



BUY HOLD SELL

Company update

Exciting FY17 ahead for core earnings, SCA clinic roll-out and new management

SomnoMed delivered another quarter of strong organic sales growth with Q4 group revenue up 28.6%, and up 27.7% full year. The success of the company's direct selling model in the USA and Europe has provided a platform for several new growth initiatives and the confidence to appoint a new global CEO. While FY17 will be another investment year in America (SCA clinic roll-out), referral patterns and reimbursement is supporting growth and leverage in "core" earnings from direct medical device sales. We continue to believe SomnoMed shares offer significant upside. Our price target of \$4.50 per share represents a 40% discount to our DCF valuation, which assesses upside to \$7.50 per share over a multi-year investment horizon. We maintain a BUY rating on SomnoMed.

Key points

Q4 trading update consistent with earnings pre-release. SomnoMed reported 14,965 device sales in the Q4 (+21.8%) and 58,983 units full year (+14.9%). Full-year revenue of ~\$44m is in line with revised guidance and +27.7% on the prior year. Direct sales via US and European medical channels is providing a very strong foundation from which to build into new territories. SomnoMed has already guided to underlying FY16 EBITDA of \$2.0m to \$2.4m (WHTMe: \$2.1m) exclusive of ~\$0.7m start-up costs relating to Sleep Centres America (SCA). In FY17 we are forecasting another 20% growth in direct device sales (~70K) and an incremental 850 units from 5 planned SCA clinics.

SCA brings a new dimension in FY17. In FY17, SomnoMed augments its US direct medical device sales business with a new, direct to patient model. The strategy targets lapsed sleep apnoea patients and thus diversifies away from the "medical channel" which has achieved stable growth for several years now. The SCA initiative should accelerate core US growth rates, and hasten market penetration and margin development. We believe these strategic moves position SomnoMed for longer-term sustained and balanced growth. We continue to see opportunities for leverage and for rapid EPS growth.

Valuation. Maintaining our price target at \$4.50 which represents a 40% discount to our underlying DCF valuation of \$7.50 per share. The discount is warranted at this stage, given that the SCA portion of the business is at start-up phase, with new management only recently having been appointed.

Risks and catalysts

Catalysts: a) quarterly volumes; b) US managed care progress; c) margin improvement; d) SCA centre roll-out. **Risks:** a) execution on US strategy; b) competition; c) average sales price erosion; d) SCA roll-out difficulties; e) working capital and liquidity pressure; f) adverse pricing and/or reimbursement outcomes.

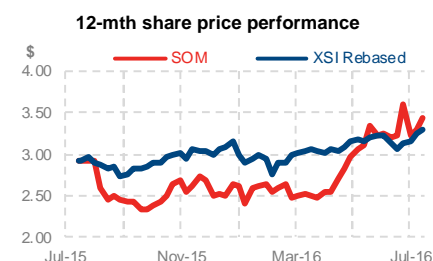
Year-end June (AUD)	FY14A	FY15A	FY16F	FY17F	FY18F
NPAT rep (\$m)	0.2	0.5	0.4	1.1	5.5
NPAT norm (\$m)	0.2	0.5	0.4	1.1	5.5
Consensus NPAT (\$m)			2.1	4.4	6.7
EPS norm (cps)	0.9	1.2	1.0	2.3	10.8
EPS growth (%)	-41.5	30.5	-19.0	135.7	373.4
P/E norm (x)	376.9	288.8	356.6	151.3	32.0
EV/EBITDA (x)	238.8	167.5	137.6	109.9	22.3
FCF yield (%)	-0.2	-0.7	0.1	-1.2	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, WHTM estimates, S&P Capital IQ

12-mth target price (AUD)	\$4.50
Share price @ 22-Jul-16 (AUD)	\$3.44
Forecast 12-mth capital return	30.8%
Forecast 12-mth dividend yield	0.0%
12-mth total shareholder return	30.8%

Market cap	\$195m
Enterprise value	\$198m
Shares on issue	57m
Sold short	0.0%
ASX 300 weight	n/a
Median turnover/day	\$0.1m

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	1-mth	6-mth	12-mth
Abs return (%)	6.8	32.3	17.5
Rel return (%)	-1.3	20.3	4.5

KEY CHANGES	03-Jun	After	Var %
NPAT: FY16F	0.4	0.4	7.2%
norm FY17F	1.1	1.1	2.3%
(\$m) FY18F	5.5	5.5	-0.3%
EPS: FY16F	0.9	1.0	7.2%
norm FY17F	2.2	2.3	2.3%
(cps) FY18F	10.8	10.8	-0.3%
DPS: FY16F	0.0	0.0	0.0%
(cps) FY17F	0.0	0.0	0.0%
FY18F	0.0	0.0	0.0%
Price target:	4.50	4.50	0.0%
Rating:	BUY	BUY	



PRICE TARGET

	Valuation	Price target
WACC (%)	12.1	
Terminal growth (%)	3.4	
NPV forecast FCF (A\$m)	110.4	
NPV perpetuity (A\$m)	299.0	
Net debt/(cash) (A\$m)	17.4	
DCF valuation (A\$m)	426.8	

DCF valuation (A\$/sh)	7.47
Price target (A\$/sh)	4.50

INTERIMS (\$m)

Half-year (AUD)	Dec 14	Jun 15	Dec 15	Jun 16
	1HA	2HA	1HA	2HE
Sales revenue	14.8	19.6	21.3	22.6
EBITDA	0.3	0.9	0.7	0.7
EBIT	0.0	0.5	0.2	0.4
Net profit	0.0	0.6	0.2	0.3
Norm EPS	-0.1	1.3	0.3	0.6
EBIT/sales (%)	0.0	2.8	1.1	1.6
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)	FY15A	FY16F	FY17F
Net debt	-8.3	-17.4	-14.7
Net debt/equity (%)	<0	<0	<0
Net debt/EV (%)	<0	<0	<0
Current ratio (x)	5.1	6.0	5.3
Interest cover (x)	<0	<0	◆
Adj cash int cover (x)	9.5	<0	
Debt/cash flow (x)	0.0	0.0	0.0
Net debt (cash)/share (\$)	<0	<0	<0
NTA/share (\$)	0.4	0.6	0.5
Book value/share (\$)	0.5	0.7	0.7
Payout ratio (%)	0	0	0
Adj payout ratio (%)	0	0	0

EPS RECONCILIATION (\$m)

	FY15A		FY16F	
	Rep	Norm	Rep	Norm
Sales revenue	34	34	44	44
EBIT	0.6	0.6	0.6	0.6
Net profit	0.5	0.5	0.4	0.4
Notional earn	0.0	0.0	0.0	0.0
Pref/conv div	0.0	0.0	0.0	0.0
Profit for EPS	0.5	0.5	0.4	0.4
Diluted shrs (m)	44	44	45	45
Diluted EPS (c)	1.2	1.2	1.0	1.0

RETURNS

	FY15A	FY16F	FY17F	FY18F
ROE (%)	3	2	3	15
ROIC (%)	3	3	4	27
Incremental ROE	6	-1	12	140
Incremental ROIC	8	1	8	165

KEY ASSUMPTIONS

Year-end June (AUD)	FY13A	FY14A	FY15A	FY16F	FY17F	FY18F	FY19F	FY20F
Revenue growth (%)	21.3	40.1	33.0	27.7	21.6	42.3	48.9	42.3
EBIT growth (%)	-52.1	-14.9	152.7	8.0	51.3	743.6	138.8	125.9
NPAT growth (%)	-7.2	-69.5	148.3	-19.3	160.8	386.8	121.0	116.5
EPS growth (%)	-0.6	-41.1	30.5	-19.6	135.7	373.4	119.7	116.1
EBIT/sales (%)	1.4	0.8	1.6	1.4	1.7	10.0	16.0	25.4
Tax rate (%)	-123.7	-6.7	23.5	31.5	26.3	27.0	27.0	27.0
ROA (%)	1.6	1.1	2.0	1.5	2.0	14.2	28.2	57.1
ROE (%)	6.4	1.7	2.5	1.3	3.2	12.9	23.3	44.4

PROFIT AND LOSS (\$m)

Year-end June (AUD)	FY13A	FY14A	FY15A	FY16F	FY17F	FY18F	FY19F	FY20F
Sales revenue	18.5	25.9	34.4	44.0	53.5	76.1	113.3	161.2
EBITDA	0.8	0.8	1.2	1.4	1.8	8.9	19.6	42.6
Deprn & amort	0.5	0.6	0.6	0.8	0.9	1.3	1.5	1.7
EBIT	0.3	0.2	0.6	0.6	0.9	7.6	18.1	40.9
Net interest expense	-0.1	0.0	-0.1	0.0	0.0	0.0	0.0	0.0
Tax	-0.4	0.0	0.2	0.2	0.2	2.0	4.9	11.1
Minorities/pref divs	0.0	0.0	0.0	0.0	-0.5	0.1	1.1	3.7
Equity accounted NPAT	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Net profit (pre-sig items)	0.7	0.2	0.5	0.4	1.1	5.5	12.1	26.2
Abns/exts/signif	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Reported net profit	0.7	0.2	0.5	0.4	1.1	5.5	12.1	26.2

CASH FLOW (\$m)

Year-end June (AUD)	FY13A	FY14A	FY15A	FY16F	FY17F	FY18F	FY19F	FY20F
EBITDA	0.8	0.8	1.2	1.4	1.8	8.9	19.6	42.6
Interest & tax	0.0	-0.5	0.1	-0.2	-0.2	-2.0	-4.9	-11.1
Working cap/other	-0.2	-1.1	-1.5	0.4	0.0	0.5	-3.0	-2.0
Operating cash flow	0.6	-0.8	-0.2	1.5	1.6	7.4	11.7	29.6
Maintenance capex	-0.2	0.3	-1.2	-1.4	-4.0	-4.1	-4.3	-4.5
Free cash flow	0.4	-0.5	-1.4	0.2	-2.4	3.2	7.4	25.1
Dividends paid	0.0	0.0	0.0	0.0	0.0	0.0	-4.3	-18.9
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	-0.2	0.0	0.0	0.0	0.0
Cash flow pre-financing	-0.2	-1.2	-1.9	-1.3	-2.7	3.2	3.2	6.1
Funded by equity	0.5	0.0	7.3	10.2	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	-0.3	1.2	-5.3	-8.9	2.7	-3.2	-3.2	-6.1

BALANCE SHEET SUMMARY (\$m)

Year-end June (AUD)	FY13A	FY14A	FY15A	FY16F	FY17F	FY18F	FY19F	FY20F
Cash	4.2	2.9	8.3	17.4	14.7	17.9	21.1	27.3
Current receivables	4.4	5.5	7.2	7.2	8.0	9.3	13.7	15.6
Current inventories	0.9	1.0	1.3	2.0	2.4	2.7	3.1	3.5
Net PPE	1.2	1.3	2.1	3.1	5.6	7.8	10.0	12.1
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	10.1	10.9	11.6	12.3	13.1
Other	0.2	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Total assets	16.1	19.1	27.8	39.8	41.6	49.4	60.2	71.7
Current payables	3.5	3.3	3.9	5.0	6.0	8.0	9.6	9.8
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	2.3	2.5	2.7	3.0	3.3
Total liabilities	4.5	6.6	6.2	7.3	8.5	10.7	12.6	13.1
Minorities/convertibles	0.6	0.2	0.2	-0.4	-0.4	-0.4	-0.4	-0.4
Shareholder equity	11.6	12.6	21.5	32.5	33.1	38.7	47.6	58.6
Total funds employed	11.6	12.6	21.5	32.5	33.1	38.7	47.6	58.6



SomnoMed Limited (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.\$17.5m cash as at end-FY16
- No debt

BOARD

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

MANAGEMENT

- Dr Peter Neustadt (Executive Chairman)
- Derek Smith (Global CEO-elect)
- 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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