

# SomnoMed

## Growth mode re-engaged

**ADD** (no change)

Current price:	A\$1.90
Target price:	A\$2.55
Previous target:	A\$2.55
Up/downside:	34.2%
Reuters:	SOM.AX
Bloomberg:	SOM AU
Market cap:	US\$124.0m
	A\$157.2m
Average daily turnover:	US\$0.06m
	A\$0.08m
Current shares o/s	82.76m
Free float:	67.1%

- SOM reported positive 1H21 results and is tracking well in-line with our FY21 forecasts. Sales remain choppy by region but margins and operating cashflow were maintained or improved, driven by a number of cost initiatives.
- Moving out of business stabilisation mode, SOM expects to re-commence a drive for greater market share to capitalise on a weakened competitive environment as COVID-19 is likely to prove costly for a number of smaller operators.
- We remain positive and take comfort in the quarter on quarter growth since the initial lockdown with significant upside as North America conditions improve and heading into a seasonally strong half. Our price target remains unchanged at A\$2.55 and we retain an Add recommendation.

### 1H21 results – tracking in line for FY21

SOM reported its 1H21 results, which are tracking in-line with our FY21 forecasts. Revenues were down 7% in the pcp (pre-COVID) to A\$30.8m. Europe continues to stand out (+2% in pcp, ~55% of revenues), as reimbursement trends remain strong and sales are higher than pre-COVID levels. North America continues to drag on the results (~35% of revenues) and tracked 23% below pcp. EBITDA improved 7% to A\$3.2m (vs A\$3.0m in the pcp) although the result was propped up in part by temporary reduction in sales and marketing (travel restrictions) and pay cuts taken over the half by management. MAS margins remained stable at 69.9% (vs 70.5%), and the half saw a small lift in gross margins (58.7% vs 58.5% in the pcp). NPAT was flat at A\$0.6m versus A\$0.8m in the pcp and in line with our forecasts (A\$0.6m). Cash balance remains strong at A\$22.7m.

### What we liked – back to growth mode

Seasonality notwithstanding (historically 52% skew to 2H), we take comfort in the quarter on quarter growth rate since the shutdowns began and in particular the cash preservation measures over this period. While we consider SOM to be a high growth company that should continue to invest in building out its market share and product range, recent results show to us that it has a solid and profitable core business which is often masked by growth expenses. The company is set to re-engage in high-growth mode with annual sales growth targets >20% although maintain positive EBITDA. We view this as the right move considering the highly fragmented market and likelihood that smaller competitors with less balance sheet capacity will remain under financial stress.

### Sentiment improving but further confirmation needed

SOM didn't provide guidance although we've noted a pick-up in positive sentiment over the last six months. Market segment risks remain although we view a renewed push for growth to capitalise on a weakened competitive environment as a solid move; however, investors appear to be requiring further confirmation / continuation of the recent positive trends before stepping in – we expect interest to arise ahead of the 3Q report in April.

### Investment view – retain positive recommendation

We have made no changes to our forecasts and our price target of A\$2.55 remains unchanged. Key downside risk to our target is slower-than-expected growth in the core markets of North America and Europe. Further risk lies in additional waves of shutdowns in dental /sleep facilities across major jurisdictions prolonging the expected time-frame to a resumption of normal trading. We retain an Add recommendation.



Price performance	1M	3M	12M
Absolute (%)	1.6	-12.9	-34.9
Relative (%)	1.9	-16.6	-29.9

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Analyst(s) own shares in the following stock(s) mentioned in this report:

– N/A

#### Financial Summary

	Jun-19A	Jun-20A	Jun-21F	Jun-22F	Jun-23F
Revenue (A\$m)	58.89	57.30	65.51	74.73	85.60
Operating EBITDA (A\$m)	4.95	4.72	4.16	7.38	10.19
Net Profit (A\$m)	-0.04	-0.44	1.56	3.31	5.30
Normalised EPS (A\$)	(0.001)	(0.005)	0.019	0.040	0.064
Normalised EPS Growth	(100%)	736%		112%	60%
FD Normalised P/E (x)	NA	NA	100.7	47.5	29.7
DPS (A\$)	-	-	-	-	-
Dividend Yield	0%	0%	0%	0%	0%
EV/EBITDA (x)	22.95	28.49	32.98	18.41	12.99
P/FCFE (x)	9.89	13.15	NA	33.31	18.31
Net Gearing	(26.3%)	(67.1%)	(58.3%)	(58.2%)	(60.7%)
P/BV (x)	6.63	4.65	4.58	4.29	3.85
ROE	(0.1%)	(1.7%)	4.6%	9.3%	13.7%
Normalised EPS/consensus EPS (x)			1.18	1.03	1.19

SOURCE: MORGANS, COMPANY REPORTS

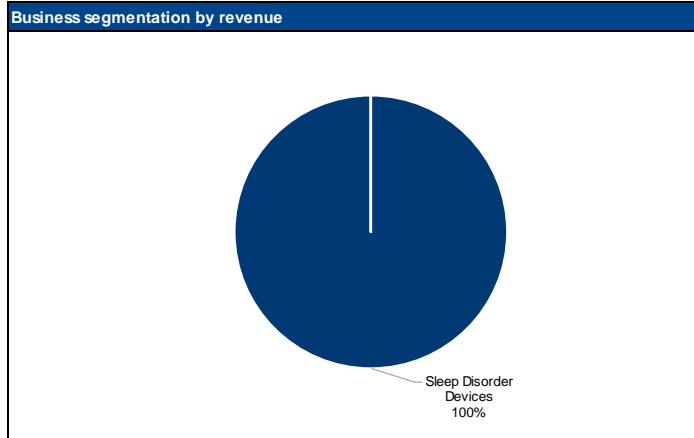
**SomnoMed**

as at February 23, 2021

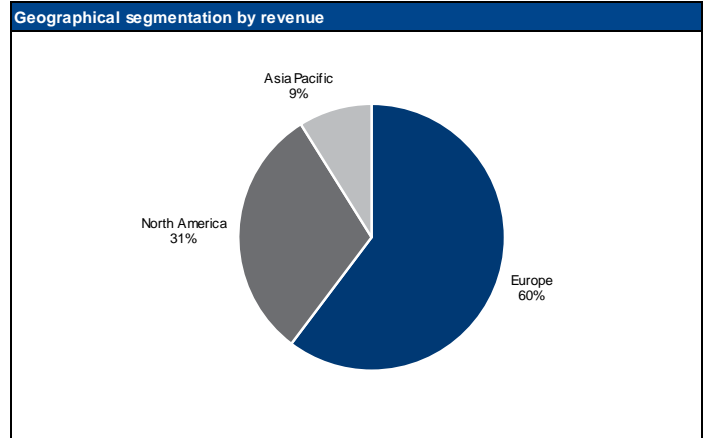
Market cap (A\$m):	157.2	Rating:	ADD
Shares outstanding (m):	82.76	Price (A\$):	1.90
Free float (%):	67.1	Target price (A\$):	2.55
Website:	www.somnomed.com.au	Upside/downside to target price (%):	34.2

**Company description**

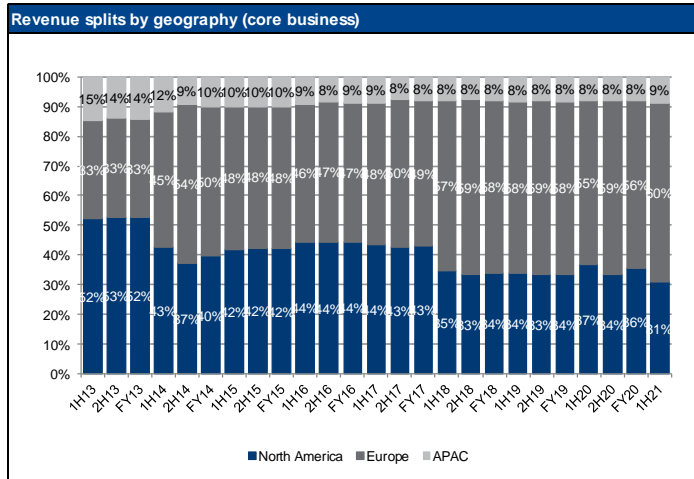
SomnoMed Limited (SOM) provides diagnostic and treatment solutions for Sleep-related Breathing Disorders including obstructive sleep apnea, snoring and bruxism. SOMNODENT : SomnoDent is an Oral Sleep Apnea (OSA) Appliance consisting of two dental plates, which look similar to a sports mouth guard. SomnoDent product has a number of designs including a Flex, Classic and G2. SomnoDent is custom made to fit patient's mouth and should be worn at night whilst sleeping in order to bring lower jaw forward and open up the airway. SomnoDent is designed for the patient who suffers from mild to moderate OSA.



SOURCE: COMPANY



SOURCE: COMPANY



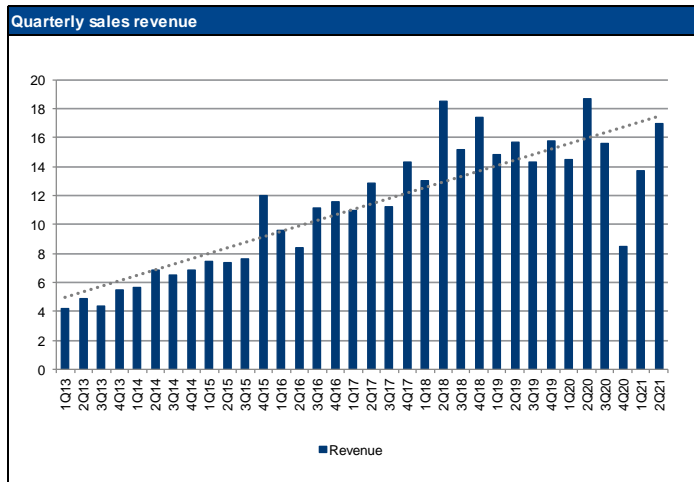
SOURCE: MORGANS, COMPANY

**COVID-19 RISKS**

The specific risks associated with the Coronavirus (COVID 19) event are:

- Patients not being able to seek diagnosis and obtain treatment and people not wanting or able to visit dentists
- Inability to collect accounts receivable from customers whose practices have been temporarily closed
- Manufacturing risk such that there is an inability to have technicians physically able to come to work and perform their duties
- Third party supply disruption of necessary raw material
- Executive management contracting COVID 19 and remaining sick or no longer being able to fulfill their duties in any capacity
- Prolonged periods of lock down in SomnoMed's sales markets
- Ongoing support of current finance providers

SOURCE: MORGANS, COMPANY



SOURCE: MORGANS, COMPANY

**Key drivers / risks**

Key Drivers

- Compliance** - Higher compliance rates (80% for COAT vs <50% for CPAP) and lower cost than CPAP competitors.
- Expansion** - European expansion continuing to show strong growth. Underserved market for treatment modality
- Turnaround** - Watching for evidence of a US turnaround after a direct retail channel move was recieved poorly by existing wholesale customers.

Key risks:

- FX** - Majority of revenues generated outside of Australia.
- Substitution** - A number of new and existing alternative products exist in the sleep apnea space which may impact SOM's ability to gain market share.
- Reimbursement** - Risk that insurance companies/governments which partially or fully subsidise the products reduce or exclude the reimbursement for the treatment.

SOURCE: MORGANS, COMPANY

**Figure 1: Financial summary**

Income statement						Valuation metrics							
	FY19A	FY20A	FY21F	FY22F	FY23F						Price Target (A\$)	\$2.55	
Total revenue	58.9	57.3	65.5	74.7	85.6	<b>DCF valuation inputs</b>							
EBITDA	4.9	4.7	4.2	7.4	10.2	Rf	3.00%	10-year rate					3.00%
Associate income	0.0	0.0	0.0	0.0	0.0	Rm-Rf	6.00%	Margin					2.0%
Depreciation	-1.4	-3.1	-3.1	-3.1	-3.1	Beta	1.27	Kd					3.50%
EBITA	3.5	1.6	1.1	4.3	7.1	CAPM (Rf+Beta(Rm-Rf))	10.6%	Ke					13.3%
Amortisation/impairment	0.0	0.0	0.0	0.0	0.0	Equity (E/EV)	60.0%	NPV cash flow (A\$m)					188.2
EBIT	3.5	1.6	1.1	4.3	7.1	Debt (D/EV)	40.0%	Minority interest (A\$m)					0.0
Net interest expense	-0.2	-0.5	0.6	0.6	0.6	Interest rate	3.50%	Net debt (A\$m)					-22.7
Pre-tax profit	0.6	0.7	1.6	4.7	7.6	Tax rate (t)	30.0%	Investments (A\$m)					0.0
Income tax expense	-0.6	-1.2	0.0	-1.4	-2.3	<b>WACC</b>	9.4%	Equity market value (A\$m)					210.9
After-tax profit	0.0	-0.4	1.6	3.3	5.3							Diluted no. of shares (m)	82.8
Minority interests	0.0	0.0	0.0	0.0	0.0								<b>\$2.55</b>
NPAT	0.0	-0.4	1.6	3.3	5.3								
Significant items	-16.4	-0.7	0.0	0.0	0.0								
<b>NPAT post abnormal</b>	<b>-16.4</b>	<b>-1.1</b>	<b>1.6</b>	<b>3.3</b>	<b>5.3</b>								
Cash flow statement						Multiples							
	FY19A	FY20A	FY21F	FY22F	FY23F		FY19A	FY20A	FY21F	FY22F	FY23F		
EBITDA	4.9	4.7	4.2	7.4	10.2	Enterprise value (A\$m)	131.5	158.5	155.8	157.1	160.5		
Change in working capital	7.8	9.1	-3.2	-1.0	-0.8	EV/Sales (x)	2.2	2.8	2.4	2.1	1.9		
Net interest (pd)/rec	0.0	0.0	0.0	0.0	0.0	EV/EBITDA (x)	26.6	33.6	37.4	21.3	15.7		
Taxes paid	0.6	1.2	0.0	1.4	2.3	EV/EBIT (x)	37.6	96.8	144.7	36.6	22.6		
Other oper cash items	0.0	0.0	0.0	0.0	0.0	PE (x)	-2306.7	-276.0	77.4	36.5	22.8		
<b>Cash flow from ops (1)</b>	<b>13.4</b>	<b>15.0</b>	<b>1.0</b>	<b>7.8</b>	<b>11.7</b>	PEG x)	23.2	-0.4	-0.2	0.3	0.4		
Capex (2)	-1.4	-3.1	-3.1	-3.1	-3.1								
Disposals/(acquisitions)	0.0	0.0	0.0	0.0	0.0								
Other investing cash flow	0.0	0.0	0.0	0.0	0.0								
<b>Cash flow from investing (3)</b>	<b>-1.4</b>	<b>-3.1</b>	<b>-3.1</b>	<b>-3.1</b>	<b>-3.1</b>								
Incr/(decr) in equity	0.0	0.0	0.0	0.0	0.0								
Incr/(decr) in debt	0.0	0.0	0.0	0.0	0.0								
Ordinary dividend paid	0.0	0.0	0.0	0.0	0.0								
Preferred dividends (4)	0.0	0.0	0.0	0.0	0.0								
Other financing cash flow	-0.6	-2.5	0.0	0.0	0.0								
<b>Cash flow from fin (5)</b>	<b>-0.6</b>	<b>-2.5</b>	<b>0.0</b>	<b>0.0</b>	<b>0.0</b>								
Forex and disc ops (6)	0.0	0.0	0.0	0.0	0.0								
<b>Inc/(decr) cash (1+3+5+6)</b>	<b>11.4</b>	<b>9.5</b>	<b>-2.1</b>	<b>4.7</b>	<b>8.6</b>								
Equity FCF (1+2+4)	11.9	12.0	-2.1	4.7	8.6								
Balance sheet						Per share data							
	FY19A	FY20A	FY21F	FY22F	FY23F		FY19A	FY20A	FY21F	FY22F	FY23F		
Cash & deposits	7.7	30.2	27.5	28.8	32.3	No. shares	62.2	82.8	82.8	82.8	82.8		
Trade debtors	10.7	7.7	8.1	9.2	10.6	EPS (cps)	-0.1	-0.5	1.9	4.0	6.4		
Inventory	1.9	2.2	0.0	0.0	0.0	Dividend per share (c)	0.0	0.0	0.0	0.0	0.0		
Other current assets	0.0	0.0	0.0	0.0	0.0	Dividend payout ratio (%)	0.0%	0.0%	0.0%	0.0%	0.0%		
Goodwill	0.0	0.0	0.0	0.0	0.0	Dividend yield (%)	0.0%	0.0%	0.0%	0.0%	0.0%		
Other intangible assets	0.0	0.0	0.0	0.0	0.0								
Fixed assets	3.2	3.9	3.9	3.9	3.9								
Investments	0.0	0.0	0.0	0.0	0.0								
Other assets	11.2	17.7	17.7	17.7	17.7								
<b>Total assets</b>	<b>34.8</b>	<b>61.7</b>	<b>57.1</b>	<b>59.6</b>	<b>64.4</b>								
Short-term borrowings	0.0	0.0	0.0	0.0	0.0								
Trade payables	8.2	8.7	3.6	3.8	4.3								
Long-term borrowings	3.0	7.5	7.5	7.5	7.5								
Other term liabilities	1.5	8.7	8.7	8.7	8.7								
Other liabilities	0.0	0.0	0.0	0.0	0.0								
<b>Total liabilities</b>	<b>16.9</b>	<b>27.9</b>	<b>22.8</b>	<b>23.0</b>	<b>23.5</b>								
Share capital	57.7	73.9	73.9	73.9	73.9								
Other reserves	7.7	8.6	8.6	8.6	8.6								
Retained earnings	-47.5	-48.7	-48.2	-45.9	-41.6								
Other equity	0.0	0.0	0.0	0.0	0.0								
<b>Total equity</b>	<b>17.8</b>	<b>33.8</b>	<b>34.3</b>	<b>36.6</b>	<b>40.9</b>								
Minority interest	0.0	0.0	0.0	0.0	0.0								
Total shareholders' equity	17.8	33.8	34.3	36.6	40.9								
Total liabilities & SE	34.8	61.7	57.1	59.6	64.4								
Operating performance						Internal liquidity							
	FY19A	FY20A	FY21F	FY22F	FY23F		FY19A	FY20A	FY21F	FY22F	FY23F		
Asset turnover (%)	36.6	29.7	27.6	32.0	34.5	Current ratio (x)	2.5	4.6	9.8	10.1	9.9		
EBITDA margin (%)	8.4	8.2	6.4	9.9	11.9	Receivables turnover (x)	4.8	6.2	8.3	8.6	8.7		
EBIT margin (%)	5.9	2.9	1.6	5.7	8.3	Payables turnover (x)	6.5	6.2	10.0	18.2	18.6		
Net profit margin (%)	-0.1	-0.8	2.4	4.4	6.2								
Return on net assets (%)	2.5	1.3	-14.4	-22.4	19.6								
Net debt (A\$m)	-4.7	-22.7	-20.0	-21.3	-24.8								
Net debt/equity (%)	-26.3	-67.1	-58.3	-58.2	-60.7								
Net interest/EBIT cover (x)													
Invested capital	20.9	20.3	11.1	14.3	15.3								
ROIC (%)	-0.2	-2.2	14.0	23.1	34.6								

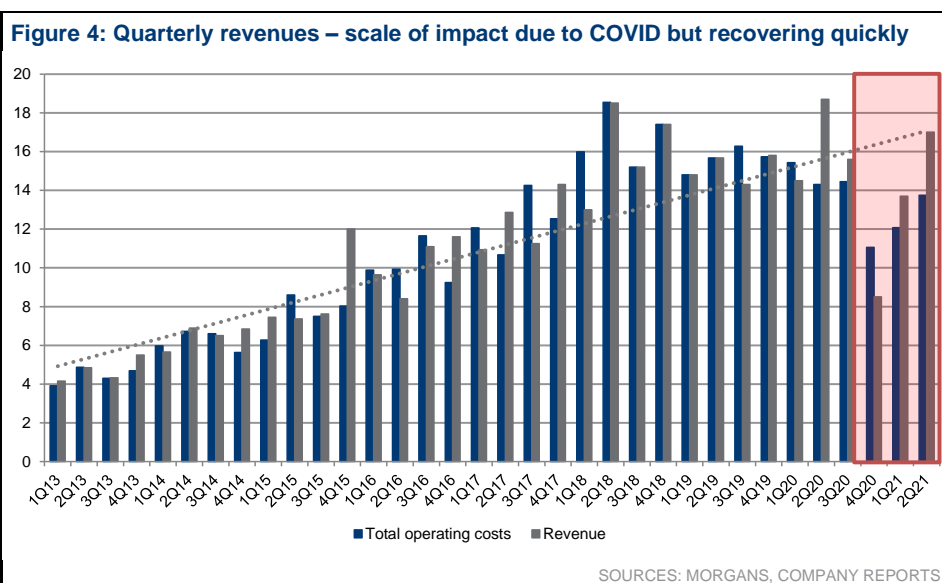
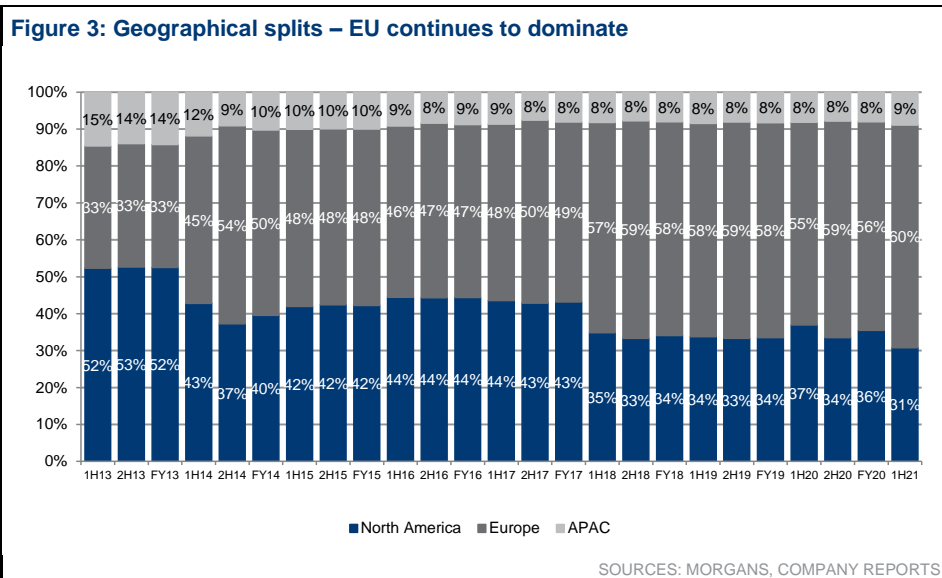
SOURCE: MORGANS RESEARCH, COMPANY

### Result overview

**Figure 2: Financial results overview**

Performance	1H20	2H20	FY20A	1H21A	HoH %	YoY %
Revenue (A\$m)	33.3	24.0	57.3	30.8	28.2%	-7.3%
EBITDA (A\$m)	3.0	1.7	4.7	3.20	88.2%	6.7%
NPAT (A\$m)	0.8	(1.3)	(0.4)	0.60	148.1%	-26.1%
MAS Margin	70.5%	69.1%	69.1%	69.9%	+0.8%	-0.6%
Gross Margin	58.5%	58.4%	58.4%	58.7%	+0.3%	+0.2%
Cash balance	8.9	30.2	30.2	25.2	-16.5%	183.6%
<b>Revenues by Region</b>						
APAC	2.7	1.9	4.6	2.7	45.3%	1.5%
North America	12.3	8.1	20.3	9.5	17.9%	-22.7%
Europe	18.3	14.1	32.4	18.6	31.8%	1.8%
<b>% geographical split</b>						
APAC	8%	8%	8%	9%	1%	1%
North America (inc RSS)	37%	34%	36%	31%	-6%	-6%
Europe	55%	59%	56%	60%	5%	5%

SOURCES: MORGANS, COMPANY REPORTS



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