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Compumedics (CMP)

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Business update - sales delays

Recommendation: Outperform

Our View – upside from new business initiatives more than offset lumpy short-term order flow - risk/reward is favorable

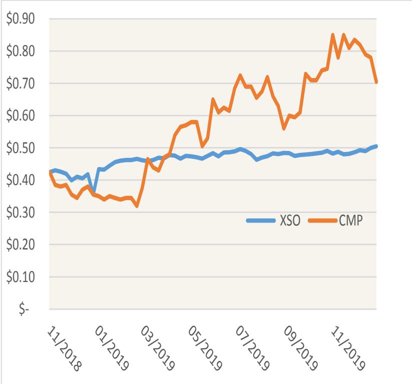
Compumedics provided a business update on Monday 13th January 2020. We are retaining our Outperform recommendation based on the medium upside from the new business initiatives. Parts of the core business is proving to be lumpy however we note highly experienced management, the nature of the client base and bureaucratic procurement process should enable delayed sales to be close. Our DCF falls to 96c per share and our preferred valuation approach – supported by EV/EBITDA methodology that derives a 97c per share valuation. Compumedics trades at a discount to many other in the listed sleep market, we feel that the risk/reward remains favourable.

There have been some delays to US orders – where several US orders have been pushed into 2H20. We estimate that this has taken $1-$2m of sales away from the 1H20 and moved them into 2H20. Sales for 1H20 are now expected to be $17.7m vs $18.7m pcp. We believe that some pf the delayed sales are quite large in nature and can be held up by customer procurement processes that don't respect for reporting dates.

We have trimmed our sales forecasts and made some revisions to EPS. Some parts of the trading update were encouraging and are medium term drivers of the future performance of the business such as MEG (brain imaging equipment) and Somfit (personal sleep tracking device).

Summary (AUD)	
Market capitalisation	124.0
Share price	0.70
52 w eek low	0.32
52 w eek high	0.89

Share price graph (AUD)



Key Points

Full year guidance remains unchanged. However, there is now a more pronounced skew to 2H20 which is greater due to delayed US sales orders.

Changes to forecasts

- We were forecasting sales of $46.2m an EBITDA of $7.3m. We have trimmed sales to $44.5M and EBITDA of $6.9m.
- Asia, Middle East and DWL business are all expected to report sales growth, offset by a decline in the US and slower conditions in Australia.
- New orders have been received in Japan via the new distribution partner (Fukuda Denshi). Given this is a new relationship, receiving fresh orders is a good start. We'd expect these sales to be mostly recorded in 2H20.

Negatives

- US orders are delayed but are likely to be completed in 2H20. The sales are delayed by the ordering cycle, management expect these to be completed. Management have said these orders are delayed but not "lost".

Positives

- A good start to Japanese distribution is a positive development.
- MEG - FDA approval is in train and this is important in driving future sales.
- And second and third MEG potential sales are progressing. FDA approval and completion of the full installation of the BNI (Barrow Neurological Institute) reference site is important to help drive future interest.
- Somfit is being used by a Melbourne professional rugby team. – creating a new reference customer.

Key Financials (AUD)	FY19A	FY20E	FY21E
Revenue	**41.5**	**44.5**	**53.1**
EBITDA	5.9	6.9	8.3
NPAT (adj)	4.0	5.0	6.0
EPS c	2.3	2.8	3.4
PE Ratio (x)	31.0	24.8	20.8
DPS c	0.0	0.0	0.0
Div Yield	0.0%	0.0%	0.0%
Franking	0.0%	0.0%	0.0%
EV	122.0	119.1	118.2
EV/EBITDA	20.7	17.2	14.2

Compumedics - Summary of Forecasts

CMP $ 0.70

PROFIT & LOSS SUMMARY (A$m)

Year end June	FY18A	FY19A	FY20E	FY21E
Total Revenue	**37.0**	**41.5**	**44.5**	**53.1**
EBITDA	4.2	5.9	6.9	8.3
Dep'n/Other Amort'n	(0.5)	(0.5)	(0.7)	(1.0)
EBIT	3.7	5.4	6.2	7.4
Net Interest	(0.2)	(0.3)	0.1	0.1
Pre-Tax Profit	3.5	5.1	6.3	7.5
Tax Expense	(0.7)	(1.1)	(1.3)	(1.5)
NPAT Adj.	**2.8**	**4.0**	**5.0**	**6.0**
Reported NPAT	2.8	4.0	5.0	6.0
Margins on Sales Revenue				
EBITDA	11.4%	14.2%	15.5%	15.7%
EBIT	10.0%	13.0%	13.9%	13.9%
NPAT Adj.	7.6%	9.6%	11.2%	11.2%
Change on pcp				
Total Revenue	7.6%	12.2%	7.3%	19.2%
EBITDA	50.0%	40.5%	17.3%	20.2%
EBIT	164.3%	45.9%	14.7%	18.7%
NPAT Adj.	115.4%	42.9%	25.0%	19.2%

PER SHARE DATA

Year end June	FY18A	FY19A	FY20E	FY21E
EPS Adj. (c)	**1.6**	**2.3**	**2.8**	**3.4**
Growth (pcp)	115.4%	42.9%	25.1%	19.2%
Dividend (c)	0.0	0.0	0.0	0.0
Franking	0%	0%	0%	0%
Gross CF per Share (c)	0.3	2.9	2.4	1.9
NTA per share (c)	13.1	15.4	13.4	16.0

KEY RATIOS

Year end June	FY18A	FY19A	FY20E	FY21E
Net Debt : Equity (%)	-8.6%	-11.0%	-15.2%	-15.1%
EBIT Interest cover (x)	18.5	18.0	(103.2)	(74.7)
Oper CF/EBITDA	32.1%	86.4%	62.2%	43.3%
Current ratio (x)	2.6	3.0	3.6	3.6
ROE (%)	12.1%	14.7%	15.5%	15.6%
Dividend Payout Ratio (%)	0.0%	0.0%	0.0%	0.0%

VALUATION MULTIPLES

Year end June	FY18A	FY19A	FY20E	FY21E
PER (x)	**44.3**	**31.0**	**24.8**	**20.8**
Dividend Yield (%)	**0.0%**	**0.0%**	**0.0%**	**0.0%**
FCF Yield (%)	n.m	0.6%	1.5%	0.5%
EV/EBITDA (x)	29.1	20.5	17.2	14.2
EV/EBIT (x)	33.0	22.4	19.2	16.1

BALANCE SHEET SUMMARY

Year end June	FY18A	FY19A	FY20E	FY21E
Cash	3.9	4.6	4.9	5.8
Receivables	18.3	17.8	19.1	22.8
Inventories	7.6	7.8	8.5	10.1
Other	0.0	0.0	0.0	0.0
Total Current Assets	29.8	30.2	32.5	38.7
Investments	0.0	0.0	0.0	0.0
Inventories	0.0	0.0	0.0	0.0
Property Plant & Equip	0.6	1.6	1.6	1.9
Intangibles	4.2	6.8	8.5	10.0
Other	0.1	0.0	0.0	0.0
Total Non-Current Asset:	4.9	8.4	10.1	11.9
TOTAL ASSETS	**34.7**	**38.6**	**42.6**	**50.5**
Accounts Payable	5.1	4.4	4.7	5.6
Borrowings	1.9	1.6	0.0	0.0
Provisions	0.0	0.0	0.0	0.0
Other	4.3	4.2	4.5	5.3
Total Current Liab	11.3	10.2	9.1	10.9
Borrowings	0.0	0.0	0.0	0.0
Provisions	0.0	0.0	0.0	0.0
Other	0.2	1.1	1.2	1.4
Total Non-Current Liab	0.2	1.1	1.2	1.4
TOTAL LIABILITIES	**11.5**	**11.3**	**10.3**	**12.3**
TOTAL EQUITY	**23.2**	**11.3**	**32.3**	**38.3**

CASH FLOW SUMMARY

Year end June	FY18A	FY19A	FY20E	FY21E
EBIT (excl Abs/Extr)	**3.7**	**5.4**	**6.2**	**7.4**
Add: Depreciation	0.5	0.5	0.7	1.0
Change in Pay.	0.2	(0.9)		
Less: Tax paid	0.0	0.0	(1.3)	(1.5)
Net Interest	(0.3)	(0.2)	0.1	0.1
Change in Rec.	(3.3)	0.5		
Change in Inv.	(0.2)	(0.2)		
Net working capital			-1.5	-3.5
Gross Cashflows	0.6	5.1	4.2	3.4
Capex	(2.0)	(4.3)	(2.4)	(2.8)
Free Cashflows	(1.4)	0.8	1.9	0.6
Dividends Paid	0.0	0.0	0.0	0.0
Acquisitions/adj	0.0	0.0	0.1	0.2
Net Cashflows	**(1.4)**	**0.8**	**2.0**	**0.8**

SEGMENTALS

Year end June	FY18A	FY19A	FY20E	FY21E
Sales				
USA	12.0	13.8	13.8	15.9
APAC	14.8	18.6	19.5	22.5
Europe	10.2	9.1	10.2	11.7
MEG	0.0	0.0	1.0	2.0
Somfit	0.0	0.0	0.0	1.0
Total sales	**37.0**	**41.5**	**44.5**	**53.1**

Updated trading and model changes

Compumedics have updated trading to reflect slower than expected sales closure in the US business with only moderate growth in other parts of the business. Guidance for the full year remains unchanged. We were above upper end of the sales range (due to a sales assumption around MEG) and at the high end of the EBITDA range. We move to lower our sales forecasts and EBITDA.

Table 1 – changes to estimates for Compumedics

	FY20E - old	FY20E - new	% change	FY21E - old	FY21E - new	% change
Sales	46.2	44.5	-3.6%	55.0	53.1	-3.5%
EBITDA	7.3	6.9	-5.2%	8.7	8.3	-4.4%
NPAT	5.3	5.0	-5.6%	6.3	6.0	-5.4%
EPS c	3.0	2.8	-5.9%	3.5	3.4	-3.8%

(source – Taylor Collison estimates)

In term of the segmental splits – we have made the following adjustments.

Our DCF falls to 96c per share and our preferred valuation approach – supported by EV/EBITDA methodology that derives a 97c per share valuation.

Table 2 – segmental splits by half

Divisional sales	1H19A	2H19A	FY19A	1H20A	2H20E	FY20E
USA	7.1	6.7	13.8	5.7	8.1	13.8
APAC	7.3	11.3	18.6	7.0	12.5	19.5
Europe	4.3	4.8	9.1	5.0	5.2	10.2
MEG					1.0	1.0
Somfit						
Other						
Corporate						
Total sales	**18.7**	**22.8**	**41.5**	**17.7**	**26.8**	**44.5**

(source – Taylor Collison estimates)

We have held EBITDA flat pcp at $1.5m for 1H20 vs 1H19. The business tends to have as seasonal skew to 2H sales and EBITDA and so the business will clearly need a strong 2H20 to hit guidance. Generally speaking - deals above $100k need customer(s) CEO/CFO/Head of Department, IT and procurement to sign off prior to finalisation. Given the nature of the equipment and at times quite large sales sizes a few deals missed deals can make the difference between sales growth on the pcp of $18.7m vs a decline of $1m. These deals are likely not lost but delayed and should provide impetus for a strong 2H20.

The new Japanese distributor also placed some orders (which is a good start given the change off distributors) and provide additional sales into 2H20.We have also assumed the completion of the BNI installation which could add $1m in additional sales.

MEG – great potential – fully functioning reference customer the key, FDA approval/ commercialisation

BNI (Barrow Neurological Institute) – a recap …BNI, the world's largest neurological disease treatment and research institution, is consistently ranked as one of the best neurosurgical training centers in the world. The Institute was founded in 1962 and has since grown to be one of the premier facilities in the world for neurology and neurosurgery, with more operative neurosurgical procedures undertaken at BNI than at any other USA institution.

Completion of the BNI deal will provide a sound reference site for further MEG sales for Compumedics. Each unit is a material sale. The upside is the operating facility can be used to help establish reimbursement codes for the testing prior to surgery and this can create big potential. The original press release made mention of the equipment sale of US$3.75m with a discount applied due to early mover status of the project. This market is an emerging growth options for the business – this is arguably underpriced by the market at this point. It has been a protracted process but the risk /reward around the project will crystallize upon full installation.

Quote from the original announcement explains it better than we can.

"The new contract establishes a strong collaboration with BNI including, American Food and Drug Administration applications and beta-site services such as biomarker test protocols and access to secure patient databases for epilepsy, autism, dementia and Parkinson's disease management services, along with associated clinical validation and verification studies. Additionally, later collaborative stages will include working on improved and expanded CPT/IDT (government health reimbursement) codes to help enhance brain healthcare.

Compumedics has overcome earlier MEG system barriers with the Compumedics Neuroscan Orion LifeSpan™'s increased precision coupled with fully-integrated MEG (Curry MEG) "gold standard" brain analysis software.

At the heart of the new Compumedics Neuroscan Orion LifeSpan™ MEG system is the patented double relaxation oscillator super conducting quantum interference device (DROS; SQUID) sensor system, enabling 50% greater MEG sensitivity and spatial resolution than the current incumbent market leader.

Additionally, a unique dual-helmet dewar, enabling optimal brain imaging localisation, applicable to the greater population including both adult and paediatric populations, is coupled to a vibration-free, vacuum-cooling system for virtual 100% coolant recycling with continuous 24/7 operation. These advancements contribute to transforming functional brain-health, but also provide a sustainable business model reinforced by high barriers of market entry, including patented technological and scientifically proven clinical deployment.

Over a 30-year period Compumedics Neuroscan has established the "gold standard" neurophysiological multi-modality (EEG, MRI, CT, SPECT, PET convergence etc.) and MEG brain analysis platform. In parallel, over a 30-year period the Korean Research Institute of Standards and Science (KRISS) MEG team, led by Dr. Lee have produced the most advanced MEG brain imaging scanner.

MEG provides at least 4-5 orders of magnitude of temporal resolution (speed of brain functional or cognitive measures) over other traditional functional MRI, PET or other conventional imaging systems.

source – Original MEG announcement. - June 2017

In May 2019, Compuemdics announced the successful installation of the equipment (as did BNI via Facebook). The paediatric helmet is currently being completed and when completed will represent (3/4Q -FY2020) full competition of the project and the final installment can be invoiced/paid.

Somfit – FDA approval/ commercialisation

The Somfit device is being used by a professional Melbourne based rugby team. This device holds great promise both as a prosumer and consumer medical device (with hospital grade standards) and if cleared by the FDA – as a sleep diagnostic device for sleep disorders. It will be less invasive, less costly than a full sleep test and in particular can be used after a device has been fitted or to determine ahead of time – if someone needs a full sleep test. We don't have much in our forecasts for this device but note these solutions do hold appeal to a mass market (Fitbit, Catapult devices etc.) – if properly marketed.

Company Overview - Compumedics

Compumedics is a leading global developer and manufacturer of medical devices (and software) for diagnosing sleep disorders, monitoring neurological disorders including long-term epilepsy monitoring (LTEM), brain research, ultrasonic monitoring of blood flow through the brain transcranial doppler (TCD). Compumedics has substantial business is Australia (market leader), Japan, China and the US. It also operates in geographies outside these main markets. Compumedics has been in business since 1987 and listed on the ASX in 2000. Compumedics is head quartered in Melbourne and has 130 employees in seven locations (Melbourne, Charlotte, Hamburg, Dresden/Singen, Paris and Daejeon (South Korea). Compumedics divisions include Sleep, Neuroscience, Neuroscan, DWL (Ultrasound) and Neuromedical supplies.

Compumedics - risks

Risks (may include but is not limited to): - Failure to gain FDA approval, for new products that have been developed., Project and customer sale closing delays. Competition from others -major players operate in the market). There are also rival therapies emerging. Patent expiration – Compumedics has been in business for well over 30 years and may suffer from patent expiration for some of its key products. Product failure and recall – other players in the past have had to recall faulty products. Trading in markets market such as China. Problems with distribution arrangements can be problematic. Bad debts. IP theft. Cyber security problems – privacy breaches or straight theft. New technology reducing the need for sleep testing and other devices and systems that Compumedics has developed.

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