

## BUY: US sales growth equals margin and EPS

We maintain our BUY rating and \$2.00 price target on SomnoMed. Their 4Q19 update provided more evidence that the restoration of US sales growth is genuine and should set the business up for a successful FY20. Bringing US profitability into line with that of its strong European business is now the major focus. A number of components are coming together to strengthen that position over the next few years. The sales and marketing organisations are more focused. A new premium product is flagged for this year, backed by a digital manufacturing platform and gross margin enhancement. A number of technology-based innovations could widen the moat around the medical and dental marketing channels and service offering, which is what differentiates SomnoMed most.

### Key points

**4Q19: further evidence of US recovery.** Core US medical device sales grew 22% in Q4, the growth coming primarily from market share gains. SomnoMed continues to regain business following the closure of its RSS venture. New high volume accounts are also being added at the expense of direct competitors.

**ROW sales.** Efforts continue to solve bottleneck issues that hampered 3Q growth in the Dutch and Swedish markets. New campaigns aim to retain patients within the oral appliance treatment pathway, even if that means deferring treatment into the seasonally slower summer months. New EU countries are becoming material to results, in aggregate. Asia Pacific has been the surprise for FY19, growing 16% yoy.

**FY19 result.** We expect SomnoMed to report on 22<sup>nd</sup> August. Group revenue of \$63m is higher than our \$62m forecast. We are modelling underlying EBITDA of \$5.0m for the core medical device business (guidance range is \$5.0m to \$5.5m). Guidance excludes the impact of closing down RSS and other, one-time write-offs.

**Valuation.** Price target maintained at \$2.00 per share, with reference to our risk-adjusted DCF valuation. Standalone, the unrisks value for the core business is \$2.85-3.00 per share, contingent upon: a) restoration of US core growth rates to high single or low double-digit percentages; and b) realisation of long-promised margin leverage at the Group level.

### Risks and catalysts

**Risks:** a) adverse reimbursement policies impacting demand; b) competition; c) tightly managed balance sheet; d) access to capital to accelerate growth strategies. **Catalysts:** a) sales growth; b) profitability in key jurisdictions; c) new product launches; d) gross margin improvement via digital manufacturing and other technologies; e) margin leverage developing at Group level.

Earnings forecasts					
Year-end June (AUD)	FY17A	FY18A	FY19F	FY20F	FY21F
NPAT rep (\$m)	-3.3	-8.6	-8.6	3.1	4.2
NPAT norm (\$m)	-2.4	-7.7	-3.6	3.1	4.2
Consensus NPAT (\$m)			3.4	3.3	4.3
EPS norm (cps)	-4.4	-13.8	-6.3	4.9	6.7
EPS growth (%)	-1476.9	-213.3	54.6	178.2	36.4
P/E norm (x)	-39.5	-12.6	-27.7	35.5	26.0
EV/EBITDA (x)	-61.1	-16.0	20.9	18.1	13.4
FCF yield (%)	-4.6	-10.5	-5.7	1.8	2.6
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

### Wilsions Equity Research

Analyst(s) who own shares in the Company: n/a  
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Recommendation	BUY
12-mth target price (AUD)	\$2.00
Share price @ 23-Jul-19 (AUD)	\$1.74
Forecast 12-mth capital return	14.9%
Forecast 12-mth dividend yield	0.0%
<b>12-mth total shareholder return</b>	<b>14.9%</b>

Market cap	\$109m
Enterprise value	\$104m
Shares on issue	63m
Sold short	0.0%
ASX 300 weight	n/a
Median turnover/day	\$0.0m

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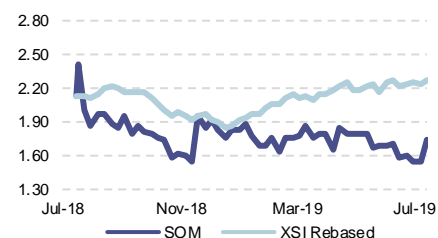
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FUNDAMENTAL  
INSIGHTS

#### 12-mth price performance (\$)

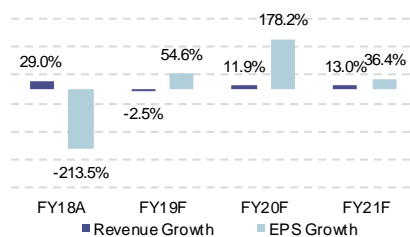


	1-mth	6-mth	12-mth
Abs return (%)			
Rel return (%)	7.4	-12.9	-25.1

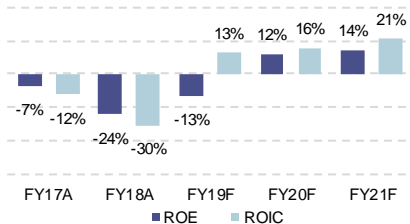
#### Key changes

		27-Mar	After	Var %
<b>NPAT:</b>	<b>FY19F</b>	-3.6	-3.6	0.0%
<b>norm</b>	<b>FY20F</b>	3.1	3.1	0.0%
<b>(\$m)</b>	<b>FY21F</b>	4.2	4.2	0.0%
<b>EPS:</b>	<b>FY19F</b>	-6.3	-6.3	0.0%
<b>norm</b>	<b>FY20F</b>	4.9	4.9	0.0%
<b>(cps)</b>	<b>FY21F</b>	6.7	6.7	0.0%
<b>DPS:</b>	<b>FY19F</b>	0.0	0.0	0.0%
<b>(cps)</b>	<b>FY20F</b>	0.0	0.0	0.0%
	<b>FY21F</b>	0.0	0.0	0.0%
<b>Price target:</b>		2.00	2.00	0.0%
<b>Rating:</b>		BUY	BUY	

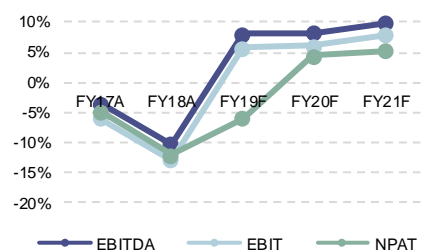
### Growth rates



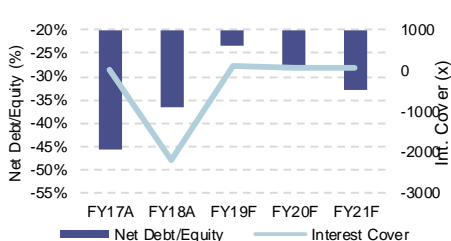
### Returns



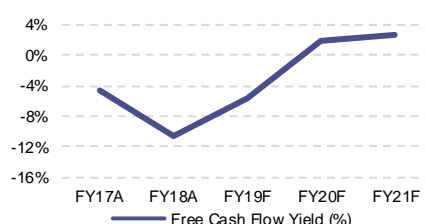
### Margin trends



### Solvency



### Free cash flow yield



### Interims (\$m)

	1H18A	2H18A	1H19E	2H19E
Sales revenue	31.6	32.0	28.8	33.2
EBITDA	-3.4	-3.1	1.6	3.4
EBIT	-4.1	-4.0	0.9	2.7
<b>Net profit</b>	<b>-5.1</b>	<b>-2.5</b>	<b>-7.5</b>	<b>3.9</b>
<b>Norm EPS</b>	<b>-9.4</b>	<b>-4.5</b>	<b>-12.9</b>	<b>6.6</b>
EBIT/sales (%)	-13.1	-12.5	3.0	8.1
Dividend (c)	0.0	0.0	0.0	0.0
Franking (%)	0.0	0.0	0.0	0.0
Payout ratio (%)	0.0	0.0	0.0	0.0
Adj payout (%)	0.0	0.0	0.0	0.0

### Key assumptions

	FY14A	FY15A	FY16A	FY17A	FY18A	FY19F	FY20F	FY21F
Revenue Growth (%)	40.1	33.0	28.0	11.9	29.0	-2.5	11.9	13.0
EBIT Growth (%)	35.0	-45.7	90.2	-747.2	178.2	-143.7	20.4	43.9
NPAT Growth (%)	-9.2	-4.8	-72.4	-1,534.2	224.6	-52.5	-184.5	36.4
<b>EPS Growth (%)</b>	<b>75.4</b>	<b>-55.3</b>	<b>-73.3</b>	<b>-1,476.9</b>	<b>213.3</b>	<b>-54.6</b>	<b>-178.2</b>	<b>36.4</b>
EBIT / Sales (%)	1.7	0.7	1.0	-5.9	-12.8	5.7	6.2	7.9
Tax Rate (%)	3.4	44.8	85.0	-14.3	-19.8	-2.6	27.0	31.1
<b>ROA (%)</b>	<b>2.3</b>	<b>0.9</b>	<b>1.1</b>	<b>-7.1</b>	<b>-19.4</b>	<b>9.0</b>	<b>8.8</b>	<b>11.8</b>
ROE (%)	5.1	2.8	0.5	-7.4	-26.1	-14.7	9.6	12.0

	FY14A	FY15A	FY16A	FY17A	FY18A	FY19F	FY20F	FY21F
SomnoMed EBITDA (\$m)	1.1	0.9	1.5	2.4	3.9	4.4	5.7	7.7
RSS EBITDA (\$m)				-4.1	-10.4	-10.2	0.0	0.0

### Financial ratios

	FY14A	FY15A	FY16A	FY17A	FY18A	FY19F	FY20F	FY21F
PE (x)	64.8	145.0	543.4	-39.5	-12.6	-27.7	35.5	26.0
EV/EBITDA (x)	98.8	119.2	70.3	-61.1	-16.0	20.9	18.1	13.4
Dividend yield (%)	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
FCF yield (%)	-0.4	-1.3	0.2	-4.6	-10.5	-5.7	1.8	2.6
Payout ratio (%)	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Adj payout (%)	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0

### Profit and loss (\$m)

	FY14A	FY15A	FY16A	FY17A	FY18A	FY19F	FY20F	FY21F
Sales revenue	25.9	34.4	44.1	49.3	63.6	62.0	69.4	78.4
EBITDA	1.1	0.9	1.5	-1.7	-6.5	5.0	5.7	7.7
Depn & amort	0.6	0.6	1.0	1.2	1.7	1.4	1.5	1.5
<b>EBIT</b>	<b>0.4</b>	<b>0.2</b>	<b>0.5</b>	<b>-2.9</b>	<b>-8.2</b>	<b>3.6</b>	<b>4.3</b>	<b>6.2</b>
Net interest expense	0.0	-0.1	0.0	-0.1	0.0	0.0	0.1	0.1
Tax	0.0	0.2	0.4	0.4	1.6	-0.1	1.1	1.9
Minorities/pref divs	-0.2	0.1	0.1	-0.8	-2.1	-1.0	0.0	0.0
Equity accounted NPAT	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
<b>Net profit (pre-sig items)</b>	<b>0.6</b>	<b>0.1</b>	<b>0.0</b>	<b>-2.4</b>	<b>-7.7</b>	<b>4.6</b>	<b>3.1</b>	<b>4.2</b>
Abns/exts/signif	-0.2	0.5	0.2	-1.0	-0.9	-13.2	0.0	0.0
<b>Reported net profit</b>	<b>0.4</b>	<b>0.6</b>	<b>0.2</b>	<b>-3.3</b>	<b>-8.6</b>	<b>-8.6</b>	<b>3.1</b>	<b>4.2</b>

### Cash flow (\$m)

	FY14A	FY15A	FY16A	FY17A	FY18A	FY19F	FY20F	FY21F
EBITDA	1.1	0.9	1.5	-1.7	-6.5	5.0	5.7	7.7
Interest & tax	-0.5	0.1	-0.2	-1.2	-0.6	-1.0	-0.8	-1.7
Working cap/other	-1.3	-1.2	0.9	0.2	-2.4	-8.9	-0.9	-1.2
<b>Operating cash flow</b>	<b>-0.8</b>	<b>-0.2</b>	<b>2.1</b>	<b>-2.7</b>	<b>-9.5</b>	<b>-4.9</b>	<b>4.0</b>	<b>4.8</b>
Maintenance capex	0.3	-1.2	-1.9	-2.4	-2.0	-1.4	-2.0	-2.0
<b>Free cash flow</b>	<b>-0.5</b>	<b>-1.4</b>	<b>0.2</b>	<b>-5.1</b>	<b>-11.5</b>	<b>-6.2</b>	<b>2.0</b>	<b>2.8</b>
Dividends paid	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Growth capex	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Invest/disposals	-0.3	-0.2	-1.3	-0.3	-0.2	0.0	0.0	0.0
Oth investing/finance flows	-0.4	-0.3	-0.4	-0.1	-0.6	-0.2	0.0	0.0
<b>Cash flow pre-financing</b>	<b>-1.2</b>	<b>-1.9</b>	<b>-1.5</b>	<b>-5.5</b>	<b>-12.3</b>	<b>-6.5</b>	<b>2.0</b>	<b>2.8</b>
Funded by equity	0.0	7.3	10.7	2.4	11.2	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	1.2	-5.3	-9.2	3.1	1.1	6.5	-2.0	-2.8

### Balance sheet summary (\$m)

	FY14A	FY15A	FY16A	FY17A	FY18A	FY19F	FY20F	FY21F
Cash	2.9	8.3	16.7	14.2	13.4	7.0	9.0	11.9
Current receivables	5.5	7.2	9.4	10.2	13.6	13.2	15.0	17.0
Current inventories	1.0	1.3	1.8	1.9	2.0	2.3	2.7	3.1
Net PPE	1.3	2.1	3.8	4.5	6.6	4.4	4.6	4.8
Intangibles/capitalised	8.5	8.9	10.2	10.4	10.1	10.4	10.8	11.1
<b>Total assets</b>	<b>19.1</b>	<b>27.8</b>	<b>42.0</b>	<b>41.2</b>	<b>45.7</b>	<b>37.9</b>	<b>42.6</b>	<b>48.4</b>
Current payables	3.3	3.9	6.9	8.0	8.4	6.9	7.6	8.2
Total debt	0.0	0.0	0.0	0.0	1.4	1.5	1.5	1.5
<b>Total liabilities</b>	<b>6.6</b>	<b>6.2</b>	<b>8.8</b>	<b>10.3</b>	<b>12.9</b>	<b>14.1</b>	<b>15.4</b>	<b>16.7</b>
<b>Shareholder equity</b>	<b>12.6</b>	<b>21.5</b>	<b>33.2</b>	<b>31.0</b>	<b>32.8</b>	<b>23.8</b>	<b>27.3</b>	<b>31.7</b>
<b>Total funds employed</b>	<b>12.6</b>	<b>21.5</b>	<b>33.2</b>	<b>31.0</b>	<b>34.2</b>	<b>25.3</b>	<b>28.8</b>	<b>33.2</b>



# SomnoMed (SOM)

## Business description

SomnoMed Limited (SOM) develops, manufactures and sells oral appliance devices for the treatment of obstructive sleep apnoea (OSA). 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

We maintain our BUY rating and \$2.00 price target on SomnoMed. Their 4Q19 update provided more evidence that the restoration of US sales growth is genuine and should set the business up for a successful FY20. Bringing US profitability into line with that of its strong European business is now the major focus. A number of components are coming together to strengthen that position over the next few years. The sales and marketing organisations are more focused. A new premium product is flagged for this year, backed by a digital manufacturing platform and gross margin enhancement. A number of technology-based innovations could widen the moat around the medical and dental marketing channels and service offering, which is what differentiates SomnoMed most.

## Revenue drivers

- Growth rates. Europe has sustained 20%+ growth for a number of years whilst US has slowed to single-digit.
- 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
- 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 the USA is improving, but still needs to develop and broaden

## Balance sheet

- Forecasting \$1.1m net cash at the end of FY19.

## Board

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

## Management

- Neil Verdal-Austin (CEO)
- Kien T. Nguyen (President, North America)
- Dr Jagdeep Bijwadia (Chief Medical Officer)

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