

# Nanosonics LTD

FDA application filed



Wilson HTM  
INVESTMENT GROUP

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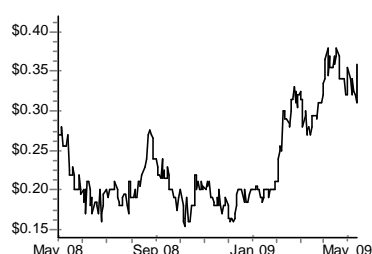
\$0.36

BUY

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## Price Performance



## Security/Capital Details

ASX Code	NAN
Market Cap	\$70 M
Issued Shares	195.1 M
Avg Mth T'over	3.01 M
12 Mth High – Low	\$0.38 - \$0.16

## Key Data/Ratios – FY 2009

Cash	\$16.1M
Cash burn	\$8.3M
EV	\$54M
Interest Cover	8.1 x
ROE	-44.7%
EPS Growth	-23.4%
PEG Ratio	x
NTA / Share	\$ 0.08
DCF	\$ 0.33
12 Mth Price Target	\$ 0.39

BUY: Total return +10% or more over a 12 month period

HOLD: Total return expected to be between +10% to -10% over a 12-month period

SELL: Total return expected to be -10% or more over a 12 month period

TOTAL RETURN OR TSR = capital growth in share price + expected dividend yield in that period

Year to June	NPAT (Rep) \$M	EPS (Norm) c	EPS Growth %	PER x	P/CF x	EV/EBITDA x	DPS c	Div Yld %	Franking %
2008a	-7.1	-3.7	-21.9	-9.8	-9.8	-5.2	0.0	0.0	0
2009e	-8.8	-4.5	-23.4	-8.0	-8.4	-5.7	0.0	0.0	0
2010e	-4.8	-2.5	45.9	-14.7	-17.9	-12.1	0.0	0.0	0
2011e	1.8	0.9	137.6	39.1	46.8	23.2	0.0	0.0	0

## Equities Research – Nanosonics LTD

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## Recommendation

We maintain our BUY recommendation despite a slight downward revision in our valuation and price target to 33 cps and 39 cps respectively. The downward revision results from slower than expected initial sales and a delay in our forecasts for the start of US sales. This is offset by higher than expected selling prices for the Trophon. The company has begun winning tenders in Australia and we expect a hard sales launch in the US in October after FDA approval for which the company has now applied. There is significant upside risk to our valuation as it excludes risk reduction upon FDA approval of the Trophon and launch of the TEE device in FY10.

## Key Points

NAN has announced:

- that the company's Trophon EPR has begun to be sold via tenders in public and private hospitals in Australia.
- An application to market the Trophon in the US has been submitted to the FDA and the company is in advanced discussions with potential distributors for the US and Canada.
- While sales have clearly begun and the company is achieving successes in tenders, we cannot but feel that sales are not ramping up as quickly as we had hoped for. This is clearly backed up by the current in-house manufacturing capacity of 35 devices per week, but with no immediate plans to take up the outsourcing capacity.
- On the positive side though, it appears the company is able to achieve higher pricing than we had expected. We understand that the device is selling for around \$10,000, which is approximately 5% more than we had expected. Our model assumes that NAN receives around 50% of the distributors selling price.
- Submission to the FDA confirms for us that sales in the US are expected to begin in FY10. However, initial sales are expected to be less than we had forecast, as the company is only expecting a hard sales launch in the US in October at a major trade fair. Thus material sales are only expected to be accounted for from 2HFY10.
- Our valuation is therefore decreased from 35 cps to 33 cps, and our 12 month price target from 43 cps to 39 cps.**
- The company has approximately \$16.1M in cash. Management believe the company will reach a low point in terms of cash available in FY10. We prefer to remain on the conservative side, and our forecasts indicate a low cash position of approximately \$9.3M in 1HFY11.
- Our valuation excludes the value of the trans-oesophageal endoscope (TEE) disinfectant. This product is a variant of the Trophon, but of course relies on the same basic technology as the Trophon. According to management, the TEE disinfection system will be released in FY10.



## Major Announcements

### Tenders and FDA Application

NAN has announced:

- that the company's Trophon EPR has begun to be sold via tenders in public and private hospitals in Australia.
- An application to market the Trophon in the US will be submitted to the FDA today, and the company is in advanced discussions with potential distributors for the US and Canada.

### Manufacturing Capacity and Sales

The company currently has the capacity to produce around 35 devices per week on a single shift per day. This equates to around 1,800 devices p.a. However with outsourcing capabilities already put in place, the company is in the position to ramp their production capability up to approximately 12,000 devices p.a. on short notice according to management.

While sales have clearly begun and the company is achieving successes in tenders, we cannot but feel that sales are not ramping up as quickly as we had hoped for. This is clearly backed up by the current in-house manufacturing capacity of 35 devices per week, but with no immediate plans to take up the outsourcing capacity.

On the positive side though, it appears the company is able to achieve higher pricing than we had expected. We understand that the device is selling for around \$10,000, which is approximately 5% more than we had expected. Our model assumes that NAN receives around 50% of the distributors selling price.

Most sales to date have been to general imaging centres, resulting in the number of cycles the device is used per day of approximately 5. We are therefore happy with our model estimate of 8 cycles per day as the company has yet to generate material exposure to the obstetrics and gynaecology markets where device use could be as high as 15-20 cycles per day.

### FDA Submission

Submission to the FDA for marketing approval confirms for us that sales in the US are expected to begin in FY10, as a 510K application generally takes 3 months to process. However, initial sales are expected to be less than we had forecast, as the company is only expecting a hard sales launch in the US in October at a major trade fair. Thus material sales are only expected to be accounted for from 2HFY10.

### Adjustments to Forecasts and Valuation

These adjustments have led to us decreasing our FY09 and FY10 forecasts as shown in Table 1.

**Table 1: Changes to forecasts**

<b>Previous Forecasts (\$M)</b>	<b>FY09</b>	<b>FY10</b>	<b>FY11</b>
Revenue	2.8	11.8	23.3
EBITDA	-8.4	-2.6	3.7
NPAT	-7.5	-2.4	2.5
<b>New Forecasts (\$M)</b>			
Revenue	0.5	8.4	20.0
EBITDA	-9.8	-5.0	2.6
NPAT	-8.8	-4.8	1.8

Source: WHTM



The effect on valuation is not as large given that we have also increased our rate of market uptake on the back of management's expectations that the low point in the company's cash reserves will occur in FY10, and that the company therefore does not need to raise cash to complete the commercialisation of the Trophon.

Our valuation is therefore decreased from 35 cps to 33 cps, and our 12 month price target from 43 cps to 39 cps.

The company has approximately \$16M in cash. Management believe the company will reach a low point in terms of cash available in FY10. We prefer to remain on the conservative side, and our forecasts indicate a low cash position of approximately \$9.3M in 1HFY11.

### **Upside Potential and Risks**

Considerable upside to this valuation remains in the form of FDA approval. FDA approval reduces the risk facing the company significantly and gives it access to the US market. The company has also stated that it expects to sign distribution and marketing agreements with partners for the US and Canada. We value the company on a DCF basis, with a discount rate of 18%. Once the company receives FDA approval and signs distribution agreements for North America, this would decrease to a maximum of 17%. This would result in our valuation increasing from 33 cps to 38 cps, and our 12 month price target would increase to 46 cps.

There is further upside potential in the company's development pipeline. Our valuation excludes the value of the trans-oesophageal endoscope (TEE) disinfectant and any other applications of the company's technology. The TEE is a variant of the Trophon, but of course relies on the same basic technology as the Trophon. In many jurisdictions the company would not even require a new product marketing application, but rather rely on modifications to the current approval.

According to management, the TEE disinfection system will be released in FY10.

There is of course the risk that the FDA decides to significantly delay approval or even deny approval of the Trophon. However we consider these scenarios to be extremely unlikely given the use of hydrogen peroxide for many years as a disinfection agent.

We therefore maintain our BUY recommendation.

## Nanosonics LTD (NAN : \$0.36)

### INVESTMENT FUNDAMENTALS

Yr Ending June	2007A	2008A	2009E	2010E	2011E
EPS Reported (c)	-3.0	-3.7	-4.5	-2.5	0.9
<b>EPS Normalised (c)</b>	<b>-3.0</b>	<b>-3.7</b>	<b>-4.5</b>	<b>-2.5</b>	<b>0.9</b>
EPS Growth (%)	N/A	-21.9%	-23.4%	45.9%	137.6%
<b>PER Normalised (x)</b>	<b>-12.0</b>	<b>-9.8</b>	<b>-8.0</b>	<b>-14.7</b>	<b>39.1</b>
DPS (c)	0.0	0.0	0.0	0.0	0.0
Payout (%)	0.0%	0.0%	0.0%	0.0%	0.0%
Yield (%)	0.0%	0.0%	0.0%	0.0%	0.0%
Franking (%)	0%	0%	0%	0%	0%

### VALUATION DATA

Yr Ending June	2007A	2008A	2009E	2010E	2011E
EV / EBITA (x)	-6.0	-5.1	-5.5	-11.3	28.9
EV / EBITDA (x)	-6.2	-5.2	-5.7	-12.1	23.2
CFPS (c)	-2.4	-3.7	-4.3	-2.0	0.8
<b>Price / CF</b>	<b>-14.9</b>	<b>-9.8</b>	<b>-8.4</b>	<b>-17.9</b>	<b>46.8</b>
Book Value / Share (\$)	0.2	0.1	0.1	0.1	0.1
<b>Price / Book (x)</b>	<b>2.2</b>	<b>2.9</b>	<b>4.7</b>	<b>6.9</b>	<b>5.8</b>

### PROFIT & LOSS (\$m)

Yr Ending June	2007A	2008A	2009E	2010E	2011E
Sales Revenue	0.0	0.0	0.5	8.4	20.0
EBITDA	-6.2	-8.8	-9.8	-5.0	2.6
Depreciation	0.2	0.2	0.3	0.4	0.5
<b>EBITA</b>	<b>-6.3</b>	<b>-9.1</b>	<b>-10.1</b>	<b>-5.4</b>	<b>2.1</b>
Amortisation	0.0	0.0	0.0	0.0	0.0
<b>EBIT</b>	<b>-6.3</b>	<b>-9.1</b>	<b>-10.1</b>	<b>-5.4</b>	<b>2.1</b>
Net Interest Expense	-0.6	-1.9	-1.2	-0.6	-0.5
<b>Pre-tax Profit</b>	<b>-5.7</b>	<b>-7.1</b>	<b>-8.8</b>	<b>-4.8</b>	<b>2.6</b>
Tax	0.0	0.0	0.0	0.0	0.8
Tax rate (%)	0.0%	0.0%	0.0%	0.0%	30.0%
Minorities / pref divs	0.0	0.0	0.0	0.0	0.0
Equity accounted NPAT	0.0	0.0	0.0	0.0	0.0
<b>Net Profit</b>	<b>-5.7</b>	<b>-7.1</b>	<b>-8.8</b>	<b>-4.8</b>	<b>1.8</b>
Abn's / Extraord's	0.0	0.0	0.0	0.0	0.0
Reported Net Profit	-5.7	-7.1	-8.8	-4.8	1.8
Revenue Growth (%)	N/A	N/A	N/A	1,531.5	137.6%
EBIT Growth (%)	N/A	-43.5%	-10.8%	46.7%	138.6%
NPAT Growth (%)	N/A	-25.3%	-23.6%	46.0%	137.5%

### PROFITABILITY RATIOS

Yr Ending June	2007A	2008A	2009E	2010E	2011E
<b>EBIT / Sales (%)</b>			-	<b>-63.9%</b>	<b>10.4%</b>
ROA (%)	N/A	-625.2%	-389.0%	-83.3%	18.1%
<b>ROE (%)</b>	<b>N/A</b>	<b>-25.5%</b>	<b>-44.7%</b>	<b>-37.8%</b>	<b>16.1%</b>
ROFE (%)	N/A	6,973.2	-	-	193.5%

### INTERIMS (\$m)

Half Yr	Dec 07	Jun 08	Dec 08	Jun 09	Dec 09
Yr Ending June	1H A	2H A	1H A	2H E	1H E
Sales Revenue	0.0	0.0	0.0	0.5	2.7
EBIT	-4.0	-5.1	-5.1	-4.9	-3.6
<b>Net Profit</b>	<b>-3.1</b>	<b>-4.1</b>	<b>-4.3</b>	<b>-4.5</b>	<b>-3.3</b>
EBIT / Sales (%)				-957.1%	-137.2%

### BALANCE SHEET (\$m)

Yr Ending June	2007A	2008A	2009E	2010E	2011E
Cash	31.9	24.2	14.6	9.8	10.3
Receivables	0.2	0.1	0.0	0.4	0.6
Inventories	0.0	0.0	0.0	0.4	0.6
Other	0.4	0.2	0.0	0.0	0.0
<b>Current Assets</b>	<b>32.4</b>	<b>24.6</b>	<b>14.7</b>	<b>10.5</b>	<b>11.6</b>
Net PPE	1.0	1.1	2.1	2.6	3.1
Investments	0.0	0.0	0.0	0.0	0.0
Intangibles	0.0	0.0	0.0	0.0	0.0
Other	0.0	0.0	1.6	5.8	9.4
<b>Non-current Assets</b>	<b>1.0</b>	<b>1.1</b>	<b>3.7</b>	<b>8.4</b>	<b>12.4</b>
<b>Total Assets</b>	<b>33.4</b>	<b>25.6</b>	<b>18.4</b>	<b>18.9</b>	<b>24.1</b>
Current Payables	1.9	0.8	1.3	4.2	6.9
Current Debt	0.0	0.0	0.0	0.0	0.0
Non-Current Debt	0.0	0.0	0.0	0.0	0.0
Provisions	0.1	0.3	2.1	4.5	5.1
Other	0.0	0.0	0.0	0.0	0.0
<b>Total Liabilities</b>	<b>2.1</b>	<b>1.1</b>	<b>3.4</b>	<b>8.7</b>	<b>12.0</b>
Equity	41.5	41.2	41.2	41.2	41.2
Reserves	0.0	0.7	0.0	0.0	0.0
Retained Profits	-10.2	-17.3	-26.1	-30.9	-29.1
Minorities	0.0	0.0	0.0	0.0	0.0
<b>Total Equity</b>	<b>31.3</b>	<b>24.6</b>	<b>15.0</b>	<b>10.2</b>	<b>12.0</b>
<b>Total Funds Employed</b>	<b>-0.6</b>	<b>0.3</b>	<b>0.4</b>	<b>0.4</b>	<b>1.7</b>

### LIQUIDITY & LEVERAGE RATIOS

Yr Ending June	2007A	2008A	2009E	2010E	2011E
Net Debt (Cash) (\$m)	-31.9	-24.2	-14.7	-9.8	-10.3
<b>Net Debt / Equity (%)</b>	<b>-101.9%</b>	<b>-98.6%</b>	<b>-97.6%</b>	<b>-95.9%</b>	<b>-85.8%</b>
Interest Cover (x)	10.1	4.7	8.1	9.0	-4.3
<b>Debt / CashFlow (x)</b>	<b>0.0</b>	<b>0.0</b>	<b>0.0</b>	<b>0.0</b>	<b>0.0</b>

### CASHFLOW (\$m)

Yr Ending June	2007A	2008A	2009E	2010E	2011E
EBIT	-6.3	-9.1	-10.1	-5.4	2.1
Dep'n and Amort'n	0.2	0.2	0.3	0.4	0.5
Net Int Rec'd (Paid)	0.6	1.9	1.2	0.6	0.5
Tax Paid	0.0	0.0	0.0	0.0	0.0
Dec / (Inc) W'kg Cap	0.0	-0.3	-0.2	-2.3	-2.6
Other	1.0	0.1	0.5	2.8	1.1
<b>Operating Cash Flow</b>	<b>-4.6</b>	<b>-7.1</b>	<b>-8.3</b>	<b>-3.9</b>	<b>1.5</b>
Capital Expenditure	-0.7	-0.4	-1.3	-0.9	-1.0
Asset Sales	0.0	0.0	0.0	0.0	0.0
Investments	0.0	0.0	0.0	0.0	0.0
Other Inv. Flows	0.0	0.0	0.0	0.0	0.0
<b>Investing Cash Flow</b>	<b>-0.7</b>	<b>-0.4</b>	<b>-1.3</b>	<b>-0.9</b>	<b>-1.0</b>
Equity Raised	30.6	0.3	0.0	0.0	0.0
Inc / (Dec) in Loans	0.0	0.0	0.0	0.0	0.0
Dividends Paid	0.0	0.0	0.0	0.0	0.0
Other Fin. Flows	-1.8	-0.7	0.0	0.0	0.0
<b>Financing Cash Flow</b>	<b>28.8</b>	<b>-0.4</b>	<b>0.0</b>	<b>0.0</b>	<b>0.0</b>
<b>Net Cash Flow</b>	<b>23.5</b>	<b>-7.9</b>	<b>-9.6</b>	<b>-4.8</b>	<b>0.5</b>

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