

*Research Initiation*

**Compumedics (CMP)**

**Brain Teaser**

**HOLD Rating, A\$0.58/Share Price Target**

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MOELIS & COMPANY

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# Executive Summary

## Compumedics (CMP)

- **HOLD rating, A\$0.58/share price target.** We initiate research coverage on Compumedics (CMP) with a HOLD rating and a A\$0.58/share price target. In this report, we provide a scenario analysis for investors, with low, base and high case assumptions. Our 12 month price target is our base case DCF valuation, rolled forward 12 months by the cost of equity. Our base case assumes 5% ongoing sales growth/year in the core business and the sale of 1 high-end neural activity imaging machine (Magnetoencephalography or “MEG”) in FY18; thereafter assume 2 MEG machine sales/year. Products distributed through distributors and CMP’s direct sales force.
- **Background.** CMP is a medical software and hardware player, providing diagnostics for sleep and neurological disorders. Core customers are hospitals, sleep clinics and universities. Strong market position with top 3 positions across most product lines in Australia, China, and the United States. Established in 1987 by Managing Director and founder David Burton, listing on the Australian Stock exchange (ASX) in December 2000 at \$0.50 per share.
- **Medical hardware & software.** Provides software & hardware primarily for diagnosing sleep and neurological disorders in hospitals, sleep clinics and universities.
  - Sleep: diagnoses disorders such as insomnia and sleep apnea.
  - Neurological: diagnoses disorders such as autism, dementia, epilepsy, multiple sclerosis, Alzheimer's and Parkinson's disease.
  - Brain blood flow: monitors blood flow around the brain.
- **Revenue model.** Around ~85% of group sales is capital equipment; the remaining ~15% sales are recurring in nature (e.g. consumables, maintenance and support).
- **Catalysts.** (1) New contracts; (2) Sale of high-end MEG machines in the short term; (3) New consumer products over the medium term.

## Investment Thesis

- 1) **Strong market position and brand name.** Top 3 market position in Australia, China and the U.S, with +20,000 systems installed worldwide. Customers include The Mayo Clinic, The University of Oxford, Royal Prince Alfred Hospital, Sydney and The Royal Children's Hospital, Melbourne.
- 2) **Sleep & neurological disorders increasing.** Global rates of sleep and neurological disorders are increasing, driven in part by the aging of the population. The global neurology devices market was worth US\$5.0bn in 2013 and is forecast to grow at 15.4% CAGR from 2015-2019 to almost US\$13.6bn. Management estimate the clinical neurology diagnostics market is worth US\$1.3bn/year, with CMP’s market share being <1% at present.
- 3) **New products could see earnings step change.** New high-end MEG machines with a sale price around US\$3.0-5.0m per machine; low cost of sale ~\$US1.0m, may see a material US\$2.0-4.0m uplift in earnings, noting EBITDA was A\$5.0m in FY16. CMP is also working on the release of low-mid range products to widen the addressable market and a cloud based e-health platform for clinicians. Longer term, management are seeking to release a consumer sleep tracking product (Somfit).
- 4) **Cost efficiency opportunities.** Operational improvements and selective outsourcing of production to continue in FY17/18. Cost savings initiatives include logistics improvements; potential sub-leasing of space, etc. These initiatives should assist with margin improvement over time.

# Company Overview

## History

- Medical software and hardware player founded in 1987 by CEO David Burton
- Software & medical devices to diagnose sleep and neurological disorders
- Listed at A\$0.50/share on the Australian Stock Exchange in December 2000

## Product Offering

- Sleep: diagnoses sleeping disorders, e.g. insomnia, sleep apnea. Used in sleep clinics and home testing.
- Neurological: diagnoses disorders such as autism, epilepsy, multiple sclerosis and Parkinson's disease. Used in hospitals, universities & sleep clinics.
- Capital sales - hardware sale & implementation fees
  - US\$10,000 - US\$1.0 range per device; noting new MEG machine US\$3.0-5.0m
- Recurring revenue - consumables, maintenance, support
  - ~15% group revenues



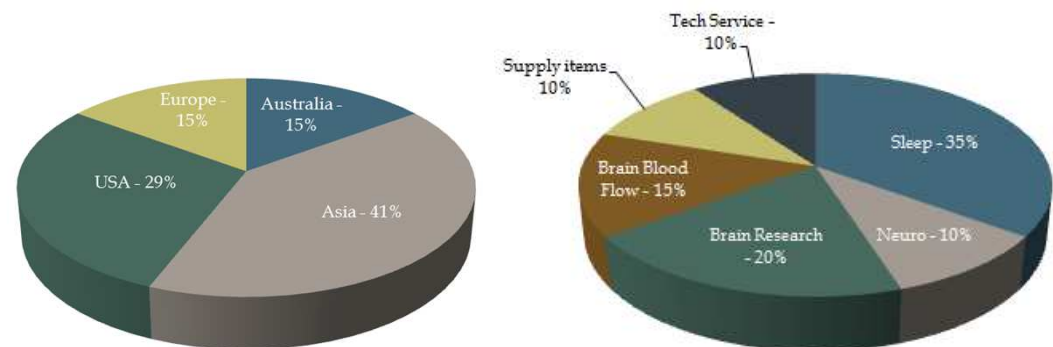
## Customers

- Hospitals
- Medical centres
- Universities

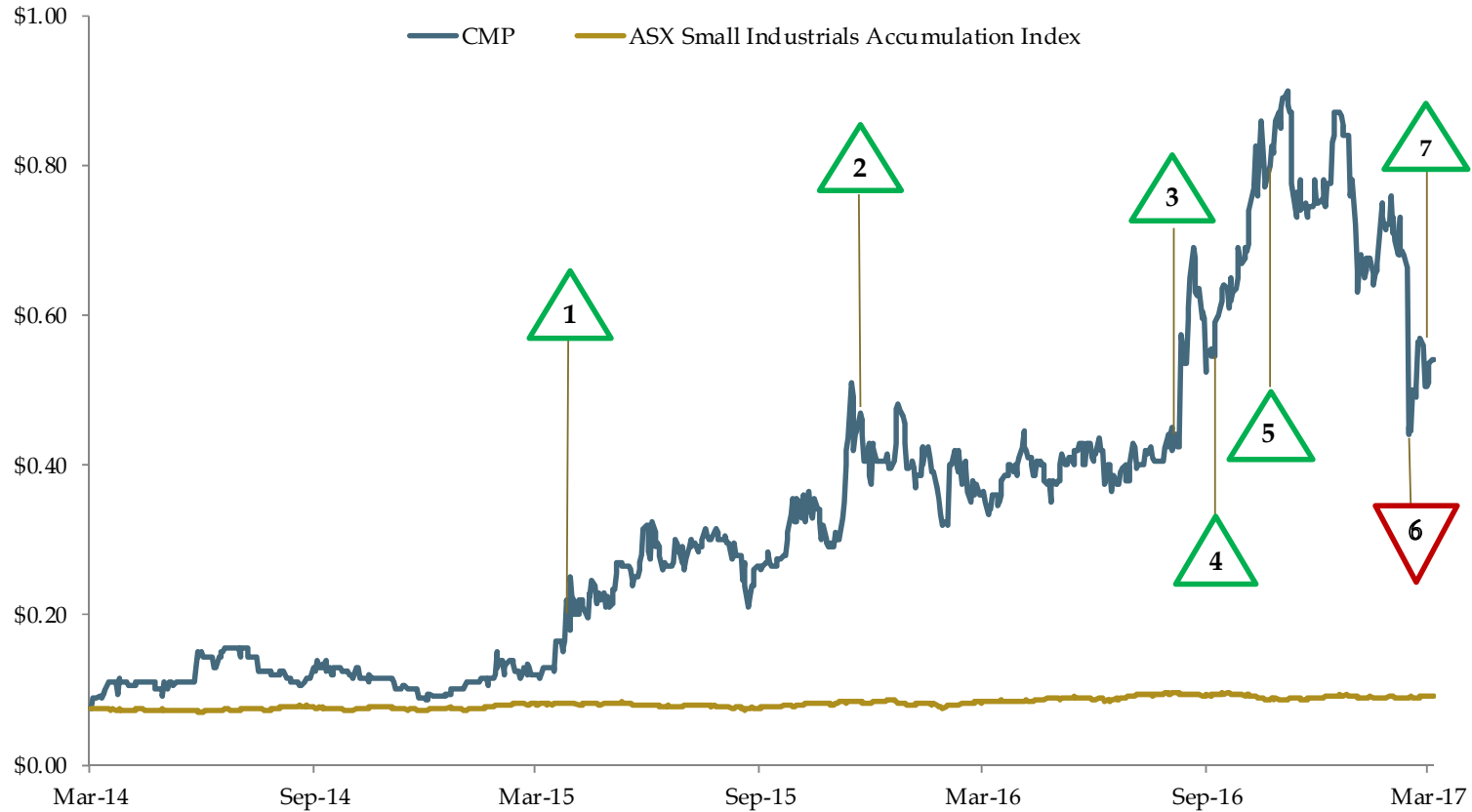
## Strategy

- Deeper penetration of existing markets
  - US => grow sales force
  - Asia => China expansion
  - Europe => German expansion
- New product categories
  - High value, premium MEG machines
  - Lower/mid tier sleep & neurology devices
- New consumer sleep products
  - Somfit sleep tracking device for consumer market
  - Medium term

## Sales Diversification



# Share Price & Key Events



Event	Date	Detail
(1)	Apr-15	Various contract wins between Apr-Sep across US, China, Germany, Aus
(2)	Dec-15	Wins US hospital contract
(3)	Aug-16	FY16 result - sales +12% pcp, NPAT +66% on pcp. FY17 guidance implies ~50% NPAT growth
(4)	Sep-16	Capital raise - \$6.5m placement undertaken at \$0.54 per share.
(5)	Oct-16	AGM - confirms guidance sales \$41-43m, EBITDA \$6.0-8.0m
(6)	Feb-17	FY17 - earnings guidance downgrade, \$4.5-7.5m EBITDA vs \$6.0-8.0m EBITDA prior.
(7)	Mar-17	DWL business receives \$2.3m sales commitment via Chinese distributor.

# Existing Products

Hospitals, medical clinics, sleep labs and universities are CMP's key customer groups

## Sleep Diagnostics



- Monitors physical and physiological behaviours while asleep
- Diagnoses insomnia and sleep apnea

## Neurology Diagnostics - Clinical



- Monitors electrical activity of the brain, spinal cord, nerves and muscles for the diagnosis of neurological diseases
- Diagnoses autism, dementia, epilepsy, multiple sclerosis, Alzheimer's and Parkinson's disease



Software & Hardware

## Brain Blood Flow Monitoring



- Monitors the blood-flow around the brain utilising sound frequencies
- Transcranial ultrasound devices

## Neurology Diagnostics - Research



- Monitors brain and central nervous system activity for research purposes

# Existing Products

## Sleep Diagnostics

### Details

### Market Size & Share

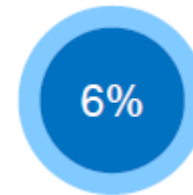
### Key Positions



- Sleep study sensors attached to the patient's head, chest, hands and legs
- Monitored 8 - 10 hours
- Breathing patterns, leg movements, eye movements, responses to light and sound
- Monitors physiological data and trend analysis

Size US\$250m/yr

CMP  
market share  
~US\$10m/yr



#### Current Market position:



#### Competitive Advantages:

- 1 Innovative strength
- 2 Active involvement in sleep science globally
- 3 Market placement and momentum
- 4 Best in class sleep analytics

## Neurology Diagnostics - Clinical

### Details

### Market Size & Share

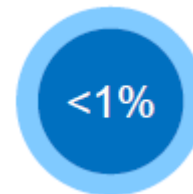
### Key Positions



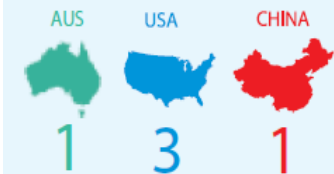
- Monitors electrical activity in the brain and spinal cord for the diagnosis of neurological-based disorders.
- EEG is used in diagnosis and/or management of brain related issues eg. epilepsy, traumatic brain injury.
- Non-invasive, pain and risk free

Size  
US\$1.3bn/yr

CMP  
market share  
~US\$7m



#### Current Market position:



#### Competitive Advantages:

- 1 Complete range from clinical to research technologies
- 2 Uncompromised system design
- 3 Highest industry quality standards
- 4 Best in class brain analytics

# Existing Products

## Neurology Diagnostics – Research

### Details

### Market Size & Share

### Key Positions

Neuvo LTM



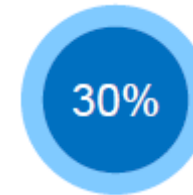
Profusion 4 EEG



- Studies brain's functionality
- Mapping of recorded EEG activity
- Complex 3D models that define the source of electrical activations

Size  
US\$20m/yr

CMP  
market share  
~US\$6m/yr



#### Current Market position:



#### Competitive Advantages:

- 1 Superior patented technology
- 2 Uncompromised system design
- 3 Unmatched innovation
- 4 Best in class brain analytics

Profusion Nexus



Grael-HD EEG System



## Brain Blood Flow Monitoring

### Details

### Market Size & Share

### Key Positions



Doppler-Box™ X



Multi-Dop® T digital

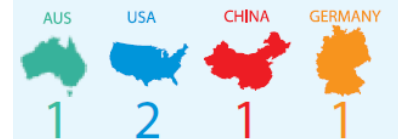
- Sound frequencies to measure brain blood flow
- Continuous real time monitoring
- Lower cost

Size  
US\$15m/yr

CMP  
market share  
~US\$5m/yr



#### Current Market position:



#### Competitive Advantages:

- 1 Full Digital Doppler Technology
- 2 Bilateral Doppler
- 3 Multi-Range Doppler Technology
- 4 Physiological Tests
- 5 Emboli Differentiation & Multi-Frequency probes
- 6 Highest Doppler sensitivity
- 7 Best signal to noise ratio
- 8 Reference gates
- 9 High and low temperature endurance systems
- 10 Space endurance systems



# New Products

## High-End Magnetoencephalography (MEG) Machines

- Detects neurological disorders such as dementia, autism, epilepsy. Records magnetic fields produced by electric currents generated by neurons in the brain.
- Traditional MRI is unable to detect these characteristics.
- CMP owns software, hardware outsourced.
- Korean hardware manufacturer. 20 year Licence agreement with Korean Research Institute of Standards and Science (KRISS) to manufacture MEG systems CMP's brain analysis software (CURRY).
  - Market opportunity: MEG global market is ~30 systems per year, implies ~US\$150m opportunity per year
  - Price: \$US3.0m-\$US5.0m per MEG device
  - Competitors: Elekta (Sweden), Yokogawa Richo (Japan); CTF MEG (Canada).



## Consumer Product (Somfit) & e-Health Cloud Platform for Clinicians

### Consumer

- Consumer sleep tracking device that collects medical grade data about an individual's sleeping patterns.
- Sleep data can be used for consultations with a GP or a sleep specialist

### e-Health

- Cloud based platform that captures and transfers medical grade sleep parameters from any web-enabled device
- neXus 360 is a web-based patient data and Lab Management System that provides integrated hardware and software solutions for both sleep and neurology clinics
- Currently in 4 sites in the US, with plans to expand across its existing ~2,500 bed network. Management plan to charge ~US\$20/bed/day



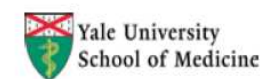
# Key Customers

High profile hospitals and research institutions and key customers including The Mayo Clinic, Stanford, Yale & Oxford Universities

## Recent Contract Wins

Facility	Country	Value (A\$)	Announced	Term
Bestmed	China	\$2.30m	Mar-17	1 year
Bestmed	China	\$3.00m	Jul-16	3 years
University Wisconsin	USA	\$1.13m	Apr-16	n/a
Westmead Children's	Australia	\$0.70m	Apr-16	n/a
Children's Hospital	USA	\$0.25m	Dec-15	n/a
Kwangwon	Korea	\$2.00m	Sep-15	3 years
ZhiNuo	China	\$1.00m	Sep-15	3 years
Various	Germany	\$5.00m	Jul-15	3 years
Bestmed	China	\$7.50m	Jun-15	3 years
Not Disclosed	USA	\$1.00m	May-15	n/a
Not Disclosed	China	\$2.20m	Apr-15	3 years
Bestmed	China	\$5.00m	Sep-14	3 years
<b>Total</b>		<b>\$31.08m</b>		

## Key Customers



# Industry Drivers

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## Increased prevalence and recognition of neurological & sleep disorders globally to drive demand for CMP's products

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<p>1</p> <p>Prevalence of Neurological Disorders</p>	<ul style="list-style-type: none"><li>➤ Approximately 1 billion people globally are suffering from neurological disorders.</li><li>➤ Every year approximately 15 million people suffer strokes, 2.5 million people are diagnosed with Multiple Sclerosis and 10 million people are affected by Parkinson's disease<sup>1</sup>.</li><li>➤ Global neurology device market was valued US\$5.0B in 2012 and is expected to reach US\$13.6B in 2019, growing at a CAGR of 15.4%<sup>2</sup>.</li></ul>
<p>2</p> <p>Prevalence of Sleep Disorders</p>	<ul style="list-style-type: none"><li>➤ Demand for sleep disorder diagnosis, driven by 'home' sleep diagnostic devices and 'in clinic' facility monitoring.</li><li>➤ Global sleep apnea device market is expected to grow at 7.7% CAGR from 2015 and is forecasted to reach \$USD 8.8 billion by 2023<sup>3</sup>.</li></ul>
<p>3</p> <p>Ageing Population</p>	<ul style="list-style-type: none"><li>➤ European, North American and Australasian countries are projected to have ~25 -35% of the population over the age of 60 by 2050. This compares to ~10-15% in 2015<sup>4</sup>.</li><li>➤ Aging of the population is expected to drive demand for diagnostic services for neurological disorders e.g. Alzeihmers, Parkinson's.</li></ul>

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1. Neurorehabilitation devices market, Grand View Research 2016.

2. "Neurology Devices Market - Global Industry Analysis, Size, Share, Growth, Trends and Forecast, 2013 - 2019", Transparency Market Research.

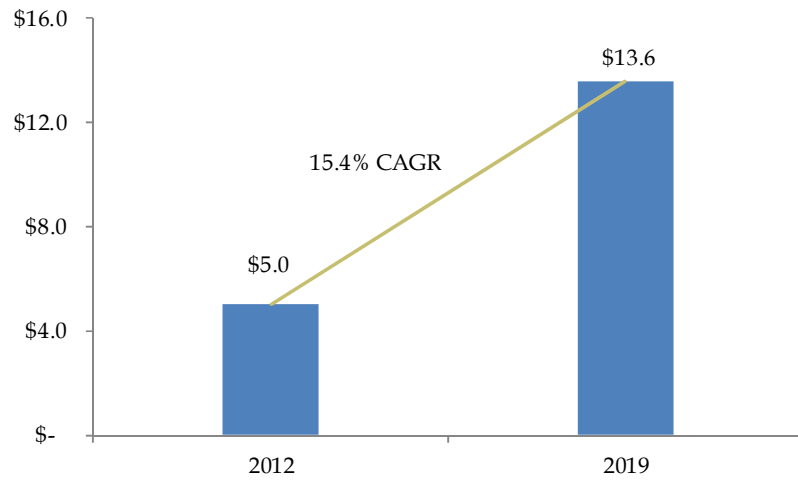
3. Global Markets Insights, June 2016, "Sleep Apnea Devices Market".

4. World Health Organisation (WHO).

# Industry Drivers

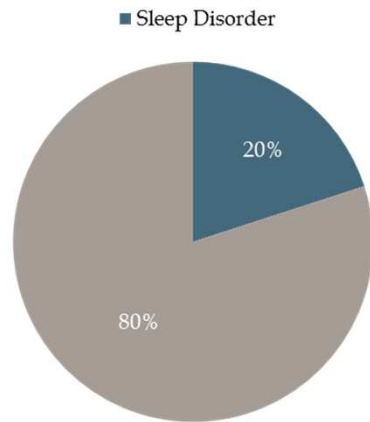
Increased prevalence of neurological & sleep disorders globally to drive demand for CMP's products

## Global Neurology Devices Market (\$US billions)



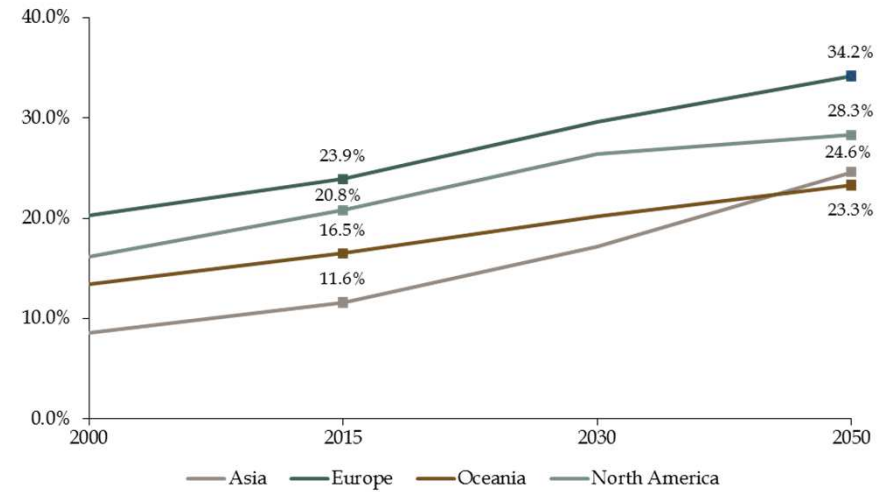
Source: Neurorehabilitation devices market, Grand View Research 2016

## Global Sleep Disorders (% of Global Population)



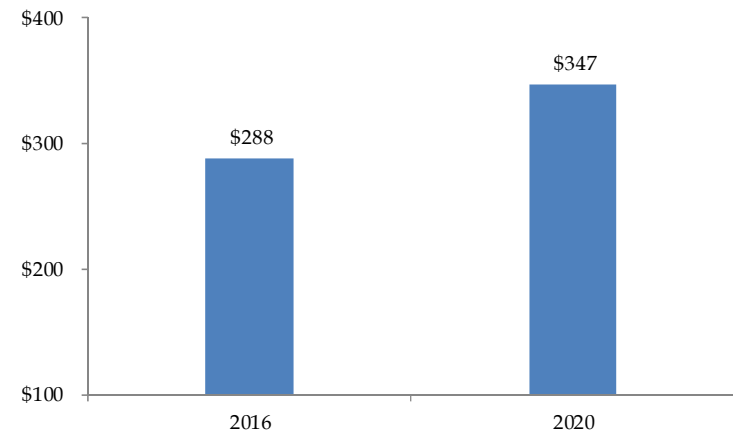
Source: Compumedics (CMP), FY16 Annual Report.

## Estimated World's Population over 60 years 2000 - 2050



Source: World Health Organisation (WHO)

## Global MEG System Market Annual Sales (\$US millions)







Source: Brain Monitoring Devices. A Global Strategic Business Report MCP-7944 (September 2015). Global Industry Analysts, Inc

## Competitors

CMP is a specialist diagnostic hardware and software player for neurology and sleep disorders. Competitors are diversified conglomerates.

- Mix of listed and unlisted competitors in sleep and neurology diagnostics

Company	Headquarters	Established	Market Cap (A\$) <sup>1</sup>	Sales	Details
<b>Sleep &amp; Neurology Diagnostics - Hardware &amp; Software</b>					
	USA	1979	Private	n/a	- Manufactures medical devices for neurophysiology including EMG & EEG devices
	USA	1989	\$A1,662m	\$US380m	- Manufacturer of medical devices and software provider for the Newborn Care, Neurology, Sleep and Hearing
	Japan	1951	\$A2,647m	\$US1,350m	- Manufacturer, developer and distributor of medical electronic equipment
	USA	2011	Private	n/a	- Manufactures high-end EGG machines
	Poland	1978	Private	n/a	- Specialises in designing and developing medical electronics and IT solutions
<b>Magnetoencephalography (MEG)</b>					
	Sweden	1972	\$A4,762m	\$US 1,330m	- Conglomerate manufacturing neurology, sleep and MEG hardware
	Canada	1970	Private	n/a	- MEG hardware and software provider

Source: Company, Moelis research.

1) Market capitalisation per Bloomberg at 17 March 2017.

## Listed Trading Comparables

- The closest listed comparables are Natus Medical (US), Nihon Kohden (Japan) and Elekta (Sweden).
- Listed players are diversified medical device manufactures covering Neurology, Sleep, Cardiology and other medical fields.
- CMP's revenue model is mainly capital equipment sales (~85%) which can be lumpy, however management are seeking to increase its recurring revenue through cloud-based e-health platform for clinicians.

Company	Ticker	Country	Price A\$	Market Cap A\$m	EV A\$m	P/E		EV/EBITDA	
						FY17	FY18	FY17	FY18
<b>Compumedics</b>	<b>CMP</b>	<b>Australia</b>	<b>0.50</b>	<b>84.4</b>	<b>79.7</b>	<b>25.8x</b>	<b>14.5x</b>	<b>14.7x</b>	<b>9.6x</b>

Sleep, Neurology - Hardware & Software									
Elekta Ab	EKTAB	Sweden	12.44	4,762	5,180	31.4x	24.4x	17.6x	13.6x
Nihon Kohden Corp	6849	Japan	29.50	2,647	2,345	21.1x	19.2x	10.3x	9.6x
Natus Medical Inc	BABY	United States	50.56	1,662	1,522	22.9x	19.7x	15.0x	12.7x
<b>Average</b>						<b>25.1x</b>	<b>21.1x</b>	<b>14.3x</b>	<b>12.0x</b>
<b>Median</b>						<b>22.9x</b>	<b>19.7x</b>	<b>15.0x</b>	<b>12.7x</b>

Medical Devices									
Resmed Inc	RMD	United States	9.28	13,146	10,510	34.2x	30.5x	17.9x	16.2x
Cochlear	COH	Australia	132.06	7,584	7,677	34.1x	30.4x	22.3x	19.9x
Fisher & Paykel Healthcare	FPH	New Zealand	8.87	5,035	5,570	28.8x	24.3x	19.4x	16.6x
Nanosonics	NAN	Australia	3.06	911	856	53.7x	37.8x	52.0x	36.3x
Medical Developments Interna	MVP	Australia	5.22	307	302	nm	nm	nm	39.5x
Impedimed	IPD	Australia	0.70	263	189	nm	nm	nm	nm
Airxpanders	AXP	Australia	0.89	256	176	nm	nm	nm	nm
Somnomed	SOM	Australia	3.43	197	180	nm	38.1x	nm	23.3x
Ellex Medical Lasers Ltd	ELX	Australia	1.15	139	135	49.8x	36.9x	16.7x	13.2x
<b>Average</b>						<b>40.1x</b>	<b>33.0x</b>	<b>25.6x</b>	<b>23.6x</b>
<b>Median</b>						<b>34.2x</b>	<b>33.7x</b>	<b>19.4x</b>	<b>19.9x</b>

Source: Bloomberg, Moelis estimates. Data as at 17 March 2017 close.

## Financials – Profit & Loss

Our base case scenario assumes 5% core sales growth ongoing; 1 MEG machine sale in FY18; thereafter 2 MEG machine sales per year

### Profit & Loss (€m)

Year Ending Jun	2015a	2016a	2017e	2018e	2019e
<b>Revenue</b>	<b>33.5</b>	<b>37.5</b>	<b>40.5</b>	<b>47.2</b>	<b>54.0</b>
<i>Growth</i>	9%	12%	8%	17%	14%
<b>EBITDA</b>	<b>4.1</b>	<b>5.0</b>	<b>5.4</b>	<b>8.3</b>	<b>11.1</b>
<i>Growth</i>	36%	22%	9%	53%	34%
Dep'n & Amort	(1.4)	(1.8)	(1.9)	(1.9)	(2.1)
<b>EBIT</b>	<b>2.7</b>	<b>3.2</b>	<b>3.6</b>	<b>6.4</b>	<b>9.0</b>
<i>Growth</i>	70%	20%	11%	80%	41%
Net Interest Expense	(0.7)	(0.4)	(0.3)	(0.3)	(0.2)
<b>Profit Before Tax</b>	<b>2.0</b>	<b>2.8</b>	<b>3.3</b>	<b>6.1</b>	<b>8.8</b>
Tax	(0.0)	0.5	0.0	(0.3)	(1.3)
Tax Rate (%)	2%	-17%	0%	5%	15%
Minorities	0.0	0.0	0.0	0.0	0.0
<b>NPAT (Underlying)</b>	<b>1.2</b>	<b>2.5</b>	<b>3.3</b>	<b>5.8</b>	<b>7.5</b>
<i>Growth</i>	nm	111%	29%	78%	28%
One-Off Items	0.8	0.7	0.0	0.0	0.0
<b>NPAT (Reported)</b>	<b>2.0</b>	<b>3.3</b>	<b>3.3</b>	<b>5.8</b>	<b>7.5</b>
<b>EPS (Underlying) (€)</b>	<b>0.7</b>	<b>1.5</b>	<b>1.9</b>	<b>3.5</b>	<b>4.4</b>
<i>Growth</i>	nm	110%	28%	78%	28%
<b>EPS (Reported) (€)</b>	<b>1.2</b>	<b>1.9</b>	<b>1.9</b>	<b>3.5</b>	<b>4.4</b>

Source: Company historical figures, forecasts Moelis estimates.

### Assumptions

#### Sales assumptions

- Core business sales growth 5% per year
- MEG sales of 1 high-end neural activity imaging machine MEG machine in FY18; thereafter assume 2 MEG machine sales/year
- No consumer Somfit product sales in our forecasts

#### Cost base assumptions

- Cost base ~\$15-17m, assume grows 5-10% per year over medium term as sales force grows and growth in R&D costs

#### Margin assumptions

- Gross margins historically ~50%, we assume rise to 55-60% over time, driven by selective outsourcing of manufacturing
- EBITDA margins historically 12-14%; we assume rise to 15-20% over time, driven by higher margin MEG machine sales

#### FY17 guidance downgraded in Feb-17 by ~15% at EBITDA line

- New guidance: \$4.5-7.5m EBITDA; NPAT \$2.5-5.5m; sales \$38-42m
- Previous guidance: \$6.0-8.0m EBITDA;

## Financials – Balance Sheet & Cash Flow

Net cash position ~\$5m at Dec-16; with gross cash conversion typically around 50-80%

### Balance Sheet (€m)

Year Ending Jun	2015a	2016a	2017e	2018e	2019e
Cash	2.2	3.1	2.2	5.5	10.7
Inventory	5.7	6.5	7.7	9.0	9.2
Current Receivables	10.3	12.8	13.4	15.6	18.9
PPE	0.8	0.8	0.9	1.0	1.1
Intangibles	2.7	2.4	2.3	2.5	2.7
Other	0.0	0.5	0.5	0.5	0.5
<b>Total Assets</b>	<b>21.7</b>	<b>26.1</b>	<b>27.0</b>	<b>34.0</b>	<b>43.1</b>
Current Payables	4.2	4.1	4.0	4.7	5.9
ST Debt	2.0	2.6	2.6	2.6	2.6
LT Debt	0.0	0.0	0.0	0.0	0.0
Provisions	2.6	2.8	2.8	3.3	3.8
Other	1.6	2.1	2.1	2.1	2.1
<b>Total Liabilities</b>	<b>10.4</b>	<b>11.5</b>	<b>11.5</b>	<b>12.7</b>	<b>14.3</b>
<b>Net Assets</b>	<b>11.3</b>	<b>14.6</b>	<b>15.5</b>	<b>21.3</b>	<b>28.8</b>
Equity & Reserves	30.7	30.8	28.4	28.4	28.4
Retained Profits	(19.4)	(16.2)	(12.9)	(7.1)	0.4
<b>Shareholders Equity</b>	<b>11.3</b>	<b>14.6</b>	<b>15.5</b>	<b>21.3</b>	<b>28.8</b>
Minorities	0.0	0.0	0.0	0.0	0.0
<b>Total Equity</b>	<b>11.3</b>	<b>14.6</b>	<b>15.5</b>	<b>21.3</b>	<b>28.8</b>
<b>Metrics</b>					
Working Capital	7.8	10.7	12.4	14.8	16.6
Working Capital/Sales (%)	23%	28%	31%	31%	31%
NTA	8.6	12.2	13.2	18.8	26.1
NTA/Share (\$)	0.05	0.07	0.08	0.11	0.15

Source: Company historical figures, forecasts Moelis estimates.

### Cash Flow Statement (€m)

Year Ending Jun	2015a	2016a	2017e	2018e	2019e
EBIT	2.7	3.2	3.6	6.4	9.0
Dep'n & Amort	1.4	1.8	1.9	1.9	2.1
Net Interest	(0.7)	(0.4)	(0.3)	(0.3)	(0.2)
Tax	(0.0)	(0.0)	0.0	(0.3)	(1.3)
Change in WC	(1.5)	(3.4)	(1.8)	(2.8)	(2.3)
Other	0.3	1.1	0.1	0.5	0.5
<b>Operating Cash Flow</b>	<b>2.2</b>	<b>2.2</b>	<b>3.4</b>	<b>5.4</b>	<b>7.7</b>
<i>Growth</i>	221%	1%	52%	58%	44%
Capex	(1.3)	(1.5)	(1.8)	(2.1)	(2.4)
Acquisitions	0.0	0.0	0.0	0.0	0.0
Divestments	0.0	0.0	0.0	0.0	0.0
Other	0.0	0.0	0.0	0.0	0.0
<b>Investing Cash Flow</b>	<b>(1.3)</b>	<b>(1.5)</b>	<b>(1.8)</b>	<b>(2.1)</b>	<b>(2.4)</b>
Equity Raised	0.0	0.2	0.0	0.0	0.0
Dividends Paid	0.0	0.0	0.0	0.0	0.0
Net Borrowings	0.5	(0.3)	(1.6)	(3.2)	(5.3)
Other	0.0	0.0	0.0	0.0	0.0
<b>Financing Cash Flow</b>	<b>0.5</b>	<b>(0.2)</b>	<b>(1.6)</b>	<b>(3.2)</b>	<b>(5.3)</b>
FX / Non Cash Items	0.2	0.1	0.0	0.0	0.0
<b>Change in Cash</b>	<b>1.5</b>	<b>0.5</b>	<b>0.0</b>	<b>0.0</b>	<b>0.0</b>
<b>Metrics</b>					
FCF	0.9	0.7	1.6	3.2	5.3
Gross Cash Conversion (%)	71%	54%	68%	72%	83%
Capex/Sales (%)	4%	4%	5%	5%	5%
Capex/Depreciation (x)	0.9 x	0.9 x	1.0 x	1.1 x	1.2 x

Source: Company historical figures, forecasts Moelis estimates.



# Scenario Analysis

Our base case scenario assumes 5% core sales growth ongoing; 1 MEG machine sale in FY18; thereafter 2 MEG machine sales per year

**Low Case** DCF Value/Share: **\$0.42**

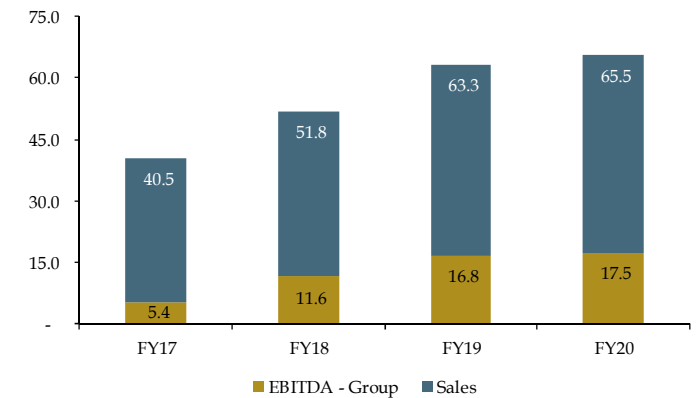
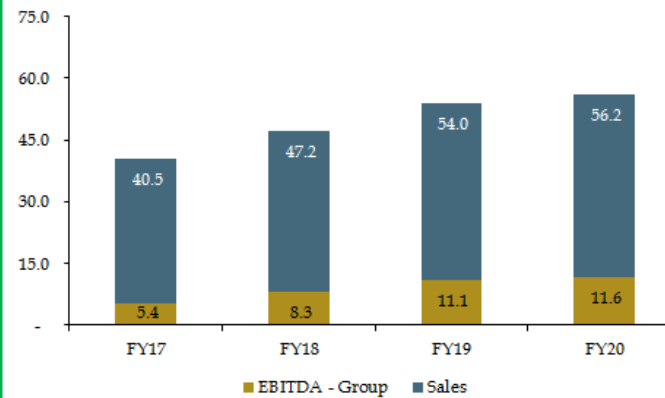
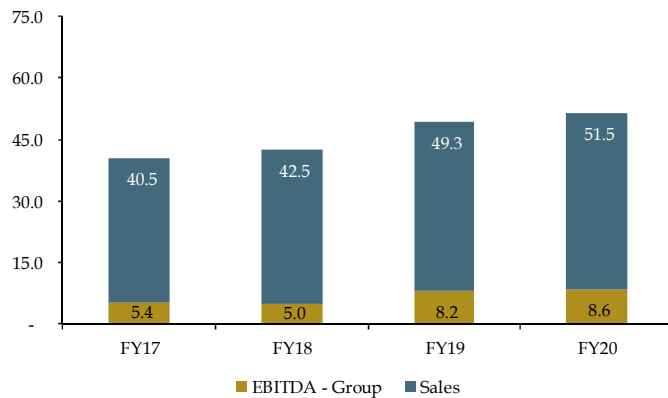
A\$m	FY17	FY18	FY19	FY20
Sales - Core	40.5	42.5	44.6	46.9
Volumes - MEG (#)	0	0	1	1
Price/Unit - MEG (A\$m)	-	4.7	4.7	4.7
Sales - MEG	-	-	4.7	4.7
<b>Sales</b>	<b>40.5</b>	<b>42.5</b>	<b>49.3</b>	<b>51.5</b>
Cost of Sales - Core	(18.2)	(19.1)	(19.9)	(20.7)
Cost of Sales - MEG	-	-	(1.9)	(1.9)
<b>Cost of Sales</b>	<b>(18.2)</b>	<b>(19.1)</b>	<b>(21.8)</b>	<b>(22.6)</b>
<b>Gross Profit</b>	<b>22.2</b>	<b>23.4</b>	<b>27.5</b>	<b>28.9</b>
Gross Profit Margin (%)	55%	55%	56%	56%
Operating Costs	(16.8)	(18.4)	(19.3)	(20.3)
<b>EBITDA</b>	<b>5.4</b>	<b>5.0</b>	<b>8.2</b>	<b>8.6</b>
EBITDA Margin (%)	13%	12%	17%	17%

**Base Case** DCF Value/Share: **\$0.58**

A\$m	FY17	FY18	FY19	FY20
Sales - Core	40.5	42.5	44.6	46.9
Volumes - MEG (#)	0	1	2	2
Price/Unit - MEG (A\$m)	-	4.7	4.7	4.7
Sales - MEG	-	4.7	9.3	9.3
<b>Sales</b>	<b>40.5</b>	<b>47.2</b>	<b>54.0</b>	<b>56.2</b>
Cost of Sales - Core	(18.2)	(19.1)	(19.9)	(20.7)
Cost of Sales - MEG	-	(1.5)	(3.8)	(3.8)
<b>Cost of Sales</b>	<b>(18.2)</b>	<b>(20.6)</b>	<b>(23.7)</b>	<b>(24.5)</b>
<b>Gross Profit</b>	<b>22.2</b>	<b>26.6</b>	<b>30.3</b>	<b>31.7</b>
Gross Profit Margin (%)	55%	56%	56%	56%
Operating Costs	(16.8)	(18.3)	(19.2)	(20.1)
<b>EBITDA</b>	<b>5.4</b>	<b>8.3</b>	<b>11.1</b>	<b>11.6</b>
EBITDA Margin (%)	13%	18%	21%	21%

**High Case** DCF Value/Share: **\$0.86**

A\$m	FY17	FY18	FY19	FY20
Sales - Core	40.5	42.5	44.6	46.9
Volumes - MEG (#)	0	2	4	4
Price/Unit - MEG (A\$m)	-	4.7	4.7	4.7
Sales - MEG	-	9.3	18.7	18.7
<b>Sales</b>	<b>40.5</b>	<b>51.8</b>	<b>63.3</b>	<b>65.5</b>
Cost of Sales - Core	(18.2)	(19.1)	(19.9)	(20.7)
Cost of Sales - MEG	-	(2.9)	(7.6)	(7.6)
<b>Cost of Sales</b>	<b>(18.2)</b>	<b>(22.0)</b>	<b>(27.5)</b>	<b>(28.3)</b>
<b>Gross Profit</b>	<b>22.2</b>	<b>29.8</b>	<b>35.8</b>	<b>37.2</b>
Gross Profit Margin (%)	55%	57%	57%	57%
Operating Costs	(16.8)	(18.2)	(18.9)	(19.7)
<b>EBITDA</b>	<b>5.4</b>	<b>11.6</b>	<b>16.8</b>	<b>17.5</b>
EBITDA Margin (%)	13%	22%	27%	27%



Source: Moelis estimates.

# Valuation & Recommendation

## Recommendation

- *HOLD rating with a A\$0.58/share price target*
- Our share price target is our base case scenario assumptions
- Target price is derived using discounted cash flow (DCF) valuation rolled forward 12 months by the cost of equity (12.8%)
- We use a 10 year forecast period for our DCF valuation
- WACC 11.9%
- Terminal growth rate 3.0%

## Key Assumptions

- Core business sales growth 5% per year
- MEG sales of 1 high-end neural activity imaging machine MEG machine in FY18; thereafter assume 2 MEG machine sales/year
- No consumer Somfit product sales in our forecasts

## Share Price Target & Total Return

Share Price Target	
DCF valuation/share	0.51
DCF grown at the cost of equity	0.58
Less forecast 12 month dividends	-
<b>12 month share price target</b>	<b>A\$0.58</b>
<hr/>	
Upside (downside) to last price	14.9%
<hr/>	
12 month yield	0.0%
12 month capital return	14.9%
<b>12 month total return</b>	<b>14.9%</b>

## Discounted Cash Flow Valuation

DCF Inputs		DCF Valuation (\$m)	
<b>Cost of Debt</b>	<b>6.0%</b>	<b>PV of Free Cash Flows</b>	<b>81.4</b>
Equity Risk Premium	6.0%	Net Debt (net cash)	4.7
Beta	1.30	Minority Interests	-
<b>Cost of Equity</b>	<b>12.8%</b>	<b>Equity Valuation</b>	<b>86.1</b>
% Debt Capital	10%	No. Shares	168.8
% Equity Capital	90%	<b>DCF Value/Share (\$)</b>	<b>0.51</b>
% Tax Rate	30%		
<b>WACC</b>	<b>11.9%</b>		
Perpetuity Growth	3.00%		

Source: Moelis estimates.

## Board of Directors

Board of Directors	Background
<b>David Burton</b> <i>Executive Chairman, CEO</i>	<ul style="list-style-type: none"> <li>– Executive Chairman David Burton, Ph.D., is the founder, Chairman and CEO of CMP.</li> <li>– Began career at the Bureau of Meteorology, where he studied radar techniques and electronic equipment.</li> <li>– Served as an advisor for the Victorian Government as a member of the Council for Knowledge, Innovation, Science and Engineering (KISE).</li> </ul>
<b>Alan Anderson</b> <i>Non-Executive Director</i>	<ul style="list-style-type: none"> <li>– Leading American attorney in the areas of commercial litigation, intellectual property and computer law.</li> <li>– He has represented Compumedics for all legal matters in the USA since late 1998.</li> </ul>
<b>David Lawson</b> <i>Executive Director, CFO</i>	<ul style="list-style-type: none"> <li>– Chief Financial Officer and the Company Secretary of the Company for +14 years.</li> <li>– Director of Swinburne Venture Pty Ltd, the intellectual property commercialisation arm of Swinburne University.</li> </ul>

## Senior Management

Senior Management	Background
<b>David Burton</b> <i>Executive Chairman, CEO</i>	<ul style="list-style-type: none"> <li>– See Directors section above.</li> </ul>
<b>David Lawson</b> <i>Executive Director, CFO</i>	<ul style="list-style-type: none"> <li>– See Directors section above.</li> </ul>
<b>Warwick Freeman</b> <i>CTO</i>	<ul style="list-style-type: none"> <li>– CTO at Compumedics since 2006.</li> <li>– Prior: Director of R&amp;D at Dataplex Pty Ltd for 11 years.</li> </ul>
<b>Kerry Hubick</b> <i>Chief Legal Officer</i>	<ul style="list-style-type: none"> <li>– Chief Legal Officer at Compumedics since 2005.</li> </ul>
<b>Christoph Witte</b> <i>General Managing Director</i>	<ul style="list-style-type: none"> <li>– Managing Director at Compumedics Germany since 2004.</li> <li>– Prior: President and head of Software R&amp;D at DWL.</li> </ul>

## Key Risks

Risk	Commentary
<i>Slower MEG sales than forecast</i>	Slower than forecast MEG sales could impact CMP's future financial performance.
<i>Contract loss</i>	Termination or cancellation of existing customer contracts may impact CMP's future financial performance.
<i>Competition</i>	Increased competition through pricing pressure, marketing or product innovation may impact CMP's future financial performance.
<i>Product Issues</i>	Technical defects/errors in CMP's software or hardware may lead to warranty claims which may impact CMP's future financial performance as well as the ability to generate new future business.
<i>Regulatory Change</i>	Changes to government policies, laws or regulations may affect healthcare funding, favour competitor offerings or require re-engineering of products which may impact CMP's future financial performance.
<i>Intellectual Property (IP)</i>	Existing legal and technical defence actions may not provide sufficient IP protection as operations grow and diversify geographically. Competitors may gain access to proprietary data and technology which may impact CMP's future financial performance.
<i>Loss of Key Personnel</i>	Loss of senior management or key operational personnel may impact CMP's future financial performance.
<i>Exchange Rates</i>	Exposure to the risk of fluctuations in foreign currencies (USD), may impact the translation of account balances and reported financial performance.

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