

Record Q1, SCA progress and France ratchets up reimbursement for oral appliance therapy

Organic growth in Q1 was pleasing and positions the company well with respect to its FY17 guidance. Q1 has also seen steady investment and progress towards the SCA clinic roll-out which is a key driver of earnings and valuation. There has been a material improvement in reimbursement status in the French market, extending the growth outlook for Europe which is SomnoMed's most profitable jurisdiction. We maintain our BUY rating and \$4.50 price target.

Key points

Q1 results on track for guidance. Aggregate Q1 volume growth of ~17% (US 20%, Europe 19%, APAC flat) and revenue growth of 13% to A\$10.9m were both as per our forecasts. We estimate ~15K device sales in Q1, which is seasonally the weakest quarter (SomnoMed is guiding to >70K device sales in FY17). The ASP product mix was also consistent with pcp but Q1 had a 3-4% FX translation headwind.

SCA plans appear to be on track. We discussed SCA progress briefly with management, learning that the first two clinic sites have been selected and that the supporting business systems are in place. We are forecasting five SCA centre openings in 2HFY17. Net operating cash outflow of ~\$1.6m implies start-up investments in developing the SCA sleep clinic initiative.

French reimbursement change supports medium-term European forecasts. French reimbursement for oral appliance therapy now covers both the device and the dental component. Furthermore, oral appliance therapy is supported as a "first-line" treatment option for mild and moderate sleep apnoea. This change brings France into line with Holland and other EU countries where oral appliance therapy has as much as 50% market share. SomnoMed and ResMed (Narval) are the key players in France, where oral appliances now have ~10% share (CPAP has 90%). We assess that France can grow to a ~5K device market for SomnoMed under these new arrangements. We understand that Belgium may announce similar funding changes in coming months.

Valuation. Our valuation basis is DCF with an explicit risk-adjustment for SCA-derived free cash flows. Un-risked, our combined valuation of SomnoMed's Core SomnoDent and SCA businesses is ~\$7.00 per share. Risk-adjusted, our valuation and price target are set at \$4.50 per share (unchanged).

Risks and catalysts

Catalysts: a) quarterly volumes; b) US managed care progress; c) margin improvement; d) SCA centre roll-out. **Risks:** a) execution on US strategy; b) competition; c) average sales price erosion; d) SCA roll-out difficulties; e) working capital and liquidity pressure; f) adverse reimbursement outcomes.

Earnings forecasts					
Year-end June (AUD)	FY15A	FY16A	FY17F	FY18F	FY19F
NPAT rep (\$m)	0.5	0.1	-0.7	5.4	12.1
NPAT norm (\$m)	0.5	0.1	-0.7	5.4	12.1
Consensus NPAT (\$m)			-0.5	4.8	10.8
EPS norm (cps)	1.2	0.2	-1.4	10.7	23.6
EPS growth (%)	30.5	-87.4	-1036.5	856.1	121.9
P/E norm (x)	323.3	2558.5	-273.2	36.1	16.3
EV/EBITDA (x)	187.9	150.2	1448.8	25.2	11.3
FCF yield (%)	-0.6	0.1	-2.0	1.5	4.0
DPS (cps)	0.0	0.0	0.0	0.0	0.0
Dividend yield (%)	0.0	0.0	0.0	0.0	0.0
Franking (%)	0	0	0	0	0

Source: Company data, Wilsons estimates, S&P Capital IQ

Wilsons Research

Issued by Wilsons Advisory and Stockbroking Limited ABN 68 010 529 665 - Australian Financial Services Licence No 238375, a participant of ASX Group and should be read in conjunction with the disclosures and disclaimer in this report. Important disclosures regarding companies that are subject of this report and an explanation of recommendations can be found at the end of this document.

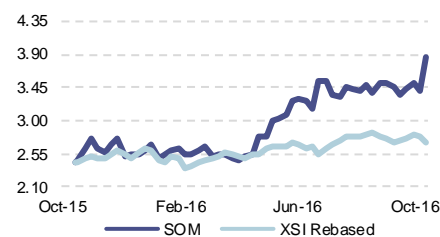
Recommendation	BUY
12-mth target price (AUD)	\$4.50
Share price @ 18-Oct-16 (AUD)	\$3.85
Forecast 12-mth capital return	16.9%
Forecast 12-mth dividend yield	0.0%
12-mth total shareholder return	16.9%

Market cap	\$219m
Enterprise value	\$222m
Shares on issue	57m
Sold short	0.0%
ASX 300 weight	n/a
Median turnover/day	\$0.1m

Shane Storey

shane.storey@wilsonsadvisory.com.au
Tel. +61 7 3212 1351

12-mth price performance (\$)



	1-mth	6-mth	12-mth
Abs return (%)	11.3	51.0	59.0
Rel return (%)	12.1	44.5	47.0

Key changes				
		19-Aug	After	Var %
NPAT:	FY17F	-0.7	-0.7	0.0%
norm	FY18F	5.4	5.4	0.0%
(\$m)	FY19F	12.1	12.1	0.0%
EPS:	FY17F	-1.4	-1.4	0.0%
norm	FY18F	10.7	10.7	0.0%
(cps)	FY19F	23.6	23.6	0.0%
DPS:	FY17F	0.0	0.0	0.0%
(cps)	FY18F	0.0	0.0	0.0%
	FY19F	0.0	0.0	0.0%
Price target:		4.50	4.50	0.0%
Rating:		BUY	BUY	

Price target		
	Valuation	Price target
WACC (%)	12.1	
Terminal growth (%)	3.4	
NPV forecast FCF (A\$m)	102.2	
NPV perpetuity (A\$m)	278.5	
Net debt/(cash) (A\$m)	17.6	
DCF valuation (A\$m)	398.3	

DCF valuation (A\$/sh) 6.97
 Price target (A\$/sh) 4.50

Interims (\$m)					
Half-year (AUD)	Dec 15	Jun 16	Dec 16	Jun 17	
	1HA	2HA	1HE	2HE	
Sales revenue	21.3	22.8	25.5	30.3	
EBITDA	0.7	0.8	0.1	0.1	
EBIT	0.2	0.2	-0.5	-0.4	
Net profit	0.2	-0.1	-0.5	-0.1	
Norm EPS	0.3	-0.2	-1.1	-0.3	
EBIT/sales (%)	1.1	1.0	-2.1	-1.3	
Dividend (c)	0.0	0.0	0.0	0.0	
Franking (%)	0.0	0.0	0.0	0.0	

Financial stability				
Year-end June (AUD)	FY16A	FY17F	FY18F	
Net debt	-17.6	-12.9	-16.2	
Net debt/equity (%)	<0	<0	<0	
Net debt/EV (%)	<0	<0	<0	
Current ratio (x)	5.3	5.1	4.8	
Interest cover (x)	<0	◆	◆	
Adj cash int cover (x)	<0			
Debt/cash flow (x)	0.0	0.0	0.0	
Net debt (cash)/share (\$)	<0	<0	<0	
NTA/share (\$)	0.6	0.5	0.6	
Book value/share (\$)	0.7	0.6	0.7	
Payout ratio (%)	0	0	0	
Adj payout ratio (%)	0	0	0	

EPS reconciliation (\$m)				
	FY16A		FY17F	
	Rep	Norm	Rep	Norm
Sales revenue	44	44	56	56
EBIT	0.5	0.5	-0.9	-0.9
Net profit	0.1	0.1	-0.7	-0.7
Notional earn	0.0	0.0	0.0	0.0
Pref/conv div	0.0	0.0	0.0	0.0
Profit for EPS	0.1	0.1	-0.7	-0.7
Diluted shrs (m)	45	45	49	49
Diluted EPS (c)	0.1	0.2	-1.4	-1.4

Returns				
	FY16A	FY17F	FY18F	FY19F
ROE (%)	0	-2	16	29
ROIC (%)	2	-4	27	55
Incremental ROE	-5	-15	275	101
Incremental ROIC	-2	-35	200	219

Key assumptions									
Year-end June (AUD)	FY13A	FY14A	FY15A	FY16A	FY17F	FY18F	FY19F	FY20F	
Revenue growth (%)	21.3	40.1	33.0	28.0	26.6	43.6	46.2	40.7	
EBIT growth (%)	-52.1	-14.9	152.7	-17.1	-305.2	-902.9	141.1	103.8	
NPAT growth (%)	-7.2	-69.5	148.3	-87.4	-1,136.2	-877.6	123.2	92.3	
EPS growth (%)	-0.6	-41.1	30.5	-87.5	-1,036.5	-856.1	121.9	91.9	
EBIT/sales (%)	1.4	0.8	1.6	1.0	-1.7	9.4	15.5	22.4	
Tax rate (%)	-123.7	-6.7	23.5	86.3	-42.7	27.0	27.0	27.0	
ROA (%)	1.6	1.1	2.0	1.1	-2.2	14.6	29.8	54.5	
ROE (%)	6.4	1.7	2.5	0.2	-2.0	13.2	24.6	41.6	

Profit and loss (\$m)									
Year-end June (AUD)	FY13A	FY14A	FY15A	FY16A	FY17F	FY18F	FY19F	FY20F	
Sales revenue	18.5	25.9	34.4	44.1	55.8	80.1	117.2	164.9	
EBITDA	0.8	0.8	1.2	1.5	0.2	8.8	19.6	38.6	
Depn & amort	0.5	0.6	0.6	1.0	1.1	1.3	1.5	1.7	
EBIT	0.3	0.2	0.6	0.5	-0.9	7.5	18.1	36.9	
Net interest expense	-0.1	0.0	-0.1	0.0	0.0	0.0	0.0	0.0	
Tax	-0.4	0.0	0.2	0.4	0.4	2.0	4.9	10.0	
Minorities/pref divs	0.0	0.0	0.0	0.0	-0.6	0.1	1.1	3.7	
Equity accounted NPAT	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	
Net profit (pre-sig items)	0.7	0.2	0.5	0.1	-0.7	5.4	12.1	23.2	
Abns/exts/signif	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	
Reported net profit	0.7	0.2	0.5	0.1	-0.7	5.4	12.1	23.2	

Cash flow (\$m)									
Year-end June (AUD)	FY13A	FY14A	FY15A	FY16A	FY17F	FY18F	FY19F	FY20F	
EBITDA	0.8	0.8	1.2	1.5	0.2	8.8	19.6	38.6	
Interest & tax	0.0	-0.5	0.1	-0.3	-0.1	-2.0	-4.9	-10.0	
Working cap/other	-0.2	-1.1	-1.5	0.9	-0.6	0.6	-1.9	-1.8	
Operating cash flow	0.6	-0.8	-0.2	2.1	-0.5	7.3	12.9	26.8	
Maintenance capex	-0.2	0.3	-1.2	-1.9	-3.9	-4.1	-4.2	-4.4	
Free cash flow	0.4	-0.5	-1.4	0.2	-4.5	3.3	8.7	22.4	
Dividends paid	0.0	0.0	0.0	0.0	0.0	0.0	-5.5	-16.5	
Growth capex	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	
Invest/disposals	-0.5	-0.3	-0.2	-1.3	-0.3	0.0	0.0	0.0	
Other inv flows	-0.1	-0.4	-0.3	-0.4	0.0	0.0	0.0	0.0	
Cash flow pre-financing	-0.2	-1.2	-1.9	-1.5	-4.7	3.3	3.2	6.0	
Funded by equity	0.5	0.0	7.3	10.7	0.0	0.0	0.0	0.0	
Funded by debt	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	
Funded by cash	-0.3	1.2	-5.3	-9.2	4.7	-3.3	-3.2	-6.0	

Balance sheet summary (\$m)									
Year-end June (AUD)	FY13A	FY14A	FY15A	FY16A	FY17F	FY18F	FY19F	FY20F	
Cash	4.2	2.9	8.3	17.6	12.9	16.2	19.4	25.4	
Current receivables	4.4	5.5	7.2	7.8	8.0	9.3	12.6	14.4	
Current inventories	0.9	1.0	1.3	1.7	2.2	2.5	2.8	3.2	
Net PPE	1.2	1.3	2.1	3.6	5.9	8.0	10.0	12.1	
Investments	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	
Intangibles/capitalised	5.3	8.5	8.9	9.7	10.6	11.2	11.9	12.6	
Other	0.2	0.0	0.0	0.0	0.0	0.0	0.0	0.0	
Total assets	16.1	19.1	27.8	40.4	39.5	47.2	56.8	67.8	
Current payables	3.5	3.3	3.9	6.1	6.0	8.0	9.6	9.8	
Total debt	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	
Other liabilities	1.0	3.2	2.4	1.7	1.8	2.1	2.3	2.6	
Total liabilities	4.5	6.6	6.2	7.7	7.8	10.1	11.9	12.4	
Minorities/convertibles	0.6	0.2	0.2	-0.4	-0.4	-0.4	-0.4	-0.4	
Shareholder equity	11.6	12.6	21.5	32.7	31.6	37.1	44.9	55.4	
Total funds employed	11.6	12.6	21.5	32.7	31.6	37.1	44.9	55.4	



SomnoMed (SOM)

Business description

SomnoMed Limited (SOM) develops, manufactures and sells oral appliance devices for the treatment of obstructive sleep apnoea (OSA), snoring and bruxism. The company has developed a global infrastructure to address the OSA market, with the majority of its sales derived from the US and Europe.

Investment thesis

Our thesis on SomnoMed is that an increasing number of OSA patients will choose an oral appliance in preference to continuous positive air pressure (CPAP) devices given increasing awareness and improving reimbursement access. SomnoMed currently enjoys a leadership position in this market. We expect that the medically oriented diagnosis and referral channels for OSA will embrace oral appliances as an alternative for OSA patients who refuse or are otherwise not well treated with CPAP.

Revenue drivers

- Growth rates. In recent years the company has sustained consistent 20-30% unit sales growth pcp comps. We think this can be maintained as the company taps the medically diagnosed OSA referral channels
- Regulatory and/or reimbursement approvals of new products, new territories

Margin drivers

- Making a high (c.70%) gross margin on its oral appliances
- We expect SG&A expense to increase modestly as the company develops and grows its market
- Low level of R&D expenditure

Key issues/catalysts

Upside risks:

- Quarterly cash flow indicates SomnoMed's sales growth progress
- Product launches
- Progress developing links to medical diagnosis channels

Risk to view

Downside risks:

- Relatively limited capital for business development investment
- Emerging competition
- If successful could face scale-up and logistics challenges when demand increases
- Reimbursement in US is improving, but still needs to develop and broaden

Balance sheet

- SomnoMed had c.\$17.6m cash as at end-FY16
- No debt

Board

- Dr Peter Neustadt (Executive Chairman)
- Ms Lee Ausburn (Non-Executive Director)
- Mr Robert Scherini (Non-Executive Director)

Management

- Dr Peter Neustadt (Executive Chairman)
- Derek Smith (Global CEO-elect)
- Neil Verdal-Austin (CFO)
- Kien T. Nguyen (President, North America)
- James R. Evanger (CEO – Sleep Centres America)
- Dr Jagdeep Bijwadia (Chief Medical Officer)

Contact details

Address: Level 3, 20 Clarke Street, Crows Nest, NSW 2065 Australia
Phone: +612 9467 0400
Website: www.somnomed.com.au



Disclaimers and disclosures

Recommendation structure and other definitions

Definitions at wilsonsadvisory.com.au/Disclosures.

Disclaimer

This document is being supplied to you solely for your information and no action should be taken on the basis of or in reliance on this document. Any advice contained in this document is general advice only and has been prepared by Wilsons without taking into account any person's objectives, financial situation or needs. Any person, before acting on any advice contained within this communication, should first consult with a Wilsons investment adviser to assess whether the advice within this communication is appropriate for their objectives, financial situation and needs. Those acting upon such information without advice do so entirely at their own risk.

Wilsons has not independently verified all of the information given in this document which is provided at a point in time and may not contain all necessary information about the company or companies covered in this report ("Companies"). Accordingly, no representation or warranty, express or implied, is made as to the accuracy or completeness of the information and opinions contained in this document. To the fullest extent permitted by law Wilsons, its related bodies corporate and their respective officers, directors, employees or agents, disclaim any and all liabilities for any loss or damage howsoever arising in connection with the use of this document or its contents. Any projections contained in this document are indicative estimates only. Such projections are contingent upon matters outside the control of Wilsons (including but not limited to economic conditions, market volatility and company-specific fundamentals) and therefore may not be realised in the future. Past performance is not an indication of future performance.

This report does not constitute an offer or invitation to purchase any securities and should not be relied upon in connection with any contract or commitment whatsoever.

Wilsons and Wilsons Corporate Finance Limited (ABN 65 057 547 323: AFSL 238 383) and their associates may have received and may continue to receive fees from the Companies in relation to corporate advisory, underwriting or other professional investment services. Please see relevant Wilsons disclosures at wilsonsadvisory.com.au/Disclosures.

Neither Wilsons nor its research analysts received any direct financial or non-financial benefits from the Companies for the production of this document. However, Wilsons' research analysts may attend site visits and/or meetings hosted by the Companies. In some instances the costs of such site visits or meetings may be met in part or in whole by the Companies if Wilsons considers it is reasonable given the specific circumstances relating to the site visit or meeting.

Wilsons advises that at the date of this report, its directors, associates and employees may have relevant interests in the Companies.

Wilsons and its related bodies may trade securities in the Companies as principal.

Regulatory disclosures

Wilsons Corporate Finance Limited ACN 057 547 323, AFSL 238 383 acted as Lead Manager in the May 2016 placement of SomnoMed Limited securities for which it received fees or will receive fees for acting in this capacity. Wilsons Advisory and Stockbroking Limited may have a conflict of interest which investors should consider before making an investment decision. Wilsons Advisory and Stockbroking Limited, Wilsons Corporate Finance Limited and its related bodies corporate trades or may trade as principal in the securities that are subject of the research report.

Wilsons contact

Phone: 1300 655 015. Website: wilsonsadvisory.com.au.

