



**BUY**

HOLD

SELL

**ACTION & RECOMMENDATION**

SomnoMed has undertaken to raise approximately \$7m at a share price of \$1.50 per share to finance its volume expansion plans and working capital requirements. We see FY15 as a transformative year for SomnoMed both operationally and strategically. SomnoMed has displayed good discipline on cash flow in recent years, so we see this transaction as a positive for shareholders. We have adjusted our EPS forecasts to recognise the dilutionary impact of new capital. Similarly, our price target is diluted by around 10% to \$1.95 per share. We maintain a BUY rating. SomnoMed remains our pick of the small cap medical device stocks.

**Cashing up before cashing in**

Company Update

**What's Changed**

- **Capital raising ahead of an expansionary phase:** SomnoMed has raised up to ~\$7m at \$1.50 per share. The proposed structure is a \$5.5m placement to sophisticated investors, followed by up to 1m shares under a share purchase plan (SPP). The use of funds are four-fold: a) capital expenditure to be applied in doubling capacity at its Manila manufacturing site; b) working capital for the USA, where an expected lift in US Managed Care sales this year will further lengthen the cash cycle; c) start-up capital for markets recently entered; and d) the introduction of digital capabilities across most of its "hub" networks.
- **Forecasts and valuation:** Our valuation is diluted by approximately 10% to \$1.95 per share after allowing for the new issued capital. EPS estimates are reduced by ~6% in FY15e and ~10% in FY16. We value SomnoMed using DCF analysis.
- **Investment view:** We continue to see FY15 as a breakthrough year for SomnoMed, with that story only strengthened by this capital raising which comes ahead of an expansionary phase of growth.

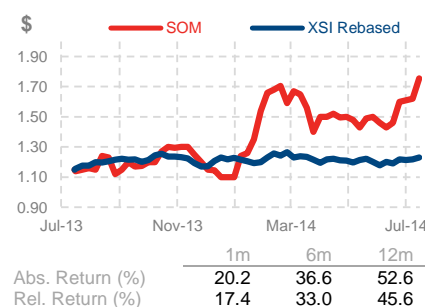
**Risks & Catalysts**

- **Catalysts:** US managed care groups implementing SomnoDent in their treatment models for sleep apnoea, continuing global volume growth, further acquisitions and capacity expansion.
- **Risks:** Execution on 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>\$1.95</b>
Share Price @ 28-Jul-14 (AUD)	\$1.76
Fcst 12m Capital Return	11.1%
Fcst 12m Dividend Yield	0.0%
<b>12m Total S'holder Return</b>	<b>11.1%</b>

Shane Storey  
shane.storey@wilsonhtm.com.au  
Tel. +61 7 3212 1351

**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		

Year-End June (AUD)	FY12A	FY13A	FY14E	FY15E	FY16E
NPAT Rep (\$m)	0.7	0.7	-0.4	2.3	4.6
NPAT Norm (\$m)	0.8	0.7	-0.4	2.3	4.6
Consensus NPAT (\$m)			0.5	1.6	4.0
EPS Norm (cps)	1.6	1.6	-0.8	4.9	9.6
EPS Growth (%)	-12	-2	-154	674	98
P/E Norm (x)	109.4	111.6	-207.6	36.1	18.3
EV/EBITDA (x)	89.3	110.2	81.8	20.7	12.9
FCF Yield (%)	0.1	0.5	-1.5	0.7	1.7
DPS (cps)	0.0	0.0	0.0	0.0	0.0
Dividend Yield (%)	0.0	0.0	0.0	0.0	0.0
Franking (%)	0	0	0	0	0

Source: Company data, WHTM estimates, S&P Capital IQ

Key Changes	22-Jul	After	Var %
<b>NPAT: FY14</b>	-0.4	-0.4	0.0%
<b>Norm FY15</b>	2.2	2.3	1.3%
<b>(\$m) FY16</b>	4.6	4.6	-0.1%
<b>EPS: FY14</b>	-0.8	-0.8	0.0%
<b>Norm FY15</b>	5.2	4.9	-6.3%
<b>(cps) FY16</b>	10.7	9.6	-9.9%
<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>2.15</b>	<b>1.95</b>	<b>-9.3%</b>
<b>Rec:</b>	<b>BUY</b>	<b>BUY</b>	

<b>Mkt Cap:</b> \$79m	<b>Enterprise Value:</b> \$82m	<b>Shares:</b> 45m	<b>Sold Short:</b> 0.0	<b>ASX 300 Wgt:</b> n/a	<b>Median T'over/Day:</b> \$0.0m
-----------------------	--------------------------------	--------------------	------------------------	-------------------------	----------------------------------



#### PRICE TARGET

	Valuation	Price Target
WACC (%)	14	
Terminal growth (%)	3	
NPV Forecast FCF	42	
NPV Perpetuity (A\$M)	45	
Net Debt / (Cash) (A\$M)	10	
Valuation (A\$M)	97	

Price target (\$/sh) **1.95**

#### INTERIMS (\$m)

Half-yr (AUD)	Dec 12	Jun 13	Dec 13	Jun 14
	1HA	2HA	1HA	2HE
Sales	9.0	9.5	12.6	13.2
EBITDA	0.6	0.2	0.6	0.4
EBIT	0.4	-0.1	0.4	0.1
<b>Net Profit</b>	<b>0.3</b>	<b>0.4</b>	<b>0.0</b>	<b>-0.4</b>
<b>Norm. EPS</b>	<b>0.6</b>	<b>1.0</b>	<b>0.0</b>	<b>-0.9</b>
EBIT/Sales	3.9	-1.2	2.8	0.4
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	-3.1	-10.3
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	3.3	4.2
Interest Cover (x)	<0	<0	<0
<b>Adj. Cash Int. Cover (x)</b>	<b>1.2</b>	<b>12.1</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	0.4
Book Value / share (\$)	0.3	0.3	0.4
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	0.4	0.4
<b>Net Profit</b>	<b>0.7</b>	<b>0.7</b>	<b>-0.4</b>	<b>-0.4</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>-0.4</b>	<b>-0.4</b>
Diluted Shrs(m)	45	45	43	43
<b>Diluted EPS (c)</b>	<b>1.6</b>	<b>1.6</b>	<b>-0.8</b>	<b>-0.8</b>

#### RETURNS

	FY13A	FY14E	FY15E	FY16E
ROE (%)	6.8	-3.1	13.6	19.5
ROIC (%)	2.6	3.5	23.1	30.6
Incremental ROE	-2.1	-74.3	53.9	33.7
Incremental ROIC	-8.1	7.3	110.0	57.5

#### 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	39.3	22.5	21.3
EBIT Growth (%)	-33.4	-103.9	720.1	-15.5	-55.4	73.5	701.5	69.1
NPAT Growth (%)	-35.2	-148.3	-4.9	-4.7	-7.2	-151.9	-721.2	102.8
<b>EPS Growth (%)</b>	<b>-50.2</b>	<b>-146.3</b>	<b>-13.1</b>	<b>-11.8</b>	<b>-2.0</b>	<b>-153.8</b>	<b>-674.4</b>	<b>97.8</b>
EBIT / Sales (%)	-25.6	0.7	5.1	3.5	1.3	1.6	10.5	14.6
Tax Rate (%)	0.9	-586.9	-10.7	-18.8	-123.7	182.1	32.6	19.3
<b>ROA (%)</b>	<b>-30.0</b>	<b>1.1</b>	<b>7.8</b>	<b>4.4</b>	<b>1.5</b>	<b>2.3</b>	<b>11.6</b>	<b>16.3</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>-3.3</b>	<b>11.2</b>	<b>18.5</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	25.8	31.6	38.3
EBITDA	-1.7	0.2	0.8	0.9	0.7	1.0	4.0	6.3
Depn & 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>0.4</b>	<b>3.3</b>	<b>5.6</b>
Net Interest Expense	-0.2	-0.1	-0.1	-0.1	-0.1	0.0	-0.1	-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>-0.4</b>	<b>2.3</b>	<b>4.6</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>-0.4</b>	<b>2.3</b>	<b>4.6</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	1.0	4.0	6.3
Interest & Tax	0.2	0.1	0.1	0.1	0.0	-0.4	-1.0	-1.0
Working Cap / Other	0.2	0.2	-1.2	-0.7	-0.2	-1.3	-0.5	-0.6
<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>-0.7</b>	<b>2.5</b>	<b>4.8</b>
Maintenance Capex	0.0	-0.5	-0.3	-0.2	-0.2	-0.4	-1.9	-3.5
<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>-1.2</b>	<b>0.5</b>	<b>1.3</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>-1.3</b>	<b>0.3</b>	<b>1.1</b>
Funded by Equity	0.0	0.4	0.3	0.1	0.5	0.0	7.0	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	1.3	-7.3	-1.1

#### 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	3.1	10.3	11.4
Current Receivables	1.4	1.6	2.2	3.7	4.4	5.0	6.8	8.3
Current Inventories	0.1	0.2	0.2	0.5	0.9	1.8	1.7	2.1
Net PPE	0.2	0.6	1.1	1.1	1.2	1.4	2.4	4.6
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	6.7	7.2	8.0
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>17.9</b>	<b>28.4</b>	<b>34.3</b>
Current Payables	1.5	1.9	2.2	2.4	3.5	4.0	5.1	6.2
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>5.8</b>	<b>7.1</b>	<b>8.4</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>12.1</b>	<b>21.4</b>	<b>26.0</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>12.1</b>	<b>21.4</b>	<b>26.0</b>



## RETURN RE-INVESTMENT MATRIX

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

Share price risk: SomnoMed's liquidity is low, posing high risks.

Business risk: SomnoMed is a 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.

## RISK MEASURES

	Low	Med	High	Spec
Share Price Risk				
Business Risk				

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.

## 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 has c.\$10m cash and no debt as at end-FY14

## 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 Verdal-Austin (CFO)
- Kien T. Nguyen (President, North America)
- Dr Jagdeep Bijwadia (Chief Medical Officer)
- Stacey Gilbert, VP Managed Care

## CONTACT DETAILS

Address: Level 3, 20 Clarke St, Crows Nest, NSW 2065 Australia

Phone: +612 9467 0400

Website: [www.somnomed.com.au](http://www.somnomed.com.au)



#### Head of Research

Shane Storey (07) 3212 1351

#### Industrials

James Ferrier (03) 9640 3827

Stewart Oldfield (03) 9640 3818

George Gabriel (03) 9640 3864

Daniel Wan (02) 8247 6694

Andrew Dalziel (07) 3212 1946

#### Healthcare and Biotechnology

Shane Storey (07) 3212 1351

#### Resources

Phillip Chippindale (02) 8247 3149

James Redfern (02) 8247 6609

Liam Schofield (02) 8247 3173

#### Quantitative

Nathan Szeitli (03) 9640 3806

#### Head of Institutional Sales

Richard Moulder (02) 8247 6603

#### Sydney

Jonathan Scales (02) 8247 6613

Duncan Gamble (02) 8247 6629

Michael Pegum (02) 8247 6602

Anthony Wilson (02) 8247 3113

Peter Tebbutt (02) 8247 6682

#### Melbourne

David Permezal (03) 9640 3885

Adam Dellaway (03) 9640 3824

#### Wealth Management Research

Peter McManus (02) 8247 3186

John Lockton (02) 8247 3118

*Email: [firstname.lastname@wilsonhtm.com.au](mailto:firstname.lastname@wilsonhtm.com.au)*

#### National Offices

Brisbane Ph: (07) 3212 1333

Sydney Ph: (02) 8247 6600

Melbourne Ph: (03) 9640 3888

Gold Coast Ph: (07) 5509 5500

Dalby Ph: (07) 4660 8000

Hervey Bay Ph: (07) 4197 1600

*Our website: [www.wilsonhtm.com.au](http://www.wilsonhtm.com.au)*

#### 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>

#### Disclaimer

Whilst Wilson HTM Ltd believes the information contained in this communication is based on reliable information, no warranty is given as to its accuracy and persons relying on this information do so at their own risk. To the extent permitted by law Wilson HTM Ltd disclaims all liability to any person relying on the information contained in this communication in respect of any loss or damage (including consequential loss or damage) however caused, which may be suffered or arise directly or indirectly in respect of such information. Any projections contained in this communication are estimates only. Such projections are subject to market influences and contingent upon matters outside the control of Wilson HTM Ltd and therefore may not be realised in the future.

The advice contained in this document is general advice. It has been prepared without taking account of any person's objectives, financial situation or needs and because of that, any person should, before acting on the advice, consider the appropriateness of the advice, having regard to the client's objectives, financial situation and needs. Those acting upon such information without first consulting one of Wilson HTM Ltd investment advisors do so entirely at their own risk. This report does not constitute an offer or invitation to purchase any securities and should not be relied upon in connection with any contract or commitment whatsoever. If the advice relates to the acquisition, or possible acquisition, of a particular financial product – the client should obtain a Product Disclosure Statement relating to the product and consider the Statement before making any decision about whether to acquire the product. This communication is not to be disclosed in whole or part or used by any other party without Wilson HTM Ltd's prior written consent.

#### Disclosure of Interest. SomnoMed Ltd

The Directors of Wilson HTM Ltd advise that at the date of this report they and their associates have relevant interests in SomnoMed Ltd. They also advise that Wilson HTM Ltd and Wilson HTM Corporate Finance Ltd A.B.N. 65 057 547 323 and their associates have received and may receive commissions or fees from SomnoMed Ltd in relation to advice or dealings in securities. Some or all of Wilson HTM Ltd authorised representatives may be remunerated wholly or partly by way of commission.

In producing research reports, members of Wilson HTM Ltd Research may attend site visits and other meetings hosted by the issuers the subject of its research reports. In some instances the costs of such site visits or meetings may be met in part or in whole by the issuers concerned if Wilson HTM Ltd considers it is appropriate and reasonable in the specific circumstances relating to the site visit or meeting.

Please see disclosures at <http://www.wilsonhtm.com.au/Disclosures>. Disclosures applicable to companies included in this report can be found in the latest relevant published research.