

Nanosonics

Australia – Health Care Supplies

Outperform

(Unchanged)

Price: **\$0.77**

Target Price: **\$1.20**

Stock's expected return (12mth)

Capital growth	55.8%
Dividend yield	0.0%
Total return	55.8%
Required market rate of return *	11.3%
Expected excess return	44.6%

* Defined as 6.25% risk-free rate plus 5% ERP

Relative price performance



Company data and ratios

ASX code	NAN
Market capitalisation (\$Am)	\$177.5
No. of shares (m)	230.5
Volume (12 mth daily avg)	260,606
12 mth price range (\$)	\$0.58 - \$0.99

Earnings adjustments

	2011f	2012f	2013f
Previous NPAT (\$m)	-5.7	-0.4	11.2
Change in NPAT (%)	-	-	-
Previous EPS (cps)	-2.5	-0.2	4.8
Change in EPS (%)	-	-	-

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Cash is King

- NAN released its 4C statement last Friday for FY12. It showed closing cash at year end of \$12.3m which is in line with our forecast. While NAN continues to have ample cash for short term requirements it is unclear when, or if the company may require further capital from shareholders. Key to this in our opinion is the requirement for further capital to expand production capabilities.
- Cash received from customers was \$1.9m. We forecast total revenues in FY12 of \$5.2m. The company has previously disclosed that it had partially filled the first order from GE Healthcare at year end. Accordingly we expect that reported revenues in FY12 will be higher than cash receipts.
- The outlook for NAN continues to be extremely positive though of course not without the risk that inevitably comes with being a larger organization and mass production of the Trophon device.
- The uptake of the Trophon by domestic clinics has been very strong and all signs from GE Healthcare in the US continue to look positive. **We estimate there may be demand for more than 150,000 devices in the US alone.**
- We maintain our Outperform recommendation and price target of \$1.20.

Earnings Forecasts

Year end June	2009	2010	2011f	2012f	2013f
NPAT (Reported) (\$M)	-8.8	-8.2	-5.7	-0.4	11.2
NPAT (Normalised) (\$M)	-8.8	-8.2	-5.7	-0.4	11.2
Diluted EPS (cps)	-4.5	-3.9	-2.5	-0.2	4.8
EPS growth (%)	21.6%	-13.3%	-36.1%	nm	nm
PE ratio (x)	-17.3	-19.9	-31.2	-448.0	15.9
Dividend per share (cps)	0.0	0.0	0.0	0.0	0.0
Yield (%)	0.0%	0.0%	0.0%	0.0%	0.0%
EV/EBITDA	-37.3	-43.4	-41.8	-501.8	21.8
Book value cps	8.3	10.4	7.7	7.6	12.4
P/BV (x)	9.3	7.4	9.9	10.2	6.2

Source – Company, LINWAR Research

Summary of FY12 cash flows

NAN issued its 4C statement last Friday which we summarise as follows:

Table 1: Summary of FY12 cash flows

Cash from customers	1.9
Expenses	-12.7
Other income	1.7
Net cash from operations	-9.1
Plant and Equipment	-1.2
Financing cash flows (exercise of options)	1.5
Net cash outflow this year	-8.8
Cash at start of year	21.1
Cash at the end of the year	12.3

Source – Company, LINWAR Research

The closing cash position is in line with LINWAR's forecast.

The company has previously disclosed that it had partially filled its first order to GE Healthcare in the US. This was done prior to year end, therefore, it is likely that reported revenues for FY12 are higher than the cash receipts figure shown above.

We had forecast total revenues in FY12 of \$5.2m including the sale of ~ 600 Trophon devices. More than half of these are represented by domestic sales.

Cash outflows are in line with the results reported for the first nine months.

Outlook

We maintain our positive outlook for NAN. In our opinion the Trophon represents:

- an overwhelming improvement in OH&S for sonographers;
- further minimization of the risk of transmission of infection between patients; and
- to our knowledge is the only solution for high level disinfection of certain ultrasound transducers beyond the discontinuation of Cytex (the toxic cleaning fluid the Trophon replaces).

The Trophon is in commercial production. The key questions now are:

- how quickly the Board intends to expand assembly capabilities; and
- what capital requirements, if any, this may require.

Our forecasts do not include a capital raising, however, the company may yet require further capital depending on the timing of various factors including:

Commercial terms on device sales; and

Capital expenditure required for plant expansion and other working capital requirements.

Financial Summary
Outperform
Profit & Loss

Year end June (\$m)	2009	2010	2011f	2012f	2013f
Sales Revenue	0.3	0.8	5.2	18.1	35.5
EBITDA	-9.5	-8.2	-8.5	-0.7	16.3
Depreciation	0.4	0.8	0.1	0.4	0.7
EBITA	-9.9	-9.0	-8.6	-1.1	15.6
Amortisation	0.0	0.0	0.0	0.0	0.0
EBIT	-9.9	-9.0	-8.6	-1.1	15.6
Net Interest Expense	-1.2	-0.8	-0.5	-0.5	-0.5
Pre-Tax Profit	-8.8	-8.2	-8.1	-0.6	16.1
Tax	0.0	0.0	-2.4	-0.2	4.8
OEI	0.0	0.0	0.0	0.0	0.0
NPAT	-8.8	-8.2	-5.7	-0.4	11.2
Net Abnormals	0.0	0.0	0.0	0.0	0.0
NPAT Reported	-8.8	-8.2	-5.7	-0.4	11.2
Normalised Earnings	-8.8	-8.2	-5.7	-0.4	11.2
<i>Margins on Operating Revenue</i>					
EBITDA	-3084%	-1073%	-163.8%	-3.9%	45.9%
EBIT	-3219%	-1174%	-165.8%	-5.9%	43.9%
NPAT	-2833%	-1071%	-109.3%	-2.2%	31.7%

Change on pcp

	#DIV/0!	146.9%	578.6%	249.8%	95.7%
Revenue					
EBITDA	7.7%	-14.1%	3.6%	-91.7%	-2401.3%
NPAT	22.5%	-6.6%	-30.7%	-93.0%	-2921.3%

Balance Sheet

Year end June (\$m)	2009	2010	2011f	2012f	2013f
Cash	13.9	21.1	12.2	7.0	8.0
Receivables	0.5	0.5	1.1	3.0	5.8
Inventories	0.9	1.6	2.0	3.5	3.7
Other	0.2	0.2	0.5	0.6	0.6
Current Assets	15.4	23.4	15.8	14.1	18.1
PPE	2.1	1.3	2.7	4.1	9.7
Intangibles	-0.1	0.0	0.2	0.2	0.2
Other	0.2	0.3	1.2	3.8	7.4
Non-Current Assets	2.1	1.6	4.0	8.1	17.2
Payables	0.9	1.0	1.4	2.9	3.0
Interest bearing liabilities	0.0	0.0	0.0	0.0	0.0
Other	0.3	0.4	0.5	1.8	3.5
Current Liabilities	1.3	1.4	1.9	4.7	6.6
Interest bearing liabilities	0.0	0.0	0.0	0.0	0.0
Other	0.0	0.0	0.0	0.0	0.0
Non-Current Liabilities	0.0	0.0	0.0	0.0	0.0
Net Assets	16.3	23.6	17.9	17.5	28.8
Contributed equity	41.4	56.6	56.6	56.6	56.6
Retained Profits	-25.9	-33.9	-39.6	-40.0	-28.7
Other	0.8	0.9	0.9	0.9	0.9
Total Equity	16.3	23.6	17.9	17.5	28.8

Balance Sheet Analysis

Year end June	2009	2010	2011f	2012f	2013f
Interest cover	n/a	n/a	n/a	n/a	n/a
Gearing (ND/ND+E)	Net Cash	Net Cash	Net Cash	Net Cash	Net Cash
Net Profit Margin	-2833%	-1071%	-109.3%	-2.2%	31.7%
Asset Turnover	0.0	0.0	0.3	0.8	1.0
Return on Assets	-49.8%	-32.8%	-28.6%	-1.8%	31.8%
Financial Leverage	1.1	1.1	1.1	1.3	1.2
Return on Equity	-53.7%	-34.7%	-31.6%	-2.3%	39.1%
Return on Inv. Capital	-719.6%	-367.9%	-146.8%	-9.2%	69.8%

Return On Invested Capital = Taxed EBIT / ND + SHF

Source – Company, LINWAR Research

Per share data

Year end June	2009	2010	2011f	2012f	2013f
Reported EPS	-4.5	-3.9	-2.5	-0.2	4.8
Normalised EPS	-4.5	-3.9	-2.5	-0.2	4.8
Normalised Growth	21.6%	-13.3%	-36.1%	-93.0%	-2921%
Ordinary DPS	0.0	0.0	0.0	0.0	0.0
Franking	0%	0%	0%	0%	0%
Payout Ratio	0.0%	0.0%	0.0%	0.0%	0.0%
FCF per share	-2.8	-3.2	-4.4	-1.7	5.4
NTA per share	8.3	10.4	7.7	7.5	12.4
EFPOWA	196.3	211.4	229.1	232.0	232.0

Segmental Analysis

Year end June (\$m)	2009	2010	2011f	2012f	2013f
Revenue					
Trophon	0.3	0.8	5.2	18.1	35.5
Unit sales	-	-	612	1,750	3,050
Cumulative unit sales	-	-	612	2,362	5,412
EBIT					
Trophon	-	9.9	9.0	8.6	15.6
Margin					
Trophon	(3,219%)	(1,174%)	(165.8%)	(5.9%)	43.9%

Cash Flow

Year end June (\$m)	2009	2010	2011f	2012f	2013f
Gross cashflow	-10.9	-8.6	-6.8	-1.4	15.0
Net Interest	1.6	0.6	0.5	0.5	0.5
Tax paid	0.0	0.0	0.0	0.2	-4.8
Other	0.2	0.2	0.2	0.2	0.2
Net operating cash flows	-9.1	-7.8	-6.2	-0.6	10.8
Payments for PPE	-1.4	-0.2	-1.4	-1.8	-6.3
Payments for acquisitions	0.0	0.0	0.0	0.0	0.0
Other	0.0	0.0	-1.4	-2.8	-3.6
Net investing cash flows	-1.4	-0.2	-2.8	-4.6	-9.8
Net share issues	0.1	15.9	0.0	0.0	0.0
Net borrowings	0.0	0.0	0.0	0.0	0.0
Dividends paid	0.0	0.0	0.0	0.0	0.0
Net financing cash flows	0.1	15.9	0.0	0.0	0.0
Change in cash held	-10.4	7.9	-9.0	-5.2	1.0
Cash at beginning of period	24.2	13.9	21.1	12.2	7.0
Other	0.0	0.0	0.0	0.0	0.0
Cash at end of period	13.8	21.8	12.2	7.0	8.0

Free Cash Flow

Year end June (\$m)	2009	2010	2011f	2012f	2013f
EBITDA	-9.5	-8.2	-8.5	-0.7	16.3
Less: Net Interest	1.6	0.6	0.5	0.5	0.5
Less: Tax paid	0.0	0.0	0.0	-0.2	4.8
Less: Capex on PP&E	1.4	0.2	-1.4	-1.8	-6.3
Less: Change in WC	1.0	0.6	-0.8	-1.8	-2.9
Free Cash Flow	-5.5	-6.8	-10.2	-4.0	12.5

Statistics & Valuation

Date	01-Aug-11
Share price	\$ 0.77
DCF Valuation	\$ 1.13
Target price	\$ 1.20
Premium/(discount) to share price	55.8%
Total Return (including dividend yield)	55.8%
No. of shares (M)	230.5
Market capitalisation (\$M)	177.5
Index	S&P/ASX100

DCF Assumptions

Risk-free rate	6.25%
Equity market risk premium	5.00%
Beta	1.50
Cost of Equity	13.75%
Assumed Gearing (D/D+E)	20.00%
WACC	12.12%

Major Shareholders

	Shares	Holding
	M	%
Maurie Stang	28.50	12.4%
Bernard Stang	28.50	12.4%
Stepen Kritzler	22.30	9.7%
Kinetic	13.70	5.9%
Wilson HTM	13.20	5.7%

Management Shareholders

	Shares	Holding
	M	%
Maurie Stang	28.5	12.4%

Current Earnings Guidance from Management

No Guidance

Valuation Ratios at \$0.77

Year end June	2009	2010	2011f	2012f	2013f
PE Ratio	-17.3	-19.9	-31.2	-448.0	15.9
EV/EBITDA	-37.3	-43.4	-41.8	-501.8	21.8
EV/EBIT	-35.7	-39.6	-41.3	-331.9	22.8
Price/FCF	na	na	na	na	62.6
Yield (%)	0.0%	0.0%	0.0%	0.0%	0.0%

Valuation Ratios at Target Price of \$1.20

Year end June	2009	2010	2011f	2012f	2013f
PE Ratio	-26.9	-31.0	-48.6	-698.1	24.7
EV/EBITDA	-27.6	-31.2	-31.2	-381.1	16.5
Yield (%)	0.0%	0.0%	0.0%	0.0%	0.0%

Peer Valuations - PE ratio

	2009	2010	2011f	2012f	2013f
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Peer Valuations - EV/EBITDA

	2009	2010	2011f	2012f	2013f
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Porter Analysis

	v. Strong	Strong	Avg	Weak	v. Weak
Threat of:					
Suppliers				✓	
Buyers					✓
New entrants				✓	
Substitutes			✓		
Industry Competition				✓	
Porter score (ascending scale of 1-25)					20

Commentary:

Suppliers - NAN has no competitor in the space
Buyers - healthcare providers
New Entrants - none on the short term horizon
Substitutes - have a number of important limitations
Industry Comp - not significant

Source – Company, LINWAR Research

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