

July 26, 2022

ADD (no change)

Stock code:	SOM AU
Price:	A\$1.20
12-month target price:	A\$1.91
Previous target price:	A\$2.51
Up/downside to target price:	59.2%
Dividend yield:	NA%
12-month TSR*:	NA%
Market cap:	A\$99.31m
Average daily turnover:	A\$0.03m
Index inclusion:	N/A

* Total stock return – Up/downside to target price + 12-month forward dividend yield.

Price performance

(%)	1M	3M	12M	3Y
Absolute	-4	-38.2	-46.9	-6.8
Rel ASX/S&P200	-8.3	-29	-38.8	-8.3


Financial summary

	Jun-21A	Jun-22F	Jun-23F	Jun-24F
Revenue (A\$m)	62.71	72.89	83.12	98.98
EBITDA Norm (A\$m)	2.74	-0.13	3.36	7.28
Net Profit (A\$m)	-0.96	-2.56	-0.32	2.41
EPS Norm (A\$)	-0.012	-0.031	-0.004	0.029
EPS Growth Norm (%)	119%	166%	-88%	
P/E Norm (x)	NA	NA	NA	41.29
DPS (A\$)	0.000	0.000	0.000	0.000
Dividend Yield (%)	0%	0%	0%	0%
EV/EBITDA (x)	29.51	NA	26.39	11.99
Gearing (Net Debt/EBITDA)	-6.85	91.90	-3.29	-1.68

Source: Company data, Morgans estimates

Related research
[SOM \(ADD - TP A\\$2.51\) - 28 Apr 2022](#)
[Sector report - 17 Mar 2022](#)
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Analyst(s) own shares in the following stocks mentioned in this report:

– N/A

SomnoMed

Strong growth across major sales engines

- SOM has recorded another record quarterly revenue result, reflecting a stronger sales and marketing push in all regions and normalisation of patient / physician engagement as COVID concerns abate.
- Sales and EBITDA guidance are in line with our FY22 forecasts. The market should be comfortable with this.
- SOM's Rest Assure program (technology-enabled devices) remains on track, with further patient validation studies complete and continued collation of clinical efficacy data set to drive prescriptions and reimbursement in future periods.
- With several clinical / manufacturing / regulatory hurdles pending, timing of commercial launch remains uncertain although commentary and typical approval timeframes would suggest likely first sales in FY24.
- Given the connected nature of the asset, we have rolled through higher costs based on the view that internal IT infrastructure upgrades will be required (HIPAA compliance) as well as ongoing third party management of health data / records.
- Our target price reduces to A\$1.91 (from A\$2.51) although we maintain a positive Add recommendation.

Event

- SOM closed FY22 strongly with record sales for the quarter of A\$21.3m (+32% on pcp), bringing revenues in the financial period to A\$72.6m (+17% in the pcp) and in line with our forecast of A\$72.9m. Guidance of FY22 breakeven EBITDA was maintain which is again in-line with our forecasts for a loss of A\$100k.
- The North American channel (~34% of sales) is back to its best, posting a standout 42% growth in the pcp to A\$24.7m as clinical and patient markets continue to normalise in a post-lockdown COVID-19 market.
- Europe (~58% of sales) continues to improve with sales growth of 15% in the pcp (to A\$42.2m) and while still volatile market to market across smaller jurisdictions, the broader growth reflects the relative maturity and acceptance across the region for COAT devices compared to the US.
- R&D: A\$1.5m expensed over the quarter in relation to the Rest Assure technology. Year-to-date R&D expenses relating to the technology closed at A\$7.8m, marginally under budget for A\$8m investment in FY22.
- The company recorded positive A\$3.3m in operating cashflow on lower inventory spend, with A\$15.6m in available cash (net cash A\$8.9m inclusive of A\$6.7m debt).

Analysis

- With a strong rebound in North America and positive double-digit growth still coming out of the European engine room, all appears solid on the existing product front. Nothing to dislike here.
- Investor focus will soon shift to the new technology piece which will potentially create a unique and entirely new revenue stream within the treatment modality. Given this is still a while away and requires further regulatory scrutiny, the potential of the new technology at this stage is unknown and is reserved as upside.
- However, given the connected nature of the device and storage / transfer of patient medical data, this asset is likely to have a significant upfront and recurring IT infrastructure cost. We estimate this to be around A\$4.5m in FY23 (scale-up / implementation) and then revert to A\$2.5m pa thereafter.

Forecast and valuation update

- We have rolled through our new IT cost assumptions and along with other names in the sector, taken the opportunity to roll through higher premiums to our cost of capital assumptions to better reflect the changing landscape for growth companies and those with regulatory risk. WACC increases to 10.2% (from 9.4%).
- As a result, our target price reduces to A\$1.91 (from A\$2.51).

Investment view

- Good time to build positions. Positive outlook and recommendation maintained.

Risks

- Downside risk to our target is slower-than-expected growth across our core market assumptions.

SomnoMed

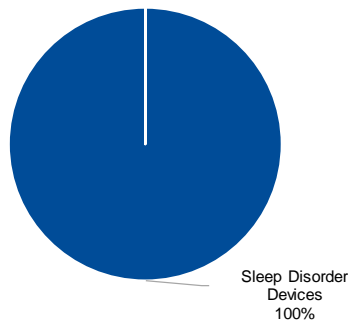
as at July 26, 2022

Rating	ADD	Price (A\$):	1.20
Market cap (A\$m):	99.31	12-month target price (A\$):	1.91
Shares outstanding (m):	83.02	Up/downside to target price (%):	59.2
Free float (%):	67.1	Dividend yield (%):	NA

Company description

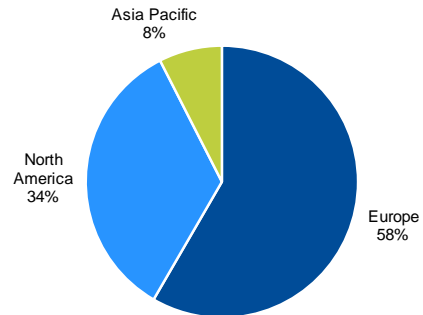
SomnoMed Limited (SOM) provides treatment solutions for sleep-related breathing disorders including obstructive sleep apnea, snoring and bruxism. The SomnoDent® product range involves a custom fitted, comfortable, clinically researched oral appliance worn at night to treat obstructive sleep apnea. The SomnoDent® product has a number of innovative designs including Avant, Fusion Flex and Classic. The SomnoDent® is designed for the patients who suffers from mild to moderate OSA and includes the proprietary BFlex soft inner liner for unparalleled comfort and retention.

Business segmentation by revenue



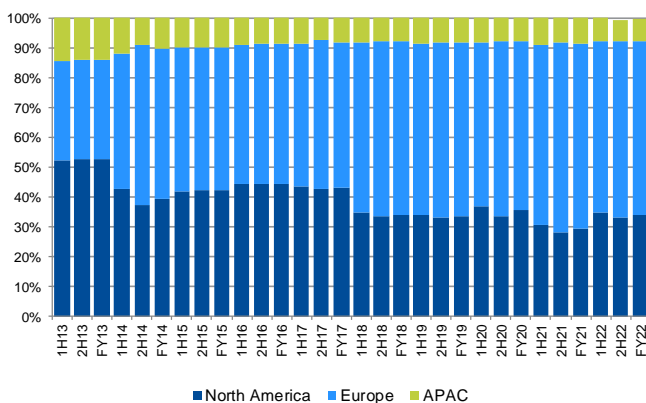
Source: Morgans estimates, company data

Geographical segmentation by revenue



Source: Morgans estimates, company data

Revenue splits by geography (core business)



Source: Morgans estimates, company data

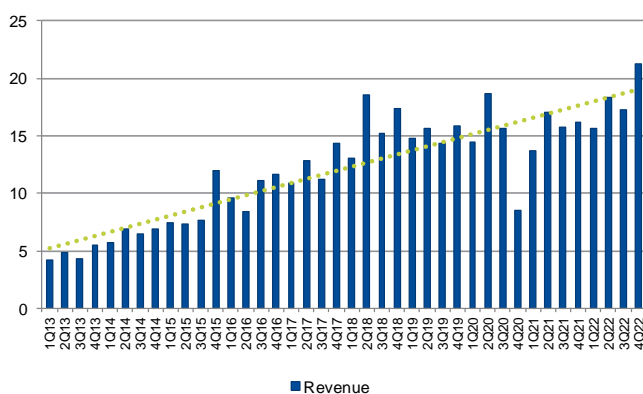
COVID-19 RISKS

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 fulfil their duties in any capacity
- Prolonged periods of lock down in SomnoMed's sales markets
- Ongoing support of current finance providers

Source: Morgans estimates, company data

Quarterly sales revenue



Source: Morgans estimates, company data

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 received 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 estimates, company data

Figure 1: Financial summary

Income statement						Valuation metrics											
	FY20A	FY21F	FY22F	FY23F	FY24F						Price Target (A\$)	\$1.91					
Total revenue	57.3	62.7	72.9	83.1	99.0	DCF valuation inputs											
EBITDA	4.7	2.7	-0.1	3.4	7.3	Rf	3.00%					10-year rate	3.00%				
Associate income	0.0	0.0	0.0	0.0	0.0	Rm-Rf	6.75%					Margin	2.0%				
Depreciation	-3.1	-3.8	-3.8	-3.8	-3.8	Beta	1.27					Kd	3.50%				
EBITA	1.6	-1.1	-4.0	-0.5	3.4	CAPM (Rf+Beta(Rm-Rf))	11.6%					Ke	14.6%				
Amortisation/impairment	0.0	0.0	0.0	0.0	0.0	Equity (E/EV)	60.0%					NPV cash flow (A\$m)	135.1				
EBIT	1.6	-1.1	-4.0	-0.5	3.4	Debt (D/EV)	40.0%					Minority interest (A\$m)	0.0				
Net interest expense	-0.5	0.6	0.4	0.2	0.1	Interest rate	3.50%					Net debt (A\$m)	-22.7				
Pre-tax profit	0.7	-0.6	-3.7	-0.5	3.4	Tax rate (t)	30.0%					Investments (A\$m)	0.0				
Income tax expense	-1.2	-0.3	1.1	0.1	-1.0	WACC	10.2%					Equity market value (A\$m)	157.9				
After-tax profit	-0.4	-1.0	-2.6	-0.3	2.4							Diluted no. of shares (m)	82.8				
Minority interests	0.0	0.0	0.0	0.0	0.0												
NPAT	-0.4	-1.0	-2.6	-0.3	2.4												
Significant items	-0.7	0.0	0.0	0.0	0.0												
NPAT post abnormals	-1.1	-1.0	-2.6	-0.3	2.4												
Cash flow statement						Multiples											
	FY20A	FY21F	FY22F	FY23F	FY24F		FY20A	FY21F	FY22F	FY23F	FY24F						
EBITDA	4.7	2.7	-0.1	3.4	7.3	Enterprise value (A\$m)	198.2	184.0	177.6	176.3	177.5						
Change in working capital	9.1	-1.8	-3.1	-0.8	-1.1	EV/Sales (x)	3.5	2.9	2.4	2.1	1.8						
Net interest (pd)/rec	0.0	0.0	0.0	0.0	0.0	EV/EBITDA (x)	42.0	67.2	-1325.1	52.5	24.4						
Taxes paid	1.2	0.3	-1.1	-0.1	1.0	EV/EBIT (x)	121.1	-167.4	-44.7	-364.9	51.5						
Other oper cash items	0.0	0.0	0.0	0.0	0.0	PE (x)	-366.8	-167.2	-62.9	-504.4	66.8						
Cash flow from ops (1)	15.0	1.3	-4.4	2.5	7.2	PEG x)	-0.5	-1.4	-0.4	5.8	-0.1						
Capex (2)	-3.1	-3.8	-3.8	-3.8	-3.8												
Disposals/(acquisitions)	0.0	0.0	0.0	0.0	0.0	Per share data						FY20A	FY21F	FY22F	FY23F	FY24F	
Other investing cash flow	0.0	0.0	0.0	0.0	0.0	No. shares	82.8	83.0	83.0	83.0	83.0						
Cash flow from investing (3)	-3.1	-3.8	-3.8	-3.8	-3.8	EPS (cps)	-0.5	-1.2	-3.1	-0.4	2.9						
Incr/(decr) in equity	0.0	0.0	0.0	0.0	0.0	Dividend per share (c)	0.0	0.0	0.0	0.0	0.0						
Incr/(decr) in debt	0.0	0.0	0.0	0.0	0.0	Dividend payout ratio (%)	0.0%	0.0%	0.0%	0.0%	0.0%						
Ordinary dividend paid	0.0	0.0	0.0	0.0	0.0	Dividend yield (%)	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	-2.5	-2.4	0.0	0.0	0.0	Growth ratios						FY20A	FY21F	FY22F	FY23F	FY24F	
Cash flow from fin (5)	-2.5	-2.4	0.0	0.0	0.0	Sales growth	-3%	9%	16%	14%	19%						
Forex and disc ops (6)	0.0	0.0	0.0	0.0	0.0	Operating cost growth	-3%	14%	22%	9%	15%						
Inc/(decr) cash (1+3+5+6)	9.5	-4.9	-8.2	-1.4	3.4	EBITDA growth	-5%	-42%	-105%	2605%	117%						
Equity FCF (1+2+4)	12.0	-2.5	-8.2	-1.4	3.4	EBITA growth	-53%	-167%	-261%	88%	813%						
						EBIT growth	-53%	-167%	-261%	88%	813%						
						NPAT growth	-1012%	-120%	-166%	88%	856%						
						Normalised EPS growth	736%	119%	166%	-88%	-856%						
Balance sheet						Operating performance											
	FY20A	FY21F	FY22F	FY23F	FY24F		FY20A	FY21F	FY22F	FY23F	FY24F						
Cash & deposits	30.2	21.1	14.7	13.4	14.6	Asset turnover (%)	29.7	26.6	35.8	45.4	52.3						
Trade debtors	7.7	10.6	9.0	10.2	12.2	EBITDA margin (%)		4.4	-0.2	4.0	7.4						
Inventory	2.2	2.3	0.0	0.0	0.0	EBIT margin (%)	2.9	-1.8	-5.5	-0.6	3.5						
Other current assets	0.0	0.0	0.0	0.0	0.0	Net profit margin (%)	-0.8	-1.5	-3.5	-0.4	2.4						
Goodwill	0.0	0.0	0.0	0.0	0.0	Return on net assets (%)	1.3	-14.4	-22.4	19.6	4.8						
Other intangible assets	0.0	0.0	0.0	0.0	0.0	Net debt (A\$m)	-22.7	-18.8	-12.3	-11.0	-12.3						
Fixed assets	3.9	4.7	4.7	4.7	4.7	Net debt/equity (%)	-67.1	-58.3	-42.7	-39.0	-40.0						
Investments	0.0	0.0	0.0	0.0	0.0	Net interest/EBIT cover (x)		20.3	11.6	13.4	16.5	17.3					
Other assets	17.7	17.4	17.4	17.4	17.4	Invested capital		-2.2	-8.3	-19.1	-1.9	14.0					
Total assets	61.7	56.2	45.7	45.7	48.9	ROIC (%)		-2.2	-8.3	-19.1	-1.9	14.0					
Short-term borrowings	0.0	0.0	0.0	0.0	0.0	Internal liquidity						FY20A	FY21F	FY22F	FY23F	FY24F	
Trade payables	8.7	10.6	3.5	4.0	4.9	Current ratio (x)	4.6	3.2	6.7	5.9	5.5						
Long-term borrowings	7.5	2.3	2.3	2.3	2.3	Receivables turnover (x)	6.2	6.8	7.4	8.6	8.8						
Other term liabilities	8.7	7.6	7.6	7.6	7.6	Payables turnover (x)	6.2	6.2	10.4	21.3	20.7						
Other liabilities	0.0	0.0	0.0	0.0	0.0												
Total liabilities	27.9	24.0	16.9	17.4	18.3												
Share capital	73.9	74.3	74.3	74.3	74.3												
Other reserves	8.6	7.8	7.8	7.8	7.8												
Retained earnings	-48.7	-49.9	-53.2	-53.7	-51.4												
Other equity	0.0	0.0	0.0	0.0	0.0												
Total equity	33.8	32.2	28.8	28.3	30.6												
Minority interest	0.0	0.0	0.0	0.0	0.0												
Total shareholders' equity	33.8	32.2	28.8	28.3	30.6												
Total liabilities & SE	61.7	56.2	45.7	45.7	48.9												

Source: Morgans estimates, company data

Changes to forecasts

Figure 2: Changes to forecasts

Metric	FY22F		FY23F		FY24F	
	Old	New	Old	New	Old	New
Revenue	72.9	72.9	83.1	83.1	99.0	99.0
% change		0%		0%		0%
EBITDA	(0.1)	(0.1)	7.4	3.4	9.8	7.3
% change		0%		-54%		-26%
NPAT (normalised)	(2.6)	(2.6)	2.5	(0.3)	4.2	2.4
% change		0%		-113%		-43%
EPS (c) normalised	(3.1)	(3.1)	3.0	(0.4)	5.1	2.9
% change		0%		-113%		-43%
DPS (c)	0	0	0	0	0	0
% change		0%		0%		0%

Source: Morgans estimates, company data

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