

stock update

RECOMMENDATION:

BUY

SomnoMed Limited

1H16 revenue tracking ahead of guidance

 Stock Code: SOM
 Last Sale: \$2.57
 Market Cap: \$135m
 Risk Level: High

20 January 2016
EVENT

- SomnoMed Ltd (SOM) released its 2Q16 sales results on 19-Jan-16.

KEY HIGHLIGHTS

- 1H16 recorded Unit Sales of 28,997 (+17.0%), MAS Revenue of \$18.1m (+30.3%) and Total Revenue of \$21.3m (+27.0%). These compare to SOM's FY16 guidance for Unit sales of 62,000 (+20.7%) and Total Revenue of \$42.0m (+22.0%).
- The discrepancy between 1H16 results and FY16 guidance is largely due to an acceleration in the replacement of North American licensee sales by direct sales, which was boosted by SOM's acquisition of Strong Dental in Canada on 3-Nov-15.
- Licensee sales which service the general dental market were expected to fall, albeit not as rapidly. The 83% fall in licensee sales in 1Q16, which SOM believes to be due to destocking by licensees, drove the underperformance in Unit Sales growth in 1Q16 which was 14.7%. Licensee sales stabilised in 2Q16, falling by 2.5% vs the pcp. This led to an improvement in Unit Sales growth in 2Q16 to 19.0%, albeit still tracking behind the guidance.
- The flip side of the coin is that direct sales attract a significantly higher Unit Price (~US\$420) than licensee sales (~US\$120). As a result, notwithstanding Unit Sales growth tracking behind guidance, MAS and Total Revenue growth are tracking ahead due to a significant increase in the effective Unit Price. Unit Price growth was also boosted by the launch of the DentiTrac compliance chip and the continued depreciation of the AUD.
- Unit Sales growth outside of North America are tracking in line with our expectations with Europe and Asia Pacific up 21.2% and 11.1% respectively in 1H16. SOM expects real global direct sales of ~25.6% to continue in 3Q16 and Licensee sales to continue to fall as a proportion of global Unit Sales to ~5% for FY16.
- Select Equities upgrades its FY16 Unit Sales, Revenue, and EBITDA forecasts to 61,383 (+19.5%), \$45.1m (+30.9%) and \$3.6m (+503.1%) respectively. These compare to our previous forecasts in Aug-15 for 61,005, \$41.3m and \$2.4m respectively.

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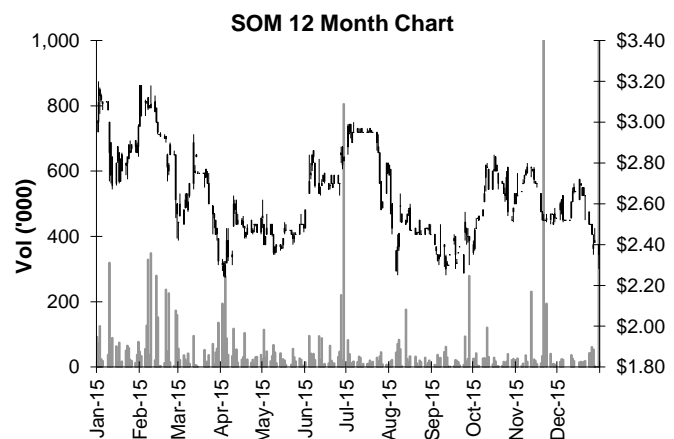
SELECT EQUITIES RECOMMENDATION

- Select Equities upgrades its SOM recommendation to BUY. The accelerated runoff of licensee sales matched by strong direct sales growth has increased the effective unit price and also the quality of those sales. Our upgraded Revenue and EBITDA forecasts are 7.3% and 21.4% ahead of company guidance respectively, and we view the EV/Revenue valuation as attractive.

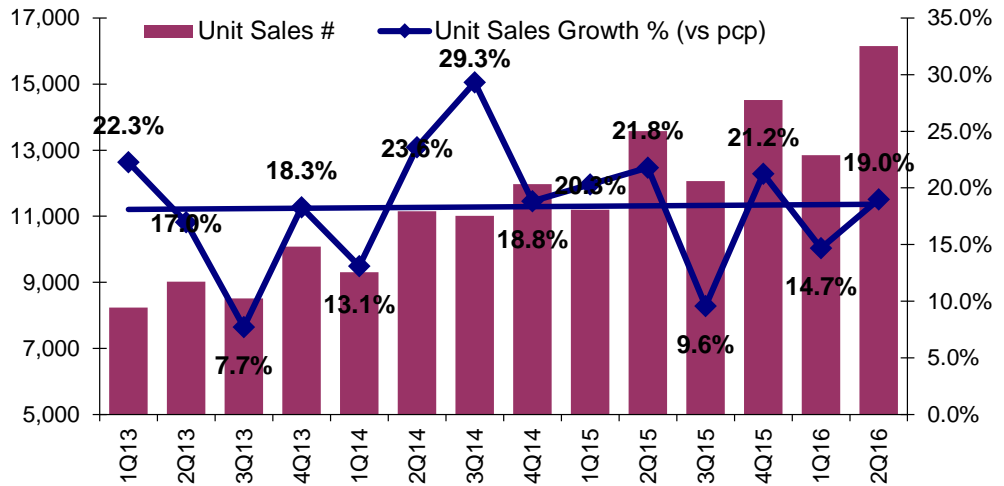
June Year End	FY14A	FY15A	FY16E	FY17E
Net Profit (\$m)	0.2	-0.1	2.1	3.7
Revenue (\$m)	30.3	34.4	45.1	54.2
EBITDA (\$m)	0.8	0.6	3.6	5.8
EPS (¢)	0.9	1.2	4.1	7.0
DPS (¢)	0.0	0.0	0.0	2.3
PER (x)	284.4	209.9	63.0	37.0
PER Rel Small Ords (%)	1896%	1399%	420%	246%
Ent. Value/ Revenue (x)	4.2	3.7	2.8	2.3
Ent. Value/ EBITDA (x)	150.7	210.3	34.9	21.8
Yield (%)	0.0%	0.0%	0.0%	0.9%
# Shares fd (m)				52.5
Avg. Mthly Volume (m)				1.3
Diluted Mkt Cap (\$m)				134.9
Net Debt (\$m)				-8.0
Enterprise Value (\$m)				127.0

Source: Company Reports and Select Equities Research

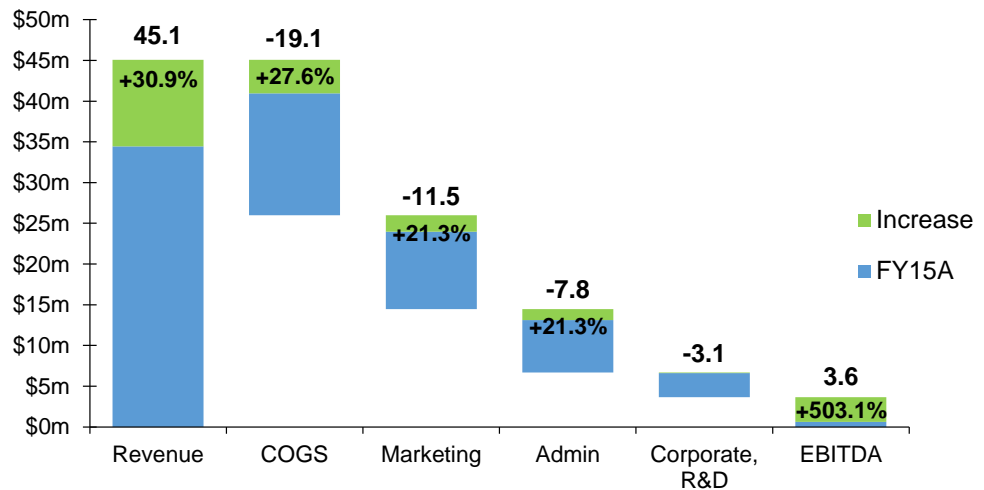
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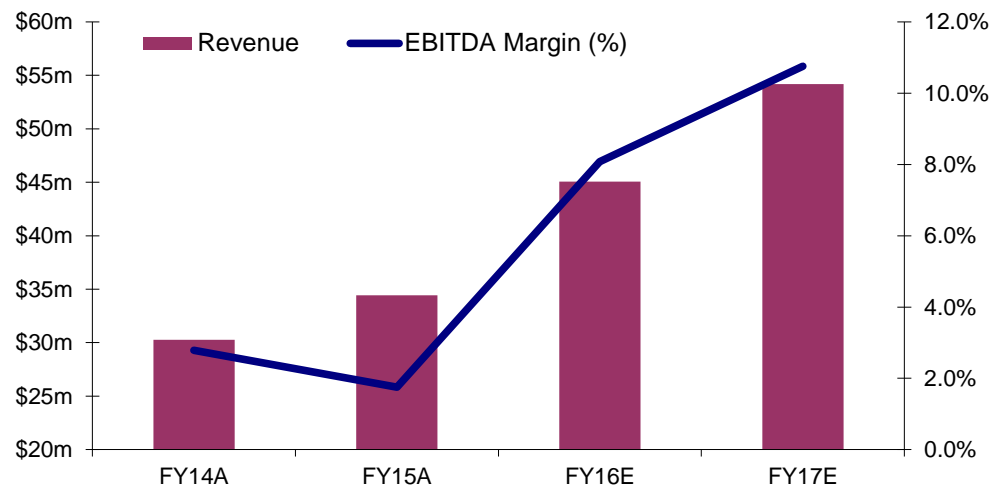
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**QUARTERLY
UNIT SALES &
GROWTH RATE**


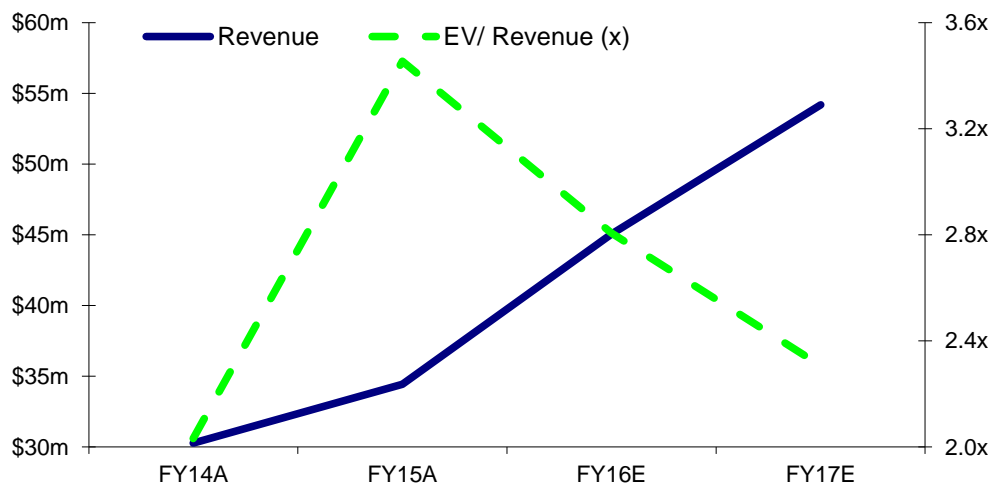
Source: Company Reports and Select Equities Research

**FY16E P&L
WATERFALL**


Source: Company Reports and Select Equities Research

**REVENUE &
EBITDA
MARGIN**


Source: Company Reports and Select Equities Research

VALUATION


Source: Company Reports and Select Equities Research

SER FY16E FORECAST REVISIONS

Date	4-Sep-13	28-Feb-14	28-Jul-14	26-Aug-14	20-Feb-15	30-Mar-15	10-Apr-15	21-May-15	21-Aug-15	20-Jan-16
Event	FY13	1H14	4Q14	FY14	1H15	Upgrade	3Q15	4Q15	FY15	2Q16
Price (\$)	\$1.18	\$1.52	\$1.76	\$1.89	\$3.18	\$2.70	\$2.63	\$2.40	\$2.55	\$2.57
Spot AUD/USD	0.9056	0.8962	0.9402	0.9278	0.7791	0.7800	0.7702	0.7875	0.7321	0.6848
Unit Sales (#)	61,916	66,060	68,481	70,380	68,434	68,434	64,776	62,280	61,005	61,383
Revenue (\$m)	40.7	41.4	38.6	39.5	42.6	41.9	38.3	37.6	41.3	45.1
Gross Profit (\$m)	24.1	26.4	24.1	24.9	27.2	26.8	24.4	24.0	23.8	26.0
Gross Margin (%)	59.1%	63.7%	62.5%	63.0%	63.9%	63.9%	63.9%	63.9%	57.6%	57.7%
EBITDA (\$m)	4.0	1.9	5.6	5.6	4.8	4.6	2.4	2.1	2.4	3.6
EBITDA Margin (%)	9.7%	4.7%	14.5%	14.2%	11.3%	11.0%	6.4%	5.6%	5.8%	8.1%
EBIT (\$m)	3.4	1.4	4.2	4.2	4.2	4.0	1.8	1.5	1.7	3.0
Normalised NPAT (\$m)	3.6	1.1	3.8	3.7	3.9	3.7	1.8	1.4	1.5	2.1
Reported EPS (¢)	8.1¢	2.4¢	7.5¢	7.6¢	7.1¢	6.7¢	3.2¢	2.6¢	2.8¢	4.1¢
EV/Revenue (x)	1.2x	1.7x	2.1x	2.2x	3.7x	3.1x	3.3x	3.1x	2.8x	2.8x
Recommendation	SpecBuy	SpecBuy	BUY	BUY	HOLD	LTBuy	HOLD	HOLD	HOLD	

Source: Select Equities Research

BUSINESS DESCRIPTION

- SOM is a developer, manufacturer and marketer of oral appliances for the treatment of sleep disordered breathing (SDB). Its core product offering is the SomnoDent MAS, an oral appliance (OA) known as a mandibular advancement splint (MAS) for the treatment of obstructive sleep apnea (OSA). The company markets a range of products and technologies, both proprietary and under licence, including SomnoDent Classic, Flex, G2, Fusion, Herbst and Air product lines, the DentiTrac compliance system, the MATRx sleep lab assessment system.

RISK FACTORS

- Given the immature status of the OA market for the treatment of SDB, demand may not eventuate as forecast. The greatest sources of risk to market demand are a lack of acceptance by the medical fraternity and the levels of insurance/government reimbursement.
- SOM's position as market leader may be threatened by new entrants or the release of a superseding product. The benefits of SOM's research and marketing expenditure may not yield positive results.
- Downward pressure on prices may come from competition, lack of demand or insufficient insurance reimbursement.
- A device that has been incorrectly fitted or manufactured may cause patient injury and result in lawsuits or product recalls.
- As the bulk of SOM's sales are made offshore, its revenues are subject to exchange rate fluctuation.
- Unit price dilution from an increase in product mix towards lower-priced mid-tier products.
- Cannibalisation and brand value dilution due to the introduction of lower-priced items.

SomnoMed Ltd

Select Equities Research

Small Caps

Code	SOM				June Year End	FY14A	FY15A	FY16E	FY17E
Last sale (\$)	20-Jan-16				\$2.57				
# Shares (m)	51.4				Financial Position (\$m)				
# Options (m)	1.1				Cash	2.9	8.3	8.0	10.1
Diluted Mkt Cap (\$m)	134.9				Accounts Receivable	5.5	7.2	8.5	9.9
Net Debt (\$m)	-8.0				Inventory	1.0	1.3	1.5	1.6
Enterprise Value (\$m)	127.0				PPE	1.3	2.1	3.5	4.8
June Year End	FY14A	FY15A	FY16E	FY17E	Other Assets	8.5	8.9	9.5	9.0
Financial Performance (\$m)					Total Assets	19.1	27.8	31.0	35.4
Revenue	30.3	34.4	45.1	54.2	Accounts Payable	3.5	4.0	4.5	5.0
Gross Profit	16.8	19.5	26.0	31.9	Borrowings	0.0	0.0	0.0	0.0
EBITDA	0.8	0.6	3.6	5.8	Provisions	0.9	0.9	1.2	1.4
D & A	-0.6	-0.6	-0.7	-0.7	Other Liabilities	2.2	1.4	0.9	0.5
EBIT	0.2	0.0	3.0	5.1	Total Liabilities	6.6	6.2	6.6	6.9
PBT	0.2	0.1	3.0	5.2	Net Assets	12.6	21.5	24.4	28.5
NPAT (pre-abs. & NCI)	0.2	-0.1	2.1	3.7	Issued Capital	26.5	33.7	34.2	34.4
Abnormals	0.0	0.6	0.0	0.0	Reserves	2.4	3.6	3.9	4.0
NPAT (pre-NCI)	0.2	0.5	2.1	3.7	Retained Earnings	-16.5	-15.9	-13.8	-10.1
NCI	0.2	0.1	0.0	0.0	NCI	0.2	0.2	0.2	0.2
NPAT (reported)	0.4	0.6	2.1	3.7	Total Equity	12.6	21.5	24.4	28.5
EPS (¢)	0.9	1.2	4.1	7.0	Cash Flows (\$m)				
DPS (¢)	0.0	0.0	0.0	2.3	Net Receipts	-0.3	-0.3	3.0	5.3
NTA (¢)	14.2	30.1	33.5	41.1	Net Interest	0.0	0.1	0.1	0.1
Book Value / Share (¢)	27.5	41.5	46.5	54.0	Tax Received/(Paid)	-0.5	-0.1	-0.5	-0.9
Valuation/Performance Ratios					Operating Cash Flow	-0.8	-0.2	2.6	4.4
PER (x)	284.4	209.9	63.0	37.0	Acquisitions & Investments	-0.3	-0.2	-1.2	-0.3
Ent. Value/ Revenue (x)	4.2	3.7	2.8	2.3	Net Purchase of PPE	-0.3	-1.2	-1.9	-1.9
Ent. Value/ EBITDA (x)	150.7	210.3	34.9	21.8	Capitalised Developments	-0.1	-0.1	-0.1	-0.1
Revenue Growth (%)	63.7%	13.8%	30.9%	20.3%	Investing Cash Flow	-0.4	-1.5	-3.3	-2.3
Gross Profit Growth (%)	37.0%	16.0%	33.4%	22.5%	Net Change in Equity	0.0	7.1	0.2	0.0
EBITDA Growth (%)	27.4%	-28.4%	503.1%	60.1%	Net Change in Debt	0.0	0.0	0.0	0.0
NPAT Growth (%)	-67.2%	-126.6%	-3558%	71.8%	Dividends	0.0	0.0	0.0	0.0
EPS Growth (%)	-32.8%	35.5%	233.3%	70.3%	Financing Cash Flow	0.0	7.1	0.2	0.0
P/NTA (x)	18.1	8.5	7.7	6.3	Net Inc/Dec Cash	-1.2	5.3	-0.5	2.2
P/BV (x)	9.3	6.2	5.5	4.8	Cash at Beginning of Yr	4.2	2.9	8.3	8.0
Yield (%)	0.0%	0.0%	0.0%	0.9%	Net FX Effect on Cash	0.0	0.0	0.1	0.0
Payout Ratio (%)	0%	0%	0%	33%	Cash at End of Year	2.9	8.3	8.0	10.1
Franking (%)	0%	0%	0%	0%	Free Cash Flow (\$m)				
Gross Margin (%)	55.5%	56.6%	57.7%	58.8%	Operating Cash Flow	-0.8	-0.2	2.6	4.4
EBITDA Margin (%)	2.8%	1.8%	8.1%	10.8%	Δ Working Capital	1.4	1.5	0.9	0.9
EBIT Margin (%)	0.8%	-0.1%	6.6%	9.4%	Normalised OCF	0.6	1.2	3.5	5.4
NPAT Margin (%)	0.8%	-0.2%	4.7%	6.8%	Less Maintenance CapEX	-1.0	-1.2	-1.3	-1.5
Current Ratio (x)	2.0	3.1	3.0	3.2	FCFE	-0.4	0.1	2.2	3.9
Interest Cover (x)	-17.0	0.2	-39.0	-42.0	FCFE/NPAT Conversion (%)	-155%	-90%	104%	105%
Net Debt/Equity (%)	-23.4%	-38.6%	-32.6%	-35.5%	P/FCFE (x)	-375.3	2420.4	60.9	35.0
ROE (%)	3.5%	0.0%	9.3%	13.8%	SomnoDent Unit Sales				
ROIC (%)	2.6%	-1.7%	13.9%	20.3%	Units #	43,438	51,355	61,383	73,958
Interim Results (\$m)					Growth (%)	21.2%	18.2%	19.5%	20.5%
Revenue	12.6	17.7	14.8	19.6	Segment Revenue (\$m)				
Gross Profit	8.1	8.7	9.5	10.0	USA	12.0	14.5	24.2	29.4
EBITDA	0.6	0.2	0.3	0.3	Growth (%)	23.3%	21.4%	66.5%	21.4%
D & A	-0.3	-0.3	-0.3	-0.3	Europe	15.2	16.5	17.1	20.6
EBIT	0.4	-0.1	0.0	0.0	Growth (%)	147.0%	8.3%	3.6%	20.9%
PBT	0.4	-0.1	0.1	0.0	Asia Pacific	3.1	3.4	3.8	4.2
NPAT (pre-abs. & NCI)	0.0	0.2	0.0	0.0	Growth (%)	18.0%	11.0%	10.5%	10.2%
NPAT (reported)	0.0	0.4	0.0	0.6					

Source: Company Reports and Select Equities Research

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