



BUY HOLD SELL

**ACTION & RECOMMENDATION**

SomnoMed continues to execute well against its growth strategies in all markets. Unit sales grew 20% in Q1 to 11,200 devices (full year guidance is 55,000 units). The signing of another US health insurer is also significant. These arrangements should make it easier for new sleep apnoea patients to access a SomnoDent device, as a first line treatment and alternative to CPAP. The market continues to reward SomnoMed for its FY15 earnings guidance. We have lifted our price target to \$2.18 but have cut the rating to HOLD.

**Strong Q1. Stock fairly valued, move to a HOLD.**

**What's Changed**

- **11,200 unit sales in Q1 with record growth in September** – volumes were slightly below our forecast (WHTME: 11,450) but up 20% on pcp. USA unit sales grew 26% against a softish (10% comp); Europe impressive – 27% (v.30% comp) and ROW 26%.
- **Volume guidance confirmed** – SOM is guiding to 25,000 devices this half (implies 13,800 in Q2). Full year guidance from August was 55,000 devices. Our forecast is unchanged at 53,885 devices.
- **New direct contract with US insurer (c.500k members)** – pleasing progress from managed care investments, SomnoMed agreeing to supply devices and dental services to patients with mild/moderate sleep apnoea as first line therapy (as alternative to CPAP). We believe this agreement is conducive to the further development of the managed care channel in North America.
- **Valuation** – our previous target price of \$1.96 has been surpassed – the market continuing to reward SomnoMed for its FY15 earnings guidance. Yesterday's reaffirmation of volume outlook and new progress on managed probably warrants some easing in our discount rate for SOM (by 100bps). We view the stock as fairly valued and have cut the rating back to HOLD. Target \$2.18/sh.

**Risks & Catalysts**

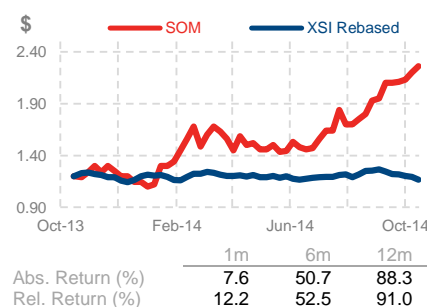
- **Catalysts:** US managed care groups implementing SomnoDent in their treatment models for sleep apnoea, continuing global volume growth, further acquisitions and capacity expansion. **Risks:** Execution on US medical strategy, competitive factors, adverse reimbursement outcomes, capacity to finance and supply growth.

<b>12m Target Price (AUD)</b>	<b>\$2.18</b>
Share Price @ 16-Oct-14 (AUD)	\$2.26
Fcst 12m Capital Return	-3.4%
Fcst 12m Dividend Yield	0.0%
<b>12m Total S'holder Return</b>	<b>-3.4%</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				
Business Risk				

Year-End June (AUD)	FY13A	FY14A	FY15E	FY16E	FY17E
NPAT Rep (\$m)	0.7	0.2	2.1	4.6	7.6
NPAT Norm (\$m)	0.7	0.2	2.1	4.6	7.6
Consensus NPAT (\$m)			1.8	4.2	161.6
EPS Norm (cps)	1.6	0.5	4.4	9.5	15.8
EPS Growth (%)	-2	-68	795	114	66
P/E Norm (x)	143.7	455.1	50.9	23.7	14.3
EV/EBITDA (x)	154.0	135.9	29.9	18.0	12.5
FCF Yield (%)	0.3	-0.4	0.6	1.2	5.9
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-Aug	After	Var %
<b>NPAT: FY15</b>	2.2	2.1	-6.4%
<b>Norm FY16</b>	4.6	4.6	0.4%
<b>(\$m) FY17</b>	7.6	7.6	0.2%
<b>EPS: FY15</b>	4.7	4.4	-6.4%
<b>Norm FY16</b>	9.5	9.5	0.4%
<b>(cps) FY17</b>	15.8	15.8	0.2%
<b>DPS: FY15</b>	0.0	0.0	0.0%
<b>(cps) FY16</b>	0.0	0.0	0.0%
<b>FY17</b>	0.0	0.0	0.0%
<b>Price Target:</b>	<b>1.96</b>	<b>2.18</b>	<b>11.5%</b>
<b>Rec:</b>	<b>BUY</b>	<b>HOLD</b>	

Mkt Cap: \$112m    Enterprise Value: \$114m    Shares: 49m    Sold Short: 0.0    ASX 300 Wgt: n/a    Median T'over/Day: \$0.0m



#### PRICE TARGET

	Valuation	Price Target
WACC (%)	13	
Terminal growth (%)	3	
NPV Forecast FCF	44	
NPV Perpetuity (A\$M)	54	
Net Debt / (Cash) (A\$M)	10	
Valuation (A\$M)	109	

Price target (\$/sh) **2.18**

#### INTERIMS (\$m)

Half-yr (AUD)	Dec 13	Jun 14	Dec 14	Jun 15
	1HA	2HA	1HE	2HE
Sales	12.6	13.3	14.4	17.0
EBITDA	0.6	0.2	1.3	2.6
EBIT	0.4	-0.1	0.9	2.2
<b>Net Profit</b>	<b>0.0</b>	<b>0.2</b>	<b>0.4</b>	<b>1.6</b>
<b>Norm. EPS</b>	<b>0.0</b>	<b>0.5</b>	<b>1.0</b>	<b>3.4</b>
EBIT/Sales	2.8	-1.0	6.4	13.0
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)	FY14A	FY15E	FY16E
Net Debt	-2.9	-10.4	-11.4
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)	4.0	4.5	4.5
Interest Cover (x)	<0	<0	<0
<b>Adj. Cash Int. Cover (x)</b>	<b>&gt;99</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	0.3	0.4
Book Value / share (\$)	0.3	0.5	0.5
Payout Ratio (%)	0	0	0
Adj. Payout Ratio (%)	0	0	0

#### EPS RECONCILIATION (\$m)

	FY14A		FY15E	
	Rep.	Norm	Rep.	Norm
Sales Revenue	26	26	31	31
EBIT	0.2	0.2	3.1	3.1
<b>Net Profit</b>	<b>0.2</b>	<b>0.2</b>	<b>2.1</b>	<b>2.1</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>0.2</b>	<b>0.2</b>	<b>2.1</b>	<b>2.1</b>
Diluted Shrs(m)	43	43	47	47
<b>Diluted EPS (c)</b>	<b>0.5</b>	<b>0.5</b>	<b>4.4</b>	<b>4.4</b>

#### RETURNS

	FY14A	FY15E	FY16E	FY17E
ROE (%)	1.8	12.2	19.1	25.3
ROIC (%)	1.9	20.9	29.9	37.4
Incremental ROE	-29.2	37.0	36.5	49.7
Incremental ROIC	-0.3	103.1	66.0	78.0

#### KEY ASSUMPTIONS

Year-end June (AUD)	FY10A	FY11A	FY12A	FY13A	FY14A	FY15E	FY16E	FY17E
Revenue Growth (%)	38.5	15.1	23.6	21.3	40.1	21.1	22.2	21.3
EBIT Growth (%)	-103.9	720.1	-15.5	-55.4	-3.2	1,253.0	78.3	48.4
NPAT Growth (%)	-148.3	-4.9	-4.7	-7.2	-69.5	867.7	119.8	66.1
<b>EPS Growth (%)</b>	<b>-146.3</b>	<b>-13.1</b>	<b>-11.8</b>	<b>-2.0</b>	<b>-68.4</b>	<b>794.8</b>	<b>114.4</b>	<b>66.1</b>
EBIT / Sales (%)	0.7	5.1	3.5	1.3	0.9	9.9	14.5	17.8
Tax Rate (%)	-586.9	-10.7	-18.8	-123.7	-6.7	34.6	19.4	9.5
<b>ROA (%)</b>	<b>1.1</b>	<b>7.8</b>	<b>4.4</b>	<b>1.5</b>	<b>1.2</b>	<b>10.3</b>	<b>14.2</b>	<b>18.2</b>
<b>ROE (%)</b>	<b>17.0</b>	<b>13.5</b>	<b>8.7</b>	<b>6.4</b>	<b>1.7</b>	<b>9.7</b>	<b>16.0</b>	<b>22.6</b>

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

Year-end June (AUD)	FY10A	FY11A	FY12A	FY13A	FY14A	FY15E	FY16E	FY17E
Sales Revenue	10.7	12.3	15.2	18.5	25.9	31.4	38.3	46.5
EBITDA	0.2	0.8	0.9	0.7	0.8	3.8	6.3	9.1
Depn & Amort	0.2	0.2	0.4	0.5	0.6	0.7	0.8	0.9
<b>EBIT</b>	<b>0.0</b>	<b>0.6</b>	<b>0.5</b>	<b>0.2</b>	<b>0.2</b>	<b>3.1</b>	<b>5.6</b>	<b>8.3</b>
Net Interest Expense	-0.1	-0.1	-0.1	-0.1	0.0	-0.1	-0.1	-0.1
Tax	-0.7	-0.1	-0.1	-0.4	0.0	1.1	1.1	0.8
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>0.8</b>	<b>0.7</b>	<b>0.7</b>	<b>0.7</b>	<b>0.2</b>	<b>2.1</b>	<b>4.6</b>	<b>7.6</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>0.8</b>	<b>0.7</b>	<b>0.7</b>	<b>0.7</b>	<b>0.2</b>	<b>2.1</b>	<b>4.6</b>	<b>7.6</b>

#### CASH FLOW (\$m)

Year-end June (AUD)	FY10A	FY11A	FY12A	FY13A	FY14A	FY15E	FY16E	FY17E
EBITDA	0.2	0.8	0.9	0.7	0.8	3.8	6.3	9.1
Interest & Tax	0.1	0.1	0.1	0.0	-0.5	-1.0	-1.0	-0.7
Working Cap / Other	0.2	-1.2	-0.7	-0.2	-1.1	-0.2	-0.6	-0.7
<b>Operating Cash Flow</b>	<b>0.5</b>	<b>-0.3</b>	<b>0.3</b>	<b>0.6</b>	<b>-0.8</b>	<b>2.6</b>	<b>4.8</b>	<b>7.7</b>
Maintenance Capex	-0.5	-0.3	-0.2	-0.2	0.3	-1.9	-3.5	-1.2
<b>Free Cash Flow</b>	<b>-0.1</b>	<b>-0.6</b>	<b>0.1</b>	<b>0.4</b>	<b>-0.5</b>	<b>0.7</b>	<b>1.3</b>	<b>6.6</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	-0.1	-0.3	-0.5	-0.3	-0.3	-0.3	-0.3
Other Inv. Flows	0.0	0.2	-0.3	-0.1	-0.4	0.0	0.0	0.0
<b>Cash Flow Pre Financing</b>	<b>-0.1</b>	<b>-0.5</b>	<b>-0.5</b>	<b>-0.2</b>	<b>-1.2</b>	<b>0.4</b>	<b>1.0</b>	<b>6.3</b>
Funded by Equity	0.4	0.3	0.1	0.5	0.0	7.0	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	-0.4	0.2	0.3	-0.3	1.2	-7.4	-1.0	-6.3

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

Year-end June (AUD)	FY10A	FY11A	FY12A	FY13A	FY14A	FY15E	FY16E	FY17E
Cash	4.3	3.9	3.5	4.2	2.9	10.4	11.4	17.7
Current Receivables	1.6	2.2	3.7	4.4	5.5	6.8	8.4	10.2
Current Inventories	0.2	0.2	0.5	0.9	1.0	1.7	2.1	2.6
Net PPE	0.6	1.1	1.1	1.2	1.3	2.2	4.4	4.6
Investments	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Intangibles / Capitalised	1.0	1.2	2.7	5.3	8.5	9.0	9.8	10.3
Other	0.1	0.1	0.5	0.2	0.0	0.0	0.0	0.0
<b>Total Assets</b>	<b>7.8</b>	<b>8.7</b>	<b>12.0</b>	<b>16.1</b>	<b>19.1</b>	<b>30.2</b>	<b>36.1</b>	<b>45.3</b>
Current Payables	1.9	2.2	2.4	3.5	3.3	5.1	6.3	7.7
Total Debt	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Other Liabilities	0.3	0.3	0.4	1.0	3.2	3.4	3.6	3.9
<b>Total Liabilities</b>	<b>2.2</b>	<b>2.5</b>	<b>2.8</b>	<b>4.5</b>	<b>6.6</b>	<b>8.6</b>	<b>9.9</b>	<b>11.5</b>
Minorities / Convertibles	0.0	0.0	0.5	0.6	0.2	0.2	0.2	0.2
<b>Shareholder Equity</b>	<b>5.7</b>	<b>6.2</b>	<b>9.2</b>	<b>11.6</b>	<b>12.6</b>	<b>21.6</b>	<b>26.2</b>	<b>33.8</b>
<b>Total Funds Employed</b>	<b>5.7</b>	<b>6.2</b>	<b>9.2</b>	<b>11.6</b>	<b>12.6</b>	<b>21.6</b>	<b>26.2</b>	<b>33.8</b>



## RETURN RE-INVESTMENT MATRIX

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

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.

## 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 closed Q1FY15 with ~\$9m cash.

## 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)
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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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