

Nanosonics

Firing up

ADD (no change)

Current price:	A\$2.80
Target price:	A\$3.04 ▲
Previous target:	A\$2.73
Up/downside:	8.5%
Reuters:	NAN.AX
Bloomberg:	NAN AU
Market cap:	US\$640.1m A\$828.6m
Average daily turnover:	US\$1.37m A\$1.84m
Current shares o/s	295.9m
Free float:	52.0%

Key changes in this note

FY17F revenue increased by 8.0%.

FY17F EBITDA decreased by 3.0%.

FY17F NPAT no change.



Price performance	1M	3M	12M
Absolute (%)	19.1	22.8	64.2
Relative (%)	17.2	19.6	60.9

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- NAN posted a maiden profit with the US sales team firing on all cylinders.
- NAN maintains a strong cash position to fund further product innovation and potential product opportunities in the infection control space.
- The higher margin consumable revenue is a growing part of the business which offsets a higher cost base.
- An upgrade to key assumption metrics results in an upgrade to our forecasts and price target.
- We maintain a positive stance on the name.

FY16 reports maiden profit, US sales firing

NAN posted a maiden FY16 net profit of A\$0.1m (compared with a loss of A\$5.5m on the pcp) and above our forecast loss of A\$0.8m. Importantly the 2HFY16 profit was A\$3.4m which creates a solid platform for growth. Sales were A\$42.8m, up 93% on the pcp, generating a gross margin of 75.2% up from 68.9% on the pcp. The direct sales team in the US has gained traction with sales up over 121% to A\$39m and an installed base of 8,700 units in the region and over 10,000 units worldwide. Operating costs increased by 40% to A\$31.3m reflecting higher research and development (up 50%) and more staff (up 18% to 150 people). NAN has significant cash reserves of A\$48.8m for future product development and growth opportunities.

Upgrades to key metrics in forecasts

Following today's results release and conference call we have made a number of key changes to our forecast assumptions. These include: an adjustment to the contribution from the higher margin consumables business (from 30% to 35%); an increase in the installed base (from 8,700 to 10,000 units); with growth of 25% in FY17 and 20% thereafter; and an increase in the cost base to 16.5% from 6% in FY17. As a result of these changes our FY17 revenue forecast has increased by 8%, however the increase in the cost base results in no change to our FY17 profit forecast. However a 14% increase in sales results in a 4% increase to A\$18.6m in NPAT for FY18.

Key catalyst to watch

The next key catalyst is the release in England of ultrasound decontamination guidelines, similar to what has been released in Wales and Scotland. This is expected to be released in 1QFY17. Once these guidelines are released, we expect sales to accelerate within the region, albeit from a low base. Europe/UK currently represents less than 5% of sales globally.

Investment view – maintain a positive stance

Given the changes to forecasts our DCF valuation has increased to A\$3.04 from A\$2.73. The key risk to our target price is a slower-than-expected US sales ramp. We maintain our positive Add recommendation.

Financial Summary	Jun-15A	Jun-16A	Jun-17F	Jun-18F	Jun-19F
Revenue (A\$m)	22.2	42.8	61.4	84.8	114.6
Operating EBITDA (A\$m)	-4.73	0.96	6.62	18.99	35.38
Net Profit (A\$m)	-5.47	0.12	7.06	18.58	35.74
Normalised EPS (A\$)	-0.02	0.00	0.02	0.06	0.12
Normalised EPS Growth	95%		5562%	163%	92%
FD Normalised P/E (x)	NA	6,643	117	45	23
DPS (A\$)	-	-	-	-	-
Dividend Yield	0%	0%	0%	0%	0%
EV/EBITDA (x)	NA	776.2	116.4	39.8	20.5
P/FCFE (x)	NA	215.7	77.4	54.4	26.3
Net Gearing	(82.8%)	(83.1%)	(90.7%)	(88.7%)	(88.5%)
P/BV (x)	17.74	13.99	13.00	10.07	7.02
ROE	(16.9%)	0.2%	11.7%	25.4%	35.7%
% Change In Normalised EPS Estimates			(5.40%)	(0.62%)	4.08%
Normalised EPS/consensus EPS (x)			0.55	0.71	

SOURCE: MORGANS, COMPANY REPORTS

Figure 1: Financial summaries

Profit and loss						Valuation details					
	Jun-15A	Jun-16A	Jun-17F	Jun-18F	Jun-19F						
Revenue	22.2	42.8	61.4	84.8	114.6	Share Price	\$2.74	Market Cap	\$810.89		
COGS	8.8	12.6	16.4	19.8	23.8	Price Target	\$3.04				
Total Operating Costs	20.5	29.3	38.4	46.1	55.5	Total shareholder return	10.9%	WACC	9.9%		
EBITDA	-4.7	1.0	6.6	19.0	35.4						
Depreciation	-1.1	-1.3	-1.4	-1.4	-1.5						
Amortisation & impairments	0.0	0.0	0.0	0.0	0.0						
EBIT	-5.8	-0.4	5.2	17.5	33.9						
Net Interest Income	0.3	0.5	1.8	2.3	2.9						
Pre-tax Profit	-5.5	0.1	7.1	19.8	36.8						
Tax	0.0	0.0	0.0	-1.2	-1.0						
Reported Profit	-5.5	0.1	7.1	18.6	35.7						
Exceptional items	0.0	0.0	0.0	0.0	0.0						
Normalised Profit	-5.5	0.1	7.1	18.6	35.7						
Gross dividends	0.0	0.0	0.0	0.0	0.0						
Cash flow statement						Key metrics/ multiples					
	Jun-15A	Jun-16A	Jun-17F	Jun-18F	Jun-19F		Jun-15A	Jun-16A	Jun-17F	Jun-18F	Jun-19F
EBITDA	-4.7	1.0	6.6	19.0	35.4	P/E	-141.9	6500.8	114.8	43.6	22.7
Net interest	0.3	0.5	1.8	2.3	2.9	Yield	0.0%	0.0%	0.0%	0.0%	0.0%
Tax	0.0	0.0	0.0	-1.2	-1.0	PEG	1.5	63.6	0.0	0.3	0.2
Changes in working capital	-0.4	1.8	3.7	-3.2	-4.2	EV/EBITDA	-156.2	758.6	113.7	38.9	20.0
Operating cash flow	-4.8	3.2	12.2	16.8	33.1	Price/ Book Value	17.4	13.7	12.7	9.9	6.9
Capex	-2.1	-1.1	-1.5	-1.6	-1.6	Price/ Net Tangible Assets	17.4	13.7	12.8	9.9	6.9
Free Cash Flow	-6.9	2.2	10.7	15.2	31.5	Operating cash flow yield	-0.6%	0.4%	1.5%	2.1%	4.1%
Acquisitions and divestments	-0.2	-0.2	0.0	0.0	0.0	Free cash flow yield	-0.9%	0.3%	1.3%	1.9%	3.9%
Other investing cash flow	6.9	-2.2	-10.7	-15.2	-31.5						
Investing cash flows	-2.3	-1.3	-1.5	-1.6	-1.6	Per share data					
Increase / decrease in Equity	28.6	0.0	0.0	0.0	0.0		Jun-15A	Jun-16A	Jun-17F	Jun-18F	Jun-19F
Increase / decrease in Debt	0.0	1.7	0.0	0.0	0.0	Diluted shares on issue	283.0	283.0	295.9	295.9	295.9
Dividends paid	0.0	0.0	0.0	0.0	0.0	Reported EPS (A\$)	-0.02	0.00	0.02	0.06	0.12
Other financing cash flows	0.0	0.0	0.0	0.0	0.0	Normalised EPS (A\$)	-0.02	0.00	0.02	0.06	0.12
Financing cash flows	28.6	1.7	0.0	0.0	0.0	Dividends per share (A\$)	0.00	0.00	0.00	0.00	0.00
						Payout ratio	0.0%	0.0%	0.0%	0.0%	0.0%
Balance Sheet						Result quality					
	Jun-15A	Jun-16A	Jun-17F	Jun-18F	Jun-19F		Jun-15A	Jun-16A	Jun-17F	Jun-18F	Jun-19F
Assets						Cash flow conversion	108.6%	286.1%	155.6%	83.0%	88.2%
Cash And Deposits	45.7	48.8	59.5	74.8	106.3	FCF vs. NPAT	127.0%	1815.0%	151.6%	82.0%	88.1%
Debtors	3.9	7.7	8.4	11.6	15.7	Gross dividends vs FCF	0.0%	0.0%	0.0%	0.0%	0.0%
Inventory	6.2	6.9	2.5	3.4	4.6	Gearing					
Other current assets	0.6	1.1	1.1	1.1	1.1		Jun-15A	Jun-16A	Jun-17F	Jun-18F	Jun-19F
Total Current Assets	56.4	64.6	71.5	90.9	127.6	Net Debt	-37.01	-47.10	-57.80	-73.03	-104.51
Fixed Assets	3.6	3.3	3.3	3.5	3.6	Net Debt / Equity	-82.8%	-83.1%	-90.7%	-88.7%	-88.5%
Investments	0.0	0.0	0.0	0.0	0.0	Net Debt / EBITDA (x)	7.83	-49.04	-8.73	-3.85	-2.95
Goodwill	0.0	0.0	0.0	0.0	0.0	EBIT interest cover (x)	-17.55	-0.73	2.82	7.71	11.74
Intangibles	0.2	0.3	0.3	0.3	0.3	Invested Capital	7.3	11.4	9.6	6.0	9.4
Other non-current assets	0.2	0.0	0.0	0.0	0.0	Enterprise Value	738.5	728.4	753.1	737.9	706.4
Total Non-Current Assets	3.9	3.6	3.6	3.7	3.8	Growth ratios					
TOTAL ASSETS	60.4	68.2	75.1	94.6	131.4		Jun-15A	Jun-16A	Jun-17F	Jun-18F	Jun-19F
Liabilities						Revenue	3.3%	92.8%	43.5%	38.1%	35.1%
Short Term Debt	8.7	0.4	0.7	0.7	0.7	Operating costs	25.3%	43.1%	31.0%	20.1%	20.3%
Creditors	2.7	4.6	4.5	5.4	6.5	EBITDA	-156.2%	120.3%	-589.8%	186.7%	86.3%
Other current liabilities	4.3	5.1	5.1	5.1	5.1	EBIT	-105.3%	93.8%	-1541.3%	236.6%	93.1%
Total Current Liabilities	15.7	10.2	10.3	11.3	12.4	NPAT	-108.8%	102.2%	-5819.7%	163.1%	92.4%
Long Term Debt	0.0	1.3	1.0	1.0	1.0	EPS growth	-94.6%	102.2%	-5561.7%	163.1%	92.4%
Other Debt (inc hybrids)	0.0	0.0	0.0	0.0	0.0	DPS growth	0.0%	0.0%	0.0%	0.0%	0.0%
Other Non current liabilities	0.0	0.0	0.0	0.0	0.0	Operating cash flow	-85.4%	167.1%	-276.6%	38.1%	97.0%
Total Non -Current liabilities	0.0	1.3	1.0	1.0	1.0	Margin analysis					
TOTAL LIABILITIES	15.7	11.5	11.4	12.3	13.4		Jun-15A	Jun-16A	Jun-17F	Jun-18F	Jun-19F
Equity						EBITDA Margin	-21.3%	2.2%	10.8%	22.4%	30.9%
Issued capital	5.1	7.3	7.3	7.3	7.3	EBIT margin	-26.1%	-0.8%	8.5%	20.7%	29.6%
Retained earnings	-63.5	-63.4	-63.4	-63.4	-63.4	NPAT margin	-24.6%	0.3%	11.5%	21.9%	31.2%
Other reserves and FX	103.1	112.7	119.8	138.3	174.1	ROE	-12.2%	0.2%	11.1%	22.6%	30.3%
TOTAL EQUITY	44.7	56.7	63.7	82.3	118.0	ROIC	-79.8%	-3.2%	54.2%	290.8%	361.7%
						ROE less WACC	-22.2%	-9.7%	1.2%	12.6%	20.4%
						ROIC less WACC	-89.7%	-13.1%	44.3%	280.9%	351.8%

SOURCE: MORGANS RESEARCH, COMPANY

Key takeaways from the result

Revenue – Total sales were A\$42.8m (+93% on the pcp) despite impact of lower GE sales during transition to a non-exclusive partnership commenced in February 2015. North America sales continued to grow strongly, contributing A\$39m (from A\$17.7m, +121% on the pcp) and comprises 91% of the sales mix geographically. APAC sales remained strong with A\$2.5m (up 11.5% on the pcp). European/ROW sales declined to A\$1.2m (from A\$2.3m, -46% on the pcp) as the region awaits further guidelines to be published in England on the requirement of high level disinfection of ultrasound probes used in semi-critical procedures.

Operating Expenses – OpEx increased to A\$31.3m (+43% on the pcp) reflecting the continued investment in the North American direct sales operations. NAN continue to invest heavily in product innovations as R&D costs increased by 49% to A\$7.3m.

EBITDA – EBITDA increased to A\$0.95m from loss of A\$4.7m on the pcp. The gain is a result of the NAN direct sales team gaining traction, booking higher margins compared to historical wholesale margins being achieved via the GE Healthcare agreement.

NPAT – A maiden profit of A\$0.1m versus a A\$5.5m loss on the pcp.

Cash balance – NAN has a solid cash position of A\$48.8m.

Geographically

North America – Strong sales of A\$39m, up 121% on the pcp as direct sales team continues to fire as well as strong GE Healthcare sales. Install base grew to >8,700 systems in operation across 3,000 facilities. Direct sales in the region is fully operational with sales specialists in the field covering >15 territories, driving higher margin direct sales and building the pipeline for future deals.

APAC – Sales of A\$2.5m for FY16, up 11% on the pcp. Install base increases to >1,000 units. Lower growth in the region due to high market penetration of >60%. NAN continue plans to expand into the Japanese market, progressing throughout the year hiring a national manager and recently presenting at the annual Japanese Society of Ultrasound in Medicine.

Europe/ROW – Weaker sales across Europe (A\$1.2m from A\$2.3m on the pcp) as still very early stage in the commercialisation of the area. European sales growth is underpinned by policy and guidelines requiring the use of high level disinfection in semi-critical procedures. Scottish guidelines were released recently while English guidelines are expected to be released in 1QFY17.

Changes to forecasts

We have made a number of key changes to our forecast assumptions. These include: an adjustment to the contribution from the higher margin consumables business (from 30% to 35%); an increase in the installed base (from 8,700 to 10,000 units); with growth of 25% in FY17 and 20% thereafter; and an increase in the cost base to 16.5% from 6% in FY17. As a result of these changes our FY17 revenue forecast has increased by 8%, however the increase in the cost base results in no change to FY17 forecast. However a 14% increase in sales in FY18 results in a NPAT increase of 4% to A\$18.6m.

Figure 2: Changes to forecasts

	FY16A			FY17F			FY18F		
	Forecast	Actual	Diff	Prev	Rev	Diff	Prev	Rev	Diff
Revenue	42.9	42.8	0%	56.6	61.4	8%	74.6	84.8	14%
EBITDA	-0.9	1.0	211%	6.8	6.6	-3%	17.4	19.0	9%
EBITDA margin	-2%	2%	212%	12%	11%	-10%	23%	22%	-4%
Net profit after tax	-0.8	0.1	116%	7.1	7.1	-1%	17.9	18.6	4%

SOURCE: MORGANS RESEARCH, COMPANY

Valuation and price target

Given the changes to forecasts our DCF valuation has increased to A\$3.04 from A\$2.73. The key risk to our target price is a slower-than-expected US sales ramp.

Figure 3: Valuation

Preferred methodology:	DCF		
DCF valuation metrics			
Risk Free Rate	4.00%	Aset Beta	1.35
Corporate Tax Rate	30%	Equity Beta	1.72
Target D / D+E	35%	Equity risk premium	5.25%
Imputation	60%	Terminal growth rate	4.0%
Explicit cash flows	149.8	No shares	295.95
Terminal item	749.3	Per share value	\$3.04
Total equity Value	899.1		

SOURCE: MORGANS RESEARCH, COMPANY

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