

# SomnoMed

## Moving down the supply chain

**ADD** (no change)

Current price:	A\$3.38
Target price:	A\$3.72 ▲
Previous target:	A\$3.10
Up/downside:	10.1%
Reuters:	SOM.AX
Bloomberg:	SOM AU
Market cap:	US\$138.7m A\$191.7m
Average daily turnover:	US\$0.08m A\$0.11m
Current shares o/s	51.09m
Free float:	87.6%



Price performance	1M	3M	12M
Absolute (%)	20.7	27.3	38
Relative (%)	17.5	16.9	44.7

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- SOM is establishing a retail sleep centre business in the US.
- The company has raised funds to boost working capital and expand to over 15 centres by FY18.
- Although FY16 guidance has been slightly downgraded, we see further upside in future years.
- Our price target increases to A\$3.72 (from A\$3.10), and we retain our Add recommendation.

### Direct sales expansion with S3 exclusive license

SOM recently acquired exclusive rights to open and operate Simple Sleep Services LLC (S3) globally (with the exception of Texas). S3 advertises directly to patients, assists in reimbursement claims, and diagnoses and treats sleep patients while using SomnoDent devices exclusively. The S3 business will be held in a majority owned subsidiary to SOM (84% owned by SOM with S3 founders holding the remaining 16%) called Sleep Centres America (SCA). No cash consideration was paid for the license, however SOM will fund the roll-out of the new treatment centres. SOM aims to operate at least five centres by FY17 and 15 centres by FY18 end. SOM has estimated the centres require approximately A\$500k start-up investment and are expected to break even within 12 months of opening.

### Entitlement issue to support S3 deal expansion

SOM announced in early May a pro-rata non-renounceable 2:25 entitlement issue at A\$2.50 per shares to raise A\$10.5m before costs. The net proceeds will be used to provide a boost to working capital and to fund any capital investment associated with the SCA transaction.

### FY16 volume guidance revised slightly down, revenues up

SOM has downgraded its previous guidance for FY16 on the back of faster-than-anticipated decline in licensee sales. Previous guidance of 62,000 units reduces to 58,000 – 60,000 units, which implies total volume growth of 13-16% on the pcp. Direct sales growth increases by 2% to 24% growth on the pcp, while revenue is upgraded c6% to A\$44-45m due to the higher share of direct sales and growing managed care revenues in the US and Europe. Due to the lower sales volumes and higher proportion of lower margin mid-range offerings, gross margins have been revised from EBITDA of A\$3m to A\$2-2.4m in FY16.

### Investment remains positive

We have updated our model to reflect the lower-than-previously anticipated unit growth in FY16, but factor in higher sales and margins anticipated in future years due to growing proportion of direct sales associated with the SCA transaction. Our price target increases to A\$3.72 and we retain our Add recommendation. The key downside risk to our target is slower-than-expected growth in the US and EU markets.

Financial Summary	Jun-14A	Jun-15A	Jun-16F	Jun-17F	Jun-18F
Revenue (A\$m)	25.89	34.43	45.03	55.04	65.05
Operating EBITDA (A\$m)	0.85	1.21	2.77	6.18	9.37
Net Profit (A\$m)	0.23	0.54	1.95	5.02	7.89
Normalised EPS (A\$)	0.00	0.01	0.04	0.09	0.15
Normalised EPS Growth	(68%)	129%	241%	158%	57%
FD Normalised P/E (x)	732.6	320.2	93.8	36.4	23.2
DPS (A\$)	-	-	-	-	-
Dividend Yield	0%	0%	0%	0%	0%
EV/EBITDA (x)	194.7	136.4	56.8	24.6	15.4
P/FCFE (x)	NA	NA	24.36	29.23	18.74
Net Gearing	(5.7%)	(38.6%)	(76.2%)	(79.6%)	(83.3%)
P/BV (x)	13.27	8.03	5.39	4.69	3.90
ROE	1.9%	3.2%	7.0%	13.8%	18.4%
% Change In Normalised EPS Estimates			13.5%	33.1%	22.3%
Normalised EPS/consensus EPS (x)			1.09	1.35	1.34

SOURCE: MORGANS, COMPANY REPORTS

Figure 1: Financial summary

Income statement						Valuation metrics				
	FY14A	FY15A	FY16F	FY17F	FY18F				Price Target (A\$)	
Total revenue	25.9	34.4	45.0	55.0	65.0	<b>DCF valuation inputs</b>				\$3.72
EBITDA	0.9	1.2	2.8	6.2	9.4	Rf	4.00%	10-year rate	4.00%	
Associate income	0.0	0.0	0.0	0.0	0.0	Rm-Rf	4.00%	Margin	2.0%	
Depreciation	-0.6	-0.6	-0.6	-0.6	-0.6	Beta	1.70	Kd	4.20%	
EBITA	0.2	0.6	2.2	5.6	8.8	CAPM (Rf+Beta(Rm-Rf))	10.8%	Ke	13.0%	
Amortisation/impairment	0.0	0.0	0.0	0.0	0.0	Equity (E/EV)	60.0%	NPV cash flow (A\$m)	200.8	
EBIT	0.2	0.6	2.2	5.6	8.8	Debt (D/EV)	40.0%	Minority interest (A\$m)	0.0	
Net interest expense	0.0	0.1	0.0	0.0	0.0	Interest rate	4.20%	Net debt (A\$m)	-0.7	
Pre-tax profit	0.2	0.7	2.2	5.6	8.8	Tax rate (t)	30.0%	Investments (A\$m)	0.0	
Income tax expense	0.0	-0.2	-0.2	-0.6	-0.9	<b>WACC</b>	9.5%	Equity market value (A\$m)	201.5	
After-tax profit	0.2	0.5	2.0	5.0	7.9			Diluted no. of shares (m)	54.1	
Minority interests	0.0	0.0	0.0	0.0	0.0	<b>DCF valuation</b>				\$3.72
NPAT	0.2	0.5	2.0	5.0	7.9					
Significant items	0.0	0.0	0.0	0.0	0.0					
<b>NPAT post abnormals</b>	<b>0.2</b>	<b>0.5</b>	<b>2.0</b>	<b>5.0</b>	<b>7.9</b>					
Cash flow statement						Multiples				
	FY14A	FY15A	FY16F	FY17F	FY18F		FY15A	FY16F	FY17F	FY18F
EBITDA	0.9	1.2	2.8	6.2	9.4	Enterprise value (A\$m)	153.4	170.9	176.1	184.1
Change in working capital	-1.6	-1.3	5.1	0.1	0.1	EV/Sales (x)	4.5	3.8	3.2	2.8
Net interest (pd)/rec	0.0	-0.1	0.0	0.0	0.0	EV/EBITDA (x)	127.2	61.8	28.5	19.7
Taxes paid	0.0	0.2	0.2	0.6	0.9	EV/EBIT (x)	266.6	78.9	31.5	21.0
Other oper cash items	0.0	0.0	0.0	0.0	0.0	PE (x)	253.9	74.4	28.9	18.4
<b>Cash flow from ops (1)</b>	<b>-0.7</b>	<b>-0.1</b>	<b>8.1</b>	<b>6.9</b>	<b>10.4</b>	PEG x)	-9.2	0.3	0.2	0.3
Capex (2)	-0.4	-1.5	-0.6	-0.6	-0.6	<b>Per share data</b>				
Disposals/(acquisitions)	0.0	0.0	0.0	0.0	0.0	No. shares	49.4	51.1	54.1	54.1
Other investing cash flow	0.0	0.0	0.0	0.0	0.0	EPS (cps)	1.1	3.6	9.3	14.6
<b>Cash flow from investing (3)</b>	<b>-0.4</b>	<b>-1.5</b>	<b>-0.6</b>	<b>-0.6</b>	<b>-0.6</b>	Dividend per share (c)	0.0	0.0	0.0	0.0
Incr/(decr) in equity	0.0	7.1	10.5	0.0	0.0	Dividend payout ratio (%)	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%
Ordinary dividend paid	0.0	0.0	0.0	0.0	0.0	<b>Growth ratios</b>				
Preferred dividends (4)	0.0	0.0	0.0	0.0	0.0	Sales grow th	32.9%	30.8%	22.2%	18.2%
Other financing cash flow	0.0	0.0	0.0	0.0	0.0	Operating cost grow th	32.7%	27.2%	15.6%	14.0%
<b>Cash flow from fin (5)</b>	<b>0.0</b>	<b>7.1</b>	<b>10.5</b>	<b>0.0</b>	<b>0.0</b>	EBITDA grow th	41.3%	129.6%	123.4%	51.5%
Forex and disc ops (6)	0.0	0.0	0.0	0.0	0.0	EBITA grow th	136.5%	276.8%	157.6%	57.1%
<b>Incr/(decr) cash (1+3+5+6)</b>	<b>-1.2</b>	<b>5.5</b>	<b>18.0</b>	<b>6.3</b>	<b>9.8</b>	EBIT grow th	136.5%	276.8%	157.6%	57.1%
Equity FCF (1+2+4)	-1.1	-1.6	7.5	6.3	9.8	NPAT grow th	136.8%	261.7%	157.6%	57.1%
						Normalised EPS grow th	-27.6%	241.4%	157.6%	57.1%
Balance sheet						Operating performance				
	FY14A	FY15A	FY16F	FY17F	FY18F		FY15A	FY16F	FY17F	FY18F
Cash & deposits	2.9	8.3	25.9	31.0	39.0	Asset turnover (%)	36.7	33.9	33.2	33.6
Trade debtors	5.5	7.2	1.9	2.3	2.7	EBITDA margin (%)	3.5	6.1	11.2	14.4
Inventory	1.0	1.3	0.0	0.0	0.0	EBIT margin (%)	1.7	4.8	10.1	13.5
Other current assets	0.0	0.0	0.0	0.0	0.0	Net profit margin (%)	1.6	4.3	9.1	12.1
Goodwill	0.0	0.0	0.0	0.0	0.0	Return on net assets (%)	2.7	6.4	14.3	1.9
Other intangible assets	0.0	0.0	0.0	0.0	0.0	Net debt (A\$m)	-8.3	-25.9	-31.0	-39.0
Fixed assets	1.3	2.1	2.1	2.1	2.1	Net debt/equity (%)	-38.6	-76.2	-79.6	-83.3
Investments	0.0	0.0	0.0	0.0	0.0	Net interest/EBIT cover (x)	n/a	n/a	n/a	
Other assets	8.5	8.9	8.9	8.9	8.9	Invested capital	11.9	13.2	8.1	8.0
<b>Total assets</b>	<b>19.1</b>	<b>27.7</b>	<b>38.7</b>	<b>44.3</b>	<b>52.7</b>	ROIC (%)	4.5	14.8	62.2	99.1
Short-term borrowings	0.0	0.0	0.0	0.0	0.0	<b>Internal liquidity</b>				
Trade payables	3.5	3.9	2.4	2.9	3.4	Current ratio (x)	4.3	11.6	11.4	12.1
Long-term borrowings	2.2	0.0	0.0	0.0	0.0	Receivables turnover (x)	5.4	10.0	26.8	26.4
Other term liabilities	0.0	1.1	1.1	1.1	1.1	Payables turnover (x)	9.1	13.5	18.4	17.5
Other liabilities	0.0	0.0	0.0	0.0	0.0					
<b>Total liabilities</b>	<b>6.6</b>	<b>6.2</b>	<b>4.7</b>	<b>5.3</b>	<b>5.8</b>					
Share capital	26.5	33.7	44.2	44.2	44.2					
Other reserves	2.6	3.7	3.7	3.7	3.7					
Retained earnings	-16.5	-15.9	-14.0	-9.0	-1.1					
Other equity	0.0	0.0	0.0	0.0	0.0					
<b>Total equity</b>	<b>12.6</b>	<b>21.5</b>	<b>34.0</b>	<b>39.0</b>	<b>46.9</b>					
Minority interest	0.0	0.0	0.0	0.0	0.0					
Total shareholders' equity	12.6	21.5	34.0	39.0	46.9					
Total liabilities & SE	19.1	27.7	38.7	44.3	52.7					

SOURCE: MORGANS RESEARCH, COMPANY

### Changes to forecasts

We reduced our forecast units sold in FY16 from c66,000 to 59,500 based on management guidance, but revise our average sales price higher as a result of a greater proportion of sales being achieved through direct channels than previously forecast. With the acquisition of a retail network, SOM has secured a large and expanding direct sales channel in the US.

As a result of our changes, revenue figures remain broadly the same at A\$45m for FY16 but increases c5% for FY17 and FY18. NPAT increases 15% to A\$2m and EBITDA rises 15% to A\$2.8m. Our FY17 & FY18 metrics increase in line with our assumptions of a higher margin environment as SOM's direct sales team continues to gather momentum in the US and Europe.

**Figure 2: Changes to forecasts**

	FY16F		FY17F		FY18F	
	Old	New	Old	New	Old	New
EBITDA	2.40	2.77	4.70	6.18	7.50	9.37
% change		15%		32%		25%
NPAT (normalised)	1.70	1.95	3.70	5.02	6.30	7.89
% change		15%		36%		25%
EPS (c ) normalised	3.20	3.60	7.00	9.28	12.90	14.58
% change		13%		33%		13%
DPS (c )	0.00	0	0.00	0	0.00	0
% change		0%		0%		0%

SOURCE: MORGANS RESEARCH, COMPANY

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Analyst owns shares in the following mentioned company(ies): SomnoMed

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