

Positive signals from US direct channel and order pipeline

Nanosonics announced a bright start to FY16 with its Q1 cash flow and quarterly report. The key point was that its direct US sales organisation managed to execute strong first sales and develop order pipelines across a range of hospitals and clinics, including those outside GE Healthcare's (GEHC) immediate ultrasound customer base. Revenue was ahead of our estimate and we have made positive adjustments to our profit forecasts in FY16-18e. GEHC continues to work down its Trophon inventories and could place re-stocking orders sooner than anticipated. Price target revised to \$1.76 per share. Nanosonics is an attractive proposition at current pricing, with a fully funded sales campaign building clear momentum. BUY rating maintained.

Key points

Q1FY16 sales of \$6.5m ahead of WHTMe (\$5.9m) – the Q1FY16 update indicated a pleasing start for the US direct sales channel. We assess that Trophon sales satisfied our forecasts in that jurisdiction and maintained recent growth trends in both Europe and ANZ. The company is executing a good proportion of its direct sales into US clinics/hospitals where GE Healthcare (GEHC) is not the principal ultrasound equipment provider. Consumable/service sales were likely ahead of our forecasts, with more GEHC Trophon inventory being deployed to hospitals and clinics during the period. The US Trophon installed base is more than 5,700 units as at Q1 (5,500 units in the sequentially previous quarter). GEHC has not yet started Trophon re-stocking orders – but could re-establish a 1,500-2,000 Trophons annual business for Nanosonics, which is not yet in our FY16-17e forecast.

Forecast changes – we have left our Trophon sales assumptions unchanged, but have increased the US installed base estimate to reflect additional placements by GEHC during the FY16 period. This change has lifted our consumables sales forecasts and had a positive impact on NPAT and EPS (+2.2m profit benefit in FY16e and +\$1.2m in FY17e).

Valuation – our revised price target of \$1.76 per share reflects our 12-month forward DCF valuation.

Risks and catalysts

Catalysts – a) commercial partnering arrangements in new markets; b) guideline updates favouring automated disinfection; c) FX tailwinds; d) improving visibility on sales mix (products, geographies); e) installed base growth. **Risks** – a) slower-than-forecast sales development; b) operating margin structure and development; c) market downgrades.

Year-end June (AUD)	FY14A	FY15A	FY16F	FY17F	FY18F
NPAT rep (\$m)	-2.6	-5.5	-2.1	2.9	8.8
NPAT norm (\$m)	-2.6	-5.5	-2.1	2.9	8.8
Consensus NPAT (\$m)			-2.0	6.7	15.0
EPS norm (cps)	-1.0	-2.0	-0.7	1.0	3.1
EPS growth (%)	56.4	-105.5	63.8	240.8	200.2
P/E norm (x)	-151.4	-73.7	-203.6	144.6	48.1
EV/EBITDA (x)	-211.1	-82.3	-194.7	118.0	42.0
FCF yield (%)	-0.6	-0.6	-1.7	1.0	2.6
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

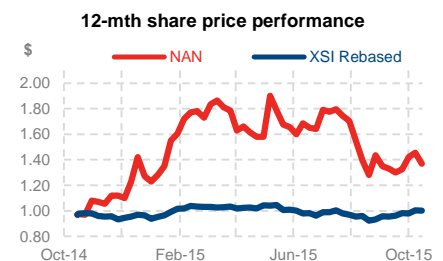
Source: Company data, WHTM estimates, S&P Capital IQ

12-mth target price (AUD)	\$1.76
Share price @ 30-Oct-15 (AUD)	\$1.51
Forecast 12-mth capital return	16.7%
Forecast 12-mth dividend yield	0.0%
12-mth total shareholder return	16.7%

Market cap	\$427m
Enterprise value	\$389m
Shares on issue	284m
Sold short	1.8
ASX 300 weight	0.0%
Median turnover/day	\$0.4m

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	1-mth	6-mth	12-mth
Abs return (%)	3.8	-16.5	41.2
Rel return (%)	-1.0	-14.7	37.9

KEY CHANGES	15-Oct	After	Var %
NPAT: FY16F	-4.3	-2.1	N/A
norm FY17F	1.7	2.9	71.1%
(\$m) FY18F	7.5	8.8	17.3%
EPS: FY16F	-1.5	-0.7	N/A
norm FY17F	0.6	1.0	71.1%
(cps) FY18F	2.7	3.1	17.3%
DPS: FY16F	0.0	0.0	0.0%
(cps) FY17F	0.0	0.0	0.0%
FY18F	0.0	0.0	0.0%
Price target:	1.72	1.76	1.9%
Rating:	BUY	BUY	



PRICE TARGET

	Valuation	Price target
WACC (%)	12	
Terminal growth (%)	6	
NPV forecast FCF (A\$m)	84	
NPV perpetuity (A\$m)	376	
Net debt/(cash) (A\$m)	37	
DCF valuation (A\$m)	497	
Growth options (A\$m)	0.0	
NAN valuation (A\$m)	497.1	

Price target (\$/sh) 1.76

INTERIMS (\$m)

Half-year (AUD)	Dec 14	Jun 15	Dec 15	Jun 16
	1HA	2HA	1HE	2HE
Sales revenue	14.3	7.9	13.6	19.0
EBITDA	1.3	-6.1	-2.1	0.1
EBIT	0.9	-6.7	-2.7	-0.3
Net profit	1.2	-6.7	-2.2	0.1
Norm EPS	0.5	-2.5	-0.8	0.0
EBIT/sales (%)	6.2	-84.9	-19.7	-1.6
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)	FY15A	FY16F	FY17F
Net debt	-45.7	-37.2	-40.4
Net debt/equity (%)	<0	<0	<0
Net debt/EV (%)	<0	<0	<0
Current ratio (x)	4.0	3.7	3.9
Interest cover (x)	17.6	3.4	<0
Adj cash int cover (x)	8.4	9.5	<0
Debt/cash flow (x)	<0	0.0	0.0
Net debt (cash)/share (\$)	<0	<0	<0
NTA/share (\$)	0.2	0.2	0.2
Book value/share (\$)	0.2	0.2	0.2
Payout ratio (%)	0	0	0
Adj payout ratio (%)	0	0	0

EPS RECONCILIATION (\$m)

	FY15A		FY16F	
	Rep	Norm	Rep	Norm
Sales revenue	22	22	33	33
EBIT	-5.8	-5.8	-3.0	-3.0
Net profit	-5.5	-5.5	-2.1	-2.1
Notional earn	0.0	0.0	0.0	0.0
Pref/conv div	0.0	0.0	0.0	0.0
Profit for EPS	-5.5	-5.5	-2.1	-2.1
Diluted shrs (m)	267	267	283	283
Diluted EPS (c)	-2.0	-2.0	-0.7	-0.7

RETURNS

	FY15A	FY16F	FY17F	FY18F
ROE (%)	-16.8	-4.8	6.7	17.7
ROIC (%)	-129.3	-95.5	29.1	121.8
Incremental ROE	-24.9	30.4	1,180.1	100.1
Incremental ROIC	66.7	-205.8	116.7	-609.3

KEY ASSUMPTIONS

Year-end June (AUD)	FY13A	FY14A	FY15A	FY16F	FY17F	FY18F	FY19F	FY20F
Revenue growth (%)	21.1	44.3	3.4	46.4	25.3	24.7	32.5	35.0
EBIT growth (%)	6.7	-56.0	105.5	-48.8	-173.8	265.6	134.4	85.3
NPAT growth (%)	23.3	-54.8	109.6	-61.7	-240.8	200.2	124.1	82.8
EPS growth (%)	10.7	-56.4	105.5	-63.8	-240.8	200.2	124.1	82.8
EBIT/sales (%)	-43.0	-13.1	-26.1	-9.1	5.4	15.7	27.9	38.2
Tax rate (%)	-0.6	1.2	0.1	0.0	0.0	0.0	0.0	0.0
ROA (%)	-19.0	-8.4	-9.6	-4.9	3.2	9.5	17.2	27.0
ROE (%)	-26.6	-12.7	-12.2	-4.7	5.7	13.1	21.7	32.8

PROFIT AND LOSS (\$m)

Year-end June (AUD)	FY13A	FY14A	FY15A	FY16F	FY17F	FY18F	FY19F	FY20F
Sales revenue	14.9	21.5	22.2	32.5	40.8	50.8	67.3	90.9
EBITDA	-5.4	-1.8	-4.7	-2.0	3.3	9.3	20.2	36.5
Depn & amort	1.0	1.0	1.1	1.0	1.1	1.3	1.5	1.7
EBIT	-6.4	-2.8	-5.8	-3.0	2.2	8.0	18.8	34.8
Net interest expense	-0.7	-0.2	-0.3	-0.9	-0.8	-0.8	-1.1	-1.5
Tax	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
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
Net profit (pre-sig items)	-5.8	-2.6	-5.5	-2.1	2.9	8.8	19.8	36.2
Abns/exts/signif	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Reported net profit	-5.8	-2.6	-5.5	-2.1	2.9	8.8	19.8	36.2

CASH FLOW (\$m)

Year-end June (AUD)	FY13A	FY14A	FY15A	FY16F	FY17F	FY18F	FY19F	FY20F
EBITDA	-5.4	-1.8	-4.7	-2.0	3.3	9.3	20.2	36.5
Interest & tax	1.1	0.0	0.3	0.9	0.8	0.8	1.1	1.5
Working cap/other	-0.2	-0.7	2.0	-6.3	0.3	1.0	-1.4	-3.4
Operating cash flow	-4.5	-2.6	-2.4	-7.4	4.3	11.2	19.9	34.5
Maintenance capex	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Free cash flow	-4.5	-2.6	-2.4	-7.4	4.3	11.2	19.9	34.5
Dividends paid	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Growth capex	-1.4	-0.5	-2.3	-1.1	-1.2	-1.2	-1.3	-1.3
Invest/disposals	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Other inv flows	0.0	-0.2	0.6	0.0	0.0	0.0	0.0	0.0
Cash flow pre-financing	-5.9	-3.3	-4.1	-8.5	3.2	10.0	18.6	33.2
Funded by equity	0.5	0.3	28.0	0.0	0.0	0.0	0.0	0.0
Funded by debt	0.0	0.2	0.0	0.0	0.0	0.0	0.0	0.0
Funded by cash	5.3	2.7	-23.9	8.5	-3.2	-10.0	-18.6	-33.2

BALANCE SHEET SUMMARY (\$m)

Year-end June (AUD)	FY13A	FY14A	FY15A	FY16F	FY17F	FY18F	FY19F	FY20F
Cash	24.1	21.2	45.7	37.2	40.4	50.3	69.0	102.2
Current receivables	4.2	5.7	3.9	6.6	8.3	7.0	8.0	9.3
Current inventories	2.9	4.2	6.2	10.4	8.7	9.3	10.0	13.0
Net PPE	1.8	1.8	3.6	3.7	3.8	3.7	3.5	3.1
Investments	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Intangibles/capitalised	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Other	0.6	0.6	1.0	1.0	1.0	1.1	1.1	1.1
Total assets	33.7	33.5	60.4	59.0	62.2	71.4	91.6	128.7
Current payables	3.0	3.0	2.7	3.3	3.5	3.7	3.9	4.7
Total debt	7.6	8.1	0.0	0.0	0.0	0.0	0.0	0.0
Other liabilities	1.4	2.0	12.9	13.1	13.2	13.3	13.4	13.6
Total liabilities	11.9	13.1	15.7	16.4	16.7	17.0	17.4	18.3
Minorities/convertibles	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Shareholder equity	21.7	20.4	44.7	42.6	45.5	54.4	74.2	110.4
Total funds employed	29.3	28.5	44.7	42.6	45.5	54.4	74.2	110.5



Nanosonics Limited (NAN)

BUSINESS DESCRIPTION

Nanosonics Limited (NAN) develops, manufactures and markets equipment for the high level disinfection of ultrasound probes and other pieces of medical device hardware. Its products are underpinned by a "NanoNebulant" technology – very fine, nebulised droplets of concentrated hydrogen peroxide which kill microorganisms on surfaces. Its lead product, the Trophon EPR, is now available in most major markets for disinfecting obstetrics/gynaecologic probes.

INVESTMENT THESIS

Our thesis on Nanosonics is that, in time, regulatory pressure will build within the radiology industry to provide greater safety and traceability. This should entail a shift away from the use of toxic, bulk liquid disinfection practices.

REVENUE DRIVERS

- Has a non-exclusive distribution arrangement with GEHC for the US and Canadian markets
- Network of third-party device distributors in Europe
- Revenue a function of both device sales (capital equipment) and consumables (cartridges of hydrogen peroxide and other products used with every disinfection cycle)

MARGIN DRIVERS

- Gross margins: devices (c.60-75%); consumables (c.80-90%)
- Contract pricing may be variable
- Business development expenses expected in both Europe and US business – building channels, increasing awareness, providing additional customer support

KEY ISSUES/CATALYSTS

Upside risks:

- Faster-than-expected sales traction in the US by GEHC
- Decision to scale-up manufacturing a leading indicator of demand
- Partnering transactions on other projects – disinfection units for transesophageal transducers, other applications

RISK TO VIEW

Downside risks:

- Large partners like GEHC are slow to move
- Regulatory and/or clinical practice changes take a long time to change
- All device manufacturers face scale-up, quality control risks

BALANCE SHEET

- Nanosonics had c.\$45m cash as at end-FY15

BOARD

- Mr Maurie Stang (Non-Exec. Chairman)
- Dr Ron Weinberger (CEO, Executive Director)
- Mr Richard England (Non-Exec. Director)
- Dr David Fisher (Non-Exec. Director)
- Mr Michael Kavanagh (Non-Exec. Director)

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