



Nanosonics (NAN)

Set to Fully Realise the trophon™ Opportunity

BUY

Risk: High

Key Information

Price (\$ps)	1.00
Target Price (\$ps)	1.20
Market Cap (\$M)	263
GICS Sector	Healthcare Eq & Services
52 week Hi-Lo (\$ps)	0.97 - 0.74
Daily Vol (M, mth avg)	0.3
Weight of S&P 200 Index (%)	0.00
Cash (\$m)	\$24M
Debt (\$m)	\$0M
Gearing (ND/ND+E) (%)	Net Cash
Forecast Total Return (%)	20.0%

Investment Fundamentals

Jun-30	FY13	FY14	FY15F	FY16F
Sales (\$m)	16.4	24.9	33.8	52.2
EBITDA (\$m)	-5.4	-1.8	-1.2	2.0
Margin (%)	-0.4	-0.1	0.0	0.0
NPAT (\$m)	-5.8	-2.6	-1.5	2.0
EPS (cps)	-2.5	-1.0	-0.6	0.7
EPS Growth (%)		-59.7%	-43.5%	1315.0%
DPS (cps)	0.0	0.0	0.0	0.0
Franking (%)	100%	100%	100%	100%

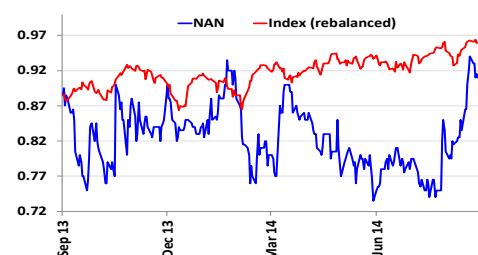
Source: Shaw Stockbroking

Ratio Analysis

Jun-30	FY13	FY14	FY15F	FY16F
PE (x)	-40.7	-101.0	-178.7	133.4
PE Rel (x)	-3.4	-8.4	-14.9	11.1
Yield	0.0%	0.0%	0.0%	0.0%
ROE	-24.2%	-12.4%	-7.5%	9.9%
P/BV (x)	10.8x	12.9x	13.9x	12.6x

PE Rel is compared to the Market (Industrials + Resources)

NAN vs S&P/ASX Market Index



Performance	1 Mth	3 Mth	12 Mth
Absolute (NAN)	13.0%	21.3%	2.8%
Rel to Market	11.8%	19.4%	-5.6%

Company Activities

NAN is a medical device company focusing on research, development and commercialisation of novel disinfection portfolio and sterilisation products utilising NAN's proprietary technology platform.

Major Shareholders

Shareholding	Shareholding
Allan Gray	11.8%
National Nominees	11.2%
Stang, Maurie	10.8%
Stang, Bernard	10.5%
Aust Executor Trustees SA Ltd	6.2%
Kritzler, Steven	5.2%

Directors and Management

Richard F England
Maurie Stang
David Fisher
Dr Ronald Weinberger
Michael Kavanagh

Event

Post NAN releasing its results and having met with management we review its considerable achievements over FY14 and how they have set it up for ongoing success through FY15 and beyond.

Highlights

- FY14 results show NAN has solid momentum heading into FY15.** FY14 Revenue growth of 44% to \$21.5m, in line with Shaw's forecast of \$22.8m, reflected all regions recording strong growth. North America +34%, ANZ +51% and Europe +800% off a low base. Gross margins continue to expand, up to 65% from 57% in FY13. Operating costs increased 22% vs revenue growth of 44%, demonstrating the scalable nature of the product. This permitted a loss after tax of \$2.6mn down from \$5.8mn in FY13 and notably due to R&D incentives NAN produced a profit in 2H14 of \$0.9mn.
- NAN's balance sheet remains robust** – its cash balance at year end stood at \$21.2m, with cash burn quickly becoming a non-issue.
- Momentum with distributors continued to build** – In the US, trophon™ is now present in 40 out of 50 top US hospitals and across 1,606 sites (up from 1,400 in April). The US strength combined with distributors now in place in Europe have set NAN up to capture the \$3bn+ global ultrasound disinfection market.
- Regulatory guidelines have also continued to strengthen in NAN's favour over FY14.** Clinical studies continue to raise awareness about the advantages of trophon™ over traditional disinfection techniques which is quickly pushing the trophon™ toward being the accepted standard of care across the globe.
- NAN's operational outlook is increasingly favorable and on track** towards the companies estimate of peak potential trophon™ and related consumables sales of \$300mn pa. With a maiden half yearly profit behind it and significant momentum NAN is now poised to take advantage of ongoing uptake of trophon™ as Europe, Asia and South America start to build in line with the growth we've seen from the US.

Recommendation

BUY. NAN is fast moving away from being a speculative medical device company towards being a steady state industrial company with multiple clients and revenue streams. We expect cash flow break-even periods to become more common in the near term and management quality to become increasingly evident to outside observers as momentum continues, which will make NAN increasingly attractive to institutional investors. We expect its share price will trade up towards our DCF based 12 month TP of \$1.20.



Financial Summary

Consolidated P&L (A\$m)	FY12	FY13	FY14	FY15F	FY16F	Key Financials	FY12	FY13	FY14	FY15F	FY16F
Operating revenues	12.3	14.9	21.5	33.8	52.2	Diluted average shares	234.7	234.7	263.1	263.1	264.2
Non operating revenues	0.2	1.5	3.4	0.0	0.0	Reported EPS	-2.0	-2.4	-1.0	-0.6	0.7
Total revenues	12.5	16.4	24.9	33.8	52.2	Reported EPS (diluted)	-2.0	-2.4	-1.0	-0.6	0.7
Total operating expenses	17.4	21.8	26.7	34.9	50.3	Cash EPS (diluted)	-2.0	-2.5	-1.0	-0.6	0.7
						EPS growth	-60%	23%	-60%	-43%	-234%
EBITDA	-5.0	-5.4	-1.8	-1.2	2.0	PER (x)	-50.1x	-40.7x	-101.0x	-178.7x	133.4x
Depreciation of assets	-0.9	-1.0	-1.0	-0.6	-0.4	DPS (cps)	0.0	0.0	0.0	0.0	0.0
Amortisation goodwill	0.0	0.0	0.0	0.0	0.0	Payout ratio (%)	0%	0%	0%	0%	0%
Amortisation other	0.0	0.0	0.0	0.0	0.0	Dividend yield (net)	0.0%	0.0%	0.0%	0.0%	0.0%
EBIT	-5.9	-6.4	-2.8	-1.8	1.5	Franking	100%	100%	100%	100%	100%
Interest charges	0.0	-0.5	-0.6	-0.6	-0.6	Dividend yield (gross)	0.0%	0.0%	0.0%	0.0%	0.0%
Interest received	0.6	1.2	0.7	0.7	0.7						
Share of net profits of asso	0.0	0.0	0.0	0.0	0.0	Key Operational Financials	FY12	FY13	FY14	FY15F	FY16F
Profit before tax	-5.3	-5.7	-2.6	-1.6	1.7	EBITDA margin (%)	-40.5%	-36.0%	-8.6%	-3.4%	3.7%
Tax	0.6	0.0	0.0	0.1	0.3	EBIT margin (%)	-47.9%	-43.0%	-13.1%	-5.3%	3.0%
OEI	0.0	0.0	0.0	0.0	0.0	NPAT margin (%)	-38.0%	-38.7%	-12.1%	-4.4%	3.8%
Normalised NPAT	-4.7	-5.8	-2.6	-1.5	2.0	Tax rate (%)	11.9%	-0.6%	1.2%	8.9%	-19.5%
Significant items (after tax)	0.0	0.0	0.0	0.0	0.0	EBITDA growth (%)	-58.4%	7.7%	-65.6%	-37.4%	-269.5%
Reported NPAT	-4.7	-5.7	-2.6	-1.5	2.0	EBIT growth (%)	-54.6%	8.7%	-56.0%	-36.7%	-186.8%
Cash NPAT	-4.7	-5.7	-2.6	-1.5	2.0	NPAT growth (%)	-58.3%	22.5%	-55.2%	-42.6%	-234.5%
Cashflows (A\$m)	FY12	FY13	FY14	FY15F	FY16F	Cash Flow Ratios	FY12	FY13	FY14	FY15F	FY16F
Operating cashflows	-5.0	-4.5	-2.6	-1.4	0.4	FCF (OC - CAPEX)	-6	-6	-3	-1	0
Investing cashflows	-0.8	-1.4	-0.5	0.0	0.0	FCF (growth pcp %)		-0.1%	-47.6%	-53.0%	-127.2%
Financing cashflows	22.8	0.5	0.3	0.0	0.0	Total CAPEX spend	-1	-1	0	0	0
Net increase in cash	17.0	-5.3	-2.7	-1.4	0.4	Net borrowings	0	0	0	0	0
Cash at end of the year	29.3	24.1	21.2	19.8	20.2						
	-	-	-	-	-						
Balance Sheet (A\$m)	FY12	FY13	FY14	FY15F	FY16F	Balance Sheet Ratios	FY12	FY13	FY14	FY15F	FY16F
Cash	29.3	24.1	21.2	19.8	20.2	Period end shares	260.4	261.2	263.1	264.2	264.2
Receivables	3.0	4.2	5.7	6.8	10.5	NAV per share	0.1	0.1	0.1	0.1	0.1
Inventories	2.4	2.9	4.2	4.2	4.2	ROE (%)	-23%	-24%	-12%	-7%	10%
Plant & equipment	1.5	1.8	1.8	1.1	0.7	P / NAV (P/BV)	9.0x	10.8x	12.9x	13.9x	12.6x
Deferred tax assets	0.0	0.0	0.0	0.0	0.0	NTA per share	0.1	0.1	0.1	0.1	0.1
Intangibles	0.1	0.0	0.0	0.0	0.0	ROTE (%)	-23%	-24%	-12%	-7%	10%
Other assets	0.4	0.6	0.6	0.6	0.6	P / NTA (x)	9.0x	10.8x	12.9x	13.9x	12.6x
Assets	36.7	33.7	33.5	32.6	36.3						
						Gearing	FY12	FY13	FY14	FY15F	FY16F
Payables	2.4	3.0	3.0	3.5	5.2	Net Debt	Net Cash	Net Cash	Net Cash	Net Cash	Net Cash
Provisions	1.0	0.8	1.5	1.5	1.5	Net Debt / Equity	Net Cash	Net Cash	Net Cash	Net Cash	Net Cash
Tax liabilities	0.0	0.0	0.0	0.0	0.0	Net Debt / (ND+E)	8.9	Net Cash	Net Cash	Net Cash	Net Cash
Borrowings	0.0	0.0	0.0	0.0	0.0	Int cover (x) (EBITDA)	8.5x	7.9x	10.0x	6.8x	-18.3x
Other liabilities	7.2	8.1	8.6	8.6	8.6	Int cover (x) (EBIT)	10.1x	9.5x	15.3x	10.5x	-14.5x
Liabilities	10.6	11.9	13.1	13.6	15.3						
Net Assets	26.1	21.7	20.4	19.0	20.9						
Net Tangible Assets	26.0	21.7	20.4	19.0	20.9						

Source: Shaw Stockbroking

Set to Fully Realise the trophon™ Opportunity

NAN's FY14 results show NAN has solid momentum heading into FY15. Its balance sheet remains robust with \$21.2m net cash, and with the reduction in losses to \$2.6mn cash burn is quickly becoming a non-issue. The key focus now is firmly on building out the trophon opportunity which the developments over FY14 suggest is increasingly likely.

Key to operational developments over FY14 was the appointment of new, and strengthening of existing, distributor relationships.

- **GE** – In August 2013 NAN and GE announced their new sales and marketing agreement. NAN's partnership with GE has now seen its products (Trophon™ and consumables) introduced into 1,606 US hospitals and into 80% of the top 50 US hospitals. The sales and gross margins being achieved, suggest GE alone could get NAN to break even over the next 12 months.
- **Toshiba** – Late in FY13 NAN announced signing a non-exclusive distribution agreement for the UK with Toshiba. Over FY15, as NAN's Toshiba contract ramps up, NAN will benefit from the UK government review expected to report over the next six months.
- **Miele** – In March NAN announced a strategic partnership with Miele Professional for the distribution of Trophon™ EPR in Germany. The appointment is a departure from NAN's model for its first two distribution partnerships (GE & Toshiba) which are both ultrasound manufacturers. Miele, being a provider of medical disinfection and sterilisation equipment is going to provide an alternative path to market. The appointment does reflect structural differences in the German market; however, it is going to enable NAN to see which path to market is more effective. We like this departure, which, particularly at this early stage of commercialisation of a new technology, covers off on any distribution risk, reflects an increasingly strategic approach to NAN's sales efforts and we would expect a dual pronged approach to other markets in the future.

Guidelines and clinical studies continued to strengthen the case for using trophon™

Regulatory guidelines have also continued to strengthen in NAN's favour over FY14, while clinical studies continued to raise awareness about the advantages of trophon™ over traditional disinfection techniques which is quickly pushing the trophon™ toward being the accepted standard of care across the globe.

- New American Institute of Ultrasound in Medicine (AIUM) guidelines released in May reinforced the importance of high level disinfection and include a reference to trophon™ technology.
- TJC Quick Safety, which accredits more than 20,000 health care organisations in the US, identified infection control as one of the top five non-compliant TJC requirements.
- A peer reviewed publication demonstrated the high level efficacy of trophon™ using multiple international standards.
- Trophon EPR efficacy was also independently validated by German testing company SMP GmbH.

Momentum in the US continues to build

trophon™ is now present in 40 out of 50 top US hospitals and across 1,606 sites (up from 1,400 in April). The increased presence combined with the clinical studies and guidelines outlined above continue to raise awareness of its advantages over traditional disinfection techniques pushing the trophon™ toward a standard of care position.

Europe is set to be next

Over FY14 NAN achieved sales of \$1.7 million, greater than a fivefold increase vs. FY13

The UK was the primary driver of the sales growth in the period with adoption of trophon™ in a number of key hospitals. 45% of UK ultrasound facilities currently use the Trystal Trio wipes. New guidelines from Health Boards in UK for high level disinfection HLD of Ultrasound transducers is expected in H1 FY15 which is expected to further drive adoption.

Miele Professional appointed as German distributor in March and market development activities underway. Clinical trials commenced in Germany with results due for announcement in Q1 FY15 which we expect will begin a repeat of the sales success seen in the US.

ROW

Trophon is approved for sale in most other major markets including: ANZ, Singapore, HK, South Korea, and Japan.

Sales in ANZ grew 57% to \$2.3 mn in FY14. Australia's largest medical imaging clinic network, I-MED, expanded adoption nationally and an Australian clinical trial demonstrated risks of cross infection using conventional disinfection.

Regulatory approvals for Korea & Japan received and commercialisation strategies in advanced stages of development

Our keypoint, which is increasingly clear from each market that NAN has entered, is that the trophon™ market opportunity looks increasingly likely to be fully realised.

The first mover advantage NAN has and the increasingly evident push by regulators, academics and clinicians towards best in practice solutions is now likely to see NAN dominate the ultrasound disinfection market, which we estimate to be a \$2-3bn or \$300mn pa opportunity.



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Rating Classification

Buy	Expected to outperform the overall market
Hold	Expected to perform in line with the overall market
Sell	Expected to underperform the overall market
Not Rated	Shaw has issued a factual note on the company but does not have a recommendation

Risk Rating

High	Higher risk than the overall market – investors should be aware this stock may be speculative
Medium	Risk broadly in line with the overall market
Low	Lower risk than the overall market.

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