

SomnoMed

A strong run but more to come

ADD (no change)

Current price:	A\$2.23
Target price:	A\$2.55 ▲
Previous target:	A\$2.02
Up/downside:	14.3%
Reuters:	SOM.AX
Bloomberg:	SOM AU
Market cap:	US\$129.7m A\$184.6m
Average daily turnover:	US\$0.11m A\$0.16m
Current shares o/s	82.76m
Free float:	67.1%

- SOM released its 1Q21 cashflow report with signs of recovery now evident and a clear path back to growth following the global shutdowns.
- While sales remain volatile, Europe continues to outperform all other jurisdictions in terms of a return to historical sales levels, backed by positive reimbursement trends and potential for these devices to act as a first-line treatment to directly compete with CPAP.
- Positive sales trends continued late into the quarter across all jurisdictions, giving further confidence of a continued recovery.
- We have made no changes to forecasts although alter our risk assumptions following continuation of improved trading conditions from COVID lows.
- Our TP increases to A\$2.55 (from A\$2.02) and we retain an Add recommendation.

1Q21 report – positive trends and closing in on pre-COVID levels

SOM reported unaudited revenues of A\$13.7m (down 6.0%) versus pre-COVID sales of A\$14.6m in the pcp. Importantly, the upward trend in sales on the prior quarter continues, showing a 61% improvement. In particular strong September sales across all regions indicate this trend is likely to continue into 2Q21. Europe continues to show strong recovery, and is tracking around pre-COVID levels – aided by strong reimbursement rates and indication from authorities to class oral appliances as first-line treatment to compete directly with CPAP. North America remains volatile but has improved to 75-85% of pre-COVID volumes (from 60-65% in the prior quarter) and revenues. Given the tight cost-containment measures SOM employed throughout COVID, the company generated A\$1.3m in operating cashflow and closed the period with A\$30.3m in cash.

COVID austerity measures to be relaxed

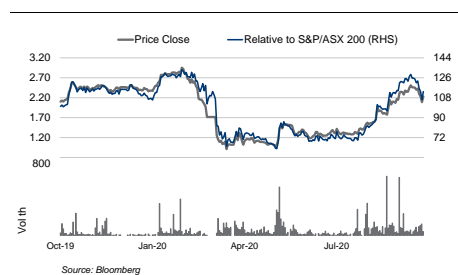
Given the level of recovery in SOM's global business, the company announced the reinstatement of all staff salaries from 2Q21. While the temporary reduction has certainly aided recent quarterly performance, we view this as a further sign of management's confidence in the near- / medium-term recovery of sales across its jurisdictions.

No changes to forecasts

We have made no changes to forecasts. Given 1Q is historically the weakest quarter (~22.7% of annualised sales), we view the A\$13.7m in 1Q sales (A\$60.4m annualised at historical splits) along with the positive trend in jurisdictional improvements is tracking to expectations compared to our FY21 forecast of A\$65.5m.

Investment view – retain positive recommendation

While we have made no changes to forecasts, we have reduced our WACC in response to lower perceived risks surrounding SOM's ability to generate cashflow positive (albeit aided) and continued easing of COVID related restrictions globally. Our WACC reduces to 9.4% (from 10.5%), resulting in an increase of our target price to A\$2.55 (from A\$2.02). Downside risks lie in further waves of shutdowns of dental / sleep facilities across its major jurisdictions prolonging the expected time-frame to a resumption of normal trading. We retain an Add recommendation.



Price performance	1M	3M	12M
Absolute (%)	6.2	64	4.7
Relative (%)	0.7	61	11.7

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

– N/A

Financial Summary

	Jun-19A	Jun-20A	Jun-21F	Jun-22F	Jun-23F
Revenue (A\$m)	58.89	57.30	65.51	74.73	85.60
Operating EBITDA (A\$m)	4.95	4.72	4.16	7.38	10.19
Net Profit (A\$m)	-0.04	-0.44	1.56	3.31	5.30
Normalised EPS (A\$)	(0.001)	(0.005)	0.019	0.040	0.064
Normalised EPS Growth	(100%)	736%		112%	60%
FD Normalised P/E (x)	NA	NA	118.2	55.8	34.8
DPS (A\$)	-	-	-	-	-
Dividend Yield	0%	0%	0%	0%	0%
EV/EBITDA (x)	27.10	34.27	39.54	22.11	15.67
P/FCFE (x)	11.61	15.43	NA	39.10	21.49
Net Gearing	(26.3%)	(67.1%)	(58.3%)	(58.2%)	(60.7%)
P/BV (x)	7.78	5.45	5.38	5.04	4.52
ROE	(0.1%)	(1.7%)	4.6%	9.3%	13.7%

SOURCE: MORGANS, COMPANY REPORTS

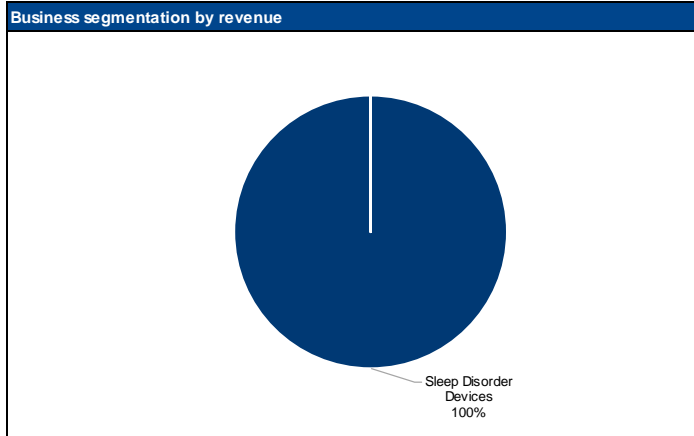
SomnoMed

as at October 21, 2020

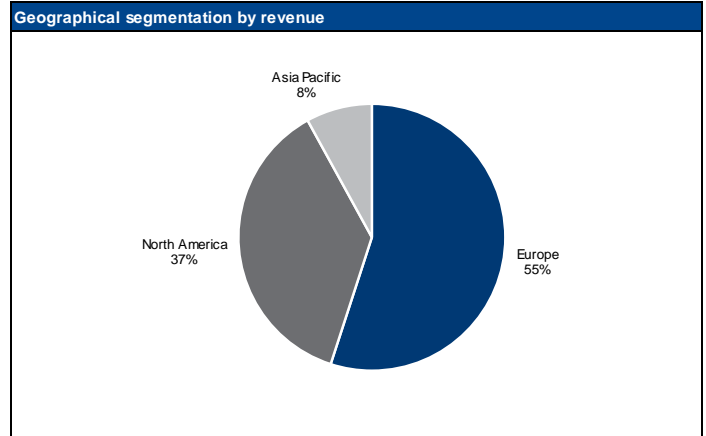
Market cap (A\$m):	184.6	Rating:	ADD
Shares outstanding (m):	82.76	Price (A\$):	2.23
Free float (%):	67.1	Target price (A\$):	2.55
Website:	www.somnomed.com.au	Upside/downside to target price (%):	14.3

Company description

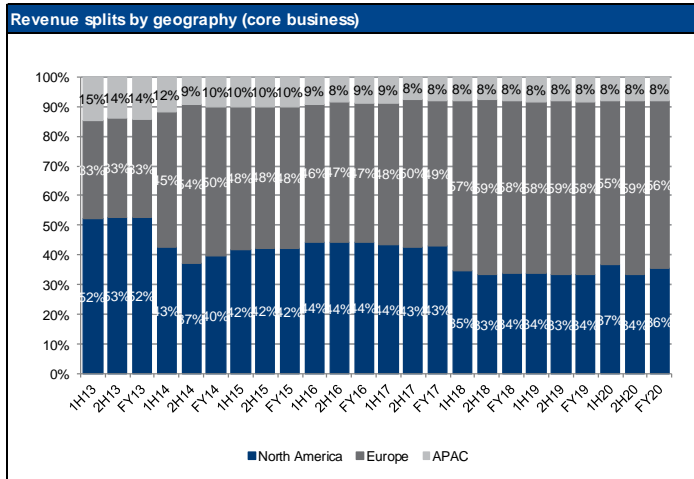
SomnoMed Limited (SOM) provides diagnostic and treatment solutions for Sleep-related Breathing Disorders including obstructive sleep apnea, snoring and bruxism. SOMNODENT: SomnoDent is an Oral Sleep Apnea (OSA) Appliance consisting of two dental plates, which look similar to a sports mouth guard. SomnoDent product has a number of designs including a Flex, Classic and G2. SomnoDent is custom made to fit patient's mouth and should be worn at night whilst sleeping in order to bring lower jaw forward and open up the airway. SomnoDent is designed for the patient who suffers from mild to moderate OSA.



SOURCE: COMPANY



SOURCE: COMPANY



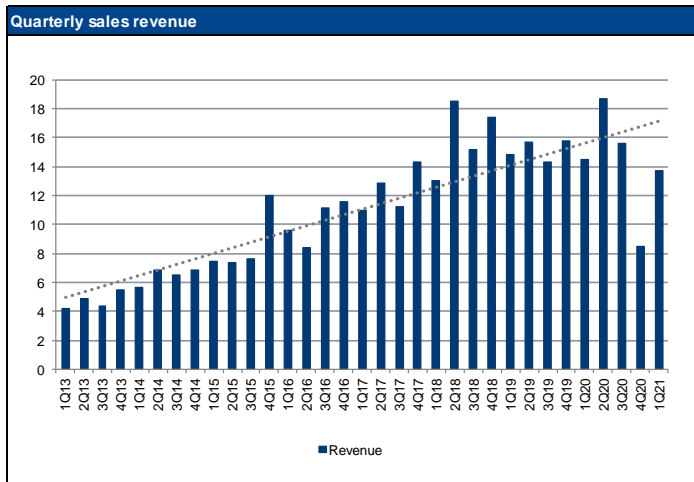
SOURCE: MORGANS, COMPANY

COVID-19 RISKS

The specific risks associated with the Coronavirus (COVID 19) event are:

- Patients not being able to seek diagnosis and obtain treatment and people not wanting or able to visit dentists
- Inability to collect accounts receivable from customers whose practices have been temporarily closed
- Manufacturing risk such that there is an inability to have technicians physically able to come to work and perform their duties
- Third party supply disruption of necessary raw material
- Executive management contracting COVID 19 and remaining sick or no longer being able to fulfil their duties in any capacity
- Prolonged periods of lock down in SomnoMed's sales markets
- Ongoing support of current finance providers

SOURCE: MORGANS, COMPANY



SOURCE: MORGANS, COMPANY

Key drivers / risks

Key Drivers

- Compliance** - Higher compliance rates (80% for COAT vs <50% for CPAP) and lower cost than CPAP competitors.
- Expansion** - European expansion continuing to show strong growth. Underserved market for treatment modality
- Turnaround** - Watching for evidence of a US turnaround after a direct retail channel move was received poorly by existing wholesale customers.

Key risks:

- FX** - Majority of revenues generated outside of Australia.
- Substitution** - A number of new and existing alternative products exist in the sleep apnea space which may impact SOM's ability to gain market share.
- Reimbursement** - Risk that insurance companies/governments which partially or fully subsidise the products reduce or exclude the reimbursement for the treatment.

SOURCE: MORGANS, COMPANY

Figure 1: Financial summary

Income statement						Valuation metrics							
	FY19A	FY20A	FY21F	FY22F	FY23F						Price Target (A\$)	\$2.55	
Total revenue	58.9	57.3	65.5	74.7	85.6	DCF valuation inputs						10-year rate	3.00%
EBITDA	4.9	4.7	4.2	7.4	10.2	Rf	3.00%					Margin	2.0%
Associate income	0.0	0.0	0.0	0.0	0.0	Rm-Rf	4.50%					Kd	3.50%
Depreciation	-1.4	-3.1	-3.1	-3.1	-3.1	Beta	1.70					Ke	13.3%
EBITA	3.5	1.6	1.1	4.3	7.1	CAPM (Rf+Beta(Rm-Rf))	10.7%					NPV cash flow (A\$m)	188.1
Amortisation/impairment	0.0	0.0	0.0	0.0	0.0	Equity (E/EV)	60.0%					Minority interest (A\$m)	0.0
EBIT	3.5	1.6	1.1	4.3	7.1	Debt (D/EV)	40.0%					Net debt (A\$m)	-22.7
Net interest expense	-0.2	-0.5	0.6	0.6	0.6	Interest rate	3.50%					Investments (A\$m)	0.0
Pre-tax profit	0.6	0.7	1.6	4.7	7.6	Tax rate (t)	30.0%					Equity market value (A\$m)	210.8
Income tax expense	-0.6	-1.2	0.0	-1.4	-2.3	WACC	9.4%					Diluted no. of shares (m)	82.8
After-tax profit	0.0	-0.4	1.6	3.3	5.3								\$2.55
Minority interests	0.0	0.0	0.0	0.0	0.0								
NPAT	0.0	-0.4	1.6	3.3	5.3								
Significant items	-16.4	-0.7	0.0	0.0	0.0								
NPAT post abnormal	-16.4	-1.1	1.6	3.3	5.3								
Cash flow statement						Multiples							
	FY19A	FY20A	FY21F	FY22F	FY23F		FY19A	FY20A	FY21F	FY22F	FY23F		
EBITDA	4.9	4.7	4.2	7.4	10.2	Enterprise value (A\$m)	131.5	158.5	155.8	157.1	160.5		
Change in working capital	7.8	9.1	-3.2	-1.0	-0.8	EV/Sales (x)	2.2	2.8	2.4	2.1	1.9		
Net interest (pd)/rec	0.0	0.0	0.0	0.0	0.0	EV/EBITDA (x)	26.6	33.6	37.4	21.3	15.7		
Taxes paid	0.6	1.2	0.0	1.4	2.3	EV/EBIT (x)	37.6	96.8	144.7	36.6	22.6		
Other oper cash items	0.0	0.0	0.0	0.0	0.0	PE (x)	-2306.7	-276.0	77.4	36.5	22.8		
Cash flow from ops (1)	13.4	15.0	1.0	7.8	11.7	PEG x)	23.2	-0.4	-0.2	0.3	0.4		
Capex (2)	-1.4	-3.1	-3.1	-3.1	-3.1								
Disposals/(acquisitions)	0.0	0.0	0.0	0.0	0.0								
Other investing cash flow	0.0	0.0	0.0	0.0	0.0								
Cash flow from investing (3)	-1.4	-3.1	-3.1	-3.1	-3.1								
Incr/(decr) in equity	0.0	0.0	0.0	0.0	0.0								
Incr/(decr) in debt	0.0	0.0	0.0	0.0	0.0								
Ordinary dividend paid	0.0	0.0	0.0	0.0	0.0								
Preferred dividends (4)	0.0	0.0	0.0	0.0	0.0								
Other financing cash flow	-0.6	-2.5	0.0	0.0	0.0								
Cash flow from fin (5)	-0.6	-2.5	0.0	0.0	0.0								
Forex and disc ops (6)	0.0	0.0	0.0	0.0	0.0								
Inc/(decr) cash (1+3+5+6)	11.4	9.5	-2.1	4.7	8.6								
Equity FCF (1+2+4)	11.9	12.0	-2.1	4.7	8.6								
Balance sheet						Per share data							
	FY19A	FY20A	FY21F	FY22F	FY23F		FY19A	FY20A	FY21F	FY22F	FY23F		
Cash & deposits	7.7	30.2	27.5	28.8	32.3	No. shares	62.2	82.8	82.8	82.8	82.8		
Trade debtors	10.7	7.7	8.1	9.2	10.6	EPS (cps)	-0.1	-0.5	1.9	4.0	6.4		
Inventory	1.9	2.2	0.0	0.0	0.0	Dividend per share (c)	0.0	0.0	0.0	0.0	0.0		
Other current assets	0.0	0.0	0.0	0.0	0.0	Dividend payout ratio (%)	0.0%	0.0%	0.0%	0.0%	0.0%		
Goodwill	0.0	0.0	0.0	0.0	0.0	Dividend yield (%)	0.0%	0.0%	0.0%	0.0%	0.0%		
Other intangible assets	0.0	0.0	0.0	0.0	0.0								
Fixed assets	3.2	3.9	3.9	3.9	3.9								
Investments	0.0	0.0	0.0	0.0	0.0								
Other assets	11.2	17.7	17.7	17.7	17.7								
Total assets	34.8	61.7	57.1	59.6	64.4								
Short-term borrowings	0.0	0.0	0.0	0.0	0.0								
Trade payables	8.2	8.7	3.6	3.8	4.3								
Long-term borrowings	3.0	7.5	7.5	7.5	7.5								
Other term liabilities	1.5	8.7	8.7	8.7	8.7								
Other liabilities	0.0	0.0	0.0	0.0	0.0								
Total liabilities	16.9	27.9	22.8	23.0	23.5								
Share capital	57.7	73.9	73.9	73.9	73.9								
Other reserves	7.7	8.6	8.6	8.6	8.6								
Retained earnings	-47.5	-48.7	-48.2	-45.9	-41.6								
Other equity	0.0	0.0	0.0	0.0	0.0								
Total equity	17.8	33.8	34.3	36.6	40.9								
Minority interest	0.0	0.0	0.0	0.0	0.0								
Total shareholders' equity	17.8	33.8	34.3	36.6	40.9								
Total liabilities & SE	34.8	61.7	57.1	59.6	64.4								
Growth ratios						Operating performance							
	FY19A	FY20A	FY21F	FY22F	FY23F		FY19A	FY20A	FY21F	FY22F	FY23F		
Sales growth	-7.4%	-2.7%	14.3%	14.1%	14.5%	Asset turnover (%)	36.6	29.7	27.6	32.0	34.5		
Operating cost growth	-23.0%	-2.5%	16.7%	9.8%	12.0%	EBITDA margin (%)	8.4	8.2	6.4	9.9	11.9		
EBITDA growth	177.1%	-4.5%	-11.9%	77.4%	38.1%	EBIT margin (%)	5.9	2.9	1.6	5.7	8.3		
EBITA growth	143.2%	-53.2%	-34.3%	299.2%	65.5%	Net profit margin (%)	-0.1	-0.8	2.4	4.4	6.2		
EBIT growth	143.2%	-53.2%	-34.3%	299.2%	65.5%	Return on net assets (%)	2.5	1.3	-14.4	-22.4	19.6		
NPAT growth	99.6%	-1012%	456.7%	111.9%	60.1%	Net debt (A\$m)	-4.7	-22.7	-20.0	-21.3	-24.8		
Normalised EPS growth	-99.6%	735.6%	-456.7%	111.9%	60.1%	Net debt/equity (%)	-26.3	-67.1	-58.3	-58.2	-60.7		
Internal liquidity						Net interest/EBIT cover (x)							
	FY19A	FY20A	FY21F	FY22F	FY23F		FY19A	FY20A	FY21F	FY22F	FY23F		
Current ratio (x)	2.5	4.6	9.8	10.1	9.9	Invested capital	20.9	20.3	11.1	14.3	15.3		
Receivables turnover (x)	4.8	6.2	8.3	8.6	8.7	ROIC (%)	-0.2	-2.2	14.0	23.1	34.6		
Payables turnover (x)	6.5	6.2	10.0	18.2	18.6								

SOURCE: MORGANS RESEARCH, COMPANY

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