

SomnoMed

Coming into a seasonally strong period

ADD (no change)

Current price:	A\$3.58
Target price:	A\$4.04
Previous target:	A\$3.88
Up/downside:	12.8%
Reuters:	SOM.AX
Bloomberg:	SOM AU
Market cap:	US\$158.9m
	A\$210.3m
Average daily turnover:	US\$0.12m
	A\$0.15m
Current shares o/s	54.24m
Free float:	87.6%



Price performance	1M	3M	12M
Absolute (%)	-2.7	12.2	-1.9
Relative (%)	-3.4	8.7	-12.8

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- SOM reported a solid quarterly result with Europe continuing to be the strongest driver within the core business. North America sales weakened however the next quarter is seasonally strong.
- Management has reiterated guidance for a solid uplift in revenues and EBITDA as the RSS business gathers pace.
- We have upgraded our price target and retain an Add recommendation.

1Q18 sales show strong growth, Europe charging

SOM recently released its 1Q18 cashflow report which again showed strong revenue growth on the pcp. Revenues increased 18.8% to A\$13.0m on the pcp with particularly strong growth in Europe offsetting a continued channel conflict in the US. European sales lifted 24% on the pcp, offsetting a 6% decline in North American sales, while APAC sales steadily improved. Notwithstanding channel conflict issues, higher patient deductibles (from ~US\$2-3k to ~US\$7-8k) are causing patients to defer elective medical treatments such as obstructive sleep apnea treatments. What this means is many patients now need to spend >\$7k before insurance coverage kicks in - resulting in the decision to delay treatment until these caps are met. With the high cost of medical treatments in the US and relative ease of hitting these deductible limits within a single benefit year, we don't see this as being a particularly significant issue although likely to add to the seasonality of sales. Operating cashflow is expected to remain volatile quarter to quarter with significant growth initiatives and working capital investments to support RSS build-up. SOM ended the period with A\$9.7m in cash and no debt.

Guidance reiterated - remains strong

SOM remain positive on the outlook for FY18 with the historically weakest quarter behind them and have reiterated FY18 guidance of A\$75m revenue and A\$5m EBITDA. The guidance implies a 52% uplift in revenues and turnaround in EBITDA (from A\$1.7m loss) from the FY17 results. Of note, SOM has seen a tripling of enquiries from the RSS business between August and October and are coming into a seasonally strong period.

Changes to forecasts

We have remodeled our RSS segment and applied a more conservative outlook on the RSS roll-out in the short term until we see more evidence of the performance and throughput to de-risk this segment as the clinics mature. SOM has now opened 12 clinics since January 2017. The result of these changes are outlined in the changes to forecast table on page 3. Even so, we maintain an increasingly positive view on the medium to long term prospects of the business once RSS achieves breakeven (after new clinic startup costs). We view RSS as a major growth platform for the company.

Investment view increasingly positive

Our DCF valuation increases to A\$4.04 (from A\$3.88), driven by improved earnings in our outer year forecasts as a result of upgrades to our long-term margin assumptions. We retain an Add recommendation. The key downside risk to our target is slower-than-expected growth in the key markets.

Financial Summary	Jun-16A	Jun-17A	Jun-18F	Jun-19F	Jun-20F
Revenue (A\$m)	44.1	49.3	75.7	120.3	154.1
Operating EBITDA (A\$m)	1.47	(2.43)	4.03	16.48	25.17
Net Profit (A\$m)	(0.16)	(3.96)	2.71	10.38	15.88
Normalised EPS (A\$)	(0.00)	(0.07)	0.05	0.19	0.29
Normalised EPS Growth	(130%)	2345%		283%	53%
FD Normalised P/E (x)	NA	NA	71.71	18.72	12.23
DPS (A\$)	-	-	-	-	-
Dividend Yield	0%	0%	0%	0%	0%
EV/EBITDA (x)	116.4	NA	44.6	10.6	6.5
P/FCFE (x)	NA	NA	179.7	13.7	7.7
Net Gearing	(53.2%)	(44.1%)	(42.3%)	(44.6%)	(52.9%)
P/BV (x)	5.68	6.03	5.63	4.38	3.26
ROE	(0.6%)	(12.1%)	8.1%	26.3%	30.6%
% Change In Normalised EPS Estimates			(34.9%)	(23.8%)	(1.0%)
Normalised EPS/consensus EPS (x)			1.16	1.05	1.05

SOURCE: MORGANS, COMPANY REPORTS

Figure 1: Financial summary

	AIFRS	AIFRS	AIFRS	AIFRS	AIFRS	Share price (A\$)	3.58									
	FY16A	FY17A	FY18F	FY19F	FY20F	Valuation metrics										
Income statement												Price Target (A\$)	\$4.04			
Total revenue	44.1	49.3	75.7	120.3	154.1	DCF valuation inputs										
EBITDA	1.5	-2.4	4.0	16.5	25.2	Rf	4.00%	10-year rate	4.00%							
Associate income	0.0	0.0	0.0	0.0	0.0	Rm-Rf	4.50%	Margin	2.0%							
Depreciation	-1.0	-1.2	-1.3	-2.0	-3.0	Beta	1.60	Kd	4.20%							
EBITA	0.4	-3.7	2.7	14.5	22.2	CAPM (Rf+Beta(Rm-Rf))	11.2%	Ke	13.6%							
Amortisation/impairment	0.0	0.0	0.0	0.0	0.0	Equity (E/EV)	60.0%	NPV cash flow (A\$m)	204.4							
EBIT	0.4	-3.7	2.7	14.5	22.2	Debt (D/EV)	40.0%	Minority interest (A\$m)	0.0							
Net interest expense	-0.2	0.1	0.2	0.2	0.4	Interest rate	4.20%	Net debt (A\$m)	-14.6							
Pre-tax profit	0.3	-3.6	3.0	14.7	22.5	Tax rate (t)	30.0%	Investments (A\$m)	0.0							
Income tax expense	-0.4	-0.4	-0.2	-4.3	-6.6	WACC	9.9%	Equity market value (A\$m)	219.0							
After-tax profit	-0.2	-4.0	2.7	10.4	15.9							Diluted no. of shares (m)	54.2			
Minority interests	0.0	0.0	0.0	0.0	0.0							DCF valuation	\$4.04			
NPAT	-0.2	-4.0	2.7	10.4	15.9											
Significant items	0.0	0.0	0.0	0.0	0.0											
NPAT post abnormals	-0.2	-4.0	2.7	10.4	15.9											
Cash flow statement																
EBITDA	1.5	-2.4	4.0	16.5	25.2	Multiples						FY16A	FY17A	FY18F	FY19F	FY20F
Change in working capital	1.0	0.3	-1.9	-4.7	-3.4	Enterprise value (A\$m)	211.8	208.4	208.7	213.9	225.7					
Net interest (pd)/rec	0.0	0.0	0.0	0.0	0.0	EV/Sales (x)	4.8	4.2	2.8	1.8	1.5					
Taxes paid	0.4	0.4	0.2	4.3	6.6	EV/EBITDA (x)	144.5	-85.6	51.8	13.0	9.0					
Other oper cash items	0.0	0.0	0.0	0.0	0.0	EV/EBIT (x)	475.4	-56.8	76.5	14.8	10.2					
Cash flow from ops (1)	2.9	-1.8	2.4	16.1	28.4	PE (x)	-1198.2	-49.0	71.7	18.7	12.2					
Capex (2)	-3.2	-3.1	-1.3	-2.0	-3.0	PEG x)	9.2	0.0	0.4	0.1	0.2					
Disposals/(acquisitions)	0.0	0.0	0.0	0.0	0.0	Per share data						FY16A	FY17A	FY18F	FY19F	FY20F
Other investing cash flow	0.0	0.0	0.0	0.0	0.0	No. shares	52.6	54.2	54.2	54.2	54.2					
Cash flow from investing (3)	-3.2	-3.1	-1.3	-2.0	-3.0	EPS (cps)	-0.3	-7.3	5.0	19.1	29.3					
Incr/(decr) in equity	10.5	2.4	0.0	0.0	0.0	Dividend per share (c)	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 payout ratio (%)	0.0%	0.0%	0.0%	0.0%	0.0%					
Ordinary dividend paid	0.0	0.0	0.0	0.0	0.0	Dividend yield (%)	0.0%	0.0%	0.0%	0.0%	0.0%					
Preferred dividends (4)	0.0	0.0	0.0	0.0	0.0	Growth ratios						FY16A	FY17A	FY18F	FY19F	FY20F
Other financing cash flow	0.0	0.0	0.0	0.0	0.0	Sales growth	28.0%	11.9%	53.4%	59.0%	28.1%					
Cash flow from fin (5)	10.5	2.4	0.0	0.0	0.0	Operating cost growth	28.1%	21.5%	38.4%	44.9%	24.2%					
Forex and disc ops (6)	0.0	0.0	0.0	0.0	0.0	EBITDA growth	25.1%	-266.1%	265.4%	309.2%	52.7%					
Incr/(decr) cash (1+3+5+6)	10.1	-2.5	1.1	14.1	25.4	EBITA growth	-17.7%	-923.0%	174.4%	430.9%	53.1%					
Equity FCF (1+2+4)	-0.3	-4.9	1.1	14.1	25.4	EBIT growth	-17.7%	-923.0%	174.4%	430.9%	53.1%					
						NPAT growth	-131.1%	2421.5%	168.3%	283.1%	53.0%					
						Normalised EPS growth	-130.2%	2345.1%	168.3%	283.1%	53.0%					
Balance sheet																
Cash & deposits	17.6	14.2	14.6	19.8	31.5	Operating performance						FY16A	FY17A	FY18F	FY19F	FY20F
Trade debtors	7.8	10.5	9.3	14.8	19.0	Asset turnover (%)	32.3	30.2	47.5	68.6	67.4					
Inventory	1.7	1.9	0.0	0.0	0.0	EBITDA margin (%)	3.3	-4.9	5.3	13.7	16.3					
Other current assets	0.0	0.0	0.0	0.0	0.0	EBIT margin (%)	1.0	-7.4	3.6	12.0	14.4					
Goodwill	0.0	0.0	0.0	0.0	0.0	Net profit margin (%)	-0.4	-8.0	3.6	8.6	10.3					
Other intangible assets	0.0	0.0	0.0	0.0	0.0	Return on net assets (%)	1.3	-11.4	1.9	2.5	1.3					
Fixed assets	3.6	4.5	4.5	4.5	4.5	Net debt (A\$m)	-17.6	-14.2	-14.6	-19.8	-31.5					
Investments	0.0	0.0	0.0	0.0	0.0	Net debt/equity (%)	-53.2	-44.1	-42.3	-44.6	-52.9					
Other assets	9.7	10.1	10.1	10.1	10.1	Net interest/EBIT cover (x)										
Total assets	40.4	41.2	38.5	49.2	65.1	Invested capital	16.5	18.3	18.0	19.9	24.6					
Short-term borrowings	0.0	0.0	0.0	0.0	0.0	ROIC (%)	-1.0	-21.7	15.0	52.1	64.6					
Trade payables	6.1	8.0	3.0	3.8	4.6	Internal liquidity						FY16A	FY17A	FY18F	FY19F	FY20F
Long-term borrowings	0.0	0.0	0.0	0.0	0.0	Current ratio (x)	4.5	3.3	7.9	9.0	11.0					
Other term liabilities	0.1	0.4	0.4	0.4	0.4	Receivables turnover (x)	5.9	5.4	7.6	10.0	9.1					
Other liabilities	0.0	0.0	0.0	0.0	0.0	Payables turnover (x)	8.6	7.3	13.0	30.2	30.6					
Total liabilities	7.3	9.0	4.0	4.8	5.6											
Share capital	44.6	46.9	46.9	46.9	46.9											
Other reserves	4.4	4.4	4.4	4.4	4.4											
Retained earnings	-15.8	-19.1	-16.9	-7.0	8.2											
Other equity	0.0	0.0	0.0	0.0	0.0											
Total equity	33.1	32.2	34.5	44.4	59.5											
Minority interest	0.0	0.0	0.0	0.0	0.0											
Total shareholders' equity	33.1	32.2	34.5	44.4	59.5											
Total liabilities & SE	40.4	41.2	38.5	49.2	65.1											

SOURCE: MORGANS RESEARCH, COMPANY

Changes to forecasts

We have remodeled our RSS segment to enhance our ability to forecast earnings impact due to the timing of clinic openings. As opening costs are immediately expensed within the financial year a clinic opens, the timing and number of clinic starts has a sizeable impact on the reported earnings within the year. This effect is more pronounced in the short-term as earnings are modest.

As a result of our updated RSS model, we sit slightly below SOM guidance of A\$5m EBITDA in FY18 due to our timing assumptions. We assume a further five clinic openings toward the end of FY18.

Figure 2: Changes to forecasts

Metric	FY18F		FY19F		FY20F	
	Old	New	Old	New	Old	New
Revenue	77.7	75.7	104.2	120.3	131.7	154.1
% change		-3%		15%		17%
EBITDA	5.9	4.0	16.6	16.5	24.3	25.2
% change		-32%		-1%		3%
NPAT (normalised)	4.2	2.7	13.6	10.4	16.0	15.9
% change		-34%		-24%		-1%
EPS (c) normalised	7.7	5.1	25.1	19.1	29.6	29.3
% change		-34%		-24%		-1%
DPS (c)	0	0	0	0	0	0
% change		0%		0%		0%

SOURCE: MORGANS RESEARCH, COMPANY

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