

stock update

RECOMMENDATION: SPECULATIVE BUY

SomnoMed Ltd

Strong unit sales growth continues

 Stock Code: SOM
 Last Sale: \$1.52
 Market Cap (fd): \$68.1
 Risk Level: High

28 February 2014 EVENT

- SomnoMed Ltd (SOM) released its 1H14 results and upgraded its FY14E revenue guidance from \$23m to \$25m.

KEY HIGHLIGHTS

- SOM reported 1H14 Revenue and EBITDA of \$12.55m (+39.1%) and \$0.6m (+17.4%) respectively.
- Unit sales were up 19.0% to 20,455. Unit sales growth rate also picked up towards the end of the half year, recording 13.1% in 1Q14 vs 24.5% in 2Q14.
- Unit sales growth was the highest in Europe at 47%. We expect the elevated growth rate to continue in 2H14 as SOM opens new markets in the region. Europe now accounts for 35% (29% in 1H13) of total unit sales, the long term projection is 45%.
- Europe also saw pricing uplift, where SOM's restructuring and acquisitions in prior periods have extended SOM's reach over the supply chain in the region and as a result SOM is capturing a greater share of the end price.
- Gross margin was lower at 65% (vs 66% in the pcp) as SOM expands its product portfolio to include a mid-tier Herbst device. This may fall further as the company launches lower margin auxiliary products such as DentiTrac compliance recorder and SomTabs cleaning tablets.
- SOM expensed \$0.9m related to investments in the Medical channel in the US in 1H14, FY14E expense is expected to be approx \$2.0m. SOM expects the Medical channel to breakeven in FY15E, roughly equating to unit sales of 6,000.
- The Kaiser pilot had been delayed due to procedural issues but is now underway in the Fontana clinic which installs 25,000 CPAP devices per annum. The pilot is expected to be completed within the next 6 months. SOM hopes to start selling units from Kaiser's San Jose clinic (35,000 CPAP devices pa) in 3 to 4 months time.
- SOM is in discussions with another smaller insurer in the US (1m policy holders vs Kaiser's 9m), to reimburse OAT as a first-line treatment of mild sleep apnea.
- Approx 90% of SOM's revenue and 85% of costs are denominated in foreign currency. Therefore, the windfall gain in revenue as a result the weakened AUD is largely offset by its effect on costs.
- SOM had a cash balance of \$4.0m (vs \$4.2m at the end of FY13), with no debt.
- No dividend was declared, as the company continues to invest heavily in building the OAT market and maintaining its industry leadership.
- SOM maintained its 43,000 unit sales target for the financial year.

 Wayne Ma
 Mark Southwell-Keely

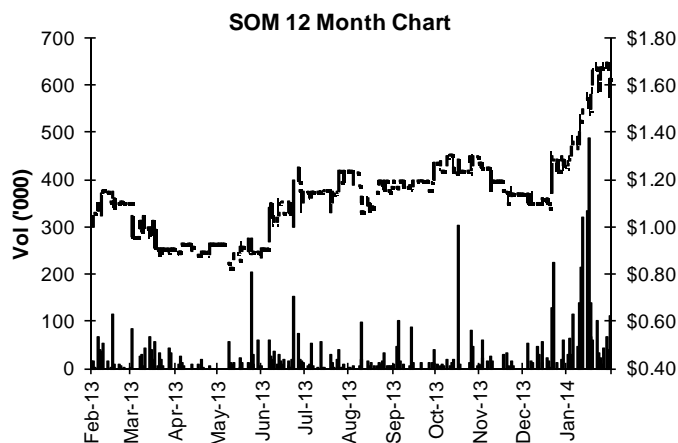
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SELECT EQUITIES RECOMMENDATION

- Select Equities continues to rate SOM as a SPECULATIVE BUY based on strong underlying unit sales growth and the potential for step change growth if the company is successful with its US Medical Initiative. Execution related risks have risen over the last several months following an increase in market expectations.

June Year End	FY13A	1H14A	FY14E	FY15E
Net Profit (\$m)	0.7	0.0	0.7	1.2
Revenue (\$m)	18.5	12.6	27.1	34.1
EBITDA (\$m)	0.7	0.6	1.6	2.2
EPS (¢)	1.3	0.0	1.6	2.6
DPS (¢)	0.0	0.0	0.0	0.0
PER (x)	115.7	95.1	95.1	58.2
PER Rel All Ords (%)	772%	634%	634%	388%
Ent. Value/ Revenue (x)	3.9	2.7	2.7	2.1
Ent. Value/ EBITDA (x)	109.0	43.8	43.8	32.7
Yield (%)	0.0%	0.0%	0.0%	0.0%
# Shares (m)				44.8
Avg. Mthly Volume ('000)				572.4
Diluted Mkt Cap (\$m)				68.1
Net Debt (\$m)				4.0
Enterprise Value (\$m)				72.1

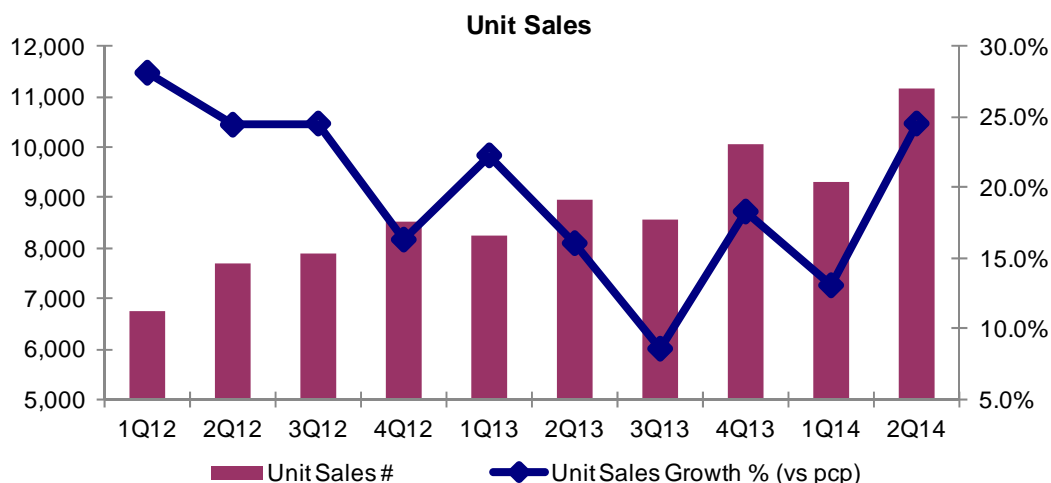
Source: Company Reports and Select Equities Research



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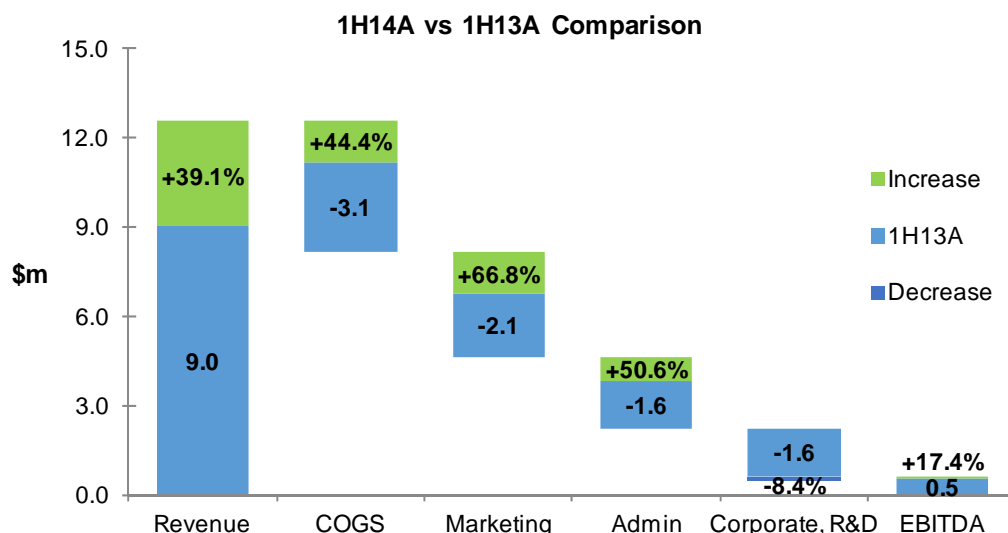
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QUARTERLY UNIT SALES



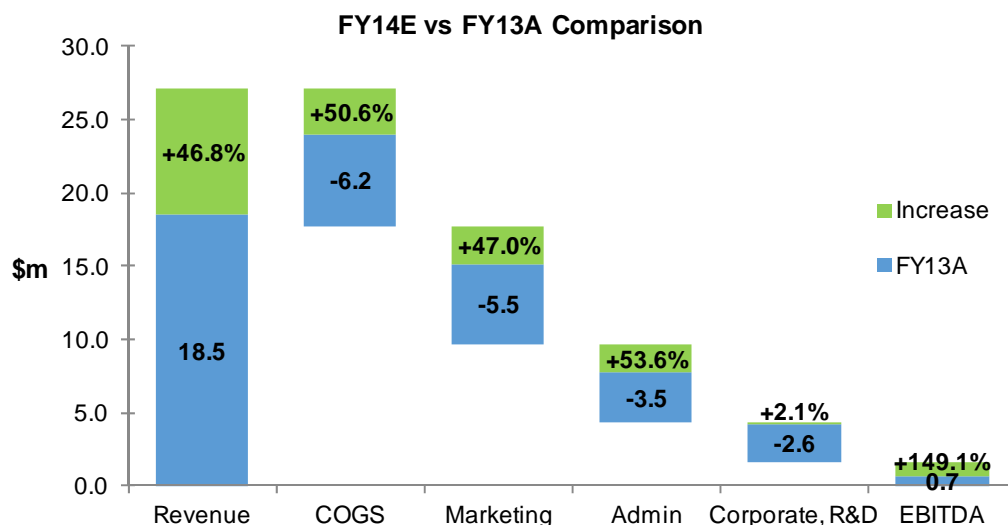
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HALF YEARLY WATERFALL

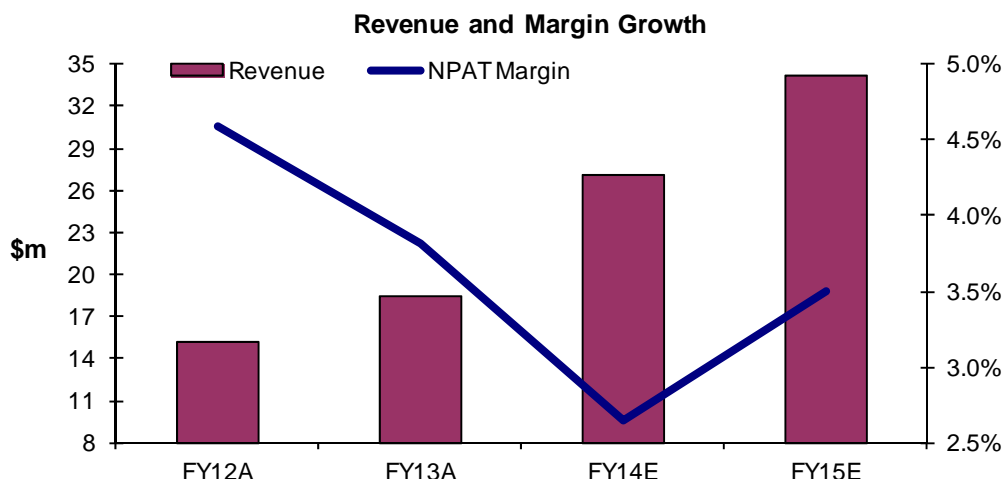


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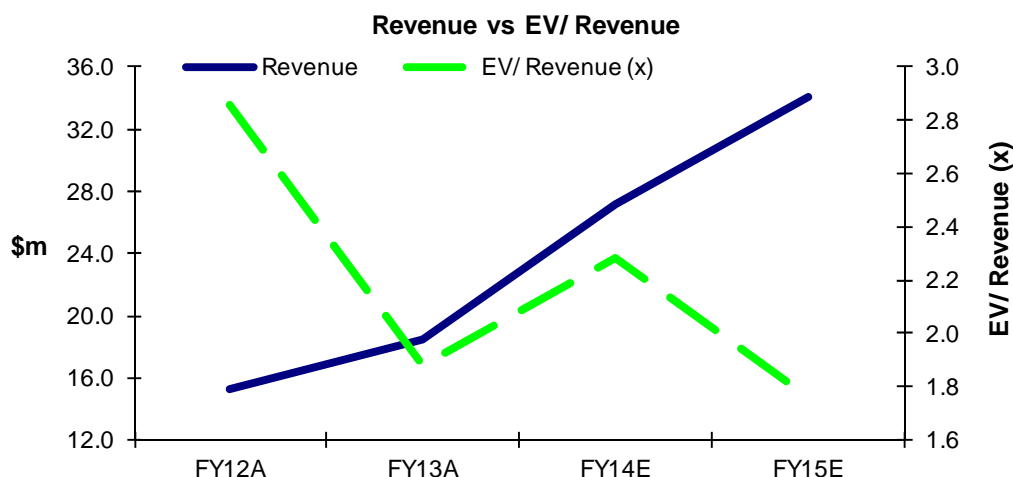
FY14E WATERFALL



Source: Company Reports and Select Equities Research

OPERATING LEVERAGE


Source: Company Reports and Select Equities Research

VALUATION


Source: Company Reports and 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 and G2 products, the Herbst product line, the DentiTrac compliance system, the MATRx sleep lab assessment system, as well as products for snoring and teeth grinding.

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.
- Future funding of the business may require a dilutive capital raising.

SomnoMed Ltd

Select Equities Research

Small Caps

Code	SOM				June Year End	FY13A	1H14A	FY14E	FY15E
Last sale (\$)	28-Feb-14				\$1.52				
# Shares (m)	44.7				Financial Position (\$m)				
# Options (m)	0.1				Cash	4.2	4.0	6.3	8.0
Diluted Mkt Cap (\$m)	68.1				Accounts Receivable	4.4	6.2	7.6	8.9
Net Debt (\$m)	4.0				Inventory	0.9	1.0	1.2	1.4
Enterprise Value (\$m)	72.1				PPE	1.2	1.3	1.3	1.2
June Year End	FY13A	1H14A	FY14E	FY15E	Investments	0.2	0.0	0.0	0.0
Financial Performance (\$m)					Intangibles	3.1	4.1	4.2	4.2
Revenue	18.5	12.6	27.1	34.1	Deferred Tax Assets	2.2	2.2	2.2	2.2
Gross Profit	12.3	8.1	17.8	22.0	Total Assets	16.1	18.9	22.7	26.0
EBITDA	0.7	0.6	1.6	2.2	Accounts Payable	3.7	5.1	6.8	8.2
D & A	-0.5	-0.3	-0.6	-0.6	Borrowings	0.0	0.0	0.0	0.0
EBIT	0.2	0.4	1.0	1.6	Provisions	0.9	1.3	1.7	2.4
PBT	0.3	0.4	1.1	1.7	Total Liabilities	4.5	6.4	8.6	10.6
NPAT (pre-abs. & NCI)	0.7	0.0	0.7	1.2	Net Assets	11.6	12.5	14.2	15.3
Abnormals	0.0	0.0	0.0	0.0	Issued Capital	26.1	26.3	26.3	26.3
NPAT (pre-NCI)	0.7	0.0	0.7	1.2	Reserves	2.4	2.7	3.6	3.6
NCI	-0.1	0.0	0.0	0.0	Retained Earnings	-17.5	-17.5	-16.8	-15.7
NPAT (reported)	0.6	0.0	0.7	1.2	NCI	0.6	1.1	1.1	1.1
EPS (¢)	1.3	0.0	1.6	2.6	Total Equity	11.6	12.5	14.2	15.3
DPS (¢)	0.0	0.0	0.0	0.0	Cash Flows (\$m)				
NTA (¢)	18.9	18.6	22.3	24.8	Net Receipts	0.5	-0.5	2.1	2.7
Book Value / Share (¢)	25.8	27.8	31.6	34.2	Net Interest	0.1	0.0	0.1	0.1
Valuation/Performance Ratios					Tax Received/(Paid)	-0.1	0.0	0.0	-0.6
PER (x)	115.7	95.1	95.1	58.2	Operating Cash Flow	0.6	-0.4	2.1	2.3
Ent. Value/ Revenue (x)	3.9	2.7	2.7	2.1	Capex & Acquisitions	-0.8	0.0	-0.2	-0.5
Ent. Value/ EBITDA (x)	109.0	43.8	43.8	32.7	Asset Sales & Divest	0.0	0.0	0.0	0.0
Ent. Value/ EBIT (x)	454.8	68.7	68.7	44.3	Investing Cash Flow	-0.8	0.0	-0.2	-0.5
Revenue Growth (%)	21.3%	39.1%	46.7%	25.7%	Change in Equity (net)	0.5	0.0	0.0	0.0
EBITDA Growth (%)	-20.4%	17.4%	148.5%	34.1%	Change in Debt (net)	0.0	0.0	0.0	0.0
NPAT Growth (%)	0.7%	-96.9%	1.7%	63.5%	Dividends	0.0	0.0	0.0	0.0
EPS Growth (%)	9.3%	-96.9%	21.7%	63.5%	Financing Cash Flow	0.5	0.0	0.0	0.0
P/NTA (x)	8.1	8.2	6.8	6.1	Net Inc/Dec Cash	0.3	-0.4	1.9	1.8
P/BV (x)	5.9	5.5	4.8	4.4	Cash at Beginning of Yr	3.5	4.2	4.2	6.3
Yield (%)	0.0%	0.0%	0.0%	0.0%	Cash at End of Year	4.2	4.0	6.3	8.0
Payout Ratio (%)	0.0%	0.0%	0.0%	0.0%	SomnoDent Unit Sales				
Gross Margin (%)	66.4%	64.8%	65.5%	64.6%	Units #	35,841	20,455	43,430	54,228
EBITDA Margin (%)	3.6%	5.1%	6.1%	6.5%	Percentage Change %	16.1%	19.0%	21.2%	24.9%
EBIT Margin (%)	0.9%	2.9%	3.9%	4.8%	Segment Revenue (\$m)				
NPAT Margin (%)	3.8%	0.1%	2.6%	3.4%	USA	9.7	5.4	11.1	13.4
Current Ratio (x)	2.2	1.9	1.9	1.9	Europe	6.2	5.7	13.0	17.5
Interest Cover (x)	-1.7	-28.6	-20.0	-15.1	Asia Pacific	2.6	1.5	3.0	3.3
Net Debt/Equity (%)	-36.5%	-31.8%	-44.4%	-52.5%	Segment Revenue Growth (%)				
ROE (%)	5.1%	5.1%	5.1%	7.6%	USA	9.5%	13.6%	14.7%	20.0%
ROIC (%)	9.6%	9.1%	9.1%	16.1%	Europe	55.6%	90.7%	112.0%	34.1%
Interim Results (\$m)					2H12	1H13	2H13	1H14	
Revenue	8.4	9.0	9.5	12.6	Asia Pacific	8.2%	13.2%	12.4%	10.3%
Gross Profit	5.8	6.0	6.3	8.1	Substantial Shareholders				
EBITDA	0.7	0.5	0.1	0.6	28-Feb-14	No. (m)		%	
D & A	-0.2	-0.2	-0.3	-0.3	Dottie Investments Pty		3.9	8.7%	
EBIT	0.4	0.3	-0.2	0.4	Belgove Pty (Peter Neustadt)		3.5	7.8%	
PBT	0.5	0.4	-0.1	0.4	Golden Words (the Kennedy's Family)		3.3	7.4%	
NPAT (pre-abs. & NCI)	0.7	0.3	0.4	0.0	TDM Asset Management		3.2	7.2%	
NPAT (reported)	0.5	0.2	0.4	0.0	Schroder Investment Management		2.9	6.6%	
					Australian Ethical Smaller Companies Trust		2.8	6.2%	

Source: Company Reports and Select Equities Research

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