



**BUY**

HOLD

SELL

**ACTION & RECOMMENDATION**

SomnoMed has announced progress on both their product and market dimensions over recent months. Their SomnoDent Fusion range and the Herbst Advance device fill out a quality product offering across multiple price points. Being inclusive on price is a sound competitive strategy because health insurance status can vary widely among patients. Whilst the core of SomnoMed's European growth remains in Holland and Sweden, their supply infrastructure now reaches most of Western Europe, having added five new countries. We expect SomnoMed to announce their Q4 volume and sales results next week. SomnoMed remains our pick of the smallcap medtech developers. It remains a BUY rated stock. Price target \$1.86 per share.

**Always building something new**

**What's Changed**

- **Product diversification driving market position** – the recent FDA approvals of SomnoDent Fusion and Herbst Advance provide yet more feature and price point competitiveness in the US market. Fusion combines the exchangeable wing features of the flagship G2 device but offers a greater titration range than the mid/high priced SomnoDent Classic/Flex. The design is expected to be popular with dentists minimising the number of re-visits and 'chair-time' in fitting the device. At the mid/low price end, SomnoMed's Herbst Advance also offers fitting advantages for dentists treating Medicare patients. Competing at all points on the price continuum is important for market share. As the company becomes more medically-facing, it is important they cater to as many different forms of insurance coverage for patients as possible. SomnoMed's product range is market leading in the USA.
- **Blocking out the market map in Europe/Scandinavia** – since we last wrote the company has added UK, Ireland, Finland, Portugal and Spain; and renegotiated its supply arrangements into Italy. Growth continues in its major European centres of Holland, Sweden and Germany, where treatment rates continue to improve. Even relatively mature markets like Sweden offer new opportunities such as publicly-funded hospitals looking to third party manufacturers to supply validated, approved oral appliances with better efficacy/compliance.
- **Quarterly next week should provide substantive update** – SomnoMed is guiding to >43,000 devices in FY14 and revenue ~A\$25m. We expect to see continued strength in Europe, a sustained volume recovery in the USA and an uptick in the Asia Pacific business.
- **Remain buyers of the stock** – our price target of \$1.86 per share represents a ~10% premium to DCF. Valuation recognises the optionality around signing new contracts with managed care organisations (MCOs) over the next 3-5 years. MCOs and similar are the keys to improving treatment rates in the US market, in our view.

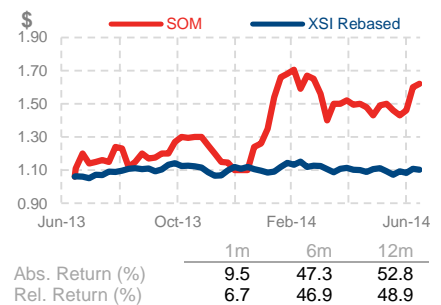
**Risks & Catalysts**

- **Catalysts:** US managed care groups implementing SomnoDent in their treatment models for sleep apnoea, continuing global volume growth, further acquisitions and capacity expansion.
- **Risks:** Will take years to execute the US medical strategy, competitive factors, adverse reimbursement outcomes, capacity to finance and supply growth given limited financial resources.

<b>12m Target Price (AUD)</b>	<b>\$1.86</b>
Share Price @ 14-Jul-14 (AUD)	\$1.61
Fcst 12m Capital Return	15.5%
Fcst 12m Dividend Yield	0.0%
<b>12m Total S'holder Return</b>	<b>15.5%</b>

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**12m Share Price Performance**



**WHTM Return Re-Investment Matrix**

Return	High	Cash Generator	Champion
	Low	Challenged	Potential
		Low	High
		Re-Investment	

**WHTM Risk Assessment**

		Low	Med	High	Spec
Share Price Risk				High	
Business Risk		High			

Key Changes	11-Apr	After	Var %
<b>NPAT: FY14</b>	0.3	0.3	0.0%
<b>Norm FY15</b>	2.0	2.0	0.0%
<b>(\$m) FY16</b>	4.0	4.0	0.0%
<b>EPS: FY14</b>	0.6	0.6	0.0%
<b>Norm FY15</b>	4.7	4.7	0.0%
<b>(cps) FY16</b>	9.2	9.2	0.0%
<b>DPS: FY14</b>	0.0	0.0	0.0%
<b>(cps) FY15</b>	0.0	0.0	0.0%
<b>FY16</b>	0.0	0.0	0.0%
<b>Price Target:</b>	<b>1.86</b>	<b>1.86</b>	<b>0.0%</b>
<b>Rec:</b>	<b>BUY</b>	<b>BUY</b>	

Mkt Cap: \$72m      Enterprise Value: \$76m      Shares: 45m      Sold Short: 0.0%

ASX 300 Wgt: n/a      Median T'over/Day: \$0.0m



#### PRICE TARGET

	Valuation	Price Target
WACC (%)		14
Terminal growth (%)		3.1
NPV Forecast FCF	20.1	
NPV Perpetuity (A\$M)		0.9
Net Debt / (Cash) (A\$M)		4.2
Valuation (A\$M)		25.2

DCF valuation (\$/shr)	1.50
Price target (\$/sh)	1.86

#### INTERIMS (\$m)

Half Yr (AUD)	Dec 12	Jun 13	Dec 13	Jun 14
	1HA	2HA	1HA	2HE
Sales	9.0	9.5	12.6	13.1
EBITDA	0.6	0.2	0.6	1.0
EBIT	0.4	-0.1	0.4	0.7
<b>Net Profit</b>	<b>0.3</b>	<b>0.4</b>	<b>0.0</b>	<b>0.2</b>
<b>Norm. EPS</b>	<b>0.5</b>	<b>1.0</b>	<b>0.0</b>	<b>0.6</b>
EBIT/Sales	3.9	-1.2	2.8	5.2
Dividend (c)	0.0	0.0	0.0	0.0
Franking (%)	0.0	0.0	0.0	0.0

#### FINANCIAL STABILITY

Year-end June (AUD)	FY13A	FY14E	FY15E
Net Debt	-4.2	-3.9	-5.2
Net Debt / Equity (%)	<0	<0	<0
<b>Net Debt / EV (%)</b>	<b>&lt;0</b>	<b>&lt;0</b>	<b>&lt;0</b>
Current Ratio (x)	3.7	3.4	3.4
Interest Cover (x)	<0	<0	<0
<b>Adj. Cash Int. Cover (x)</b>	<b>1.2</b>	<b>&lt;0</b>	<b>&lt;0</b>
Debt / CashFlow (x)	0.0	0.0	0.0
Net Debt (cash) / share	<0	<0	<0
NTA / share (\$)	0.2	0.2	0.2
Book Value / share (\$)	0.3	0.3	0.3
Payout Ratio (%)	0	0	0
Adj. Payout Ratio (%)	0	0	0

#### EPS RECONCILIATION (\$m)

	FY13A		FY14E	
	Rep.	Norm.	Rep.	Norm.
Sales Revenue	18	18	26	26
EBIT	0.2	0.2	1.0	1.0
<b>Net Profit</b>	<b>0.7</b>	<b>0.7</b>	<b>0.3</b>	<b>0.3</b>
Notional Earn.	0.0	0.0	0.0	0.0
Pref./Conv. Div.	0.0	0.0	0.0	0.0
<b>Profit for EPS</b>	<b>0.7</b>	<b>0.7</b>	<b>0.3</b>	<b>0.3</b>
Diluted Shrs(m)	47	47	43	43
<b>Diluted EPS (c)</b>	<b>1.5</b>	<b>1.5</b>	<b>0.6</b>	<b>0.6</b>

#### RETURNS

	FY13A	FY14E	FY15E	FY16E
ROE (%)	6.8	2.1	14.9	23.8
ROIC (%)	2.6	9.0	23.5	35.1
Incremental ROE	-2.1	-25.5	112.0	64.4
Incremental ROIC	-8.1	35.2	128.4	165.4

#### KEY ASSUMPTIONS

Year-end June (AUD)	FY09A	FY10A	FY11A	FY12A	FY13A	FY14E	FY15E	FY16E
Revenue Growth (%)	111.5	38.5	15.1	23.6	21.3	38.7	14.0	20.4
EBIT Growth (%)	-33.4	-103.9	720.1	-15.5	-55.4	335.4	199.6	62.0
NPAT Growth (%)	-35.2	-148.3	-4.9	-4.7	-7.2	-63.4	694.6	95.0
<b>EPS Growth (%)</b>	<b>-50.2</b>	<b>-146.8</b>	<b>-11.6</b>	<b>-25.2</b>	<b>6.9</b>	<b>-60.2</b>	<b>694.6</b>	<b>95.0</b>
EBIT / Sales (%)	-25.6	0.7	5.1	3.5	1.3	4.0	10.6	14.3
Tax Rate (%)	0.9	-586.9	-10.7	-18.8	-123.7	75.9	35.0	21.6
<b>ROA (%)</b>	<b>-30.0</b>	<b>1.1</b>	<b>7.8</b>	<b>4.4</b>	<b>1.5</b>	<b>5.6</b>	<b>14.4</b>	<b>18.9</b>
<b>ROE (%)</b>	<b>-34.0</b>	<b>17.0</b>	<b>13.5</b>	<b>8.7</b>	<b>6.4</b>	<b>2.2</b>	<b>15.0</b>	<b>22.6</b>

#### PROFIT & LOSS (\$m)

Year-end June (AUD)	FY09A	FY10A	FY11A	FY12A	FY13A	FY14E	FY15E	FY16E
Sales Revenue	7.7	10.7	12.3	15.2	18.5	25.6	29.2	35.2
EBITDA	-1.7	0.2	0.8	0.9	0.7	1.6	3.8	5.8
Deprn & Amort	0.3	0.2	0.2	0.4	0.5	0.6	0.7	0.7
<b>EBIT</b>	<b>-2.0</b>	<b>0.0</b>	<b>0.6</b>	<b>0.5</b>	<b>0.2</b>	<b>1.0</b>	<b>3.1</b>	<b>5.0</b>
Net Interest Expense	-0.2	-0.1	-0.1	-0.1	-0.1	0.0	0.0	-0.1
Tax	0.0	-0.7	-0.1	-0.1	-0.4	0.8	1.1	1.1
Minorities / pref divs	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Equity accounted NPAT	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
<b>Net Profit pre Sig. Items</b>	<b>-1.8</b>	<b>0.8</b>	<b>0.7</b>	<b>0.7</b>	<b>0.7</b>	<b>0.3</b>	<b>2.0</b>	<b>4.0</b>
Abn's / Ext's / Signif.	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
<b>Reported Net Profit</b>	<b>-1.8</b>	<b>0.8</b>	<b>0.7</b>	<b>0.7</b>	<b>0.7</b>	<b>0.3</b>	<b>2.0</b>	<b>4.0</b>

#### CASH FLOW (\$m)

Year-end June (AUD)	FY09A	FY10A	FY11A	FY12A	FY13A	FY14E	FY15E	FY16E
EBITDA	-1.7	0.2	0.8	0.9	0.7	1.6	3.8	5.8
Interest & Tax	0.2	0.1	0.1	0.1	0.0	-0.4	-1.1	-1.0
Working Cap / Other	0.2	0.2	-1.2	-0.7	-0.2	-1.2	-0.4	-0.5
<b>Operating Cash Flow</b>	<b>-1.3</b>	<b>0.5</b>	<b>-0.3</b>	<b>0.3</b>	<b>0.6</b>	<b>0.0</b>	<b>2.3</b>	<b>4.3</b>
Maintenance Capex	0.0	-0.5	-0.3	-0.2	-0.2	-0.4	-0.7	-0.9
<b>Free Cash Flow</b>	<b>-1.4</b>	<b>-0.1</b>	<b>-0.6</b>	<b>0.1</b>	<b>0.4</b>	<b>-0.4</b>	<b>1.6</b>	<b>3.4</b>
Dividends Paid	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Growth Capex	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Invest. / Disposals	0.0	0.0	-0.1	-0.3	-0.5	-0.3	-0.3	-0.3
Other Inv. Flows	0.0	0.0	0.2	-0.3	-0.1	0.1	0.0	0.0
<b>Cash Flow Pre Financing</b>	<b>-1.4</b>	<b>-0.1</b>	<b>-0.5</b>	<b>-0.5</b>	<b>-0.2</b>	<b>-0.5</b>	<b>1.3</b>	<b>3.1</b>
Funded by Equity	0.0	0.4	0.3	0.1	0.5	0.0	0.0	0.0
Funded by Debt	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Funded by Cash	1.4	-0.4	0.2	0.3	-0.3	0.5	-1.3	-3.1

#### BALANCE SHEET SUMMARY (\$m)

Year-end June (AUD)	FY09A	FY10A	FY11A	FY12A	FY13A	FY14E	FY15E	FY16E
Cash	4.0	4.3	3.9	3.5	4.2	3.9	5.2	8.3
Current Receivables	1.4	1.6	2.2	3.7	4.4	5.3	6.4	7.6
Current Inventories	0.1	0.2	0.2	0.5	0.9	1.3	1.6	1.9
Net PPE	0.2	0.6	1.1	1.1	1.2	1.3	1.4	1.4
Investments	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Intangibles / Capitalised	0.3	1.0	1.2	2.7	5.3	6.6	7.0	7.4
Other	0.0	0.1	0.1	0.5	0.2	0.0	0.0	0.0
<b>Total Assets</b>	<b>6.0</b>	<b>7.8</b>	<b>8.7</b>	<b>12.0</b>	<b>16.1</b>	<b>18.5</b>	<b>21.5</b>	<b>26.6</b>
Current Payables	1.5	1.9	2.2	2.4	3.5	4.0	4.8	5.7
Total Debt	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Other Liabilities	0.2	0.3	0.3	0.4	1.0	1.8	2.0	2.2
<b>Total Liabilities</b>	<b>1.7</b>	<b>2.2</b>	<b>2.5</b>	<b>2.8</b>	<b>4.5</b>	<b>5.7</b>	<b>6.7</b>	<b>7.9</b>
Minorities / Convertibles	0.0	0.0	0.0	0.5	0.6	1.1	1.1	1.1
<b>Shareholder Equity</b>	<b>4.3</b>	<b>5.7</b>	<b>6.2</b>	<b>9.2</b>	<b>11.6</b>	<b>12.7</b>	<b>14.8</b>	<b>18.8</b>
<b>Total Funds Employed</b>	<b>4.3</b>	<b>5.7</b>	<b>6.2</b>	<b>9.2</b>	<b>11.6</b>	<b>12.7</b>	<b>14.8</b>	<b>18.8</b>



## RETURN RE-INVESTMENT MATRIX

Return	High	Cash Generator	Champion
	Low	Challenged	Potential
		Low	High
		Re-investment	

Return: Lead product launched (SomnoDent) in all major markets. Enjoys the leadership position in this emerging category of treatments for obstructive sleep apnoea.

Re-investment: Opportunities grow the global market by fostering links between medical and dental aspects of sleep apnoea. Increase awareness of alternatives to CPAP.

## RISK MEASURES

	Low	Med	High	Spec
Share Price Risk			High	
Business Risk		High		

Share price risk: SOM liquidity is low, posing high risks.

Business risk: Small company with limited resources addressing a global opportunity. Competition increasing could grow market; could take market. These risks are mitigated by having a well-coordinated infrastructure for product manufacturing and supply.

## BUSINESS DESCRIPTION

SomnoMed Limited (SOM) develops, manufactures and sells oral appliance devices for the treatment of obstructive sleep apnoea (OSA), snoring and bruxism. The company has developed a global infrastructure to address the OSA market, with the majority of its sales derived from the US and Europe.

## INVESTMENT THESIS

Our thesis on SomnoMed is that an increasing number of OSA patients will choose an oral appliance in preference to continuous positive air pressure (CPAP) devices given increasing awareness and improving reimbursement arrangements. SomnoMed currently enjoys a leadership position in this market. We see ResMed's (RMD) recent entry into this market as validation of our investment thesis. We expect that the medically oriented diagnosis and referral channels for OSA will embrace oral appliances as an alternative for OSA patients who refuse treatment with CPAP.

## REVENUE DRIVERS

- Growth rates. In recent years the company has sustained consistent 20-30% unit sales growth pcp comps. We think this can increase to 35% or higher as the company taps the medically diagnosed OSA referral channels
- Regulatory and/or reimbursement approvals of new products, new territories

## MARGIN DRIVERS

- Making a high (c.70%) gross margin on its oral appliances
- We expect SG&A expense to increase modestly as the company develops and grows its market
- Low level of R&D expenditure

## KEY ISSUES/CATALYSTS

- Upside risks:
- Quarterly cash flow indicates SomnoMed's sales growth progress
- Product launches
- Progress developing links to medical diagnosis channels

## RISK TO VIEW

- Downside risks:
- Relatively limited capital for business development investment
- Emerging competition
- If successful, could face scale-up and logistics challenges when demand increases
- Reimbursement in US is improving, but still needs to develop and broaden

## BALANCE SHEET

- SOM had c.\$4M cash as at end-1HFY14

## BOARD

- Dr Peter Neustadt (Executive Chairman)
- Ms Lee Ausburn (Non-Executive Director)
- Mr Robert Scherini (Non-Executive Director)

## MANAGEMENT

- Dr Peter Neustadt (Executive Chairman)
- Neil Verdall-Austin (CFO)
- Kien T. Nguyen (President, North America)
- Dr Jagdeep Bijwadia (Chief Medical Officer)
- Stacey Gilbert, VP Managed Care

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#### Return Reinvestment Matrix and Risk Measures

Definitions at <http://www.wilsonhtm.com.au/Disclosures>

#### Recommendation Structure and Other Definitions

Definitions at <http://www.wilsonhtm.com.au/Disclosures>

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