

Australian Equity Research

26 February 2017

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BUY↑

from HOLD

PRICE TARGET A\$3.20

unchanged

Price (20-Feb) A\$2.70

Ticker NAN-ASX

52-Week Range (A\$):	1.83 - 3.60
Avg Daily Vol (000s) :	746.3
Market Cap (A\$M):	834
Shares Out. (M) :	297.7
Enterprise Value (A\$M):	777
Last Cash Balance (A\$M):	56.9
Last Quarter Cash Burn (A\$M):	5.7
Major Shareholders:	M Stang Allan Gray B Stang

FYE Jun	2016A	2017E	2018E	2019E
Sales (A\$M)	42.8	71.0	102.8	146.4
PBT (A\$M)	0.1	13.3	31.8	59.3
Net Income (A\$M)	0.1	25.0	31.8	47.0
EPS (AUc)	0.04	4.6	10.9	16.1
Cash Position (A\$M)	48.8	60.9	91.4	108.5



Source: FactSet

Priced as of close of business 20 February 2017

Company Update

Scratching the surface; upgrade to BUY

Investment Perspective

The potential role for trophon in preventing infection from contaminated ultrasound transducers has received a boost with three more professional bodies (WFUMB, ASUM/ACIPC and Ireland's HSE) issuing updated guidelines that reinforce the need to high-level disinfect (HLD) these devices between every patient. These add to existing guidelines previously issued by the several bodies, including the US Center For Disease Control (CDC), which are likely to establish HLD of ultrasound transducers between patients as the standard of care. As NAN's trophon is the only fully-automated, point-of-care system that is able to disinfect the entire transducer, we believe the company is in a strong position to dominate this market. What makes these new guidelines significant is that they highlight the need to use HLD for all transducers used in semi-critical procedures (i.e., in contact with broken skin or mucous membranes) and not just intracavity (vaginal or rectal) examinations. Extending the use of trophon to disinfect surface probes used in semi-critical procedures has the potential to boost the amount of high-margin consumable used annually by each trophon. Due to the recent decline in NAN's share price, we are upgrading our recommendation to BUY and maintain our \$3.20 price target which is based on a 12yr DCF (10.1% discount rate, no terminal value).

Key Points

New guidelines - requiring that all ultrasound transducers be high-level disinfected between every patient have been issued by three leading professional bodies:

- World Federation for Ultrasound in Medicine and Biology (WFUMB);
- Joint guidelines from the Australasian Society for Ultrasound in Medicine (ASUM) / Australasian College for Infection Prevention and Control (ACIPC);
- Ireland's Health Service Executive (HSE).

The WFUMB includes professional bodies from the US, Europe, Australia, New Zealand, Asia, Latin America, and Africa.

Going semi-critical - all the new guidelines being issued are recommending High Level Disinfection (HLD) for ultrasound transducers that are used in semi-critical procedures, i.e. transducers that come in direct contact with mucous membranes or broken skin. This will include any surface probes that are used in Emergency Departments (ED) or in surgery. The need for this has been highlighted in a recent study conducted in an Australian ED that showed 57% of transducers had high blood contamination and 46% had microbial contamination. We understand that some sites, such as Johns Hopkins, have already started routinely disinfecting surface probes.

All consuming - the potential expansion into HLD of surface probes could have a material impact on future income for NAN. While it may lead to some additional trophon sales, the real kicker would come from increased use of consumables. Our model assumes an average of 4 disinfection cycles per day (960/year) for each trophon. Based on 35 cycles per A\$110 bottle (CG estimate), an increase to 5 cycles per day would increase consumable sales per machine from A\$3,000/year to A\$3,750/year. If this occurred across the current install base, it would equate to an additional A\$9M in annual consumable sales to end users.

FINANCIAL SUMMARY**Financial Performance**

Year End	June	2014A	2015A	2016A	2017E	2018A	2019A	2020E	2021E	2022E	2023E	2024E
trophon sales (CG Est)	\$M	16.4	16.6	25.7	46.3	62.6	85.4	100.2	118.3	144.5	123.4	144.4
Consumable sales (CG Est)	\$M	5.3	5.7	17.1	24.4	37.5	53.5	71.8	90.9	113.5	134.7	152.8
Revenue from MES contracts (CGe)	\$M	-	-	-	0.3	2.7	7.5	13.5	19.5	25.5	30.3	33.9
Sales of goods and services	\$M	21.5	22.2	42.8	71.0	102.8	146.4	185.5	228.7	283.5	288.4	331.1
Cost of sales	\$M	(7.6)	(6.9)	(10.6)	(19.9)	(28.8)	(41.0)	(52.0)	(64.0)	(79.4)	(80.7)	(92.7)
Gross Margin	\$M	13.9	15.3	32.2	51.1	74.0	105.4	133.6	164.6	204.1	207.6	238.4
Interest revenue	\$M	0.7	0.9	1.1	1.9	2.6	3.1	3.8	4.8	5.9	6.1	6.1
Government grants	\$M	1.7	0.1	-	-	-	-	-	-	-	-	-
Other income	\$M	1.7	2.2	0.1	-	-	-	-	-	-	-	-
Total other income	\$M	4.1	3.2	1.2	1.9	2.6	3.1	3.8	4.8	5.9	6.1	6.1
Staff expense	\$M	(12.0)	(13.9)	(20.1)	(26.1)	(30.0)	(33.1)	(34.7)	(36.4)	(38.3)	(40.2)	(42.2)
Operations	\$M	(8.1)	(9.5)	(12.6)	(13.7)	(14.9)	(16.2)	(17.0)	(17.8)	(18.7)	(19.6)	(20.6)
Total operational expense	\$M	(20.1)	(23.4)	(32.7)	(39.8)	(44.9)	(49.2)	(51.7)	(54.3)	(57.0)	(59.8)	(62.8)
Borrowing costs	\$M	(0.6)	(0.6)	(0.6)	-	-	-	-	-	-	-	-
Net profit before tax	\$M	(2.6)	(5.5)	0.1	13.3	31.8	59.3	85.7	115.2	153.1	153.9	181.7
Tax benefit / (expense)	\$M	0.0	0.0	(0.0)	11.7	-	(12.3)	(25.7)	(34.6)	(45.9)	(46.2)	(54.5)
Net profit after tax	\$M	(2.6)	(5.5)	0.1	25.0	31.8	47.0	60.0	80.7	107.2	107.7	127.2
Earnings per share (cps)	cps	(1.0)	(2.0)	0.0	4.6	10.9	16.1	20.6	27.7	36.8	37.0	43.6
Dividend per share (dps)	cps	-	-	-	-	9.8	14.5	18.5	24.9	33.1	33.3	39.3

Balance Sheet

Year End	June	2014A	2015A	2016A	2017E	2018A	2019A	2020E	2021E	2022E	2023E	2024E
Cash & Cash Equivalents	\$M	21.2	45.7	48.8	60.9	91.4	108.5	124.9	150.3	183.6	195.6	228.5
Current Assets	\$M	31.6	56.4	64.6	76.6	107.1	124.3	140.6	166.0	199.3	211.3	244.3
Non-Current Assets	\$M	1.9	3.9	3.6	17.1	17.1	17.1	17.1	17.1	17.1	17.1	17.1
TOTAL ASSETS	\$M	33.5	60.4	68.2	93.7	124.2	141.4	157.8	183.1	216.4	228.4	261.4
Current Debt	\$M	0.0	0.0	0.4	0.4	0.4	0.4	0.4	0.4	0.4	0.4	0.4
Current Liabilities	\$M	4.8	15.2	8.9	7.9	7.9	7.9	7.9	7.9	7.9	7.9	7.9
Non-Current Debt	\$M	0.0	0.0	1.3	1.3	1.3	1.3	1.3	1.3	1.3	1.3	1.3
Non-Current Liabilities	\$M	8.3	0.5	2.6	2.6	2.6	2.6	2.6	2.6	2.6	2.6	2.6
TOTAL LIABILITIES	\$M	13.1	15.7	11.5	10.5	10.5	10.5	10.5	10.5	10.5	10.5	10.5
Equity	\$M	78.5	108.2	120.0	119.7	147.1	159.5	169.9	187.2	209.8	211.0	231.2
Accumulated Profits / (Losses)	\$M	-58.0	-63.5	-63.4	-36.5	-33.3	-28.6	-22.6	-14.6	-3.9	6.9	19.6
TOTAL EQUITY	\$M	20.4	44.7	56.7	83.2	113.7	130.9	147.3	172.6	205.9	217.9	250.9

Cash Flow

Year End	June	2014A	2015A	2016A	2017E	2018A	2019A	2020E	2021E	2022E	2023E	2024E
Receipts	\$M	23.0	26.9	41.2	71.0	102.8	146.4	185.5	228.7	283.5	288.4	331.1
Suppliers & Employers	\$M	-28.0	-30.3	-39.1	-59.7	-73.7	-90.2	-103.6	-118.3	-136.3	-140.6	-155.5
Interest Received	\$M	0.7	0.9	1.1	1.9	2.6	3.1	3.8	4.8	5.9	6.1	6.1
Tax Paid	\$M	1.7	0.1	0.0	0.0	0.0	-12.3	-25.7	-34.6	-45.9	-46.2	-54.5
Cash From Operations	\$M	-2.6	-2.4	3.2	13.3	31.8	47.0	60.0	80.7	107.2	107.7	127.2
Cash From Investing	\$M	-0.5	-2.3	-1.3	-1.3	-1.3	-1.3	-1.3	-1.3	-1.3	0.7	2.7
Cash From Financing	\$M	0.3	28.6	1.7	0.0	0.0	-28.6	-42.3	-54.0	-72.6	-96.4	-97.0
Opening Cash Balance	\$M	24.1	21.2	45.7	48.8	60.9	91.4	108.5	124.9	150.3	183.6	195.6
Net Incr / (Decr) In Cash	\$M	-2.8	24.5	3.1	12.0	30.5	17.1	16.4	25.4	33.3	12.0	32.9
Closing Cash Balance	\$M	21.2	45.7	48.8	60.9	91.4	108.5	124.9	150.3	183.6	195.6	228.5

Valuation

Risk Free Rate	%	4.60%		Forecast Period	years		12
Market Premium	%	5.50%		12-Month Price Target	\$		\$3.20
Beta	x	1.0		Current Price	\$		\$2.70
Discount Rate	%	10.1%		Return	%		19%

SOURCES: Company reports, Canaccord Genuity estimates

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Investment Recommendation

Date and time of first dissemination: February 26, 2017, 22:35 ET

Date and time of production: February 26, 2017, 22:36 ET

Target Price / Valuation Methodology:

Nanosonics Limited - NAN

Target price is based on 12-year discounted cash flow (10.1% discount rate) with no terminal value of cash profits generated from the sale of the trophon ultrasound disinfection system and associated accessories and consumables.

Risks to achieving Target Price / Valuation:

Nanosonics Limited - NAN

Poor sales support from GE, manufacturing problems, supply of sub-assemblies from external parties, hiccups, resistance from hospital to invest in new technologies, development of alternative systems by competitors, issue with product performance resulting in recall.

Distribution of Ratings:

Global Stock Ratings (as of 02/26/17)

Rating	Coverage Universe		IB Clients
	#	%	%
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Hold	288	30.06%	15.97%
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Speculative Buy	58	6.05%	74.14%
	958*	100.0%	

*Total includes stocks that are Under Review

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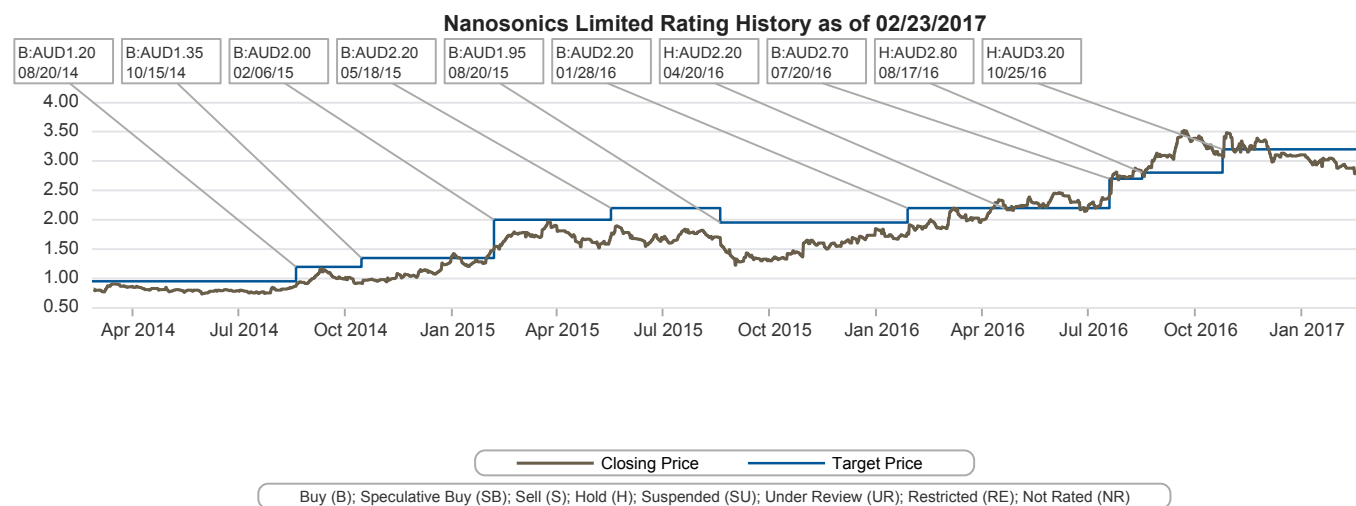
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