

## An eye on RSS channel conflict but the core offering to prevail in US direct market

We maintain a BUY rating and 12-month price target of \$4.50 per share. SomnoMed has reported its 1H17 earnings detail and reiterated its FY17 guidance. The RSS sleep centre roll-out in America is reporting volume ramp profiles similar to those seen in the "S3" centres in Texas, on which the RSS model is based. Push-back from "direct" customers remains a near-term potential headwind which we are monitoring carefully. We don't expect this to have a materially adverse impact on SomnoMed's US device business, believing that the core offering (price, quality, reimbursement access and turnaround times) will underpin US business performance through this marketplace transition. RSS is up and running, and is going to be a permanent fixture in the US sleep market from this point.

### Key points

**1H17 result.** Core medical device unit sales were 33,309 over the 1H (up 14.9% on pcp) which was broadly in line with our forecasts but ~5% below the run-rate implied by full-year guidance (70,000+). Revenue of \$23.8m grew 11.5% on pcp noting ~4% pcp currency headwinds on both EUR and USD sales. SomnoMed's global medical device business reported underlying EBITDA of \$1.4m (Wilsons: \$1.3m) driven by Europe, primarily, which was up again by 18% in volume terms (segment profit +20%). SomnoMed's full-year EBITDA guidance for its global medical device business is \$4.0m (Wilsons: \$3.6m). The new Renew Sleep Solutions (RSS) business recorded a 1H EBITDA loss of \$1.0m which compared well with our forecast.

**Forecasts, outlook.** No changes to our forecasts which remain modestly below company guidance. Guidance is unchanged, the most important element being the EBITDA outlook (\$4m for SomnoMed and -\$4m for RSS). The key variation between guidance and our forecasts is in the US business, where we have allowed for some continued softness in direct demand as the customer base digests and responds to the potential competitive impact of RSS on their practices. This reaction will occur and resolve as RSS rolls out over the next few years – but we think SomnoMed's offering (price, quality, access, turnaround times) will underpin reliable demand growth over forecast period.

**\$4.50 price target.** Our DCF valuation is based on consolidated model of SomnoMed's global device biz + dominant equity interest in the RSS business.

### Risks and catalysts

**Catalysts:** a) quarterly volumes; b) US managed care progress; c) margin improvement; d) RSS centre roll-out. **Risks:** a) execution on US strategy; b) competition; c) average sales price erosion; d) RSS 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)	0.6	0.2	-1.6	4.6	11.5
NPAT norm (\$m)	0.6	0.2	-1.4	4.6	11.5
Consensus NPAT (\$m)			-1.1	5.0	12.2
EPS norm (cps)	1.2	0.3	-2.5	8.0	20.1
EPS growth (%)	-55.3	-73.3	-877.5	421.1	151.1
P/E norm (x)	255.8	958.7	-123.3	38.4	15.3
EV/EBITDA (x)	187.2	110.4	-1730.6	20.4	8.4
FCF yield (%)	-0.8	0.1	-2.1	-0.3	3.6
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

### Wilsons Research

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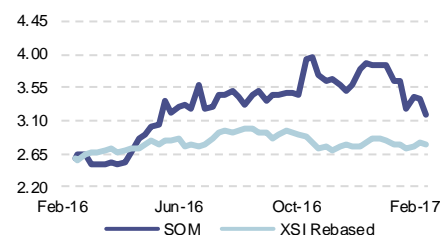
Recommendation	BUY
12-mth target price (AUD)	\$4.50
Share price @ 23-Feb-17 (AUD)	\$3.07
Forecast 12-mth capital return	46.6%
Forecast 12-mth dividend yield	0.0%
<b>12-mth total shareholder return</b>	<b>46.6%</b>

Market cap	\$176m
Enterprise value	\$163m
Shares on issue	57m
Sold short	0.0%
ASX 300 weight	n/a
Median turnover/day	\$0.0m

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



	1-mth	6-mth	12-mth
Abs return (%)	-15.4	-5.3	23.7
Rel return (%)	-16.0	2.2	16.2

Key changes				
		27-Jan	After	Var %
NPAT:	FY17F	-1.3	-1.4	N/A
norm	FY18F	4.6	4.6	0.0%
(\$m)	FY19F	11.5	11.5	0.0%
EPS:	FY17F	-2.4	-2.5	N/A
norm	FY18F	8.0	8.0	-0.1%
(cps)	FY19F	20.0	20.1	0.5%
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
<b>DCF methodology</b>	
WACC (%)	12.0
Term. grwth assumption (%)	3.5
PV of forecast FCFs (\$m)	61.5
PV of terminal value (\$m)	179.3
Enterprise value (\$m)	240.8
Net debt (cash) (\$m)	-13.6
Equity value (\$m)	254.4

DCF valuation (A\$/sh)	4.43
<b>Price target (A\$/sh)</b>	<b>4.50</b>

Interims (\$m)				
Half-year (AUD)	Dec 15	Jun 16	Dec 16	Jun 17
	1HA	2HA	1HE	2HE
Sales revenue	21.3	22.8	23.8	27.4
EBITDA	0.9	0.6	0.4	-0.5
EBIT	0.4	0.0	-0.2	-1.3
<b>Net profit</b>	<b>0.3</b>	<b>-0.2</b>	<b>-0.3</b>	<b>-1.0</b>
<b>Norm EPS</b>	<b>0.8</b>	<b>-0.4</b>	<b>-0.7</b>	<b>-1.8</b>
EBIT/sales (%)	2.1	0.0	-0.7	-4.7
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	-13.6	-13.0
Net debt/equity (%)	<0	<0	<0
<b>Net debt/EV (%)</b>	<b>&lt;0</b>	<b>&lt;0</b>	<b>&lt;0</b>
Current ratio (x)	5.3	4.7	4.4
Interest cover (x)	<0	28.1	◆
<b>Adj cash int cover (x)</b>	<b>&lt;0</b>	<b>60.9</b>	
Debt/cash flow (x)	0.0	0.0	0.0
Net debt (cash)/share (\$)	<0	<0	<0
NTA/share (\$)	0.5	0.4	0.5
Book value/share (\$)	0.6	0.6	0.6
Payout ratio (%)	0	0	0
Adj payout ratio (%)	0	0	0

EPS reconciliation (\$m)				
	FY16A		FY17F	
	Rep	Norm	Rep	Norm
Sales revenue	44	44	51	51
EBIT	0.6	0.5	-1.7	-1.5
<b>Net profit</b>	<b>0.2</b>	<b>0.2</b>	<b>-1.6</b>	<b>-1.4</b>
Notional earn	0.0	0.0	0.0	0.0
Pref/conv div	0.0	0.0	0.0	0.0
<b>Profit for EPS</b>	<b>0.2</b>	<b>0.2</b>	<b>-1.6</b>	<b>-1.4</b>
Diluted shrs (m)	48	52	55	55
<b>Diluted EPS (c)</b>	<b>0.3</b>	<b>0.3</b>	<b>-2.9</b>	<b>-2.5</b>

Returns				
	FY16A	FY17F	FY18F	FY19F
ROE (%)	1	-4	14	28
ROIC (%)	2	-6	22	46
Incremental ROE	-4	-33	426	82
Incremental ROIC	6	-65	146	134

Key assumptions								
Year-end June (AUD)	FY13A	FY14A	FY15A	FY16A	FY17F	FY18F	FY19F	FY20F
Revenue growth (%)	21.3	40.1	33.0	28.0	16.1	46.9	45.2	47.2
EBIT growth (%)	-39.1	35.0	-45.7	90.2	-424.0	-525.4	170.2	81.8
NPAT growth (%)	-9.0	-9.2	-4.8	-72.4	-934.2	-433.7	151.1	78.2
<b>EPS growth (%)</b>	<b>-2.5</b>	<b>75.4</b>	<b>-55.3</b>	<b>-73.3</b>	<b>-877.5</b>	<b>-421.1</b>	<b>151.1</b>	<b>78.2</b>
EBIT/sales (%)	1.8	1.7	0.7	1.0	-2.9	8.3	15.4	19.1
Tax rate (%)	-93.3	3.4	44.8	85.0	-44.5	27.0	27.0	27.0
<b>ROA (%)</b>	<b>2.0</b>	<b>2.3</b>	<b>0.9</b>	<b>1.1</b>	<b>-3.5</b>	<b>12.1</b>	<b>24.0</b>	<b>35.3</b>
ROE (%)	6.3	5.1	2.8	0.5	-4.2	11.4	20.5	29.1

SomnoMed EBITDA (\$m)	0.8	1.1	0.9	1.5	3.6	7.5	11.2	14.6
RSS EBITDA (\$m)	0.0	0.0	0.0	0.0	-3.7	0.5	8.0	19.6

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	51.2	75.2	109.2	160.8
EBITDA	0.8	1.1	0.9	1.5	-0.1	8.0	19.3	34.2
Depn & amort	0.5	0.6	0.6	1.0	1.4	1.7	2.4	3.5
<b>EBIT</b>	<b>0.3</b>	<b>0.4</b>	<b>0.2</b>	<b>0.5</b>	<b>-1.5</b>	<b>6.2</b>	<b>16.9</b>	<b>30.7</b>
Net interest expense	-0.1	0.0	-0.1	0.0	-0.1	0.0	0.0	0.0
Tax	-0.4	0.0	0.2	0.4	0.6	1.7	4.6	8.3
Minorities/pref divs	0.1	-0.2	0.1	0.1	-0.7	0.0	0.8	1.8
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>0.7</b>	<b>0.6</b>	<b>0.1</b>	<b>0.0</b>	<b>-1.4</b>	<b>4.6</b>	<b>11.5</b>	<b>20.6</b>
Abns/exts/signif	-0.1	-0.2	0.5	0.2	-0.3	0.0	0.0	0.0
<b>Reported net profit</b>	<b>0.6</b>	<b>0.4</b>	<b>0.6</b>	<b>0.2</b>	<b>-1.6</b>	<b>4.6</b>	<b>11.5</b>	<b>20.6</b>

Cash flow (\$m)								
Year-end June (AUD)	FY13A	FY14A	FY15A	FY16A	FY17F	FY18F	FY19F	FY20F
EBITDA	0.8	1.1	0.9	1.5	-0.1	8.0	19.3	34.2
Interest & tax	0.0	-0.5	0.1	-0.2	-0.1	-1.7	-4.6	-8.3
Working cap/other	-0.3	-1.3	-1.2	0.9	-0.1	-3.3	-4.7	-7.9
<b>Operating cash flow</b>	<b>0.6</b>	<b>-0.8</b>	<b>-0.2</b>	<b>2.1</b>	<b>-0.3</b>	<b>3.0</b>	<b>10.0</b>	<b>18.1</b>
Maintenance capex	-0.2	0.3	-1.2	-1.9	-3.5	-3.6	-3.7	-3.9
<b>Free cash flow</b>	<b>0.4</b>	<b>-0.5</b>	<b>-1.4</b>	<b>0.2</b>	<b>-3.8</b>	<b>-0.5</b>	<b>6.3</b>	<b>14.1</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	-0.5	-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
<b>Cash flow pre-financing</b>	<b>-0.2</b>	<b>-1.2</b>	<b>-1.9</b>	<b>-1.5</b>	<b>-4.0</b>	<b>-0.5</b>	<b>6.3</b>	<b>14.1</b>
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	4.0	0.5	-6.3	-14.1

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	13.6	13.0	19.3	33.5
Current receivables	4.4	5.5	7.2	7.8	8.3	12.3	18.0	26.9
Current inventories	0.9	1.0	1.3	1.7	2.2	3.3	4.8	7.2
Net PPE	1.2	1.3	2.1	3.6	5.0	6.4	7.1	6.9
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	10.5	11.1	11.7	12.4
Other	0.2	0.0	0.0	0.0	0.0	0.0	0.0	0.0
<b>Total assets</b>	<b>16.1</b>	<b>19.1</b>	<b>27.8</b>	<b>40.4</b>	<b>39.6</b>	<b>46.1</b>	<b>61.0</b>	<b>86.8</b>
Current payables	3.5	3.3	3.9	6.1	6.8	8.6	10.9	14.0
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
<b>Total liabilities</b>	<b>4.5</b>	<b>6.6</b>	<b>6.2</b>	<b>7.7</b>	<b>8.7</b>	<b>10.6</b>	<b>13.2</b>	<b>16.6</b>
Minorities/convertibles	0.6	0.2	0.2	-0.4	-0.4	-0.4	-0.4	-0.4
<b>Shareholder equity</b>	<b>11.6</b>	<b>12.6</b>	<b>21.5</b>	<b>32.7</b>	<b>30.9</b>	<b>35.5</b>	<b>47.8</b>	<b>70.2</b>
<b>Total funds employed</b>	<b>11.6</b>	<b>12.6</b>	<b>21.5</b>	<b>32.7</b>	<b>30.9</b>	<b>35.5</b>	<b>47.8</b>	<b>70.2</b>

## SomnoMed Limited – 1H17 results

### Summary

We maintain a BUY rating and 12-month price target of \$4.50 per share. SomnoMed has reported its 1H17 earnings and reiterated its FY17 guidance. Investors will need to keep an eye on the RSS roll-out in America, which did provoke some modest push-back from “direct” customers in the 1H, who perceived a competitive threat. We don’t expect this phenomenon to have a materially adverse impact on SomnoMed’s US device business, believing that the core offering (price, quality, reimbursement access and turnaround times) will underpin US business performance through this marketplace transition. RSS is up and running, and is going to become a permanent fixture in the US sleep market from here.

**Table 1: SomnoMed’s 1H17 results vs pcg and Wilsons’ estimates**

(\$ in mn)	1H16a	1H17a	%chg	Forecast	%chg	Var (abs\$)	%var
USA	9.5	10.4	9%	10.9	15%	(0.6)	-5%
Europe	9.9	11.4	15%	10.9	11%	0.4	4%
APAC	2.0	2.1	6%	1.9	-2%	0.2	8%
<b>Net revenue</b>	<b>21.3</b>	<b>23.8</b>	<b>11%</b>	<b>23.8</b>	<b>12%</b>	<b>(0.0)</b>	<b>0%</b>
COGS	9.1	10.1	11%	9.8	8%	0.3	3%
<b>Gross profit</b>	<b>12.3</b>	<b>13.7</b>	<b>12%</b>	<b>14.0</b>	<b>14%</b>	<b>(0.3)</b>	<b>-2%</b>
SG&A	9.8	11.3	16%	11.5	18%	(0.2)	-1%
Corporate	1.6	2.0	23%	2.1	32%	(0.1)	-6%
<b>EBITDA</b>	<b>0.9</b>	<b>0.4</b>	<b>-56%</b>	<b>0.4</b>	<b>-54%</b>	<b>(0.0)</b>	<b>0%</b>
- SomnoMed	0.9	1.4	54%	1.3	43%	0.1	8%
- RSS	-	(1.0)	n/a	(0.9)	n/a	(0.1)	0%
Interest, other	0.0	(0.1)	nm	-	0%	(0.1)	0%
Tax	0.1	0.4	nm	0.2	nm	0.2	nm
Minorities	0.0	(0.2)	nm	(0.2)	nm	(0.0)	15%
Adjustments	(0.2)	(0.3)	nm	-	nm	(0.3)	0%
NPAT	0.2	(0.6)	nm	(0.3)	nm	(0.3)	96%
Adjusted NPAT	0.3	(0.3)	nm	(0.3)	nm	(0.0)	14%
Adjusted EPS (cps)	0.8	(0.7)	nm	(0.6)	nm	(0.1)	17%
Diluted shares	51.5	53.1	3%	54.0	5%		
<b>Operating cash flow</b>	<b>0.9</b>	<b>(0.9)</b>	<b>nm</b>	<b>(1.0)</b>	<b>nm</b>	<b>0.1</b>	<b>6%</b>
<b>% of net revenue</b>	<b>Dec-15a</b>	<b>Dec-16a</b>	<b>Wilson's</b>				
Gross profit	57.5%	57.6%	58.9%				
MAS gross profit	68.0%	69.1%	69.1%				
SG&A	45.8%	47.7%	48.3%				
Corporate, R&D	7.5%	8.3%	8.8%				
Operating income	4.3%	1.7%	1.8%				
Pre-tax profit	2.2%	-0.5%	-1.2%				
Net income	0.8%	-2.5%	-1.3%				
<b>FY17 Guidance</b>	<b>SomnoMed</b>	<b>Wilson's</b>	<b>RSS</b>	<b>Wilson's</b>			
Units	70,000+	68,889	1,000+	800			
Revenue	\$54m+	49.3	\$2m+	2.1			
EBITDA	\$4m	3.6	-\$4m	-3.7			

Source: SomnoMed, Wilsons’ estimates



## Results notes

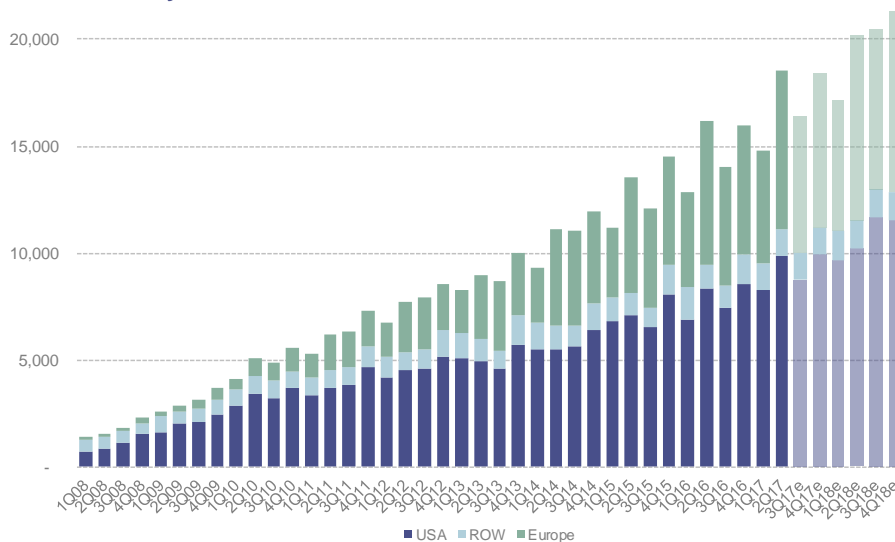
### INCOME STATEMENT

Core medical device unit sales were 33,309 in the 1H (up 14.9% on pcp) which was broadly in line with our forecasts but ~5% below the run-rate implied by full-year guidance (70,000+). Revenue of \$23.8m grew 11.5% on pcp noting ~4% pcp currency headwinds on both EUR and USD sales. SomnoMed's global medical device business reported underlying EBITDA of \$1.4m (Wilsons: \$1.3m) driven by Europe, primarily, which was up again by 18% in volume terms. SomnoMed's full-year EBITDA guidance for its global medical device business remains \$4.0m (Wilsons: \$3.6m). The new RSS business recorded a 1H EBITDA loss of \$1.0m which compared well with our forecast:

- USA.** Unit sales of 18,128 devices was up 15.5% on pcp with a softening in direct sales. Segments of the US direct customer base are cautious about SomnoMed setting up in competition to them with RSS clinics. This needs to be carefully monitored over the next few periods. SomnoMed describes positive experiences from customers adjacent to the S3 clinics in Texas, who report volume increases following local advertising campaigns. SomnoMed's product quality, pricing and turnaround times will remain an attractive feature for the majority of sleep dentist/physician customers. Revenue in the US increased 9% to \$10.4m.
- Europe.** Unit volume growth 18.1% across 16 active countries. Revenue in Europe was \$11.4m (up 15%) and earnings were up 20% to \$1.3m. The outlook in Europe is supported by recent reimbursement changes in France and Belgium, both of which have recently put market access for oral appliances on par with CPAP therapy.
- Asia Pacific.** Revenue increased by 6% to \$2.1m with flattish earnings. Australian sales were better in Q2 with dental customers returning to SomnoDent after trying out a new entrant to the domestic market in Q1 – the O<sub>2</sub>Vent device by Oventus (ASX:OVN, not covered by Wilsons).
- RSS.** As reported at the Q2 update, SomnoMed has opened its RSS campaign, with treatment centres now accepting sleep apnoea patients in Oklahoma City and Tulsa. Start-up losses of \$1.0m were a little lower than we had forecast.

**NPAT.** The reported net loss of \$600K was lower than our forecast of \$300K principally on account of higher tax. SomnoMed pre-paid tax relating to the US business but this will normalise full year.

Figure 1: Quarterly device unit sales FY08-18e



Source: SomnoMed, Wilsons

## Earnings outlook

### Revised forecasts

**Table 2: Revenue and EBITDA forecasts by division and jurisdiction**

SomnoMed												
	FY15	1HFY16	2HFY16	FY16	1HFY17e	2HFY17e	FY17e	1HFY18e	2HFY18e	FY18e	FY19e	FY20e
<b>Medical device unit sales</b>	<b>51,355</b>	28,997	29,986	<b>58,983</b>	33,309	35,580	<b>68,889</b>	41,222	44,742	<b>85,964</b>	<b>107,656</b>	<b>136,089</b>
SomnoMed	51,355	28,997	29,986	58,983	33,309	34,780	68,089	38,722	40,442	79,164	91,656	104,587
USA - RSS	-	-	-	-	-	800	800	2,500	4,300	6,800	16,000	31,502
<b>SomnoMed revenue (\$m)</b>	<b>34.4</b>	21.3	22.8	<b>44.1</b>	23.7	25.5	<b>49.2</b>	28.4	30.7	<b>59.1</b>	<b>71.3</b>	<b>86.2</b>
USA	14.5	9.5	10.1	19.6	10.3	11.7	22.0	13.6	14.7	28.2	35.6	45.5
EMEA	16.5	9.9	10.7	20.6	11.3	11.9	23.2	12.8	13.9	26.8	31.4	36.0
AsiaPac	3.4	2.0	1.9	3.9	2.1	1.9	4.0	2.1	2.1	4.1	4.4	4.7
Medical device revenue	28.9	18.1	19.2	37.2	20.3	21.6	41.9	24.3	26.1	50.4	61.1	74.3
Managed care revenue	5.5	3.3	3.6	6.8	3.5	3.9	7.4	4.1	4.6	8.7	10.2	11.9
<b>Gross profit (\$m)</b>	<b>19.5</b>	12.3	13.1	<b>25.3</b>	13.7	15.0	<b>28.7</b>	16.8	18.0	<b>34.8</b>	<b>41.9</b>	<b>50.4</b>
- MAS gross margin	67.4%	68.0%	68.1%	68.0%	67.5%	69.7%	68.6%	69.2%	68.9%	69.1%	68.5%	67.8%
- Core gross margin	56.6%	57.5%	57.5%	57.5%	57.8%	59.0%	58.4%	59.3%	58.6%	58.9%	58.7%	58.4%
SG&A expenses	16.0	10.1	10.8	20.9	11.3	10.7	22.0	11.3	11.7	22.9	25.9	30.8
Corporate and R&D	2.7	1.6	1.9	3.5	2.0	2.1	4.1	2.1	2.2	4.3	4.6	4.9
Other adjustments	(0.1)	(0.3)	(0.3)	(0.6)	-	-	-	-	-	-	-	-
<b>EBITDA (\$m)</b>	<b>0.9</b>	0.9	0.6	<b>1.5</b>	1.4	2.2	<b>3.6</b>	3.5	4.1	<b>7.6</b>	<b>11.3</b>	<b>14.7</b>
- EBITDA margin	2.5%	4.3%	2.5%	3.3%	5.9%	8.7%	7.4%	12.2%	13.3%	12.8%	15.9%	17.0%

RSS												
	FY15	1HFY16	2HFY16	FY16	1HFY17e	2HFY17e	FY17e	1HFY18e	2HFY18e	FY18e	FY19e	FY20e
Treatments	-	-	-	-	-	800	800	2,500	4,300	6,800	16,000	31,502
<b>RSS revenue (\$m)</b>	<b>-</b>	-	-	-	-	2.1	<b>2.1</b>	6.6	11.3	<b>17.9</b>	<b>42.1</b>	<b>82.9</b>
<b>RSS gross profit (\$m)</b>	<b>-</b>	-	-	-	-	1.9	<b>1.9</b>	5.9	10.2	<b>16.1</b>	<b>37.9</b>	<b>74.6</b>
SG&A expenses	-	-	-	-	1.0	1.1	2.1	3.5	6.0	9.5	22.3	43.9
Corporate and R&D	-	-	-	-	-	3.5	3.5	3.0	3.1	6.1	7.5	11.0
<b>EBITDA (\$m)</b>	<b>-</b>	-	-	-	(1.0)	(2.7)	<b>(3.7)</b>	(0.6)	1.1	<b>0.5</b>	<b>8.0</b>	<b>19.6</b>
- EBITDA margin	-	-	-	-	-	-	-	9.5%	2.8%	19.1%	23.7%	-

Source: SomnoMed, Wilsons' estimates

**Table 3: Income statement forecasts FY16-20**

	FY15	1HFY16	2HFY16	FY16	1HFY17e	2HFY17e	FY17e	1HFY18e	2HFY18e	FY18e	FY19e	FY20e
<b>Medical device unit sales</b>	<b>51,355</b>	28,997	29,986	<b>58,983</b>	33,309	35,580	<b>68,889</b>	41,222	44,742	<b>85,964</b>	<b>107,656</b>	<b>136,089</b>
SomnoMed	51,355	28,997	29,986	58,983	33,309	34,780	68,089	38,722	40,442	79,164	91,656	104,587
RSS	-	-	-	-	-	800	800	2,500	4,300	6,800	16,000	31,502
<b>Group revenue (\$m)</b>	<b>34.4</b>	21.3	22.8	<b>44.1</b>	23.7	27.6	<b>51.3</b>	35.0	42.0	<b>77.0</b>	<b>113.4</b>	<b>169.1</b>
SomnoMed	34.4	21.3	22.8	44.1	23.7	25.5	49.2	28.4	30.7	59.1	71.3	86.2
RSS	-	-	-	-	-	2.1	2.1	6.6	11.3	17.9	42.1	82.9
<b>Gross profit (\$m)</b>	<b>19.5</b>	12.3	13.1	<b>25.3</b>	13.7	16.9	<b>30.6</b>	22.8	28.1	<b>50.9</b>	<b>79.8</b>	<b>124.9</b>
SomnoMed	19.5	12.3	13.1	25.3	13.7	15.0	28.7	16.8	18.0	34.8	41.9	50.4
RSS	-	-	-	-	-	1.9	1.9	5.9	10.2	16.1	37.9	74.6
SG&A expense	16.0	10.1	10.8	20.9	12.3	11.8	24.2	14.7	17.6	32.4	48.3	74.7
Corporate, R&D and other expense	2.6	1.3	1.7	2.9	2.0	5.6	7.6	5.1	5.3	10.4	12.1	15.9
<b>EBITDA (\$m)</b>	<b>0.9</b>	0.9	0.6	<b>1.5</b>	0.4	(0.5)	<b>(0.1)</b>	2.9	5.2	<b>8.1</b>	<b>19.4</b>	<b>34.3</b>
SomnoMed	0.9	0.9	0.6	1.5	1.4	2.2	3.6	3.5	4.1	7.6	11.3	14.7
RSS	-	-	-	-	(1.0)	(2.7)	(3.7)	(0.6)	1.1	0.5	8.0	19.6
Depreciation and amortisation	0.6	0.5	0.6	1.0	0.6	0.8	1.4	0.8	0.9	1.7	2.4	3.5
<b>EBIT (\$m)</b>	<b>0.2</b>	0.4	0.0	<b>0.5</b>	(0.2)	(1.3)	<b>(1.5)</b>	2.1	4.2	<b>6.3</b>	<b>17.0</b>	<b>30.8</b>
Net interest	0.1	0.0	0.0	0.0	(0.1)	-	0.1	-	-	-	-	-
Tax	0.2	0.1	0.3	0.4	0.4	0.2	0.6	0.6	1.1	1.7	4.6	8.3
Minorities	0.1	0.0	0.1	0.1	(0.2)	(0.5)	(0.7)	(0.1)	0.1	(0.0)	0.8	1.8
<b>NPAT (\$m)</b>	<b>0.6</b>	0.2	(0.0)	<b>0.2</b>	(0.6)	(1.0)	<b>(1.6)</b>	1.7	3.0	<b>4.7</b>	<b>11.6</b>	<b>20.6</b>
<b>Core EPS (cps)</b>	<b>1.2</b>	0.8	(0.4)	<b>0.3</b>	(0.7)	(1.8)	<b>(2.4)</b>	2.9	5.3	<b>8.1</b>	<b>20.2</b>	<b>35.9</b>

Source: SomnoMed, Wilsons' estimates



## Guidance

Management reiterated the guidance provided at the AGM for a break-even this “transitional” year with start-up costs in RSS (\$4m loss) balancing out the \$4m underlying EBITDA from the core medical device business (+170% from \$1.4m in FY16).

## Wilson's' view

Our revised forecasts still sit slightly below guidance for global medical device. We have allowed for some further easing in direct US demand following on from the observations of 1H – looking for 68,900 device sales globally versus guidance of more than 70,000. We assume the following in our jurisdictional forecasts:

- **USA.** Similar aggregate revenue growth in 2H (15.7%). We are forecasting continued improvement in US profitability. Successful starts from the RSS centres are important – we are forecasting 800 treatments (versus guidance of 1,000) with a full-year loss of ~\$3.7m.
- **Europe to remain the profit driver.** As always, Europe remains the key to supporting the earnings guidance as SomnoMed's most profitable jurisdiction. We think the volume outlook is sustainable with untapped opportunities remaining in Netherlands and the Nordics + France developing over the next 12 months. Cost control in the 1H was excellent.



## Valuation, recommendation

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**Price target maintained at \$4.50 per share; BUY maintained.** Our DCF valuation of \$4.43 results from our consolidated model of SomnoMed's global device and dominant equity interest in the RSS business. The inputs to the model are described below.

**Table 4: DCF valuation summary**

<b>DCF Assumptions</b>			
Effective WACC	12.0%	Explicit forecast period (years)	10
Risk-free rate	4.5%	Terminal growth rate	3.5%
Risk premium	6.0%	Tax rate	25%
Implied equity beta	1.25		
<b>Valuation</b>			
PV of future cash flows (\$m)	61.5		
PV of terminal value (\$m)	179.3		
Enterprise value (\$m)	240.8		
Less net debt (cash) (\$m)	(13.6)	Basic diluted shares (m)	57.4
<b>Equity value (\$m)</b>	<b>254.4</b>	<b>DCF value per share (\$/share)</b>	<b>4.43</b>
		<b>Risked price target (\$/share)</b>	<b>4.50</b>

Source: *Wilson*s



## 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.\$16.7m cash as at end-1HFY17
- No significant debt

### Board

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

### Management

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

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### Recommendation structure and other definitions

Definitions at [wilsonsadvisory.com.au/Disclosures](http://wilsonsadvisory.com.au/Disclosures).

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