

Nanosonics Limited

NAN : ASX

BUY

Target: \$0.75 ↓

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COMPANY STATISTICS:

Share Price	\$0.51
Valuation	\$0.75
12 Month Range	\$0.47-\$0.60
Market Cap	\$132M
Issued Shares	261M
Options (various)	3.8M
Convertible Notes	\$7.5M
Cash Balance (31/12/12)	\$25.8m
Debt (30/6/12)	nil

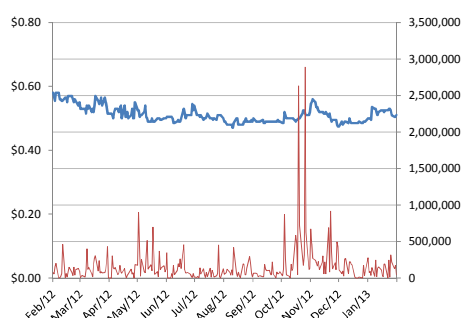
SIGNIFICANT SHAREHOLDERS

Bernard Stang	11.0%
Maurie Stang	10.9%
Allan Gray Australia	9.8%
Kinetic Investments	7.1%
Steve Kritzler	7.5%
Fisher Funds	5.1%

EARNINGS SUMMARY:

YE 30 June	FY12A	FY13F	FY14F
Sales (\$m)	12.3	16.3	27.2
Other Income (\$m)	0.9	1.1	0.6
Net Profit (\$m)	(4.7)	(4.1)	0.5
EPS (c)	(1.9)	(1.6)	0.2
Op. Cash Burn (\$m)	(18.2)	(21.3)	(27.5)
Net Cash Burn (\$m)	(-5.9)	(5.0)	(0.3)
Net Cash (\$m)	29.3	24.3	24.0

SHARE PRICE PERFORMANCE:



Source: IRESS

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

Trophonification of the US

Investment Perspective

NAN has reported revenue of \$3.2M for Q2, up 15.6%pcp and bringing YTD sales revenue to \$4.4M. While we believe the lower Q1 sales reflected overstocking by GE from fulfilling its minimum purchase obligations rather than an underlying lack of interest in the Trophon, we have revised down or forecast sales Trophon for FY13 from \$21.5M to \$15.7M, and FY14 from \$37.9M to \$26.0M. We believe the past 18 months have provided NAN with valuable insights into how to better target the sales process and also how to make the sales effort by GE more effective. These should translate into greater sales traction over the next 12 months making NAN a “when” rather than an “if” story. However, we have reduced our 12-month price target for NAN to \$0.75 (previously \$0.90) to reflect our reduction in near-term sales.

Investment highlights

- **Revenue vs sales:** - NAN recognises revenue from the Trophon when units are shipped to GE (rather than sold to end users). As is typical in the early stage of such launches, the revenue reported by NAN can end-up very “lumpy”, as we saw in Q1, and not reflect the accelerating uptake by customers. We believe this trend in customer sales has continued during H1 with a number of large and high profile sites placing significant initial orders for the Trophon. We are expecting this to result in a material increase in sales during H2, but not to the extent we had originally forecast.
- **GE up:** - while GE is a major player in the US ultrasound market, with over 35% market share and a well-established distribution network, we were expecting this to result in more rapid penetration of the Trophon into the US ultrasound market. However, as with all new products, it has taken time to refine the sales process and also to ensure the right organizational alignment and incentives are in place within GE. NAN’s management has been very proactive in looking to improve the sales effort within GE, including putting in place NAN’s own sales personnel to help drive the sales effort.
- **Infectious marketing:** - the initial focus of GE’s marketing efforts has been the end users (the sonographers). However it has become apparent that Infection Control staff and OH&S officers can be key advocates and decision makers with regards to site purchases of the Trophon and turn the device from a “nice to have” to a “must have”. NAN’s own sales personnel have had very good success in closing sales by targeting their own and GE’s sales efforts to these individuals.
- **Real momentum building:** - We believe the number of large, high profile sites placing initial orders with GE has continued to build. Furthermore, the company is getting reverse enquiries from potential customers over the internet on a daily basis. With the recent deaths in the UK cause by infection from unsterilized probes, we can see multiple factors contribution for sales growth over the next 12 months.

12-month target reduced to \$0.75; BUY maintained

We have reduced our price target for NAN to \$0.75 (previously \$0.90) to reflect slower than expected near term sales. However, it is clear the Trophon is getting traction in the market and this is a case of “when”, not “if”.

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FINANCIAL SUMMARY**Financial Performance**

Year End	June	2010A	2011A	2012A	2013E	2014E	2015E	2016E	2017E	2018E	2019E	2020E
Operating Revenue	\$M	0.8	2.2	12.3	16.3	27.2	48.2	76.7	94.7	109.5	119.7	131.7
Interest Revenue	\$M	0.8	1.1	0.6	0.9	0.9	1.0	1.5	2.3	3.3	4.2	5.2
Gov't Grants	\$M	0.2	0.0	0.2	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Total Revenue	\$M	1.7	3.3	13.0	17.3	28.1	49.2	78.2	97.0	112.8	124.0	136.9
Operating Expenses	\$M	-9.5	-13.5	-17.5	-20.5	-26.7	-37.2	-50.1	-57.9	-63.3	-65.8	-68.5
EBITDA	\$M	-7.8	-10.2	-4.4	-3.3	1.4	12.0	28.1	39.1	49.5	58.2	68.4
Depreciation & Amortisation	\$M	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Amortisation of Intangibles	\$M	-0.4	-1.0	-0.9	-0.9	-0.9	-0.9	-0.9	-0.9	-0.9	-0.9	-0.9
EBIT	\$M	-8.2	-11.2	-5.3	-4.1	0.5	11.2	27.2	38.3	48.7	57.4	67.5
Interest Expense	\$M	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Tax Expense	\$M	0.0	0.0	0.6	0.0	0.0	0.0	0.0	-7.0	-14.6	-17.2	-20.2
Profit After Tax	\$M	-8.2	-11.2	-4.7	-4.1	0.5	11.2	27.2	31.3	34.1	40.1	47.2
Per Share												
EPS	cps	-3.9	-4.9	-1.9	-1.6	0.2	4.3	10.4	12.0	13.1	15.4	18.1
Cash Backing	cps	9.4	5.4	11.3	9.3	9.2	13.1	23.2	34.9	47.6	62.7	80.5

Cash Flow

Year End	June	2010A	2011A	2012A	2013E	2014E	2015E	2016E	2017E	2018E	2019E	2020E
Receipts	\$M	0.7	1.9	10.9	16.3	27.2	48.2	76.7	94.7	109.5	119.7	131.7
Suppliers & Employers	\$M	-9.1	-12.6	-17.2	-21.4	-27.6	-38.1	-51.0	-58.8	-64.1	-66.6	-69.4
Interest Received	\$M	0.6	1.0	0.6	0.9	0.9	1.0	1.5	2.3	3.3	4.2	5.2
Tax Paid	\$M	0.0	0.7	0.6	0.0	0.0	0.0	0.0	-7.0	-14.6	-17.2	-20.2
Cash From Operations	\$M	-7.8	-9.0	-5.0	-4.1	0.5	11.2	27.2	31.3	34.1	40.1	47.2
Cash From Investing	\$M	-0.2	-1.2	-0.8	-0.8	-0.8	-0.8	-0.8	-0.8	-0.8	-0.8	-0.8
Cash From Financing	\$M	15.2	1.4	22.8	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Opening Cash Balance	\$M	13.9	21.1	12.4	29.3	24.3	24.0	34.3	60.7	91.1	124.3	163.6
Net Incr / (Decr) In Cash	\$M	7.3	-8.8	17.0	-5.0	-0.3	10.3	26.3	30.4	33.2	39.3	46.4
Closing Cash Balance	\$M	21.1	12.4	29.3	24.3	24.0	34.3	60.7	91.1	124.3	163.6	210.0

Balance Sheet

Year End	June	2010A	2011A	2012A	2013E	2014E	2015E	2016E	2017E	2018E	2019E	2020E
Cash & Cash Equivalents	\$M	21.1	12.4	29.3	24.3	24.0	34.3	60.7	91.1	124.3	163.6	210.0
Current Assets	\$M	23.4	15.1	35.0	30.0	29.7	40.0	66.3	96.8	130.0	169.3	215.7
Non-Current Assets	\$M	1.6	1.7	1.7	1.5	1.5	1.5	1.5	1.5	1.5	1.5	1.5
TOTAL ASSETS	\$M	24.9	16.8	36.7	31.5	31.2	41.5	67.9	98.3	131.5	170.8	217.2
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	1.4	2.5	3.5	3.4	3.4	3.4	3.4	3.4	3.4	3.4	3.4
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	0.0	0.0	7.2	7.2	7.2	7.2	7.2	7.2	7.2	7.2	7.2
TOTAL LIABILITIES	\$M	1.37	2.54	10.66	10.56	10.56	10.56	10.56	10.56	10.56	10.56	10.56
Equity	\$M	57.5	59.3	75.7	75.7	75.7	75.7	75.7	75.7	75.7	75.7	75.7
Accumulated Profits / (Losses)	\$M	-33.9	-45.0	-49.7	-53.8	-53.3	-42.1	-14.9	16.3	50.4	90.5	137.8
TOTAL EQUITY	\$M	23.6	14.3	26.0	21.9	22.4	33.5	60.7	92.0	126.1	166.2	213.5

Valuation

Risk Free Rate	%	5.60%
Market Premium	%	5.50%
Beta	x	1.2
Discount Rate	%	12.2%
Forecast Period	years	12
12-Month Price Target	\$	\$0.75
Current Price	\$	\$0.51
Return	%	47%

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. Given the company's current market capitalisation of \$130M, 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: - as this is a very different product from those that GE has previously sold, 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.

Where we gain some comfort around this risk is that the first year US sales of \$10.7M are quite respectable for a new product and the investment by GE's healthymagination fund plus comments from both GE and NAN management indicate that the Trophon is getting a good deal of attention from GE.

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, 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 this can be managed 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.

Recent Company Announcements

Date	Event
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
29-Jun-10	Has recommenced production following successful in-field testing of the updated Trophon units
14-Apr-10	Recommences production of Trophon following in-field testing of units containing the new components
26-Feb-10	Halts production of Trophon after externally supplied component found not to meet quality criteria
22-Jan-10	Share Purchase Plan (SPP) raises \$3.6M at \$0.55 per share
22-Dec-09	Independent testing demonstrates Trophon able to sterilise probes with high level of microbes
08-Dec-09	Raises \$12.0M at \$0.55 per share via underwritten placement to institutional and sophisticated investors
10-Jul-09	Receives notification that FDA has completed its initial review of the Trophon EPR 510(k) submission
03-Jun-09	First shipment of Trophon EPR sent to France to French distribution partner Euro Diffusion Medicale
13-May-09	Submits 510(k) application to FDA and wins tender to supply hospitals in two Australian states
30-Mar-09	First sales of Trophon EPR through distribution partners in New Zealand and Australia
03-Feb-09	Receives full approval and certification from the Australian TGA allowing sales in Australia and New Zealand
12-Dec-08	Trophon EPR validated by leading ultrasound OEMs including Philips and Siemens

SOURCE: Company announcements on ASX website

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Price Chart:*

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Global Stock Ratings
(as of 2 January 2013)**

Rating	Coverage Universe		IB Clients
	#	%	%
Buy	568	57.9%	31.0%
Speculative Buy	62	6.3%	58.1%
Hold	306	31.2%	12.4%
Sell	39	4.0%	5.1%
	981*	100.0%	

*Total includes stocks that are Under Review

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