

Nanosonics LTD

Sales Delay



Wilson HTM
INVESTMENT GROUP

26 February 2010

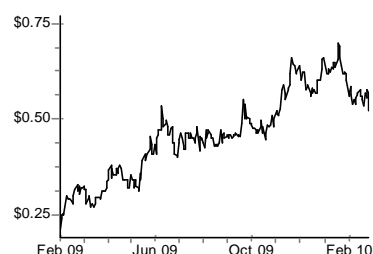
\$0.52

BUY

Graeme Wald PhD MBA
03 9640 3840
graeme.wald@wilsonhtm.com.au

Shane Storey PhD MBA
07 3212 1351
shane.storey@wilsonhtm.com.au

Price Performance



Security/Capital Details

ASX Code	NAN
Market Cap	\$117 M
Issued Shares	208.8 M
Avg Mth T'over	5.59 M
12 Mth High – Low	\$0.70 - \$0.27

Key Data/Ratios – FY 2010

Cash	\$16M
Burn	\$8.3M
EV	\$100M
Interest Cover	12.1 x
ROE	-44.9%
EPS Growth	13.6%
PEG Ratio	x
NTA / Share	\$ 0.09
DCF	\$ 1.03
12 Mth Price Target	\$ 1.20

Important Disclosure

Wilson HTM Corporate Finance Ltd acted as Lead Manager and underwriter for the December 2009 placement and advisor in relation to the share purchase plan by Nanosonics Ltd and will earn fees for acting in this capacity.

Recommendation

We reduce our valuation from \$1.20 to \$1.03 as the company experiences a delay in sales as a result of a suppliers component not being of adequate quality. It seems the company is making progress in turning the “in-principle” agreement to supply 200 Trophon units to an Australian company into reality by discussing roll-out plans, this has yet to turn into revenues. We are confident that this issue will be resolved and maintain our BUY recommendation. FDA approval is expected early in 2Hcal10, and a commercialisation deal for the US could be achieved by then.

Key Points

We reduce our valuation from \$1.20 to \$1.03 as the company experiences a delay in sales as a result of a suppliers component not being of adequate quality. We understand that NAN is working both with the company involved to resolve the issue and looking to source the component from other suppliers.

It seems the company is making progress in turning the “in-principle” agreement to supply 200 Trophon units to an Australian company into reality by discussing roll-out plans but this has yet to turn into revenues.

While management are actively trying to resolve the quality control issues, there is a large degree of uncertainty about timing, leading to considerable revenue uncertainty. We have therefore reduced our forecasts as shown below.

	Previous	New	% change
FY10			
Revenue (\$M)	7.1	3.1	-56.3%
EBITDA (\$M)	-5.1	-8.0	-56.9%
NPAT (\$M)	-4.6	-7.9	-71.7%
No. of Trophons sold	1,230	490	-60.2%
FY11			
Revenue (\$M)	24	12.3	-48.9%
EBITDA (\$M)	1	-7.0	
NPAT (\$M)	0.3	-7.4	
No. of Trophons sold	2,767	1,955	-29.3%
FY12			
Revenue (\$M)	54.4	36.3	-33.3%
EBITDA (\$M)	21.1	8.2	-61.1%
NPAT (\$M)	14.6	5.1	-65.1%
No. of Trophons sold	7,280	5,421	-25.5%

It must be noted that a reduction unit sales at this early stage of the company's development has a material impact on future profitability as a major part of the company's future earnings rely on revenues from consumables used in the installed base. Consumables have margins of at least 80%.

We are confident that this issue will be resolved and therefore maintain our BUY recommendation

Year to June	NPAT (Rep) \$M	EPS (Norm) c	EPS Growth %	PER x	P/CF x	EV/EBITDA x	DPS c	Div Yld %	Franking %
2009a	-8.8	-4.4	-20.2	-12.7	-12.1	-10.4	0.0	0.0	0
2010e	-7.9	-3.8	13.6	-14.7	-14.2	-12.5	0.0	0.0	0
2011e	-7.4	-3.5	7.4	-15.9	-14.1	-16.1	0.0	0.0	0
2012e	5.1	2.4	168.8	23.1	90.3	13.8	0.0	0.0	0

Component Problems

We are reducing our valuation from \$1.20 to \$1.03 as the company experiences a delay in sales as a result of a component that is supplied to them not being of adequate quality. We understand that NAN is working both with the company involved to resolve the issue and looking to source the component from other suppliers.

It is a credit to the company and management that such a problem has been picked up at this early stage, rather than when a large number of Trophon's have been shipped or are in the field.

However it is of course disappointing that this has occurred.

While management are actively trying to resolve the quality control issues, there is a large degree of uncertainty about when the one can expect it to be resolved, leading to considerable uncertainty about revenues.

In addition, while progress is being made in turning the "in-principle" agreement to supply 200 Trophon's to an Australian company into reality by negotiating a roll-out program, it is clear to us that this may also be delayed.

Revised forecasts

We have revised our forecasts as shown in Table 1.

	Previous	New	% change
FY10			
Revenue (\$M)	7.1	3.1	-56.3%
EBITDA (\$M)	-5.1	-8.0	-56.9%
NPAT (\$M)	-4.6	-7.9	-71.7%
No. of Trophons sold	1,230	490	-60.2%
FY11			
Revenue (\$M)	24	12.3	-48.9%
EBITDA (\$M)	1	-7.0	
NPAT (\$M)	0.3	-7.4	
No. of Trophons sold	2,767	1,955	-29.3%
FY12			
Revenue (\$M)	54.4	36.3	-33.3%
EBITDA (\$M)	21.1	8.2	-61.1%
NPAT (\$M)	14.6	5.1	-65.1%
No. of Trophons sold	7,280	5,421	-25.5%

Source: WHTM

Our DCF valuation decreases from \$1.20 to \$1.03, and while this may appear to be disproportionately large reduction in valuation, one has to remember that a large part of the company's value lies in its ability to generate annuity revenues from consumables which is a direct function the installed base of Trophon devices. This effect is amplified when one takes into account that margins on devices are around 60%, while margins for consumables are at least 80%.

We emphasise the inherent uncertainty in our forecasts and valuation given the nature of the problem.

With cash reserves of \$21.4M we believe the company has sufficient reserves to commercialise the Trophon despite this short term setback.

News Flow

The major piece of news flow now would be that this component issue has been resolved. Other major events include a commercialisation deal for the Trophon for the US market, and FDA approval of the Trophon. FDA approval is only expected in 2Hcal10, but a commercialisation deal could be achieved before that.

Nanosonics LTD (NAN : \$0.52)

INVESTMENT FUNDAMENTALS

Yr Ending June	2008A	2009A	2010E	2011E	2012E
EPS Reported (c)	-3.7	-4.4	-3.8	-3.5	2.4
EPS Normalised (c)	-3.7	-4.4	-3.8	-3.5	2.4
EPS Growth (%)	N/A	-20.2%	13.6%	7.4%	168.8%
PER Normalised (x)	-15.3	-12.7	-14.7	-15.9	23.1
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	2008A	2009A	2010E	2011E	2012E
EV / EBITA (x)	-9.4	-10.0	-11.6	-14.3	16.0
EV / EBITDA (x)	-9.6	-10.4	-12.5	-16.1	13.8
CFPS (c)	-3.7	-4.6	-4.0	-4.0	0.6
Price / CF	-15.3	-12.1	-14.2	-14.1	90.3
Book Value / Share (\$)	0.1	0.1	0.1	0.1	0.1
Price / Book (x)	4.4	6.7	6.4	10.4	7.3

PROFIT & LOSS (\$m)

Yr Ending June	2008A	2009A	2010E	2011E	2012E
Sales Revenue	0.0	0.3	3.1	12.3	36.3
EBITDA	-8.8	-9.5	-8.0	-7.0	8.2
Depreciation	0.2	0.4	0.6	0.9	1.1
EBITA	-9.1	-10.0	-8.7	-7.9	7.1
Amortisation	0.0	0.0	0.0	0.0	0.0
EBIT	-9.1	-9.9	-8.7	-7.9	7.1
Net Interest Expense	-1.9	-1.2	-0.7	-0.5	-0.2
Pre-tax Profit	-7.1	-8.8	-7.9	-7.4	7.2
Tax	0.0	0.0	0.0	0.0	2.2
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
Net Profit	-7.1	-8.8	-7.9	-7.4	5.1
Abn's / Extraord's	0.0	0.0	0.0	0.0	0.0
Reported Net Profit	-7.1	-8.8	-7.9	-7.4	5.1
Revenue Growth (%)	N/A	N/A	887.7%	301.9%	196.1%
EBIT Growth (%)	N/A	-9.4%	12.9%	9.2%	189.9%
NPAT Growth (%)	N/A	-22.5%	9.2%	7.4%	168.9%

PROFITABILITY RATIOS

Yr Ending June	2008A	2009A	2010E	2011E	2012E
EBIT / Sales (%)			-284.0%	-64.2%	19.5%
ROA (%)	N/A	-388.6%	-150.0%	-56.4%	27.1%
ROE (%)	N/A	-42.8%	-44.9%	-47.7%	35.4%
ROFE (%)	N/A	-715.8%	-313.0%	-154.6%	71.0%

INTERIMS (\$m)

Half Yr	Dec 08	Jun 09	Dec 09	Jun 10	Dec 10
Yr Ending June	1H A	2H A	1H A	2H E	1H E
Sales Revenue	0.0	0.3	0.6	2.5	4.6
EBIT	-5.1	-4.8	-4.4	-4.3	-4.4
Net Profit	-4.3	-4.4	-4.1	-3.8	-4.1
EBIT / Sales (%)			-777.6%	-171.6%	-94.7%

BALANCE SHEET (\$m)

Yr Ending June	2008A	2009A	2010E	2011E	2012E
Cash	24.2	13.9	16.0	4.7	4.0
Receivables	0.1	0.5	0.2	0.4	1.2
Inventories	0.0	0.9	0.2	0.4	1.2
Other	0.2	0.2	0.0	0.0	0.0
Current Assets	24.6	15.4	16.3	5.5	6.5
Net PPE	1.1	1.9	2.3	4.4	5.3
Investments	0.0	0.0	0.0	0.0	0.0
Intangibles	0.0	0.2	0.0	0.0	0.0
Other	0.0	0.1	5.3	14.8	24.4
Non-current Assets	1.1	2.2	7.6	19.2	29.7
Total Assets	25.6	17.6	23.9	24.7	36.2
Current Payables	0.8	0.9	2.3	6.4	17.1
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	0.3	0.3	2.4	6.5	2.3
Other	0.0	0.0	0.0	0.0	0.0
Total Liabilities	1.1	1.3	4.8	13.0	19.4
Equity	41.2	41.4	52.9	52.9	52.9
Reserves	0.7	0.8	0.0	0.0	0.0
Retained Profits	-17.3	-25.9	-33.8	-41.2	-36.1
Minorities	0.0	0.0	0.0	0.0	0.0
Total Equity	24.6	16.3	19.1	11.7	16.8
Total Funds Employed	0.3	2.4	3.1	7.1	12.8

LIQUIDITY & LEVERAGE RATIOS

Yr Ending June	2008A	2009A	2010E	2011E	2012E
Net Debt (Cash) (\$m)	-24.2	-13.9	-16.0	-4.7	-4.0
Net Debt / Equity (%)	-98.6%	-85.1%	-83.7%	-39.9%	-23.7%
Interest Cover (x)	4.7	8.3	12.1	15.3	-44.0
Debt / CashFlow (x)	0.0	0.0	0.0	0.0	0.0

CASHFLOW (\$m)

Yr Ending June	2008A	2009A	2010E	2011E	2012E
EBIT	-9.1	-9.9	-8.7	-7.9	7.1
Dep'n and Amort'n	0.2	0.4	0.6	0.9	1.1
Net Int Rec'd (Paid)	1.9	1.2	0.7	0.5	0.2
Tax Paid	0.0	0.0	0.0	0.0	0.0
Dec / (Inc) W'kg Cap	-0.3	-0.1	-1.0	-2.3	-7.1
Other	0.1	-0.7	0.0	0.5	0.0
Operating Cash Flow	-7.1	-9.1	-8.3	-8.3	1.3
Capital Expenditure	-0.4	-1.2	-1.1	-3.0	-2.0
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	-0.2	0.0	0.0	0.0
Investing Cash Flow	-0.4	-1.4	-1.1	-3.0	-2.0
Equity Raised	0.3	0.1	12.1	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	-0.7	0.1	-0.6	0.0	0.0
Financing Cash Flow	-0.4	0.2	11.4	0.0	0.0
Net Cash Flow	-7.9	-10.4	2.1	-11.3	-0.7



Recommendation Structure

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

Other definitions

CS Coverage Suspended. Wilson HTM Ltd has suspended coverage of this company.

NR Not Rated. The recommendation has been suspended temporarily. Such suspension is in line with Wilson HTM Investment Group Ltd policies in circumstances where Wilson HTM Corporate Finance Ltd is acting in an advisory capacity in a merger or strategic transaction involving the company and in certain other situations.

Disclaimer

Whilst Wilson HTM Ltd believes the information contained in this communication is based on reliable information, no warranty is given as to its accuracy and persons relying on this information do so at their own risk. To the extent permitted by law Wilson HTM Ltd disclaims all liability to any person relying on the information contained in this communication in respect of any loss or damage (including consequential loss or damage) however caused, which may be suffered or arise directly or indirectly in respect of such information. Any projections contained in this communication are estimates only. Such projections are subject to market influences and contingent upon matters outside the control of Wilson HTM Ltd and therefore may not be realised in the future.

The advice contained in this document is general advice. It has been prepared without taking account of any person's objectives, financial situation or needs and because of that, any person should, before acting on the advice, consider the appropriateness of the advice, having regard to the client's objectives, financial situation and needs. Those acting upon such information without first consulting one of Wilson HTM Ltd investment advisors do so entirely at their own risk. This report does not constitute an offer or invitation to purchase any securities and should not be relied upon in connection with any contract or commitment whatsoever. If the advice relates to the acquisition, or possible acquisition, of a particular financial product – the client should obtain a Product Disclosure Statement relating to the product and consider the Statement before making any decision about whether to acquire the product. This communication is not to be disclosed in whole or part or used by any other party without Wilson HTM Ltd's prior written consent.

Disclosure of Interest. Nanosonics LTD

The Directors of Wilson HTM Ltd advise that at the date of this report they and their associates have relevant interests in Nanosonics LTD. They also advise that Wilson HTM Ltd and Wilson HTM Corporate Finance Ltd A.B.N. 65 057 547 323 and their associates have received and may receive commissions or fees from Nanosonics LTD in relation to advice or dealings in securities. Some or all of Wilson HTM Ltd authorised representatives may be remunerated wholly or partly by way of commission.

In producing research reports, members of Wilson HTM Ltd Research may attend site visits and other meetings hosted by the issuers the subject of its research reports. In some instances the costs of such site visits or meetings may be met in part or in whole by the issuers concerned if Wilson HTM Ltd considers it is appropriate and reasonable in the specific circumstances relating to the site visit or meeting.

Wilson HTM Investment Group Ltd is a substantial securities holder of Nanosonics LTD (nan.asx)

Regulatory Disclosures

Wilson HTM Corporate Finance Ltd acted as Lead Manager and underwriter for the December 2009 placement and advisor in relation to the share purchase plan by Nanosonics Ltd and will earn fees for acting in this capacity.

Wilson HTM Investment Group Ltd and its related bodies corporate trades or may trade as principal in the securities that are subject of the research report.

Wilson HTM Corporate Finance Ltd has received compensation for corporate advisory services from this company, its subsidiaries or affiliates during the previous 12 months.

BRISBANE
Ph: 07 3212 1333
Fax: 07 3212 1399

SYDNEY
Ph: 02 8247 6600
Fax: 02 8247 6601

MELBOURNE
Ph: 03 9640 3888
Fax: 03 9640 3800

GOLD COAST
Ph: 07 5509 5500
Fax: 07 5509 5599

DALBY
Ph: 07 4660 8000
Fax: 07 4660 4169

HERVEY BAY
Ph: 07 4197 1600
Fax: 07 4197 1699

TOWNSVILLE
Ph: 07 4725 5787
Fax: 07 4725 5104

GEELONG
Ph: 03 5225 1500
Fax: 03 5225 1599

Our web site: www.wilsonhtm.com.au