

SomnoMed

Pain for no gain

ADD (previously HOLD)

Current price:	A\$1.60
Target price:	A\$2.15
Previous target:	A\$2.23
Up/downside:	34.4%
Reuters:	SOM.AX
Bloomberg:	SOM AU
Market cap:	US\$72.89m
	A\$100.5m
Average daily turnover:	US\$0.01m
	A\$0.02m
Current shares o/s	57.87m
Free float:	87.6%

- SOM held its AGM today and announced the full closure of the RSS business on 1 January 2019.
- We see this as a positive move that marks the end of an era which has created two years of earnings drag as well as sustained discontent amongst its North American wholesalers.
- SOM has reconfirmed its guidance for FY19 of underlying EBITDA at breakeven; however, large one-off exit costs will weigh on the reported results.
- We have reduced our price target to A\$2.15 due to the removal of our long-term forecasts in the RSS business. We upgrade to an Add recommendation due to recent share price weakness.

AGM dishes up a nice surprise

SOM held its AGM today with the significant news being the closure of all RSS centres from 1 January 2019. Management had only recently called for a halt in the rollout and closed eight grossly underperforming centres but has now extended this to all existing centres. We believe this shows the increasing level of difficulty in navigating this channel. Significantly higher levels of 'out-of-pocket' medical costs before an insurer begins to contribute as well as a ~25% reduction in reimbursement once those levels were hit added significant levels of seasonality to the business as well as a reducing overall demand for the treatment. We see the move out of the business and securing a larger working capital facility as positive as it removes a question mark over a potential capital raising. Also it removes a significant short-term cost burden and allows focus on the profitable core business. SOM expects close-out costs for the RSS operations to be in the range of A\$3-4m although more detail will be provided as sub-leasing arrangements for the centres are negotiated.

Underlying guidance unchanged

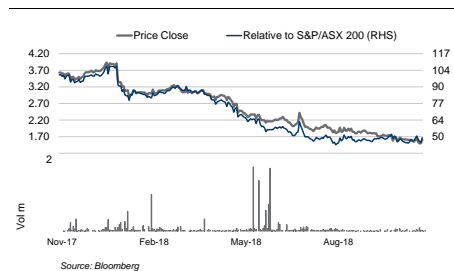
SOM reconfirmed the previous FY19 guidance of underlying EBITDA at breakeven (reflecting a RSS loss between A\$5m - A\$6m and a core business profit of A\$5m - A\$5.5m). We expect RSS close-out costs to be treated as a one-off item. In any case, we look to the 1H19 report in February for further clarification.

Changes to forecasts - RSS removed from FY20 and one-off costs

Due to the closure of RSS in 2H19, we have removed our forecast revenues and EBITDA contributions from the RSS business for FY20 and beyond. Also we have slightly lowered our gross margin to reflect the loss of a higher proportion of direct sales from RSS and adjusting for the one-off closure cost in FY19 of A\$4m.

Investment view

Our DCF valuation reduces to A\$2.15 from A\$2.23. We have set our target price at the same level. We view the removal of the RSS business as a positive in the short to medium term and it allows management to refocus on the profitable core business. Key downside risks to our targets are slower-than-expected growth in the core markets of North America and Europe. We upgrade to an Add recommendation due to recent price weakness with greater than 30% upside to the new target price.



Price performance	1M	3M	12M
Absolute (%)	1.3	-18.4	-55.9
Relative (%)	1.2	-9.2	-50.7

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Analyst(s) own shares in the following stock(s) mentioned in this report:

- N/A

Financial Summary

	Jun-17A	Jun-18A	Jun-19F	Jun-20F	Jun-21F
Revenue (A\$m)	49.33	63.61	71.57	69.58	78.05
Operating EBITDA (A\$m)	(3.40)	(6.42)	(1.21)	7.61	7.91
Net Profit (A\$m)	(4.92)	(9.71)	(2.10)	3.36	3.60
Normalised EPS (A\$)	(0.09)	(0.16)	(0.03)	0.05	0.06
Normalised EPS Growth	2748%	83%	(78%)		7%
FD Normalised P/E (x)	NA	NA	NA	29.66	27.63
DPS (A\$)	-	-	-	-	-
Dividend Yield	0%	0%	0%	0%	0%
EV/EBITDA (x)	NA	NA	NA	10.91	10.17
P/FCFE (x)	NA	NA	NA	15.44	16.65
Net Gearing	(44.1%)	(37.1%)	(38.8%)	(45.1%)	(48.2%)
P/BV (x)	2.87	2.76	2.97	2.72	2.50
ROE	(15.1%)	(28.4%)	(6.0%)	9.6%	9.4%
% Change In Normalised EPS Estimates			(13%)	131%	(19%)
Normalised EPS/consensus EPS (x)			0.66	2.25	0.67

SOURCE: MORGANS, COMPANY REPORTS

Figure 1: Financial summary

Income statement						Valuation metrics					
	FY17A	FY18A	FY19F	FY20F	FY21F	Price Target (A\$)					
Total revenue	49.3	63.6	71.6	69.6	78.1	DCF valuation inputs					\$2.15
EBITDA	-3.4	-6.4	-1.2	7.6	7.9	Rf	4.00%	10-year rate	4.00%	Margin	2.0%
Associate income	0.0	0.0	0.0	0.0	0.0	Rm-Rf	6.00%	Kd	4.20%	Ke	18.0%
Depreciation	-1.2	-1.7	-2.0	-3.0	-3.0	Beta	1.70	NPV cash flow (A\$m)	120.4	Minority interest (A\$m)	0.0
EBITA	-4.6	-8.1	-3.2	4.6	4.9	CAPM (Rf+Beta(Rm-Rf))	14.2%	Net debt (A\$m)	-13.4	Investments (A\$m)	0.0
Amortisation/impairment	0.0	0.0	0.0	0.0	0.0	Equity (E/EV)	60.0%	Equity market value (A\$m)	133.7	Diluted no. of shares (m)	62.2
EBIT	-4.6	-8.1	-3.2	4.6	4.9	Debt (D/EV)	40.0%				\$2.15
Net interest expense	0.1	0.0	0.2	0.2	0.2	Interest rate	4.20%				
Pre-tax profit	-4.5	-8.1	-3.0	4.8	5.1	Tax rate (t)	30.0%				
Income tax expense	-0.4	-1.6	0.9	-1.4	-1.5	WACC	12.5%				
After-tax profit	-4.9	-9.7	-2.1	3.4	3.6						
Minority interests	0.0	0.0	0.0	0.0	0.0						
NPAT	-4.9	-9.7	-2.1	3.4	3.6						
Significant items	0.0	0.0	-4.0	0.0	0.0						
NPAT post abnormals	-4.9	-9.7	-6.1	3.4	3.6						
Cash flow statement						Multiples					
	FY17A	FY18A	FY19F	FY20F	FY21F		FY17A	FY18A	FY19F	FY20F	FY21F
EBITDA	-3.4	-6.4	-1.2	7.6	7.9	Enterprise value (A\$m)	113.7	112.9	112.5	116.0	118.7
Change in working capital	0.3	-3.1	2.2	0.4	-0.5	EV/Sales (x)	2.3	1.8	1.6	1.7	1.5
Net interest (pd)/rec	0.0	0.0	0.0	0.0	0.0	EV/EBITDA (x)	-33.5	-17.6	-93.2	15.2	15.0
Taxes paid	0.4	1.6	-0.9	1.4	1.5	EV/EBIT (x)	-24.6	-14.0	-35.1	25.2	24.2
Other oper cash items	0.0	0.0	0.0	0.0	0.0	PE (x)	-18.8	-10.2	-47.5	29.7	27.6
Cash flow from ops (1)	-2.7	-7.9	0.1	9.4	9.0	PEG x)	0.0	0.1	0.6	-0.1	3.8
Capex (2)	-3.1	-1.7	-2.0	-3.0	-3.0	Per share data					
Disposals/(acquisitions)	0.0	0.0	0.0	0.0	0.0	No. shares	57.9	62.2	62.2	62.2	62.2
Other investing cash flow	0.0	0.0	0.0	0.0	0.0	EPS (cps)	-8.5	-15.6	-3.4	5.4	5.8
Cash flow from investing (3)	-3.1	-1.7	-2.0	-3.0	-3.0	Dividend per share (c)	0.0	0.0	0.0	0.0	0.0
Incr/(decr) in equity	2.4	10.4	0.0	0.0	0.0	Dividend payout ratio (%)	0.0%	0.0%	0.0%	0.0%	0.0%
Incr/(decr) in debt	0.0	0.0	0.0	0.0	0.0	Dividend yield (%)	0.0%	0.0%	0.0%	0.0%	0.0%
Ordinary dividend paid	0.0	0.0	0.0	0.0	0.0	Growth ratios					
Preferred dividends (4)	0.0	0.0	0.0	0.0	0.0		FY17A	FY18A	FY19F	FY20F	FY21F
Other financing cash flow	0.0	0.0	0.0	0.0	0.0	Sales growth	11.9%	29.0%	12.5%	-2.8%	12.2%
Cash flow from fin (5)	2.4	10.4	0.0	0.0	0.0	Operating cost growth	23.7%	32.8%	3.9%	-14.8%	13.2%
Forex and disc ops (6)	0.0	0.0	0.0	0.0	0.0	EBITDA growth	-331.7%	-88.9%	81.2%	730.5%	3.9%
Inc/(decr) cash (1+3+5+6)	-3.5	0.8	-1.9	6.4	6.0	EBITA growth	-1138.7%	-74.9%	60.4%	243.7%	6.4%
Equity FCF (1+2+4)	-5.8	-9.6	-1.9	6.4	6.0	EBIT growth	-1138.7%	-74.9%	60.4%	243.7%	6.4%
						NPAT growth	-3033.1%	-97.2%	78.4%	260.0%	7.3%
						Normalised EPS growth	2747.7%	-83.5%	-78.4%	-260.0%	7.3%
Balance sheet						Operating performance					
	FY17A	FY18A	FY19F	FY20F	FY21F		FY17A	FY18A	FY19F	FY20F	FY21F
Cash & deposits	14.2	13.4	13.0	16.5	19.1	Asset turnover (%)	30.2	36.6	42.7	43.8	45.2
Trade debtors	10.5	14.1	8.8	8.6	9.6	EBITDA margin (%)	-6.9	-10.1	-1.7	10.9	10.1
Inventory	1.9	2.0	0.0	0.0	0.0	EBIT margin (%)	-9.4	-12.7	-4.5	6.6	6.3
Other current assets	0.0	0.0	0.0	0.0	0.0	Net profit margin (%)	-10.0	-15.3	-2.9	4.8	4.6
Goodwill	0.0	0.0	0.0	0.0	0.0	Return on net assets (%)	-14.4	1.9	2.5	1.3	-14.4
Other intangible assets	0.0	0.0	0.0	0.0	0.0	Net debt (A\$m)	-14.2	-13.4	-13.0	-16.5	-19.1
Fixed assets	4.5	6.6	6.6	6.6	6.6	Net debt/equity (%)	-44.1	-37.1	-38.8	-45.1	-48.2
Investments	0.0	0.0	0.0	0.0	0.0	Net interest/EBIT cover (x)					
Other assets	10.1	9.6	9.6	9.6	9.6	Invested capital	18.3	19.7	22.7	20.5	20.1
Total assets	41.2	45.7	38.1	41.3	45.0	ROIC (%)	-27.0	-49.4	-9.2	16.3	17.9
Short-term borrowings	0.0	0.0	0.0	0.0	0.0	Internal liquidity					
Trade payables	8.0	8.4	3.3	3.5	4.1		FY17A	FY18A	FY19F	FY20F	FY21F
Long-term borrowings	0.0	0.0	0.0	0.0	0.0	Current ratio (x)	3.3	3.5	6.6	7.1	7.0
Other term liabilities	0.4	0.7	0.7	0.7	0.7	Receivables turnover (x)	5.4	5.2	6.3	8.0	8.6
Other liabilities	0.0	0.0	0.0	0.0	0.0	Payables turnover (x)	7.5	8.5	12.4	18.1	18.4
Total liabilities	9.0	9.6	4.5	4.7	5.3						
Share capital	46.9	57.7	57.7	57.7	57.7						
Other reserves	4.4	6.1	6.1	6.1	6.1						
Retained earnings	-19.1	-27.8	-30.3	-27.3	-24.1						
Other equity	0.0	0.0	0.0	0.0	0.0						
Total equity	32.2	36.1	33.6	36.6	39.7						
Minority interest	0.0	0.0	0.0	0.0	0.0						
Total shareholders' equity	32.2	36.1	33.6	36.6	39.7						
Total liabilities & SE	41.2	45.7	38.1	41.3	45.0						

SOURCE: MORGANS RESEARCH, COMPANY

Changes to forecasts

Figure 2: Changes to forecasts

Metric	FY19F		FY20F		FY21F	
	Old	New	Old	New	Old	New
Revenue	74.3	71.6	77.4	69.6	83.9	78.1
% change		-4%		-10%		-7%
EBITDA	(0.9)	(1.2)	4.8	7.6	9.1	7.9
% change		-41%		57%		-13%
NPAT (normalised)	(1.8)	(2.1)	1.5	3.4	4.5	3.6
% change		-13%		131%		-19%
EPS (c) normalised	(3.0)	(3.4)	2.3	5.4	7.2	5.8
% change		-13%		131%		-19%
DPS (c)	0	0	0	0	0	0
% change		0%		0%		0%

SOURCE: MORGANS RESEARCH, COMPANY

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