

Nanosonics

Workman-like performance

ADD (no change)

Current price:	A\$2.36
Target price:	A\$2.91
Previous target:	A\$3.61
Up/downside:	23.5%
Reuters:	NAN.AX
Bloomberg:	NAN AU
Market cap:	US\$554.9m
	A\$702.6m
Average daily turnover:	US\$2.89m
	A\$3.77m
Current shares o/s	297.77m
Free float:	52.0%

Key changes in this note

FY18F revenue down by 7.0%.

FY18F EBITDA down by 36.0%.

FY18F NPBT down by 37%.



Price performance	1M	3M	12M
Absolute (%)	3.1	-20.3	-18.3
Relative (%)	2.8	-19.9	-21.6

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- NAN posted a FY17 result which was slightly below our forecast, importantly unit sales growth continues despite uncertainty around healthcare reforms in the US.
- R&D to increase significantly ahead of the launch of two new products over the next 24 months. The key catalysts include increasing sales with existing customers particularly in the US and expanding the adoption of MES agreements.
- We have downgraded forecasts and price target, however maintain a positive stance on NAN.

FY17 result slightly below forecast

NAN posted a net profit before tax of A\$13.9m (Morgans A\$16.0m and consensus of A\$16.2m). Revenue was A\$67.5m (US A\$62.3m up 60%, Europe A\$1.7m up 58%, APAC A\$3.5m up 30%) which was below our forecast of A\$72.4m. However we note that the move to Managed Equipment Service (MES) agreements in the UK skews the revenue recognition to later periods and under a capital sales approach an extra A\$1.2m would have been recognised. The installed base increased by 4,100 units to 14,100 (US 12,400 and ROW 1,400). Gross margin decreased to 74.3% from 75.1% and the EBITDA margin was 20.8%. Net operating cashflow was \$16.4m, up from A\$3.2m in pcp. The cash reserves were solid at A\$61.6m.

R&D spend to ramp up ahead on new product launch

Management has called out significantly higher R&D spend in FY18, increasing to A\$14.0m from A\$9.5m. More importantly two new product launches are expected over the next two years which we believe will help drive growth in the installation base. For commercial reasons little detail has been released around disinfection area or target market.

Catalysts to focus on and changes to forecasts

The continued growth of the business will be dependent on the following: an ability to penetrate deeper into existing facilities (approx. 3.5 units per facilities in US, estimated can move to 8 units); expand to new geographies (Middle East and Japan); publication of further disinfection guidelines (England pending and further European publications expected); and expansion of MES agreements to help overcome funding issues in certain hospital settings (UK likely to be mainly MES). Management has called out unit growth in 1HFY18 of approximately 1,700 units which is line with 2HFY17 and inclusive of the increase in R&D spend, operating costs are expected to be A\$48m. To reflect this guidance we have reduced our forecast by 37% to A\$13.3m and by 31% to A\$26.6m for FY18 and FY19 respectively.

Investment view remains positive

Given the changes to forecasts our DCF valuation has reduced to A\$2.91 from A\$3.61. Our price target is set at the same level. The key risk is a slower-than-expected US sales ramp. Our positive Add recommendation is maintained.

Financial Summary	Jun-16A	Jun-17A	Jun-18F	Jun-19F	Jun-20F
Revenue (A\$m)	42.8	67.6	79.0	103.2	133.8
Operating EBITDA (A\$m)	0.96	14.19	13.54	25.64	42.69
Net Profit (A\$m)	0.12	26.25	13.29	26.56	31.67
Normalised EPS (A\$)	0.00	0.09	0.04	0.09	0.11
Normalised EPS Growth		20815%	(49%)	100%	19%
FD Normalised P/E (x)	5,599	27	53	26	22
DPS (A\$)	-	-	-	-	-
Dividend Yield	0%	0%	0%	0%	0%
EV/EBITDA (x)	646.6	45.2	46.0	23.4	13.4
P/FCFE (x)	181.8	47.9	39.7	30.4	25.8
Net Gearing	(83.1%)	(70.6%)	(78.9%)	(80.6%)	(81.7%)
P/BV (x)	11.79	8.05	6.99	5.53	4.43
ROE	0.2%	36.5%	14.1%	23.3%	22.2%
% Change In Normalised EPS Estimates			(36.8%)	(30.8%)	(25.7%)
Normalised EPS/consensus EPS (x)			0.59	0.80	0.61

SOURCE: MORGANS, COMPANY REPORTS

Figure 1: Financial summary

Profit and loss						Valuation details			
	Jun-16A	Jun-17A	Jun-18F	Jun-19F	Jun-20F				
Revenue	42.8	67.6	79.0	103.2	133.8	Share Price	\$2.36	Market Cap	A\$702.7m
COGS	12.6	16.0	19.6	23.3	27.3	Price Target	\$2.91		
Total Operating Costs	29.3	37.4	45.8	54.3	63.8	Total shareholder return	23.5%	WACC	9.9%
EBITDA	1.0	14.2	13.5	25.6	42.7				
Depreciation	-1.3	-1.2	-1.5	-1.5	-1.5				
Amortisation & impairments	0.0	0.0	0.0	0.0	0.0				
EBIT	-0.4	13.0	12.1	24.2	41.2				
Net Interest Income	0.5	1.0	1.2	2.3	4.1				
Pre-tax Profit	0.1	13.9	13.3	26.5	45.2				
Tax	0.0	12.3	0.0	0.0	-13.6				
Reported Profit	0.1	26.2	13.3	26.6	31.7				
Exceptional items	0.0	0.0	0.0	0.0	0.0				
Normalised Profit	0.1	26.2	13.3	26.6	31.7				
Gross dividends	0.0	0.0	0.0	0.0	0.0				

Cash flow statement						Key metrics/ multiples				
	Jun-16A	Jun-17A	Jun-18F	Jun-19F	Jun-20F		Jun-16A	Jun-17A	Jun-18F	Jun-19F
EBITDA	1.0	14.2	13.5	25.6	42.7	P/E	5599.2	26.8	52.9	26.5
Net interest	0.5	1.0	1.2	2.3	4.1	Yield	0.0%	0.0%	0.0%	0.0%
Tax	0.0	12.3	0.0	0.0	-13.6	PEG	54.8	0.0	-1.1	0.3
Changes in working capital	1.8	-11.1	4.3	-3.3	-4.3	EV/EBITDA	646.6	45.2	46.0	23.4
Operating cash flow	3.2	16.4	19.1	24.7	28.9	Price/ Book Value	11.8	8.1	7.0	5.5
Capex	-1.1	-1.0	-1.4	-1.6	-1.6	Price/ Net Tangible Assets	11.8	8.1	7.0	5.5
Free Cash Flow	2.2	15.3	17.7	23.1	27.3	Operating cash flow yield	0.5%	2.3%	2.7%	3.5%
Acquisitions and divestments	-0.2	-0.2	0.0	0.0	0.0	Free cash flow yield	0.3%	2.2%	2.5%	3.3%
Other Investing cash flow	-2.2	-15.3	-17.7	-23.1	-27.3					
Investing cash flows	-1.3	-1.2	-1.4	-1.6	-1.6					
Increase / decrease in Equity	0.0	0.0	0.0	0.0	0.0	Per share data				
Increase / decrease in Debt	1.7	-0.5	0.0	0.0	0.0	Diluted shares on issue	283.0	297.7	297.7	297.7
Dividends paid	0.0	0.0	0.0	0.0	0.0	Reported EPS (A\$)	0.00	0.09	0.04	0.09
Other financing cash flows	0.0	0.0	0.0	0.0	0.0	Normalised EPS (A\$)	0.00	0.09	0.04	0.09
Financing cash flows	1.7	-0.5	0.0	0.0	0.0	Dividends per share (A\$)	0.00	0.00	0.00	0.00
						Payout ratio	0.0%	0.0%	0.0%	0.0%

Balance Sheet						Result quality				
	Jun-16A	Jun-17A	Jun-18F	Jun-19F	Jun-20F		Jun-16A	Jun-17A	Jun-18F	Jun-19F
Assets						Cash flow conversion	286.1%	21.8%	132.0%	87.2%
Cash And Deposits	48.8	63.0	80.7	103.9	131.1	FCF vs. NPAT	1815.0%	58.5%	133.2%	87.1%
Debtors	7.7	8.9	10.8	14.1	18.3	Gross dividends vs FCF	0.0%	0.0%	0.0%	0.0%
Inventory	6.9	7.7	3.2	4.1	5.4					
Other current assets	1.1	1.7	1.7	1.7	1.7	Gearing				
Total Current Assets	64.6	81.4	96.4	123.8	156.5	Net Debt	-47.10	-61.64	-79.34	-102.47
Fixed Assets	3.3	3.5	3.4	3.5	3.6	Net Debt / Equity	-83.1%	-70.6%	-78.9%	-80.6%
Investments	0.0	0.0	0.0	0.0	0.0	Net Debt / EBITDA (x)	-49.04	-4.34	-5.86	-4.00
Goodwill	0.0	0.0	0.0	0.0	0.0	EBIT interest cover (x)	-0.73	13.14	10.26	10.34
Intangibles	0.3	0.3	0.3	0.3	0.3	Invested Capital	11.4	14.5	25.5	21.3
Other non-current assets	0.0	14.2	14.2	14.2	14.2	Enterprise Value	620.9	641.0	623.3	600.2
Total Non-Current Assets	3.6	17.9	17.8	17.9	18.0					
TOTAL ASSETS	68.2	99.3	114.2	141.8	174.6	Growth ratios				
						Revenue	92.8%	58.0%	16.8%	30.7%
Liabilities						Operating costs	43.1%	27.6%	22.5%	18.6%
Short Term Debt	0.4	0.4	0.6	0.6	0.6	EBITDA	120.3%	1378.1%	-4.6%	89.4%
Creditors	4.6	3.7	5.4	6.4	7.5	EBIT	93.8%	3581.9%	-6.7%	100.0%
Other current liabilities	5.1	6.9	6.9	6.9	6.9	NPAT	102.2%	21901.5%	-49.4%	99.9%
Total Current Liabilities	10.2	11.1	12.9	13.9	15.0	EPS growth	102.2%	20815.2%	-49.4%	99.9%
Long Term Debt	1.3	0.9	0.8	0.8	0.8	DPS growth	0.0%	0.0%	0.0%	0.0%
Other Debt (inc hybrids)	0.0	0.0	0.0	0.0	0.0	Operating cash flow	167.1%	407.8%	16.3%	29.7%
Other Non curren liabilities	0.0	0.0	0.0	0.0	0.0					
Total Non -Current liabilities	1.3	0.9	0.8	0.8	0.8	Margin analysis				
TOTAL LIABILITIES	11.5	12.0	13.7	14.7	15.8	EBITDA Margin	2.2%	21.0%	17.1%	24.8%
						EBIT margin	-0.8%	19.2%	15.3%	23.4%
Equity						NPAT margin	0.3%	38.8%	16.8%	25.7%
Issued capital	7.3	11.8	11.8	11.8	11.8	ROE	0.2%	30.1%	13.2%	20.9%
Retained earnings	-63.4	-37.2	-37.2	-37.2	-37.2	ROIC	-3.2%	89.2%	47.4%	113.3%
Other reserves and FX	112.7	112.7	126.0	152.6	184.2	ROE less WACC	-9.7%	20.2%	3.3%	11.0%
TOTAL EQUITY	56.7	87.3	100.5	127.1	158.8	ROIC less WACC	-13.1%	79.3%	37.4%	103.4%
TOTAL EQUITY + LIABLILITY	68.2	99.3	114.2	141.8	174.6					

SOURCE: MORGANS RESEARCH, COMPANY

FY17 result comments and changes to forecasts

Further comments not already discussed on front page:

- Net profit after tax included a non-cash benefit of A\$12.3m as prior year losses from the Australian operations are recouped. For simplicity we have assumed no tax will be payable until FY20, we will adjust our forecast each reporting period depending on the book entry recorded. As a result we are focussed on the before tax line in our analysis.
- Operating costs in FY17 increased by 16.5% to A\$38.1m (SG&A of A\$28.6m and R&D of A\$9.5m) which was in line with management guidance.
- We have made the following changes to forecasts in FY18: revenue reduced by 7.0% reflecting a rebasing from the lower FY17 result; COGS margin increased by A\$0.6m in line with actual margin and operating costs increased by A\$1.2m to A\$47.1m, to be broadly in line with management guidance.

Figure 2: Actual v forecast and changes to forecasts

	FY17F			FY18F			FY19F		
	Forecast	Actual	Diff	Prev	Rev	Diff	Prev	Rev	Diff
Revenue	72.4	67.6	-7%	84.8	79.0	-7%	114.6	103.2	-10%
EBITDA	16.0	14.2	-11%	21.0	13.5	-36%	37.1	25.6	-31%
EBITDA margin	22%	21%	-5%	25%	17%	-31%	32%	25%	-22%
Net profit before tax	16.0	13.9	-13%	21.0	13.3	-37%	38.4	26.6	-31%

SOURCE: MORGANS RESEARCH, COMPANY

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