

BUY: And suddenly, Germany

We maintain our BUY rating with a revised target price of \$2.29 per share. SomnoMed is guiding approximately 30% EBITDA growth in FY20 prompting us to upgrade our FY20e forecast by 8%. A new premium product (AVANT) launches this year, refreshing price points at the premium end and strengthening the competitive position across the spectrum of lower price points. After years of patient work SomnoMed announced its first material success in Germany, signing a major health insurer. We look to Europe as the swing factor this year. Efforts to ease treatment bottlenecks in large markets (Netherlands, Nordics) are important. Newer, fast moving marketplaces (France, Belgium and now Germany) could generate exciting European growth and possibly surpass guidance. Europe remains SomnoMed's primary profit centre.

Key points

FY19 snapshot. SomnoMed reported FY19 core EBITDA growth of 27% to \$5.0m, which was consistent with guidance and our forecasts. With the failed RSS venture excluded, revenue grew 12% to \$58.9m with all major jurisdictions reporting double-digit growth (USA +11%, EU 13% and APAC 16%).

Guidance and forecasts. SomnoMed is targeting \$67m-\$69m revenue in FY20 and ~100bps in margin expansion (EBITDA range \$6.3m-\$6.7m). Our revised FY20e EBITDA forecast of \$6.2m (+8.7%) reflects favourable operating leverage with revenue estimates broadly unchanged.

Results takeaways. a) US revenue growth is spread across multiple dental and medical channels now but with some possible concessions on pricing and SG&A investment in the 2H19; b) the new product launch (AVANT) should refresh US price points at the premium end whilst driving share gains at lower price points with legacy products (FUSION, FLEX) becoming 'fighting brands'; c) highly penetrated European markets are de-bottlenecking whilst new markets with favourable reimbursement are trending higher; d) note the hard-won beachhead established in Germany with a major health insurer adopting SomnoDent in its sleep apnoea treatment plans – the cost/benefits of sleep therapy using CPAP is a contentious issue in Germany so this development is perhaps the most revelatory aspect of the FY19 update; e) Asia Pacific remains in growth; and f) new strategies for identifying and capturing patients most likely to respond to therapy could be enabling for sleep physicians seeking alternatives for their mild and moderate sleep apnoea patients.

Valuation. Price target of \$2.29 per share equals our 12-month forward DCF valuation. We risk the valuation for residual uncertainties relating to the sustainability of US growth. On an un-risked basis, our forecasts can support valuations >\$3.00 per share.

Recommendation	BUY
12-mth target price (AUD)	\$2.29
Share price @ 16-Aug-19 (AUD)	\$1.99
Forecast 12-mth capital return	15.1%
Forecast 12-mth dividend yield	0.0%
12-mth total shareholder return	15.1%

Market cap	\$125m
Enterprise value	\$118m
Shares on issue	63m
Sold short	0.0%
ASX 300 weight	n/a
Median turnover/day	\$0.0m

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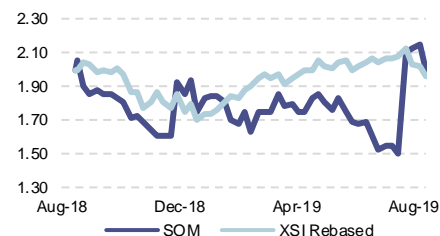
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FUNDAMENTAL
INSIGHTS

12-mth price performance (\$)



	1-mth	6-mth	12-mth
Abs return (%)	28.4	22.1	0.0
Rel return (%)	34.0	19.3	1.5

Key changes

		25-Jul	After	Var %
NPAT:	FY20F	3.1	3.3	7.1%
norm	FY21F	4.2	4.1	-1.7%
	FY22F		5.2	
EPS:	FY20F	4.9	5.3	7.1%
norm	FY21F	6.7	6.6	-1.7%
	FY22F		8.2	
DPS:	FY20F	0.0	0.0	0.0%
(cps)	FY21F	0.0	0.0	0.0%
	FY22F		0.0	
Price target:		2.00	2.29	14.5%
Rating:		BUY	BUY	

Earnings forecasts

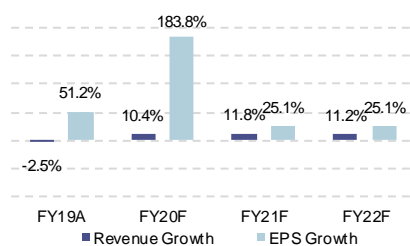
Year-end June (AUD)	FY18A	FY19A	FY20F	FY21F	FY22F
NPAT rep (\$m)	-8.6	-8.6	3.3	4.1	5.2
NPAT norm (\$m)	-7.2	-3.6	3.3	4.1	5.2
Consensus NPAT (\$m)			3.3	4.3	5.3
EPS norm (cps)	-12.9	-6.3	5.3	6.6	8.2
EPS growth (%)	-191.8	51.2	183.8	25.1	25.1
P/E norm (x)	-15.5	-31.7	37.9	30.3	24.2
EV/EBITDA (x)	-18.1	23.6	19.5	16.2	13.4
FCF yield (%)	-9.2	-5.0	1.5	1.8	1.7
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

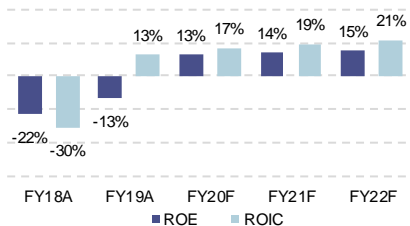
Wilson's Equity Research

Analyst(s) who own shares in the Company: n/a
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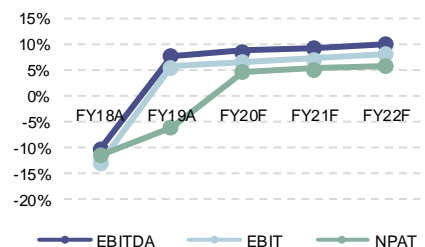
Growth rates



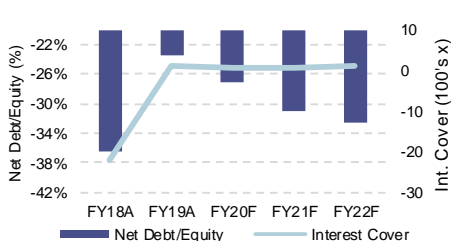
Returns



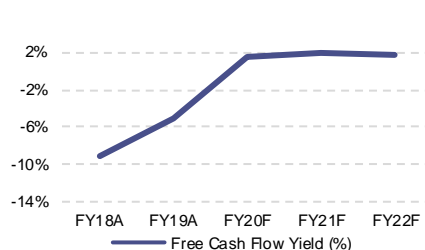
Margin trends



Solvency



Free cash flow yield



Interims (\$m)

	1H19A	2H19A	1H20E	2H20E
Sales revenue	28.8	33.2	30.5	38.0
EBITDA	1.6	3.4	1.3	4.7
EBIT	0.9	2.7	0.6	4.0
Net profit	-7.5	3.9	0.4	2.9
Norm EPS	-12.9	6.6	0.6	4.6
EBIT/sales (%)	3.0	8.1	1.9	10.5
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

	FY15A	FY16A	FY17A	FY18A	FY19A	FY20F	FY21F	FY22F
Revenue Growth (%)	33.0	28.0	11.9	29.0	-2.5	10.4	11.8	11.2
EBIT Growth (%)	-45.7	90.2	-747.2	178.2	-143.7	28.9	24.2	25.4
NPAT Growth (%)	-4.8	-72.4	-1,534.2	202.3	-49.0	-190.5	25.1	25.1
EPS Growth (%)	-55.3	-73.3	-1,476.9	191.8	-51.2	-183.8	25.1	25.1
EBIT / Sales (%)	0.7	1.0	-5.9	-12.8	5.7	6.7	7.4	8.4
Tax Rate (%)	44.8	85.0	-14.3	-19.8	-2.6	27.0	26.6	27.0
ROA (%)	0.9	1.1	-7.1	-19.4	9.0	9.7	11.3	13.2
ROE (%)	2.8	0.5	-7.4	-24.3	-14.7	10.5	12.2	14.0

	FY15A	FY16A	FY17A	FY18A	FY19A	FY20F	FY21F	FY22F
SomnoMed EBITDA (\$m)	0.9	1.5	2.4	3.9	4.4	6.0	7.2	8.8
RSS EBITDA (\$m)			-4.1	-10.4	-10.2	0.0	0.0	0.0

Financial ratios

	FY15A	FY16A	FY17A	FY18A	FY19A	FY20F	FY21F	FY22F
PE (x)	165.8	621.4	-45.1	-15.5	-31.7	37.9	30.3	24.2
EV/EBITDA (x)	135.1	79.7	-69.2	-18.1	23.6	19.5	16.2	13.4
Dividend yield (%)	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
FCF yield (%)	-1.1	0.2	-4.1	-9.2	-5.0	1.5	1.8	1.7
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)

	FY15A	FY16A	FY17A	FY18A	FY19A	FY20F	FY21F	FY22F
Sales revenue	34.4	44.1	49.3	63.6	62.0	68.4	76.5	85.1
EBITDA	0.9	1.5	-1.7	-6.5	5.0	6.0	7.2	8.8
Depn & amort	0.6	1.0	1.2	1.7	1.4	1.5	1.5	1.6
EBIT	0.2	0.5	-2.9	-8.2	3.6	4.6	5.7	7.1
Net interest expense	-0.1	0.0	-0.1	0.0	0.0	0.1	0.1	0.1
Tax	0.2	0.4	0.4	1.6	-0.1	1.2	1.5	1.9
Minorities/pref divs	0.1	0.1	-0.8	-2.1	-1.0	0.0	0.0	0.0
Equity accounted NPAT	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Net profit (pre-sig items)	0.1	0.0	-2.4	-7.7	4.6	3.3	4.1	5.2
Abns/exts/signif	0.5	0.2	-1.0	-0.9	-13.2	0.0	0.0	0.0
Reported net profit	0.6	0.2	-3.3	-8.6	-8.6	3.3	4.1	5.2

Cash flow (\$m)

	FY15A	FY16A	FY17A	FY18A	FY19A	FY20F	FY21F	FY22F
EBITDA	0.9	1.5	-1.7	-6.5	5.0	6.0	7.2	8.8
Interest & tax	0.1	-0.2	-1.2	-0.6	-1.0	-0.9	-1.6	-2.0
Working cap/other	-1.2	0.9	0.2	-2.4	-8.9	-1.2	-1.3	-1.2
Operating cash flow	-0.2	2.1	-2.7	-9.5	-4.9	3.9	4.3	5.6
Maintenance capex	-1.2	-1.9	-2.4	-2.0	-1.4	-2.0	-2.0	-3.4
Free cash flow	-1.4	0.2	-5.1	-11.5	-6.2	1.9	2.3	2.2
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	-0.2	-1.3	-0.3	-0.2	0.0	0.0	0.0	0.0
Oth investing/finance flows	-0.3	-0.4	-0.1	-0.6	-0.2	0.0	0.0	0.0
Cash flow pre-financing	-1.9	-1.5	-5.5	-12.3	-6.5	1.9	2.3	2.2
Funded by equity	7.3	10.7	2.4	11.2	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	-5.3	-9.2	3.1	1.1	6.5	-1.9	-2.3	-2.2

Balance sheet summary (\$m)

	FY15A	FY16A	FY17A	FY18A	FY19A	FY20F	FY21F	FY22F
Cash	8.3	16.7	14.2	13.4	7.0	9.0	11.3	13.4
Current receivables	7.2	9.4	10.2	13.6	13.2	15.0	17.0	19.0
Current inventories	1.3	1.8	1.9	2.0	2.3	2.7	3.0	3.3
Net PPE	2.1	3.8	4.5	6.6	4.4	4.6	4.8	6.0
Intangibles/capitalised	8.9	10.2	10.4	10.1	10.4	10.8	11.1	11.7
Total assets	27.8	42.0	41.2	45.7	37.9	42.5	47.7	54.0
Current payables	3.9	6.9	8.0	8.4	6.9	7.2	7.6	8.0
Total debt	0.0	0.0	0.0	1.4	1.5	1.5	1.5	1.5
Total liabilities	6.2	8.8	10.3	12.9	14.1	15.0	16.1	17.3
Shareholder equity	21.5	33.2	31.0	32.8	23.8	27.5	31.6	36.8
Total funds employed	21.5	33.2	31.0	34.2	25.3	29.0	33.1	38.3



SomnoMed FY19

Table 1: SomnoMed's FY19 results vs Wilsons' forecasts and pcp

(\$ in mn)	FY18a	FY19a	%chg	Forecast	%chg	Var (abs\$)	%var
USA	17.8	19.8	11%	19.6	10%	0.2	1%
Europe	30.4	34.3	13%	36.4	20%	(2.1)	-6%
APAC	4.2	4.9	16%	4.8	14%	0.1	2%
Core revenue	52.4	58.9	12%	60.8	16%	(1.9)	-3%
COGS	20.5	24.3	18%	23.7	15%	0.6	3%
Gross profit	31.9	34.6	9%	37.1	16%	(2.5)	-7%
Opex	28.0	29.6	6%	32.1	15%	(2.5)	-8%
Underlying EBITDA	3.9	4.9	27%	5.0	27%	(0.0)	0%
Interest, other	0.1	0.2	45%	0.0	-74%	0.2	nm
Tax	1.6	0.6	-60%	(0.1)	-106%	0.7	nm
Minorities	(2.1)	-	nm	(1.0)	-52%	1.0	nm
Reported NPAT	(8.6)	(16.4)	-91%	(8.6)	0%	(7.9)	-92%
NPAT (normalised)	0.2	(0.0)	nm	-	-100%	(0.0)	nm
Normalised EPS (cps)	33.0	(7.0)	nm	(13.7)	-141%	6.7	-49%
Operating cash flow	(9.5)	(6.5)	31%	(4.9)	-48%	(1.6)	-34%
% of net revenue	FY18a	FY19a		Wilsons			
Gross margin	60.8%	58.7%		61.0%			
MAS gross profit	73.0%	70.0%		70.0%			
EBITDA margin	7.4%	8.4%		8.2%			

Source: SOM, Wilsons estimates

Income statement

Core sales revenue increased by 12% to \$59m but was 3% below our forecast and guidance. Patient treatment bottlenecks in the more active European markets slowed growth in the middle quarters. Underlying (Core) EBITDA of \$4.95m was consistent with guidance and with our forecast, representing a 27% increase over FY18. Segment highlights included:

- **USA.** US core revenue was up 11% in constant currency. Ongoing recovery in the US following the RSS shutdown, with earnings uplift a function of intense business development following the closure of RSS and refocusing on the dental and medical channels.
- **Europe.** Core EBIT increased on a relatively mature product cycle and Holland and Sweden showed recovery following capacity and tender one-off issues. Developing markets grew well, above 20%. Recent progress with signing on a first direct insurance with one of the largest German insurers could contribute to ongoing growth in Europe.
- **Asia Pacific.** Core revenue increased by 16% to \$4.78m

Gross and operating margin improvement. Gross margin of 61% was a slight improvement compared to 60.8% over pcp. Pre-tax profit margin improved to 8.2%, up from 7.4%, attributable to meaningfully improved margin in the US and AsiaPac.

Cash flow. Operating cash flow was negative \$6.5m reflecting operating and other losses from RSS prior that business's closure. Cash flow in the core business was \$2.6m.

Balance sheet. SomnoMed reported \$8.0m net cash at the end of FY19 after taking on modest debt financing during the period.



Outlook

Guidance. Management provided the following guidance for FY20:

- Revenue \$67m to \$69m (+14% to +17% growth)
- EBITDA range of \$6.3m to \$6.7m (+26% to +34% growth)

Earnings changes.

- Short term revenue adjustments relate to reductions in European sales forecasts, accommodating a slowing in Dutch/Nordic growth rates. These are partially offset by increases in US sales reflecting the momentum that has built across multiple channels in that jurisdiction. Our FY22 forecast sales forecast is up 7% expecting sustained US double-digit growth.
- EBITDA changes reflect a more stably rate of overall margin expansion from 8.4% in FY19a to 10.3% by the end of FY22e. Partially attributable to new digital manufacturing platform that is now in place, with the first digitally made product to be launched soon.

Table 2: Changes to forecasts FY20-FY22e

		FY20e	FY21e	FY22e
Revenue - previous	\$m	69.7	78.6	79.6
Revenue - new	\$m	68.4	76.5	85.1
- Change	%	-2%	-3%	7%
EBITDA - previous	cps	5.7	7.7	7.9
EBITDA - new	cps	6.2	7.2	8.8
- Change	%	9%	-6%	11%
NPAT - previous	cps	3.1	4.2	4.5
NPAT - new	cps	3.4	4.1	5.2
- Change	%	11%	-2%	15%

Source: Wilsons estimates

Table 3: Divisional outlook FY17-22e

	FY17e	FY18e	FY19e	1HFY20	2HFY20	FY20e	FY21e	FY22e
SomnoMed revenue (\$m)	47.7	52.4	60.8	30.5	38.0	68.4	76.5	85.1
USA	19.7	17.8	18.3	8.5	10.3	18.8	19.6	21.2
EMEA	24.0	30.4	38.1	19.6	25.3	44.9	51.9	58.6
AsiaPac	3.9	4.2	4.4	2.4	2.3	4.7	5.0	5.4
Gross profit (\$m)	27.8	31.9	35.4	18.0	22.8	40.9	46.3	51.9
- MAS gross margin	68.0%	63.5%	69.5%	70.3%	71.0%	70.7%	71.9%	72.7%
- Core gross margin	58.4%	60.8%	58.2%	59.2%	60.1%	59.7%	60.5%	61.0%
SG&A expenses	21.3	23.6	25.6	13.8	15.2	29.0	33.1	36.8
Corporate and R&D	4.1	4.8	5.4	2.7	2.9	5.6	6.0	6.3
EBITDA (\$m)	2.4	3.9	5.0	1.5	4.7	6.2	7.2	8.8
- EBITDA margin	5.0%	7.4%	8.2%	5.0%	12.4%	9.1%	9.5%	10.3%

Source: Wilsons' estimates



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 with a revised target price of \$2.29 per share. SomnoMed is guiding approximately 30% EBITDA growth in FY20 prompting us to upgrade our FY20e forecast by 8%. A new premium product (AVANT) launches this year, refreshing price points at the premium end and strengthening the competitive position across the spectrum of lower price points. After years of patient work SomnoMed announced its first material success in Germany, signing a major health insurer. We look to Europe as the swing factor this year. Efforts to ease treatment bottlenecks in large markets (Netherlands, Nordics) are important. Newer, fast moving marketplaces (France, Belgium and now Germany) could generate exciting European growth and possibly surpass guidance. Europe remains SomnoMed's primary profit centre.

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)
- Hervé Fiévet (CFO)

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