

RSS taking patients in Oklahoma; good Q2

We maintain a BUY rating and 12-month price target of \$4.50 per share. SomnoMed has opened its first two RSS treatment centres in Q2. RSS is a key driver of our investment view because it can accelerate US market penetration and support rapid margin development. SomnoMed's core business achieved our 1H earnings targets, with organic GM expansion outweighing some minor disruption to "direct" US sales and RSS start-up costs. Our view is that RSS' direct to patient marketing efforts will increase demand for all oral appliance providers, including SomnoMed's direct customer base.

Key points

First RSS centre openings in Oklahoma. SomnoMed has opened its Renew Sleep Solutions (RSS) campaign, with treatment centres now accepting sleep apnoea patients in Oklahoma City and Tulsa. At least three further RSS clinics are planned to open before July. The 1H start-up EBITDA losses in RSS were lower than expected at \$1.0m v our estimate of \$1.2m.

Mild "push-back" from US direct channel is a transitory impact, offset by GM gains. US "direct" demand growth was slightly down, probably reflecting caution among SomnoMed's customer base over what RSS is doing. Some customers will see RSS as directly competitive and respond accordingly. Ultimately, normal prescribing patterns should resume if customers see RSS' marketing efforts lifting local demand for all providers. That has been the anecdotal experience for some operators adjacent to the S3 clinics in Texas (on which RSS' operating model is based). 18,128 unit sales in USA over 1H was in line with forecasts. Improvements to manufacturing (digital) and supply chain (scale) lifted device-level GM by 80 bps to 69.3% (+\$2m increase in GP v pcp).

Core device earnings in line. SomnoMed's global medical device business reported EBITDA of \$1.4m (We:\$1.3m) driven by Europe, primarily, which was up again by 18% in volume terms. Australia rebounded, as well. SomnoMed's EBITDA guidance for its global medical device business is \$4.0m (W: \$3.6m).

Forecasts. EPS changes of approximately 2% reflect some additional caution in our US direct sales forecasts, allowing for transitory RSS-related disruption to prescribing habits. This will occur and resolve as RSS rolls out nationally. Our detailed divisional forecasts for FY17-18e are presented on p.3. Full-year volume forecast (66,771 ex-RSS) is ~4% below guidance of 70,000+.

Valuation. Our DCF valuation is \$5.41 per share, with an explicit risk-adjustment for the RSS business. We have maintained our price target at \$4.50 which is set at a discount to our DCF.

Risks and catalysts

See p.4 for important catalysts and risks.

Earnings forecasts					
Year-end June (AUD)	FY15A	FY16A	FY17F	FY18F	FY19F
NPAT rep (\$m)	0.5	0.1	-1.0	5.3	11.8
NPAT norm (\$m)	0.5	0.1	-1.0	5.3	11.8
Consensus NPAT (\$m)			-0.7	5.5	12.4
EPS norm (cps)	1.2	0.2	-1.9	10.4	23.1
EPS growth (%)	30.5	-87.4	-1389.0	638.2	121.3
P/E norm (x)	314.9	2492.1	-193.3	35.9	16.2
EV/EBITDA (x)	184.8	147.8	-2008.2	25.2	11.3
FCF yield (%)	-0.7	0.1	-2.4	1.3	2.2
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

Issued by Wilsons Advisory and Stockbroking Limited ABN 68 010 529 665 - Australian Financial Services Licence No 238375, a participant of ASX Group and should be read in conjunction with the disclosures and disclaimer in this report. Important disclosures regarding companies that are subject of this report and an explanation of recommendations can be found at the end of this document.

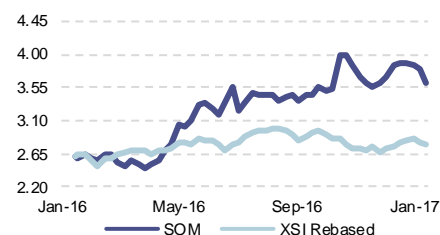
Recommendation	BUY
12-mth target price (AUD)	\$4.50
Share price @ 23-Jan-17 (AUD)	\$3.75
Forecast 12-mth capital return	20.0%
Forecast 12-mth dividend yield	0.0%
12-mth total shareholder return	20.0%

Market cap	\$216m
Enterprise value	\$218m
Shares on issue	57m
Sold short	0.0%
ASX 300 weight	n/a
Median turnover/day	\$0.1m

Shane Storey

shane.storey@wilsonsadvisory.com.au
Tel. +61 7 3212 1351

12-mth price performance (\$)



	1-mth	6-mth	12-mth
Abs return (%)	-7.2	4.9	38.9
Rel return (%)	-6.2	9.9	32.4

Key changes				
		19-Oct	After	Var %
NPAT:	FY17F	-0.7	-1.0	N/A
norm	FY18F	5.4	5.3	-2.0%
(\$m)	FY19F	12.1	11.8	-2.3%
EPS:	FY17F	-1.4	-1.9	N/A
norm	FY18F	10.7	10.4	-2.0%
(cps)	FY19F	23.6	23.1	-2.3%
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
WACC (%)	12.1	
Terminal growth (%)	3.4	
NPV forecast FCF (A\$m)	77.0	
NPV perpetuity (A\$m)	221.5	
Net debt/(cash) (A\$m)	12.2	
DCF valuation (A\$m)	310.7	

DCF valuation (A\$/sh) 5.41
 Price target (A\$/sh) 4.50

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	28.1
EBITDA	0.7	0.8	0.4	-0.5
EBIT	0.2	0.2	-0.2	-1.0
Net profit	0.2	-0.1	-0.2	-0.8
Norm EPS	0.3	-0.2	-0.4	-1.5
EBIT/sales (%)	1.1	1.0	-0.7	-3.7
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	-12.2	-15.0
Net debt/equity (%)	<0	<0	<0
Net debt/EV (%)	<0	<0	<0
Current ratio (x)	5.3	5.1	4.7
Interest cover (x)	<0	◆	◆
Adj cash int cover (x)	<0		
Debt/cash flow (x)	0.0	0.0	0.0
Net debt (cash)/share (\$)	<0	<0	<0
NTA/share (\$)	0.6	0.5	0.6
Book value/share (\$)	0.7	0.6	0.7
Payout ratio (%)	0	0	0
Adj payout ratio (%)	0	0	0

EPS reconciliation (\$m)				
	FY16A		FY17F	
	Rep	Norm	Rep	Norm
Sales revenue	44	44	52	52
EBIT	0.5	0.5	-1.2	-1.2
Net profit	0.1	0.1	-1.0	-1.0
Notional earn	0.0	0.0	0.0	0.0
Pref/conv div	0.0	0.0	0.0	0.0
Profit for EPS	0.1	0.1	-1.0	-1.0
Diluted shrs (m)	45	45	49	49
Diluted EPS (c)	0.1	0.2	-1.9	-1.9

Returns				
	FY16A	FY17F	FY18F	FY19F
ROE (%)	0	-3	16	27
ROIC (%)	2	-5	25	48
Incremental ROE	-5	-21	316	71
Incremental ROIC	-2	-40	182	136

Key assumptions								
Year-end June (AUD)	FY13A	FY14A	FY15A	FY16A	FY17F	FY18F	FY19F	FY20F
Revenue growth (%)	21.3	40.1	33.0	28.0	17.7	46.2	40.7	43.1
EBIT growth (%)	-52.1	-14.9	152.7	-17.1	-362.6	-714.7	140.8	83.7
NPAT growth (%)	-7.2	-69.5	148.3	-87.4	-1,526.2	-653.4	122.6	69.9
EPS growth (%)	-0.6	-41.1	30.5	-87.5	-1,389.0	-638.2	121.3	69.6
EBIT/sales (%)	1.4	0.8	1.6	1.0	-2.3	9.7	16.6	21.3
Tax rate (%)	-123.7	-6.7	23.5	86.3	-33.4	27.0	27.0	27.0
ROA (%)	1.6	1.1	2.0	1.1	-2.9	14.1	25.3	38.0
ROE (%)	6.4	1.7	2.5	0.2	-2.9	12.7	20.1	27.2

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	51.9	75.9	106.8	152.9
EBITDA	0.8	0.8	1.2	1.5	-0.1	8.7	19.3	34.2
Depn & amort	0.5	0.6	0.6	1.0	1.1	1.3	1.5	1.7
EBIT	0.3	0.2	0.6	0.5	-1.2	7.4	17.7	32.6
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	0.4	0.4	2.0	4.8	8.8
Minorities/pref divs	0.0	0.0	0.0	0.0	-0.6	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	0.1	-1.0	5.3	11.8	20.1
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	0.1	-1.0	5.3	11.8	20.1

Cash flow (\$m)								
Year-end June (AUD)	FY13A	FY14A	FY15A	FY16A	FY17F	FY18F	FY19F	FY20F
EBITDA	0.8	0.8	1.2	1.5	-0.1	8.7	19.3	34.2
Interest & tax	0.0	-0.5	0.1	-0.3	-0.2	-2.0	-4.8	-8.8
Working cap/other	-0.2	-1.1	-1.5	0.9	-0.8	0.3	-5.2	-3.3
Operating cash flow	0.6	-0.8	-0.2	2.1	-1.1	7.0	9.2	22.1
Maintenance capex	-0.2	0.3	-1.2	-1.9	-4.0	-4.2	-4.5	-4.8
Free cash flow	0.4	-0.5	-1.4	0.2	-5.1	2.8	4.7	17.3
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
Cash flow pre-financing	-0.2	-1.2	-1.9	-1.5	-5.4	2.8	4.7	17.3
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	5.4	-2.8	-4.7	-17.3

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	12.2	15.0	19.8	36.9
Current receivables	4.4	5.5	7.2	7.8	8.0	9.3	15.6	18.9
Current inventories	0.9	1.0	1.3	1.7	2.4	2.9	3.5	4.2
Net PPE	1.2	1.3	2.1	3.6	5.9	8.2	10.6	13.0
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	10.6	11.3	12.0	12.8
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	40.4	39.1	46.7	61.5	85.8
Current payables	3.5	3.3	3.9	6.1	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	1.7	1.8	2.1	2.3	2.6
Total liabilities	4.5	6.6	6.2	7.7	7.8	10.1	11.9	12.4
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	32.7	31.3	36.7	49.6	73.4
Total funds employed	11.6	12.6	21.5	32.7	31.3	36.7	49.6	73.4

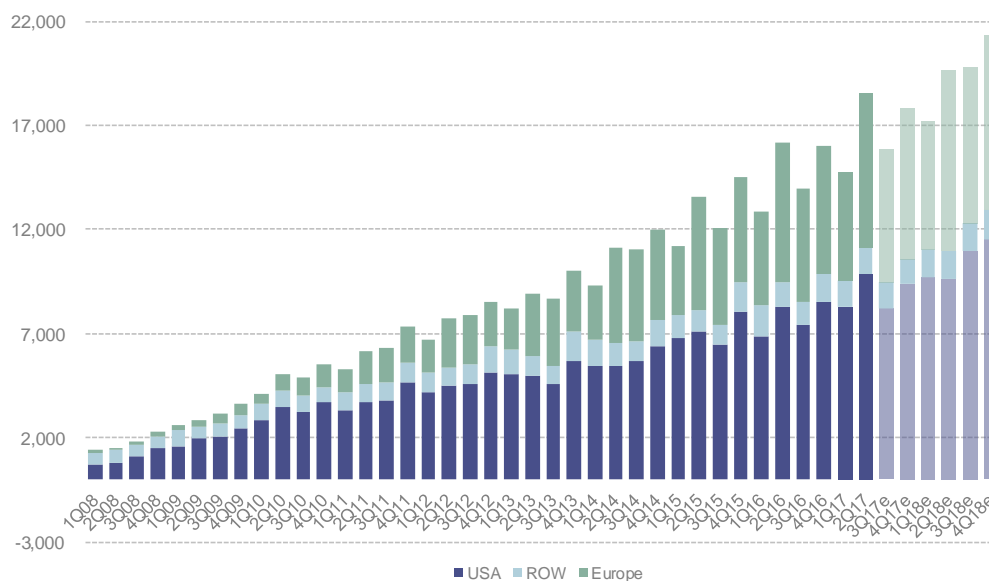
SomnoMed Q2 – forecasts

Table 1: SomnoMed revenue and earnings model FY16-19e

	FY15	1HFY16	2HFY16	FY16	1HFY17e	2HFY17e	FY17e	1HFY18e	2HFY18e	FY18e	FY19e
Medical Device Volumes	51,355	28,997	29,986	58,983	33,309	34,462	67,771	41,297	43,510	84,806	106,465
USA - Medical	28,474	15,199	15,966	31,165	18,128	17,562	35,690	21,210	20,548	41,758	48,439
USA - RSS	-	-	-	-	-	800	800	2,500	4,300	6,800	16,000
EMEA	18,409	11,133	11,587	22,720	12,681	13,600	26,281	14,837	15,912	30,749	35,976
AsiaPac	4,472	2,665	2,434	5,099	2,500	2,500	5,000	2,750	2,750	5,500	6,050
Medical Device Sales (AUDm)	28.9	17.9	19.4	37.3	20.5	22.6	43.1	26.2	27.5	53.8	65.7
Gross profits	19.8	12.2	13.3	25.6	14.2	15.6	29.8	18.0	18.8	36.8	44.6
MAS Gross Margin	68.6%	68.5%	68.7%	68.6%	69.3%	68.9%	69.1%	68.5%	68.2%	68.4%	67.9%
Managed care revenue (A\$m)	5.5	3.5	3.4	6.8	3.3	3.9	7.2	4.2	4.5	8.7	9.5
Core SomnoMed Revenue (A\$m)	34.4	21.3	22.8	44.1	23.8	26.5	50.3	30.4	32.0	62.5	75.2
Core SomnoMed EBITDA (A\$m)	0.6	0.2	0.2	0.4	1.4	2.2	3.6	3.4	3.6	7.0	10.5
RSS Sales (AUDm)	-	-	-	-	-	1.6	1.6	4.9	8.5	13.4	31.6
RSS EBITDA	-	-	-	-	(1.0)	(2.7)	(3.7)	(0.5)	2.2	1.7	8.8
GROUP EBITDA	0.6	0.2	0.2	0.4	0.4	(0.5)	(0.1)	2.8	5.8	8.7	19.3

Source: SomnoMed, Wilsons' estimates

Figure 1: Historical and forecast quarterly unit volumes (FY08-19e)



Source: SomnoMed, Wilsons' estimates

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)

Contact details

Address: Level 3, 20 Clarke Street, Crows Nest, NSW 2065 Australia
Phone: +612 9467 0400
Website: www.somnomed.com.au



Disclaimers and disclosures

Recommendation structure and other definitions

Definitions at wilsonsadvisory.com.au/Disclosures.

Disclaimer

This document is being supplied to you solely for your information and no action should be taken on the basis of or in reliance on this document. Any advice contained in this document is general advice only and has been prepared by Wilsons without taking into account any person's objectives, financial situation or needs. Any person, before acting on any advice contained within this communication, should first consult with a Wilsons investment adviser to assess whether the advice within this communication is appropriate for their objectives, financial situation and needs. Those acting upon such information without advice do so entirely at their own risk.

Wilsons has not independently verified all of the information given in this document which is provided at a point in time and may not contain all necessary information about the company or companies covered in this report ("Companies"). Accordingly, no representation or warranty, express or implied, is made as to the accuracy or completeness of the information and opinions contained in this document. To the fullest extent permitted by law Wilsons, its related bodies corporate and their respective officers, directors, employees or agents, disclaim any and all liabilities for any loss or damage howsoever arising in connection with the use of this document or its contents. Any projections contained in this document are indicative estimates only. Such projections are contingent upon matters outside the control of Wilsons (including but not limited to economic conditions, market volatility and company-specific fundamentals) and therefore may not be realised in the future. Past performance is not an indication of future performance.

This report does not constitute an offer or invitation to purchase any securities and should not be relied upon in connection with any contract or commitment whatsoever.

Wilsons and Wilsons Corporate Finance Limited (ABN 65 057 547 323: AFSL 238 383) and their associates may have received and may continue to receive fees from the Companies in relation to corporate advisory, underwriting or other professional investment services. Please see relevant Wilsons disclosures at wilsonsadvisory.com.au/Disclosures.

Neither Wilsons nor its research analysts received any direct financial or non-financial benefits from the Companies for the production of this document. However, Wilsons' research analysts may attend site visits and/or meetings hosted by the Companies. In some instances the costs of such site visits or meetings may be met in part or in whole by the Companies if Wilsons considers it is reasonable given the specific circumstances relating to the site visit or meeting.

Wilsons advises that at the date of this report, its directors, associates and employees may have relevant interests in the Companies.

Wilsons and its related bodies may trade securities in the Companies as principal.

Regulatory disclosures

Wilsons Corporate Finance Limited ACN 057 547 323, AFSL 238 383 acted as Lead Manager in the May 2016 placement of SomnoMed Limited securities for which it received fees or will receive fees for acting in this capacity. Wilsons Advisory and Stockbroking Limited may have a conflict of interest which investors should consider before making an investment decision. Wilsons Advisory and Stockbroking Limited, Wilsons Corporate Finance Limited and its related bodies corporate trades or may trade as principal in the securities that are subject of the research report.

Wilsons contact

Phone: 1300 655 015. Website: wilsonsadvisory.com.au.

