

Nanosonics Limited

NAN : ASX : A\$0.95

BUY

Target: A\$1.35

Matthijs Smith

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COMPANY STATISTICS:

Share price	\$0.95
Valuation	\$1.20
12-month range	\$0.74-\$1.20
Market capitalisation	\$251M
Issued shares	264M
Options (various)	3.8M
Cash (30/09/14)	\$23.6M
Debt (30/06/14)	nil

MAJOR SHAREHOLDERS

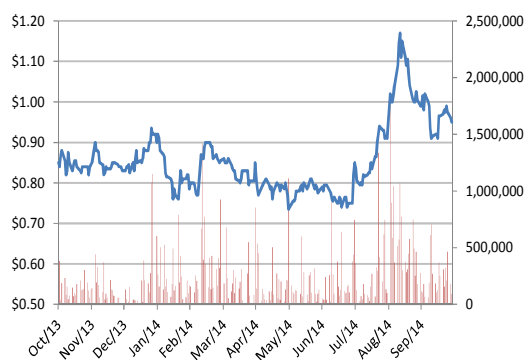
Allan Gray	11.9%
Maurie Stang	10.7%
Bernard Stang	9.3%
Kinetic Investments	7.0%

EARNINGS SUMMARY

YE 30 June	FY14A	FY15E	FY16E
Sales (\$M)	21.5	31.7	46.9
Other income (\$M)	4.1	4.1	2.7
Net profit (\$M)	(2.6)	(2.1)	4.4
EPS (cps)	(1.0)	(1.0)	(0.8)
Op cash burn (\$M)	(20.1)	(24.5)	(28.4)
Net cash burn (\$M)	(2.8)	(2.6)	4.0
Net cash (\$M)	21.2	18.6	22.6

Source: Canaccord Genuity estimates

SHARE PRICE PERFORMANCE



COMPANY DESCRIPTION:

NAN is developing and commercialising products for low-temperature sterilisation based on its patented nanonebulant technology. Its first product, the Trophon EPR, is for sterilising ultrasound probes and has been launched in several markets including Australia, NZ, Europe and the US where it is marketed by GE Healthcare.

Lifesciences - Biotechnology

New Welsh Guidelines Support trophon

Investment Perspective

The National Health Service (NHS) Wales has released new guidelines for the decontamination of flexible endoscopes which includes guidance for the disinfection of ultrasound probes. These guidelines highlight the need for ultrasound probes to be disinfected between each patient with a strong preference for systems that are automated, validated, approved by the ultrasound probe manufacturers and provide an audit trail to show the probe was properly disinfected. Current practice in the UK uses manual wipes such as Tristel which do not adequately meet many aspects these new guidelines. We believe that trophon is the only system that provides a simple means for healthcare facilities in Wales to comply with these new guidelines and thus are likely to help drive adoption of trophon in Wales that may have a spill over effect into the rest of the UK and Europe.

Result Highlights

trophon provides unique combination of features:- the revised NHS Wales guidelines reiterate the need for ultrasound probe disinfection systems that are simple to use and can be relied upon. In terms of features, this translates to systems that are located at the point of care, are automated so as to minimize human error or non-compliance, and provides an audit trail to show the probe has been properly disinfected. To our knowledge, trophon is the only system currently in the market that provides these benefits. In addition, the new guidelines highlight the need disinfection procedures to be validated by the OEM and for there to be clear data showing they are able to provide effective disinfection. The trophon is currently approved by manufacturers for use with over 600 different ultrasound probes and its ability to provide effective high level disinfection has been shown in every one of several clinical studies conducted by both the company and by independent research groups.

Clearly they like it:- while industry guideline are not able to recommend or endorse any specific products, the NHS Wales guidelines provide a second case where use of trophon has been highlighted. The first release in May 2014 of the American Institute of Ultrasound in Medicine guidelines highlighted the effectiveness of hydrogen peroxide nanodroplet systems such as the trophon. These new NHS Wales guidelines include a photo of the trophon as and "an example of technology designed to provide validated decontamination process of TVUS (transvaginal) and TVUR (transrectal) ultrasound probes". We are expecting new guidelines to be issued out of Scotland over the coming months

Maintain BUY recommendation and \$1.35 price target:. Our price target is based on a 12-year discounted cash flow valuation with no terminal value of trophon and associated consumables in the major medical markets.

FINANCIAL SUMMARY**Financial Performance**

Year End	June	2013A	2014E	2015E	2016E	2017E	2018A	2019A	2020E	2021E	2022E	2023E
trophon sales - units (CG Est)	#	2,343	2,699	3,795	4,850	6,565	7,953	8,713	9,738	10,713	12,739	14,198
Install base trophon - units (CG Est)	#	5,123	7,822	11,617	16,467	23,032	30,985	39,697	49,435	60,147	72,887	87,085
trophon sales (CG Est)	\$M	12.7	16.7	24.4	35.3	50.5	64.4	75.6	90.5	108.9	137.6	162.0
Consumable sales (CG Est)	\$M	2.0	4.4	7.3	11.6	19.0	29.6	43.6	61.1	75.1	91.2	109.7
Sales of goods and services	\$M	14.9	21.5	31.7	46.9	69.4	94.0	119.2	151.6	184.0	228.8	271.7
Cost of sales	\$M	(6.4)	(7.6)	(11.5)	(16.3)	(23.1)	(29.7)	(35.8)	(43.4)	(52.1)	(64.3)	(76.2)
Gross Margin	\$M	8.5	13.9	20.2	30.6	46.4	64.3	83.3	108.2	131.9	164.5	195.5
Interest revenue	\$M	1.2	0.7	0.7	0.8	1.3	2.3	3.0	3.6	4.4	5.4	6.6
Government grants	\$M	1.5	1.7	-	-	-	-	-	-	-	-	-
Other income	\$M	-	1.7	2.0	2.0	1.0	-	-	-	-	-	-
Total other income	\$M	2.7	4.1	2.7	2.8	2.3	2.3	3.0	3.6	4.4	5.4	6.6
Staff expense	\$M	(9.2)	(12.0)	(15.0)	(18.0)	(20.7)	(22.8)	(23.9)	(23.9)	(23.9)	(23.9)	(23.9)
Operations	\$M	(7.2)	(8.1)	(9.5)	(10.4)	(11.2)	(11.6)	(11.6)	(11.6)	(11.6)	(11.6)	(11.6)
Total operational expense	\$M	(16.4)	(20.1)	(24.5)	(28.4)	(31.9)	(34.4)	(35.5)	(35.5)	(35.5)	(35.5)	(35.5)
Borrowing costs	\$M	(0.5)	(0.6)	(0.6)	(0.6)	(0.6)	(0.6)	(0.6)	(0.6)	(0.6)	(0.6)	(0.6)
Net profit before tax	\$M	(5.7)	(2.6)	(2.1)	4.4	16.2	31.6	50.3	75.8	100.3	133.8	166.0
Tax benefit / (expense)	\$M	(0.0)	0.0	-	-	-	-	(12.7)	(22.7)	(30.1)	(40.1)	(49.8)
Net profit after tax	\$M	(5.8)	(2.6)	(2.1)	4.4	16.2	31.6	37.6	53.0	70.2	93.6	116.2
Earnings per share (cps)	cps	(2.2)	(1.0)	(0.8)	1.6	5.9	11.5	13.6	19.2	25.4	33.9	42.1
Dividend per share (dps)	cps	-	-	-	-	-	10.3	12.2	17.3	22.9	30.5	37.9

Balance Sheet

Year End	June	2013A	2014E	2015E	2016E	2017E	2018A	2019A	2020E	2021E	2022E	2023E
Cash & Cash Equivalents	\$M	24.1	21.2	18.6	22.6	38.3	69.5	78.1	96.9	118.8	148.8	183.3
Current Assets	\$M	31.7	31.6	29.0	33.0	48.7	79.9	88.5	107.2	129.2	159.2	193.7
Non-Current Assets	\$M	2.0	1.9	1.9	1.9	1.9	1.9	1.9	1.9	1.9	1.9	1.9
TOTAL ASSETS	\$M	33.7	33.5	31.0	34.9	50.7	81.8	90.4	109.2	131.2	161.2	195.6
Current Debt	\$M	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Current Liabilities	\$M	4.2	4.8	4.5	4.5	4.5	4.5	4.5	4.5	4.5	4.5	4.5
Non-Current Debt	\$M	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Non-Current Liabilities	\$M	7.7	8.3	8.3	8.3	8.3	8.3	8.3	8.3	8.3	8.3	8.3
TOTAL LIABILITIES	\$M	11.9	13.1	12.8	12.8	12.8	12.8	12.8	12.8	12.8	12.8	12.8
Equity	\$M	77.1	78.5	78.3	75.7	79.7	123.9	131.9	149.1	169.4	197.0	229.2
Accumulated Profits / (Losses)	\$M	-55.4	-58.0	-60.2	-53.6	-41.8	-54.9	-54.3	-52.7	-51.0	-48.7	-46.4
TOTAL EQUITY	\$M	21.7	20.4	18.2	22.1	37.9	69.0	77.6	96.4	118.4	148.4	182.8

Cash Flow

Year End	June	2013A	2014E	2015E	2016E	2017E	2018A	2019A	2020E	2021E	2022E	2023E
Receipts	\$M	14.0	23.0	33.7	48.9	70.4	94.0	119.2	151.6	184.0	228.8	271.7
Suppliers & Employers	\$M	-21.1	-28.0	-36.0	-44.7	-55.0	-64.1	-71.4	-78.9	-87.6	-99.9	-111.8
Interest Received	\$M	1.1	0.7	0.2	0.3	0.8	1.7	2.5	3.0	3.9	4.9	6.1
Tax Paid	\$M	1.5	1.7	0.0	0.0	0.0	0.0	-12.7	-22.7	-30.1	-40.1	-49.8
Cash From Operations	\$M	-4.5	-2.6	-2.1	4.4	16.2	31.6	37.6	53.0	70.2	93.6	116.2
Cash From Investing	\$M	-1.4	-0.5	-0.5	-0.5	-0.5	-0.5	-0.5	-0.5	-0.5	-0.5	1.5
Cash From Financing	\$M	0.5	0.3	0.0	0.0	0.0	0.0	-28.5	-33.8	-47.7	-63.2	-84.3
Opening Cash Balance	\$M	29.3	24.1	21.2	18.6	22.6	38.3	69.5	78.1	96.9	118.8	148.8
Net Incr / (Decr) In Cash	\$M	-5.2	-2.8	-2.6	4.0	15.8	31.2	8.6	18.7	22.0	30.0	34.5
Closing Cash Balance	\$M	24.1	21.2	18.6	22.6	38.3	69.5	78.1	96.9	118.8	148.8	183.3

Valuation

Risk Free Rate	%	4.60%		Forecast Period	years	12
Market Premium	%	5.50%		12-Month Price Target	\$	\$1.35
Beta	x	1.1		Current Price	\$	\$0.95
Discount Rate	%	10.7%		Return	%	42%

SOURCES: Company reports, Canaccord Genuity estimates

Investment Risks

The opportunity with NAN is to invest in a fully-funded company that is in the early stages of growing sales in a unique and commercially attractive product. If this is successful, investors have the potential to make significant capital gains. However, the road to riches is never without risk and the key risks that we see facing NAN are:

Poor sales support from GE: - this is a very different product from those previously sold by GE. As with any distributor relationship, it may not get the sales traction that we are expecting. This could arise from inappropriate sales incentives within GE, lack of familiarity with the necessary sales process for the products, or simply lack of attention as GE focuses on sales of its other product during tough market conditions. This revised agreement in which GE and GE Ventures have made financial commitments to invest in sales and marketing activities for the trophon, partially mitigates this risk

Manufacturing hiccups: the company has already had to make a number of post-launch improvements, and had its production disrupted by issues with supplied components. These disruptions could occur again and, if they did, would have an impact on sales. We also do not dismiss manufacturing issues arising from scale-up production or relocation to a new facility which could also impact on sales or product quality.

We believe having Resmed's ex-Head of Manufacturing, Gerard Putt in the company, who has been through the scale-up production of high-end devices should limit this risk. We have already seen the impact of his expertise on manufacturing efficiency.

Customer push-back: with an increasing focus on healthcare budgets, NAN may experience some resistance from potential customers unwilling or unable to make the purchase. NAN may be forced to explore other sales models (for instance provide the instrument and make money on higher price consumables) which could disenfranchise existing customers. However, we believe the tangible commercial benefits and the sales traction to date indicate that the company can manage this with the correct sales strategy.

European malaise: despite being the first market to gain approval, sales in Europe have been minimal. We have modelled a slow ramp up in sales in Europe but the combination of economic uncertainty in the region with a fragmented market and different requirements in different countries may mean sales continue to be slow. However, the company has now established two high quality partnerships with Toshiba (UK) and Miele (Germany) that will greatly assist with adoption in these markets.

Appendix: Company Announcements

Date	Event
29-Oct-14	New guidelines for the disinfection of ultrasound probes released by NHS Wales
17-Sep-14	European study show trophon significantly more effective than manual wipe disinfection
07-Aug-14	trophon approved in Japan with commercial sales expected to start 2H FY2015
19-May-14	trophon-EPR included in new guidelines from American Institute of Ultrasound in Medicine
28-Mar-14	Nanosonics signs strategic partnership with Miele for distribution of trophon EPR in Germany
31-Oct-13	Awarded Janssen 2013 Industry Excellence Award
23-Oct-13	Michael Kavanagh commences as CEO and President
10-Oct-13	Australian study highlights risk of cross-infection from ultrasound probes following conventional disinfection
30-Aug-13	South Korean regulator approved trophon
28-Aug-13	Michael Kavanagh appointed as CEO, Ron Weinberger in charge of product development & commercialisation
14 Aug-13	GE commits to additional investment in sales and marketing of Nanosonics's trophon
17-Apr-13	Signs Toshiba up as non-exclusive distributor of the trophon in the UK
09-Apr-13	Provides update that 458 ultrasound probes are certified by OEM's for disinfection using a trophon
22 Mar-13	California-based Scripps Health network installs 21 trophons as part of initial roll out through its 29 sites
12-Oct-12	Wins Emerging Exporter at 2012 Premier's NSW Export Awards
30-Jul-12	Michael Kavanagh, Senior VP of global marketing for Cochlear, joins the Board as a Non-Executive Director
25-Jun-12	GE Healthcare's healthymagination Fund invests \$7.5M into NAN via a convertible note
04-May-12	Raises \$15.5M at \$0.53 per share via institutional placement that included \$10.6M from Allan Gray
14-Oct-11	Will increase manufacturing capacity by 50% to 6000 Trophon units per annum
19-Dec-11	Ron Weinberger to take up the role of CEO after acting as interim CEO since May 2011
07-Jul-11	GE Healthcare launches Trophon ultrasound probe steriliser into the US market
16-May-11	Exclusive distribution contract for North America and Canada with GE Healthcare
16-May-11	CEO David Radford resigns and Ron Weinberger, currently Executive Director, becomes interim CEO
13-Apr-11	Appoints McGregor Grant as CFO and Gerard Putt, ex-Resmed, as Head of Manufacturing
28-Feb-11	FDA approves Trophon ultrasound probe steriliser for sale in the US
16-Dec-10	Russian distributor, AVA Medical, commits to 200 Trophon units during 2011
21-Sep-10	Initial agreement with GE Healthcare for distribution of Trophon ultrasound probe steriliser in US and Canada
20-Sep-10	Australian distributor included as Queensland Specialty Product Provider for supply of the Trophon EPR

Source: IRESS

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Site Visit:

An analyst has visited Nanosonics Limited's material operations in Sydney and Boston. No payment or reimbursement was received from the issuer for the related travel costs.

Price Chart:*



Date	Analyst	Rating	Target Price	Date	Analyst	Rating	Target Price
1) 10/10/2012	Smith	Buy	0.90	4) 08/21/2013	Smith	Buy	1.05
2) 02/07/2013	Smith	Buy	0.75	5) 01/31/2014	Smith	Buy	0.95
3) 07/31/2013	Smith	Buy	0.90	6) 08/21/2014	Smith	Buy	1.20

*Price charts assume event 1 indicates initiation of coverage or the beginning of the measurement period.

**Distribution of Ratings:
Global Stock Ratings
(as of 1 October 2014)**

Rating	Coverage Universe		IB Clients	
	#	%	#	%
Buy	627	60.2%		36.7%
Speculative Buy	53	5.1%		54.7%
Hold	317	30.5%		13.9%
Sell	43	4.1%		2.3%
	1041	100.0%		

*Total includes stocks that are Under Review

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