

March 2017

## Compumedics Ltd - Brain Teaser

Please click [here](#) for the full report.

### Research Initiation

- **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.