

Australian Equity Research

30 October 2015

BUY

unchanged

PRICE TARGET A\$1.95

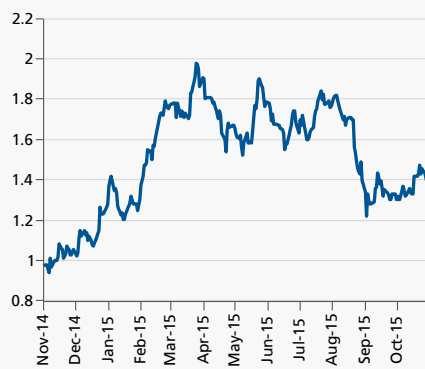
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Price (30-Oct) A\$1.64

Ticker NAN-ASX

52-Week Range (A\$):	0.94 - 2.02
Avg Daily Vol (000s) :	441.6
Market Cap (A\$M):	425
Shares Out. (M) :	283.5
Enterprise Value (A\$M):	388
Last Cash Balance (A\$M):	45.7
Last Quarter Cash Burn (A\$M):	(5.7)
Major Shareholders:	M Stang Allan Gray B Stang Kinetic

FYE Jun	2015A	2016E	2017E	2018E
Sales (A\$M)	22.2	36.6↑	56.1↑	87.4↑
Previous	22.2	36.5	55.9	87.0
PBT (A\$M)	(5.5)	(1.9)↑	13.1↑	37.1↑
Previous	(5.5)	(2.0)	12.9	36.8
Net Income (A\$M)	(5.5)	(1.9)↑	13.1↑	37.1↑
Previous	(5.5)	(2.0)	12.9	36.8
EPS (AUC)	(1.96)	(0.64)↑	4.49↑	12.75↑
Previous	(1.96)	(0.69)	4.41	12.62
Cash Position (A\$M)	45.7	41.6	52.3	87.2



Source: FactSet

Canaccord Genuity (Australia) Limited was the Lead Manager to the Placement of 15.1 million shares at \$1.65 per share to raise A\$25 million in March 2015.

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Company Update

Strong start to FY16

Investment Perspective

NAN has posted a strong result for Q1 FY16 with sales revenue of \$6.5M, up 56% (or 46% cc) on Q4 FY15 (\$4.1M). The company has been open and consistent in guiding the market that the transition of adding direct sales effort to the US market was going to impact near-term sales due to temporary loss of sales to GE and the time required to ramp up the direct sales pipeline. However, the well-flagged decline in sales in the last two quarters appeared to concern the market about the timing and ability of the company to make this transition. Today's announcement has brought the reassurance that NAN is well on track, and we can expect to see a material impact from the direct sales effort over the coming quarters. As a consequence, we are maintaining our BUY recommendation for NAN and our A\$1.95 price target which is based on a 12-year DCF (10.1% discount rate, no terminal value).

Install base continues to grow

The US install base increased from >5,000 units to >5,700 units with GE continuing to sell trophon from its remaining stock of inventory. Management indicated that around 40% of sales came from capital equipment (i.e., trophon units) which would include sales in the UK, Germany, ANZ as well as direct sales in the US. We are expecting direct sales to grow materially over the coming quarters as the sales pipeline builds and matures. Management has indicated the time from initiation to final sales can be between 3 to 9 months depending on the customer and their budget cycle. Furthermore, management has indicated that GE is likely to continue selling trophon. We estimate sales of trophon units to GE could resume in Q3 FY16. As a result, we believe we are likely to see a significant increase in sales momentum in 2H FY16.

Consumable revenues becoming significant

Management indicated that consumables accounted for approximately 60% of this quarter's revenue (\$3.9M or \$3.6M cc), which is up 50% from the previous quarter (50% of Q4 FY15 sales or \$2.2M). This number is consistent with having a global install base of >7,000 units with an average of 3-4 cycles per machine per day. While individual quarters cannot be relied on for establishing long-term projections, it is clear that the growing install base is starting to create a significant annuity revenue stream from ongoing sales of consumables.

Underlying drivers continue to improve

The company is still awaiting new guidelines on the reprocessing of ultrasound probes to be issued in Scotland and England and expects that this will happen before the end of the year. Also, during the quarter, the US Centers for Disease Control (CDC) issued an alert recommending that all hospitals and medical facilities immediately review their processes for reprocessing reusable medical equipment, such as ultrasound probes, between patients. Along with the recent data showing that trophon is the only system that is able to kill the cervical cancer-causing HPV virus, we believe that this will provide a greater impetus for healthcare facilities to adopt trophon in order to satisfy inspections by accreditors such as the Joint Commission.

FINANCIAL SUMMARY**Financial Performance**

Year End	June	2014A	2015A	2016E	2017E	2018A	2019A	2020E	2021E	2022E	2023E	2024E
trophon sales (CG Est)	\$M	16.4	16.6	27.8	40.3	62.1	75.5	94.3	113.2	142.9	176.7	184.5
Consumable sales (CG Est)	\$M	5.3	5.7	8.9	15.8	25.3	39.0	60.3	85.6	107.5	134.0	162.4
Sales of goods and services	\$M	21.5	22.2	36.6	56.1	87.4	114.6	154.6	198.8	250.5	310.7	346.9
Cost of sales	\$M	(7.6)	(6.9)	(10.3)	(14.2)	(20.9)	(25.6)	(31.9)	(39.9)	(51.6)	(65.1)	(72.1)
Gross Margin	\$M	13.9	15.3	26.4	41.9	66.5	89.0	122.7	158.9	198.9	245.6	274.8
Interest revenue	\$M	0.7	0.9	1.5	1.9	2.6	3.1	3.8	4.8	5.9	6.1	6.1
Government grants	\$M	1.7	0.1	-	-	-	-	-	-	-	-	-
Other income	\$M	1.7	2.2	-	-	-	-	-	-	-	-	-
Total other income	\$M	4.1	3.2	1.5	1.9	2.6	3.1	3.8	4.8	5.9	6.1	6.1
Staff expense	\$M	(12.0)	(13.9)	(18.8)	(19.7)	(20.7)	(20.7)	(20.7)	(20.7)	(20.7)	(20.7)	(20.7)
Operations	\$M	(8.1)	(9.5)	(10.4)	(11.0)	(11.3)	(11.3)	(11.3)	(11.3)	(11.3)	(11.3)	(11.3)
Total operational expense	\$M	(20.1)	(23.4)	(29.1)	(30.7)	(32.0)	(32.0)	(32.0)	(32.0)	(32.0)	(32.0)	(32.0)
Borrowing costs	\$M	(0.6)	(0.6)	(0.6)	-	-	-	-	-	-	-	-
Net profit before tax	\$M	(2.6)	(5.5)	(1.9)	13.1	37.1	60.1	94.5	131.7	172.8	219.7	248.9
Tax benefit / (expense)	\$M	0.0	0.0	-	-	-	(13.5)	(28.3)	(39.5)	(51.9)	(65.9)	(74.7)
Net profit after tax	\$M	(2.6)	(5.5)	(1.9)	13.1	37.1	46.6	66.1	92.2	121.0	153.8	174.2
Earnings per share (cps)	cps	(1.0)	(2.0)	(0.6)	4.5	12.7	16.0	22.7	31.6	41.5	52.8	59.8
Dividend per share (dps)	cps	-	-	-	-	11.5	14.4	20.4	28.5	37.4	47.5	53.8

Balance Sheet

Year End	June	2014A	2015A	2016E	2017E	2018A	2019A	2020E	2021E	2022E	2023E	2024E
Cash & Cash Equivalents	\$M	21.2	45.7	41.6	52.3	87.2	98.0	119.9	150.3	186.0	230.5	268.1
Current Assets	\$M	31.6	56.4	52.3	63.1	97.9	108.8	130.6	161.0	196.7	241.2	278.8
Non-Current Assets	\$M	1.9	3.9	3.9	3.9	3.9	3.9	3.9	3.9	3.9	3.9	3.9
TOTAL ASSETS	\$M	33.5	60.4	56.2	67.0	101.8	112.7	134.6	164.9	200.6	245.2	282.7
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	4.8	15.2	6.5	6.5	6.5	6.5	6.5	6.5	6.5	6.5	6.5
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	8.3	0.5	0.5	0.5	0.5	0.5	0.5	0.5	0.5	0.5	0.5
TOTAL LIABILITIES	\$M	13.1	15.7	7.0	7.0	7.0	7.0	7.0	7.0	7.0	7.0	7.0
Equity	\$M	78.5	108.2	114.6	112.3	143.4	149.6	164.9	186.0	209.6	238.8	258.9
Accumulated Profits / (Losses)	\$M	-58.0	-63.5	-65.4	-52.3	-48.6	-43.9	-37.3	-28.1	-16.0	-0.6	16.8
TOTAL EQUITY	\$M	20.4	44.7	49.2	60.0	94.8	105.7	127.6	157.9	193.6	238.2	275.7

Cash Flow

Year End	June	2014A	2015A	2016E	2017E	2018A	2019A	2020E	2021E	2022E	2023E	2024E
Receipts	\$M	23.0	26.9	36.6	56.1	87.4	114.6	154.6	198.8	250.5	310.7	346.9
Suppliers & Employers	\$M	-28.0	-30.3	-39.4	-44.9	-52.9	-57.6	-63.9	-71.9	-83.6	-97.2	-104.1
Interest Received	\$M	0.7	0.9	0.9	1.9	2.6	3.1	3.8	4.8	5.9	6.1	6.1
Tax Paid	\$M	1.7	0.1	0.0	0.0	0.0	-13.5	-28.3	-39.5	-51.9	-65.9	-74.7
Cash From Operations	\$M	-2.6	-2.4	-1.9	13.1	37.1	46.6	66.1	92.2	121.0	153.8	174.2
Cash From Investing	\$M	-0.5	-2.3	-2.3	-2.3	-2.3	-2.3	-2.3	-2.3	-2.3	-0.3	1.7
Cash From Financing	\$M	0.3	28.6	0.0	0.0	0.0	-33.4	-42.0	-59.5	-83.0	-108.9	-138.4
Opening Cash Balance	\$M	24.1	21.2	45.7	41.6	52.3	87.2	98.0	119.9	150.3	186.0	230.5
Net Incr / (Decr) In Cash	\$M	-2.8	24.5	-4.2	10.8	34.8	10.9	21.9	30.4	35.7	44.6	37.5
Closing Cash Balance	\$M	21.2	45.7	41.6	52.3	87.2	98.0	119.9	150.3	186.0	230.5	268.1

Valuation

Risk Free Rate	%	4.60%		Forecast Period	years	12
Market Premium	%	5.50%		12-Month Price Target	\$	\$1.95
Beta	x	1.0		Current Price	\$	\$1.64
Discount Rate	%	10.1%		Return	%	19%

SOURCES: Company reports, Canaccord Genuity estimates

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Nanosonics Limited - NAN

Target price is based on 12-year discounted cash flow with no terminal value of cash profits generated from the sale of the trophon ultrasound disinfection system and associated accessories and consumables.

Risks to achieving Target Price / Valuation:

Nanosonics Limited - NAN

Poor sales support from GE, manufacturing problems, supply of sub-assemblies from external parties, hiccups, resistance from hospital to invest in new technologies, development of alternative systems by competitors, issue with product performance resulting in recall.

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Rating	Coverage Universe		IB Clients
	#	%	%
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Hold	286	29.21%	11.89%
Sell	27	2.76%	3.70%
Speculative Buy	59	6.03%	55.93%
	979*	100.0%	

*Total includes stocks that are Under Review

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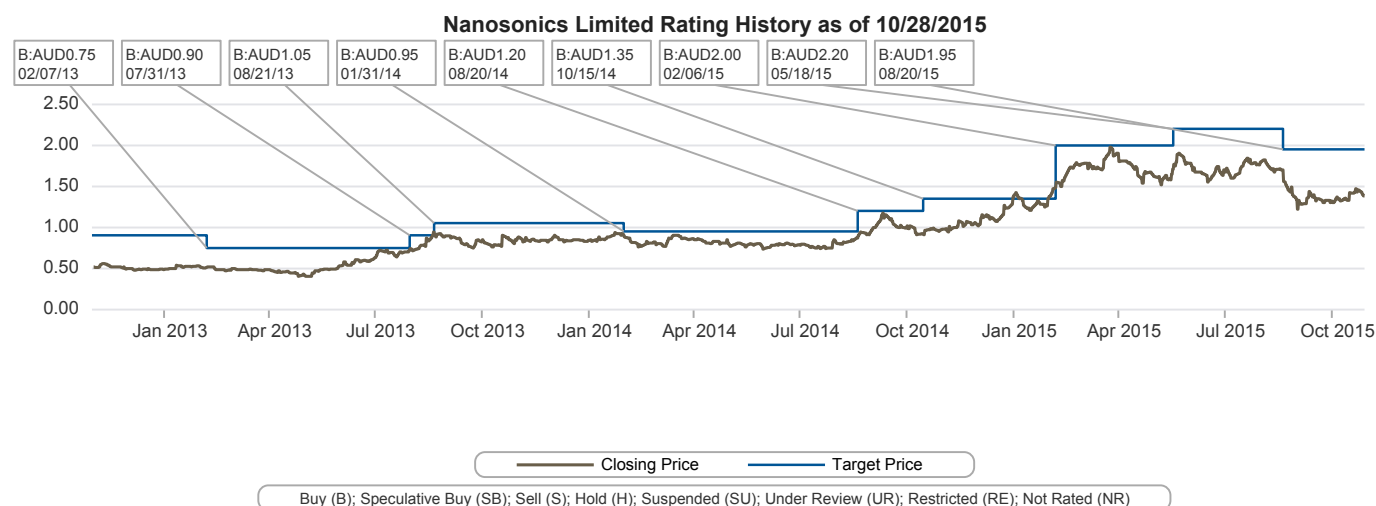
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