



## Sustained European growth underpins a solid Q2 – upgrading FY16

SomnoMed continues to find ways to grow sales in its well-established European markets. Consequently, the company reported 16,151 device sales in Q2 worldwide, which was 10% ahead of our forecast. We have upgraded our full-year forecast to 62,000 devices, bringing us in line with company guidance. The major sleep apnoea markets continue to enjoy strong underlying patient growth rates via demographic drivers, improved disease awareness and diagnostics. We think the outlook for the oral appliance segment of that market is excellent, where SomnoMed should benefit from improving referral rates, market access and an increasingly scalable business. We have revised our price target up to \$3.04 per share and maintain a BUY rating.

### Key points

**Q2 trading update** – SomnoMed reported 16,151 device sales in Q2 and A\$21.3m in total revenue for the 1H. Q2 device volumes were c.10% above our forecast, driven by sustained sales growth in Europe. There is still much underlying growth available in SomnoMed's established European markets such as Holland, the Nordics, Germany and France. SomnoMed also achieved 22% sales growth in its US direct sales channel and 11% growth in the Asia Pacific (both geographies in line with our forecasts).

**Forecasts** – we have upgraded our full-year volume forecast by 3% to 62,000 devices (in line with company guidance). The upgrade principally applies to Europe, where a number of positive events are unfolding for oral appliance therapy, generally: increased interest from German physicians and health insurers, a review of French reimbursement, potential access to public health markets in Norway and improved market access developing in Belgium. Offshore sales continue to benefit from the weakening AUD – we are now forecasting full-year revenue of \$45m (guidance is \$42m). Our current EBITDA forecast of \$3.1m is slightly ahead of company guidance (\$3.0m).

**Valuation** – no change to our long-term view on the stock, expecting SomnoMed to preserve and grow its leadership position in oral appliance therapy. Target price revised up to \$3.04 per share. Our primary valuation for SomnoMed is based on a discounted cash flow (DCF) methodology.

### Risks and catalysts

**Catalysts:** a) quarterly volume reports versus guidance; b) US managed care progress; c) margin improvement via digital manufacturing technologies and leverage; d) acquisitions. **Risks:** a) execution on US strategy; b) increased competition; c) ASP erosion and adverse reimbursement changes; d) capacity to finance and supply growth.

Year-end June (AUD)	FY14A	FY15A	FY16F	FY17F	FY18F
NPAT rep (\$m)	0.2	0.5	1.8	3.1	4.4
NPAT norm (\$m)	0.2	0.5	1.8	3.1	4.4
Consensus NPAT (\$m)			1.6	2.9	5.3
EPS norm (cps)	0.9	1.2	4.1	7.0	10.0
EPS growth (%)	-41.1	30.5	245.5	67.8	43.2
P/E norm (x)	277.2	212.4	61.5	36.6	25.6
EV/EBITDA (x)	164.8	115.7	44.1	28.2	20.3
FCF yield (%)	-0.4	-1.1	-0.6	1.8	2.5
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

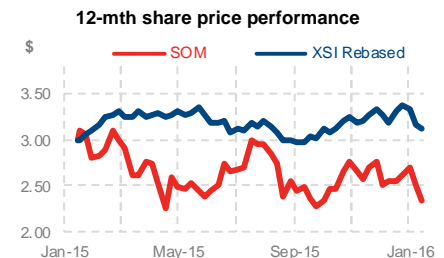
Source: Company data, WHTM estimates, S&P Capital IQ

12-mth target price (AUD)	\$3.04
Share price @ 19-Jan-16 (AUD)	\$2.55
Forecast 12-mth capital return	19.4%
Forecast 12-mth dividend yield	0.0%
<b>12-mth total shareholder return</b>	<b>19.4%</b>

Market cap	\$134m
Enterprise value	\$137m
Shares on issue	52m
Sold short	0.0%
ASX 300 weight	n/a
Median turnover/day	\$0.0m

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	1-mth	6-mth	12-mth
Abs return (%)	-7.1	-17.0	-21.7
Rel return (%)	-1.9	-15.7	-25.7

KEY CHANGES	04-Nov	After	Var %
<b>NPAT:</b> FY16F	1.6	1.8	15.0%
<b>norm</b> FY17F	2.9	3.1	5.1%
<b>(\$m)</b> FY18F	4.0	4.4	10.2%
<b>EPS:</b> FY16F	3.6	4.1	15.0%
<b>norm</b> FY17F	6.6	7.0	5.1%
<b>(cps)</b> FY18F	9.0	10.0	10.2%
<b>DPS:</b> FY16F	0.0	0.0	0.0%
<b>(cps)</b> FY17F	0.0	0.0	0.0%
<b>FY18F</b>	0.0	0.0	0.0%
<b>Price target:</b>	3.00	3.04	1.5%
<b>Rating:</b>	<b>BUY</b>	<b>BUY</b>	



#### PRICE TARGET

	Valuation	Price target
WACC (%)	12.1	
Terminal growth (%)	3.0	
NPV forecast FCF (A\$m)	40	
NPV perpetuity (A\$m)	109	
Net debt/(cash) (A\$m)	7	
DCF valuation (A\$m)	156	

Price target (A\$/sh) **3.04**

#### INTERIMS (\$m)

Half-year (AUD)	Dec 14	Jun 15	Dec 15	Jun 16
	1HA	2HA	1HE	2HE
Sales revenue	14.8	19.6	20.7	24.7
EBITDA	0.3	0.9	1.0	2.1
EBIT	0.0	0.5	0.6	1.8
<b>Net profit</b>	<b>0.0</b>	<b>0.6</b>	<b>0.5</b>	<b>1.4</b>
<b>Norm EPS</b>	<b>-0.1</b>	<b>1.3</b>	<b>1.1</b>	<b>3.1</b>
EBIT/sales (%)	0.0	2.8	2.9	7.2
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	-6.6	-8.7
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)	5.1	4.6	4.7
Interest cover (x)	<0	<0	<0
<b>Adj cash int cover (x)</b>	<b>9.5</b>	<b>2.5</b>	<b>&lt;0</b>
Debt/cash flow (x)	0.0	0.0	0.0
Net debt (cash)/share (\$)	<0	<0	<0
NTA/share (\$)	0.4	0.4	0.4
Book value/share (\$)	0.5	0.5	0.6
Payout ratio (%)	0	0	0
Adj payout ratio (%)	0	0	0

#### EPS RECONCILIATION (\$m)

	FY15A		FY16F	
	Rep	Norm	Rep	Norm
Sales revenue	34	34	45	45
EBIT	0.6	0.6	2.4	2.4
<b>Net profit</b>	<b>0.5</b>	<b>0.5</b>	<b>1.8</b>	<b>1.8</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>0.5</b>	<b>0.5</b>	<b>1.8</b>	<b>1.8</b>
Diluted shrs (m)	44	44	44	44
<b>Diluted EPS (c)</b>	<b>1.2</b>	<b>1.2</b>	<b>4.1</b>	<b>4.1</b>

#### RETURNS

	FY15A	FY16F	FY17F	FY18F
ROE (%)	3.1	8.2	12.4	15.5
ROIC (%)	3.4	11.0	16.3	22.1
Incremental ROE	6.4	24.3	50.6	35.5
Incremental ROIC	8.0	35.4	51.0	110.7

#### KEY ASSUMPTIONS

Year-end June (AUD)	FY13A	FY14A	FY15A	FY16F	FY17F	FY18F	FY19F	FY20F
Revenue growth (%)	21.3	40.1	33.0	31.8	12.3	15.4	10.4	14.7
EBIT growth (%)	-55.4	-8.6	152.7	328.4	70.6	44.6	-3.9	75.1
NPAT growth (%)	-7.2	-69.5	148.3	245.5	67.8	43.2	-3.3	73.6
<b>EPS growth (%)</b>	<b>-0.6</b>	<b>-41.1</b>	<b>30.5</b>	<b>245.5</b>	<b>67.8</b>	<b>43.2</b>	<b>-3.3</b>	<b>73.6</b>
EBIT/sales (%)	1.3	0.8	1.6	5.2	7.9	9.9	8.6	13.1
Tax rate (%)	-123.7	-6.7	23.5	25.0	25.0	25.0	25.0	25.0
<b>ROA (%)</b>	<b>1.5</b>	<b>1.1</b>	<b>2.0</b>	<b>7.3</b>	<b>11.0</b>	<b>14.0</b>	<b>12.4</b>	<b>20.6</b>
<b>ROE (%)</b>	<b>6.4</b>	<b>1.7</b>	<b>2.5</b>	<b>7.6</b>	<b>11.1</b>	<b>13.9</b>	<b>12.5</b>	<b>20.8</b>

#### PROFIT AND LOSS (\$m)

Year-end June (AUD)	FY13A	FY14A	FY15A	FY16F	FY17F	FY18F	FY19F	FY20F
Sales revenue	18.5	25.9	34.4	45.4	51.0	58.8	64.9	74.5
EBITDA	0.7	0.8	1.2	3.1	4.8	6.7	6.6	10.9
Depn & amort	0.5	0.6	0.6	0.7	0.8	0.9	1.0	1.1
<b>EBIT</b>	<b>0.2</b>	<b>0.2</b>	<b>0.6</b>	<b>2.4</b>	<b>4.0</b>	<b>5.8</b>	<b>5.6</b>	<b>9.8</b>
Net interest expense	-0.1	0.0	-0.1	-0.1	-0.1	-0.1	-0.1	-0.1
Tax	-0.4	0.0	0.2	0.6	1.0	1.5	1.4	2.5
Minorities/pref divs	0.0	0.0	0.0	0.0	0.0	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
<b>Net profit (pre-sig items)</b>	<b>0.7</b>	<b>0.2</b>	<b>0.5</b>	<b>1.8</b>	<b>3.1</b>	<b>4.4</b>	<b>4.3</b>	<b>7.4</b>
Abns/exts/signif	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
<b>Reported net profit</b>	<b>0.7</b>	<b>0.2</b>	<b>0.5</b>	<b>1.8</b>	<b>3.1</b>	<b>4.4</b>	<b>4.3</b>	<b>7.4</b>

#### CASH FLOW (\$m)

Year-end June (AUD)	FY13A	FY14A	FY15A	FY16F	FY17F	FY18F	FY19F	FY20F
EBITDA	0.7	0.8	1.2	3.1	4.8	6.7	6.6	10.9
Interest & tax	0.0	-0.5	0.1	-0.5	-0.9	-1.4	-1.3	-2.3
Working cap/other	-0.2	-1.1	-1.5	-2.4	-0.5	-0.9	-0.9	-1.2
<b>Operating cash flow</b>	<b>0.6</b>	<b>-0.8</b>	<b>-0.2</b>	<b>0.1</b>	<b>3.4</b>	<b>4.5</b>	<b>4.4</b>	<b>7.4</b>
Maintenance capex	-0.2	0.3	-1.2	-0.9	-1.0	-1.2	-1.3	-1.5
<b>Free cash flow</b>	<b>0.4</b>	<b>-0.5</b>	<b>-1.4</b>	<b>-0.8</b>	<b>2.4</b>	<b>3.3</b>	<b>3.1</b>	<b>5.9</b>
Dividends paid	0.0	0.0	0.0	0.0	0.0	0.0	-1.5	-5.2
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	-1.0	-0.3	0.0	0.0	0.0
Other inv flows	-0.1	-0.4	-0.3	0.0	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>-1.7</b>	<b>2.1</b>	<b>3.3</b>	<b>1.7</b>	<b>0.8</b>
Funded by equity	0.5	0.0	7.3	0.0	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	1.7	-2.1	-3.3	-1.7	-0.8

#### BALANCE SHEET SUMMARY (\$m)

Year-end June (AUD)	FY13A	FY14A	FY15A	FY16F	FY17F	FY18F	FY19F	FY20F
Cash	4.2	2.9	8.3	6.6	8.7	11.8	13.6	14.4
Current receivables	4.4	5.5	7.2	9.9	10.9	12.5	13.9	15.9
Current inventories	0.9	1.0	1.3	2.2	2.4	2.8	3.1	3.6
Net PPE	1.2	1.3	2.1	2.3	2.4	2.5	2.5	2.7
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	9.9	10.3	10.6	10.8	11.1
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>30.9</b>	<b>34.7</b>	<b>40.2</b>	<b>44.0</b>	<b>47.6</b>
Current payables	3.5	3.3	3.9	4.9	5.4	6.3	7.0	7.9
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	2.6	2.8	3.1	3.3	3.7
<b>Total liabilities</b>	<b>4.5</b>	<b>6.6</b>	<b>6.2</b>	<b>7.5</b>	<b>8.2</b>	<b>9.3</b>	<b>10.3</b>	<b>11.6</b>
Minorities/convertibles	0.6	0.2	0.2	0.2	0.2	0.2	0.2	0.2
<b>Shareholder equity</b>	<b>11.6</b>	<b>12.6</b>	<b>21.5</b>	<b>23.3</b>	<b>26.4</b>	<b>30.9</b>	<b>33.7</b>	<b>36.0</b>
<b>Total funds employed</b>	<b>11.6</b>	<b>12.6</b>	<b>21.5</b>	<b>23.3</b>	<b>26.4</b>	<b>30.9</b>	<b>33.7</b>	<b>36.0</b>



## 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.\$7.4M cash as at end-1HFY16
- 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)
- Neil Verdal-Austin (CFO)
- Kien T. Nguyen (President, North America)
- Dr Jagdeep Bijwadia (Chief Medical Officer)

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