in niche industrial markets, and Microfluidics' technological advances and strong customer base were attractive to IDEX and the Company will be folded into IDEX' Quadro and Fitzpatrick pharmaceutical product line platform.

2) Due to healthy premium offered by IDEX for the MFLU shares as well as the overwhelming support shown by the Microfluidics board and management, we do not believe that a more beneficial offer will be forthcoming for the MFLU shareholders, and thus we are recommending that MFLU investors take advantage of this offer and tender their shares even though the merger share price did not meet our \$2 price target, albeit set just three months ago. Thus, we are lowering our rating on MFLU shares to Neutral at this time, and will continue to monitor this situation in case modifications or delays develop related to the merger agreement.

### Conclusion/Stock Valuation

Through cost saving programs, new product introductions, and a new focus on recurring revenue streams, Microfluidics' new management has turned the Company around and now has an industry leadership position in the growing pharma/biotech market (vaccines, protein-based therapeutics, etc.), an improved balance sheet and a return to annual profitability forecast for this year (2010E) and next (2011E). Perhaps due to its smaller size or the relatively newness of its

**Current Price            \$1.34**

**Price Target            N/A**

Estimates	F2008A	F2009A	F2010E
Revenue(\$000s)	\$14,871	\$15,739	\$17,154
1Q March	3,522	3,559	4,315 A
2Q June	4,374	3,469	4,512 A
3Q September	3,511	4,462	4,077 A
4Q December	3,464	4,249	4,250 E
Prev. Rev. Estimate (\$000s)			\$18,327
EPS	(\$0.39)	(\$0.03)	\$0.00
1Q March	(0.04)	(0.07)	0.01 A
2Q June	(0.08)	(0.02)	0.01 A
3Q September	(0.10)	0.04	(0.02) A
4Q December	(0.17)	0.01	0.00 E
Previous EPS Estimate			\$0.01
P/E (x)	N/A	N/A	339.3
EBITDA/Share	-\$0.31	\$0.10	\$0.14
EV/EBITDA (x)	N/A	-5.2	16.1

Stock Data	
52-Week Range	\$0.53-\$1.34
Shares Outstanding (mil.)	10.4
Market Capitalization (mil.)	\$14.0
Enterprise Value (mil.)	\$16.7
Debt to Capital (9/10)	76.0%
Book Value/Share (9/10)	\$0.14
Price/Book	9.4 x
Average Trading Volume (10-day)	30,000
Insider Ownership	4.0%
Institutional Ownership	50.0%
Short interest	0
Dividend / Yield	\$0.00/0.0%



**Price target and ratings changes over the past 3 years:**

Initiated - October 18, 2010 – Target \$2.00

Rating changed to Neutral - January 17, 2011

management team, Microfluidics' shares have historically traded at a discount to its industry peers, and although we feel that MFLU shares could eventually reach \$2 per share based on a 20X earnings multiple on our estimated earnings of \$0.10 for 2011 given our original 12-18 month time frame set in October 2010, nevertheless we believe that the recent tender offer by IDEX is a fair one at this point in time, and thus are lowering our rating on MFLU to Neutral.

### Catalysts/Investor Timeline

- 1) Q4/2010 financial results announced – late-February 2011
- 2) Launch of five new products for year – By end of year 2010
- 3) Growth in India, China & Japan distributorships – 2010-11
- 4) BARDA awards in vaccine area – Ongoing Q4/2010 - 2011
- 5) INTERPHEX 2011 in New York City - March 29-31, 2011

### Risk Factors

We believe an investment in Microfluidics involves the following risks:

- **Reliance on large customers and international and distributors** — In its most recently completed fiscal year, over one-quarter or 28% of the Company's sales were to three large customers. Similarly, approximately \$2 million or 13% of sales in 2009 were to clients in Asia, where the Company relies on distributors rather than internal sales managers to find and service these accounts. In addition, a large US-based customer, Abraxis Biosciences, has recently merged with Celgene (Nasdaq/CELG/Not Rated) and any change in future plans for the manufacture or sale of Abraxis' products and/or development programs could have an adverse affect on the Company. Overall, however, the Company's client list still remains very diverse, even with large partners, which may soften the negative effect of a loss of a key partner in the future.
- **Need to raise additional capital and/or repay long-term debt** – Microfluidics is currently operating at or near a profit and has done so on a quarterly basis for the past year. We are also forecasting that the Company will remain profitable and cash flow positive throughout the remainder of this year and next year. However, in 2007 and 2008 and the first half of 2009, in a more recessionary economy, the Company did not operate at a profit. As of the most recent quarter end September 2010, Microfluidics held a little under \$2 million in cash and equivalents on its balance sheet, offset by a little over \$4.7 million in convertible debentures. Although these debentures are not callable until 2015, should any circumstances change with regard to these notes, Microfluidics would need to use a substantial portion of its cash on hand, dip into its \$1 million line of credit, and/or tap alternative sources of funding, including potentially the sale of common stock, in order to buy back its debenture obligations.
- **Share price issues** – Until recently, Microfluidics shares trade below \$1 on the OTC bulletin board, and at low trading volumes as well, making share prices highly susceptible to the appearance in the market of a large block of shares. In addition, should the holders of the current convertible debt issues convert these notes into common stock and also exercise a series of warrants attached to the notes (at \$2 and \$3), shareholder ownership would be highly concentrated. However, in the short-term, Company management has made a concerted effort to increase investor awareness of the stock, and in the long-term positive financial operating performance of the company will play a key role in determining the ultimate price of these shares.

**Microfluidics International Corporation**  
**Consolidated Statements of Operations**  
 (In 000s, except per share data)

FYE December	2006	2007	2008	1Q09	2Q09	3Q09	4Q09	2009	1Q10	2Q10	3Q10	4Q10E	2010E	2011E
				March	June	September	December		March	June	September	December		
Revenue	\$15,654	\$12,992	\$14,871	\$3,559	\$3,469	\$4,462	\$4,249	\$15,739	\$4,315	\$4,512	\$4,077	\$4,250	\$17,154	\$18,870
Cost of sales	7,001	5,646	7,298	1,653	1,493	1,533	1,620	6,299	1,731	1,627	1,644	1,700	6,702	7,170
Gross Profit	8,653	7,346	7,573	1,906	1,976	2,929	2,629	9,440	2,584	2,885	2,433	2,550	10,452	11,700
Operating Expenses:														
Research and development	1,763	1,863	2,117	452	393	418	449	1,712	451	509	468	470	1,898	2,080
Selling	2,985	3,584	4,844	1,216	913	995	1,192	4,316	1,041	1,076	1,093	1,020	4,230	4,340
General and administrative	2,701	3,081	4,494	804	722	965	799	3,290	845	979	939	850	3,613	3,680
Total operating expenses	7,449	8,528	11,455	2,472	2,028	2,378	2,440	9,318	2,337	2,564	2,500	2,340	9,741	10,100
Income (loss) from operations	1,204	(1,182)	(3,882)	(566)	(52)	551	189	122	247	321	(67)	210	711	1,600
Interest and other expense	(35)	(20)	(154)	(126)	(126)	(126)	(127)	(505)	(141)	(178)	(176)	(175)	(670)	(500)
Interest income	50	64	25	2	1	0	0	3	0	0	0	0	0	20
Income (loss) before tax	1,219	(1,138)	(4,011)	(690)	(177)	425	62	(380)	106	143	(243)	35	41	1,120
Provision for income taxes	(58)	369	0	0	0	0	(18)	(18)	0	0	0	0	0	0
Net income (loss)	1,277	(1,507)	(4,011)	(690)	(177)	425	80	(362)	106	143	(243)	35	41	1,120
Basic income per share	\$0.13	(\$0.15)	(\$0.39)	(\$0.07)	(\$0.02)	\$0.04	\$0.01	(\$0.03)	\$0.01	\$0.01	(\$0.02)	\$0.00	\$0.00	\$0.11
Diluted income per share	\$0.12	(\$0.15)	(\$0.39)	(\$0.07)	(\$0.02)	\$0.04	\$0.01	(\$0.03)	\$0.01	\$0.01	(\$0.02)	\$0.00	\$0.00	\$0.10
Basic shares outstanding	10,013	10,183	10,296	10,371	10,372	10,387	10,390	10,380	10,401	10,414	10,423	10,440	10,380	10,550
Diluted shares outstanding	10,612	10,183	10,296	10,371	10,372	10,465	10,605	10,380	10,618	10,613	10,423	10,620	10,380	10,750
Key ratios:														
Revenue growth	34.4%	-17.0%	14.5%	1.1%	-20.7%	27.1%	22.7%	5.8%	21.2%	30.1%	-8.6%	0.0%	9.0%	10.0%
Gross margin	55.3%	56.5%	50.9%	53.6%	57.0%	65.6%	61.9%	60.0%	59.9%	63.9%	59.7%	60.0%	60.9%	62.0%
R&D/revenue	11.3%	14.3%	14.2%	12.7%	11.3%	9.4%	10.6%	10.9%	10.5%	11.3%	11.5%	11.0%	11.1%	11.0%
Selling/revenues	19.1%	27.6%	32.6%	34.2%	26.3%	22.3%	28.1%	27.4%	24.1%	23.8%	26.8%	24.0%	24.7%	23.0%
General & administrative/revenues	17.3%	23.7%	30.2%	22.6%	20.8%	21.6%	18.8%	20.9%	19.6%	21.7%	23.0%	20.0%	21.1%	19.5%
Depreciation, amort, non-cash comp	320.0%	\$400	\$707	\$505	\$99	\$152	\$164	\$920	\$184	\$185	\$190	\$190	\$749	\$800
Operating margin	7.7%	-9.1%	-26.1%	-15.9%	-1.5%	12.3%	4.4%	0.8%	5.7%	7.1%	-1.6%	4.9%	4.1%	8.5%
Cash Flow/share	\$0.12	(\$0.11)	(\$0.32)	(\$0.02)	(\$0.01)	\$0.06	\$0.02	\$0.05	\$0.03	\$0.03	(\$0.01)	\$0.02	\$0.07	\$0.18
EBITDA/share	\$0.11	(\$0.08)	(\$0.31)	(\$0.01)	\$0.00	\$0.07	\$0.03	\$0.10	\$0.04	\$0.05	\$0.01	\$0.04	\$0.14	\$0.23

**Balance Sheets**
**Quarterly Earnings Comparisons**

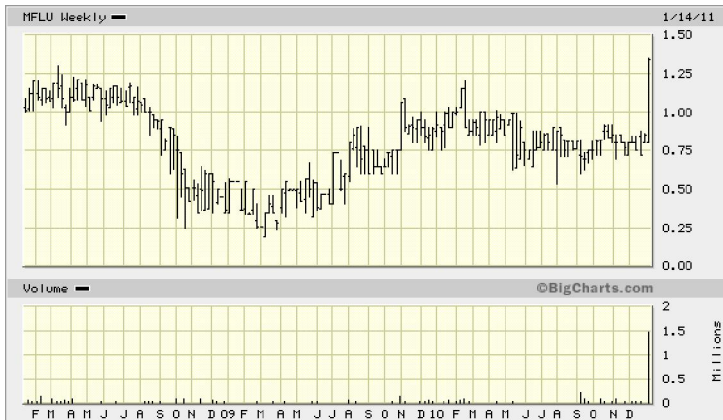
Assets:	(\$000s)		Revenues (in \$Mill)					
	12/31/09	9/30/10	March	June	September	December	Total	
Cash and equivalents	\$2,185	\$1,980	2008	\$3,522	\$4,374	\$3,511	\$3,464	\$14,871
Accounts receivable, net	2,571	2,861	2009	3,559	3,469	4,462	4,249	15,739
Inventories	2,916	2,675	2010E	4,315	4,512	4,077	4,250	17,154
Prepaid expenses & other current	280	281	<b>Earnings per Share</b>					
Total current	7,952	7,797	2008	(\$0.04)	(\$0.08)	(\$0.10)	(\$0.17)	(\$0.39)
Property & equip., net	891	684	2009	(0.07)	(0.02)	0.04	0.01	(0.03)
Other assets	535	396	2010E	0.01	0.01	(0.02)	0.00	0.00
TOTAL ASSETS	\$9,378	\$8,877						
Liabilities:								
Accounts payable	\$545	\$1,009						
Accrued expenses	1,727	1,265						
Customer advances	1,137	390						
Total current	3,409	2,664						
Convertible debt	4,679	4,720						
Total liabilities	8,088	7,384						
Stockholders' equity	1,290	1,493						
TOTAL LIAB & EQ	\$9,378	\$8,877						

Operating Statistics				
	2007	2008	2009	2010E
<b>Sales by Region (\$000s)</b>				
US	\$7,707	\$6,811	\$8,819	\$ 9,000
Other North America	141	612	1,037	1,400
Asia	2,800	2,478	1,988	2,300
Europe	2,344	4,970	3,895	4,450
Total	12,992	14,871	15,739	\$ 17,150
<b>Largest Customer (%)</b>				
	7.2%	20.2%	15.3%	12.5%
	Teva	Glaxo	Novartis	Novartis
<b>Sales by Industry (\$000s)</b>				
Pharma/Biotech	\$6,129	\$8,759	\$11,364	\$ 12,900
Chemical/Other	6,863	6,112	4,374	4,250
Total	\$12,992	\$14,871	\$15,738	\$17,150

Source: Dawson James Securities, Inc. estimates; Company documents

## Important Disclosures:

### Price Chart:



#### Price target and ratings changes over the past 3 years:

Initiated – October 18, 2010 – Target \$2.00

Rating lowered to Neutral on January 17, 2011

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**Ratings definitions:** **1) Buy:** the stock is expected to appreciate and produce a total return of at least 20% over the next 12-18 months; **2) Neutral:** the stock is fairly valued for the next 12-18 months; and **3) Sell:** the stock is expected to decline at least 20% over the next 12-18 months and should be sold.

Ratings Distribution	Company Coverage		Investment Banking	
	# of Companies	% of Total	# of Companies	% of Totals
Buy	16	73%	5	31%
Neutral	6	27%	4	67%
Sell	0	0%	0	0%
Total	22	100%	9	41%

**Information about valuation methods and risks can be found in the “STOCK VALUATION” and “RISKS” sections of this report.**

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